

TELEFONICA S A
Form 20-F
May 19, 2008

As filed with the Securities and Exchange Commission on May 19, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

- ☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b)
OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
- ☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2007
OR
- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
OR
- ☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR
15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
for the transition period from _____ to _____

Commission file number: 001-09531

TELEFÓNICA, S.A.
(Exact name of Registrant as specified in its charter)

KINGDOM OF SPAIN
(Jurisdiction of incorporation or organization)

Distrito C, Ronda de la Comunicación, s/n
28050 Madrid, Spain
(Address of principal executive offices)

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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

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

The number of outstanding shares of each class of capital stock of Telefónica, S.A. at December 31, 2007 was:

Ordinary Shares, nominal value €1.00 per share: 4,773,496,485

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934.
Yes ☐ No ☒

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 ☒ No ☐

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 ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark which financial statement item the registrant has elected to follow.
Item 17 ☐ Item 18 ☒

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ☐ International Financial Reporting Standards as Issued by the international Accounting Standards Board ☒ Other ☐

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.
Item 17 ☐ Item 18 ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ☐ No ☒

TABLE OF CONTENTS

	Page
Cautionary Statement Regarding Forward-Looking Statements	i
Certain Terms and Conventions	iii
Presentation of Certain Financial Information	vi
Part I	1
Item 1. Identity of Directors, Senior Management and Advisors	1
A. Directors and Senior Management	1
B. Advisers	1
C. Auditors	1
Item 2. Offer Statistics and Expected Timetable	1
Item 3. Key Information	1
A. Selected Financial Data	1
B. Capitalization and Indebtedness	3
C. Reasons for the Offer and Use of Proceeds	3
D. Risk Factors	3
Item 4. Information on the Company	9
A. History and Development of the Company	9
B. Business Overview	14
C. Organizational Structure	64
D. Property, Plant and Equipment	64
Item 4A. Unresolved Staff Comments	66
Item 5. Operating and Financial Review and Prospects	66
A. Operating Results	66
B. Liquidity and Capital Resources	100
C. Research and Development, Patents and Licenses, etc.	104
D. Trend Information	105
E. Off-Balance Sheet Arrangements	106
F. Tabular Disclosure of Contractual Obligations	106
Item 6. Directors, Senior Management and Employees	107
A. Directors and Senior Management	107
B. Compensation	114
C. Board Practices	120
D. Employees	120
E. Share Ownership	121
Item 7. Major Shareholders and Related Party Transactions	121
A. Major Shareholders	121
B. Related Party Transactions	122
C. Interests of Experts and Counsel	124
Item 8. Financial Information	124
Item 9. The Offering and Listing	129
A. Offer and Listing Details	129
B. Plan of Distribution	134
C. Markets	134
D. Selling Shareholders	134
E. Dilution	134

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	F.	Expenses of the Issue	134
Item 10.		Additional Information	134
	A.	Share Capital	134
	B.	Memorandum and Articles of Association	134
	C.	Material Contracts	138
	D.	Exchange Controls	139
	E.	Taxation	141

	F.	Dividends and Paying Agents	145
	G.	Statements by Experts	146
	H.	Documents on Display	146
	I.	Subsidiary Information	146
Item 11.		Quantitative and Qualitative Disclosures About Market Risk	146
Item 12.		Description of Securities Other Than Equity Securities	164
Part II			165
Item 13.		Defaults, Dividend Arrearages and Delinquencies	165
Item 14.		Material Modifications to the Rights of Security Holders and Use of Proceeds	165
Item 15.		Controls and Procedures	165
Item 16.		[Reserved]	165
Item 16A.		Audit Committee Financial Expert	165
Item 16B.		Code of Ethics	166
Item 16C.		Principal Accountant Fees and Services	166
Item 16D.		Exemptions from the Listing Standards for Audit Committees	167
Item 16E.		Purchases of Equity Securities by the Issuer and Affiliated Purchasers	167
Part III			167
Item 17.		Financial Statements	167
Item 18.		Financial Statements	167
Item 19.		Exhibits	167

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, as amended, Section 21E of the 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”, “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures About Market Risk” 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;

- o trends affecting our financial condition or results of operations;
- o acquisitions or investments which we may make in the future;
 - o our capital expenditures plan;
 - o our estimated availability of funds;
- o our ability to repay debt with estimated future cash flows;
- o 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;

- o our strategic partnerships; and
- o 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 business that could affect the matters referred to in such forward-looking statements include but are not limited to:

- o changes in general economic, business or political conditions in the domestic or international markets (particularly in Latin America) in which we operate or have material investments that may affect demand for our services;
 - o changes in currency exchange rates and interest rates;
- o general economic conditions in the countries in which we operate;

failure to generate sufficient cash flow through our business or an increase in our capital expenditures leading to greater dependency on external financing;

- o failure to maintain satisfactory working relationships with our partners;
 - o the actions of existing and potential competitors in each of our markets;
- o the impact of current, pending or future legislation and regulation in countries where we operate;
- o failure to renew or obtain the necessary licenses to carry out our operations;

- o the potential effects of technological changes;
- o unanticipated service network interruptions;

o the impact of impairment of goodwill and assets as a result of changes in the economic, regulatory, business or political environment; and

- o the outcome of pending litigation.

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 €1.00 per share, 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 stock exchanges such as the London, 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.

In October 2007, we began taking steps to delist our shares from the Paris and Frankfurt stock exchanges. This was completed in the first quarter of 2008.

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

As used herein, “Atento” means Atento Holding, Inversiones y Teleservicios, S.A. and its consolidated subsidiaries, unless the context requires otherwise.

As used herein, “O2 Group” means Telefónica O2 Europe PLC and its consolidated subsidiaries, “O2 UK” means O2 (UK) Ltd. and its consolidated subsidiaries and “O2 Germany” means O2 (Germany) GmbH & Co OHG and its consolidated subsidiaries, unless the context requires otherwise.

Below 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 the number of our customers. For example, a customer that has fixed line telephony service and broadband service represents two accesses rather than a single customer. In addition, we fully count the accesses of all companies over which we exercise control or joint control. The following are the main categories of accesses:

- o Fixed telephony accesses: includes public switched telephone network, or PSTN, lines (including public use telephony), and integrated services digital network, or ISDN, lines and circuits. For purposes of calculating our number of fixed line accesses, we multiply our lines in service as follows: PSTN (x1); basic ISDN (x1); primary ISDN (x30, x20 or x10); 2/6 digital accesses (x30).

- o Internet and data accesses: includes broadband accesses (retail asymmetrical digital subscriber line “ADSL”, satellite, fiber optic and circuits over 2 Mbps), narrowband accesses (Internet service through the PSTN lines) and other accesses, including the remaining non-broadband final client circuits.

- o Pay TV: includes cable TV, direct to home satellite TV, or DTH, and Internet Protocol TV, or IPTV.

- o Mobile accesses: includes contract and pre-pay mobile telephony.

o Unbundled local loop, or ULL: includes accesses to both ends of the copper local loop leased to other operators to provide voice and DSL services (fully unbundled loop, fully UL) or only DSL service (shared unbundled loop, “shared UL”).

o Wholesale ADSL: means wholesale asymmetrical digital subscriber line.

o Other: includes other circuits for other operators.

iii

Certain technical terms used with respect to our business are as follows:

- “ARPU” is the average revenue per user per month. ARPU is calculated by dividing total service revenue (excluding inbound roaming revenue) from sales to customers for the preceding 12 months by the weighted average number of customers for the same period, and then divided by 12 months. ARPU is calculated using gross service revenue before deduction of wholesale discounts.
- “CDMA” means Code Division Multiple Access, which is a type of radio communication technology.
- “Commercial activity” includes the addition of new lines, replacement of handsets and changes in types of contracts.
- “Customer revenue” means service revenue less interconnection revenue.
- “Duo bundle” means broadband plus voice service. We measure “duo bundles” in terms of units, where each bundle of broadband and voice service counts as one unit.
- “Final clients accesses” means accesses provided to residential and corporate clients.
- “Gross adds” means the gross increase in the customer base in a period.
- “HSDPA” means High Speed Downlink Packet Accesses, which is a 3G mobile telephony communications protocol in the High-Speed Packet Access (HSPA) family, which allows networks based on UMTS to have higher data transfers speeds and capacity.
- “Interconnection revenue” means revenues received from other operators which use our networks to connect to our customers.
- “ISP” means Internet service provider.
- “LMDS” means local multipoint distribution service.
- “Local loop” means the physical circuit connecting the network termination point at the subscriber’s premises to the main distribution frame or equivalent facility in the fixed public telephone network.
- “MOU”, or minutes of use, is calculated by dividing the total number of voice minutes for the preceding 12 months by the weighted average number of mobile accesses for the same period, and then divided by 12 months.
- “MVNO” means mobile virtual network operator, which is a mobile operator that is not entitled to use spectrum for the provision of mobile services. Consequently, an MVNO must subscribe to an access agreement with a mobile network operator in order to provide mobile access to their customers. An MVNO pays such mobile network operator for using the infrastructure to facilitate coverage to their customers. There are two types of MVNOs: (i) pure MVNOs, which are typically telecommunications companies without licensed frequency allocation and want to complete their telecommunications service portfolio (for example, ONO in Spain); and (ii) reseller MVNOs which are companies that purchase wholesale mobile minutes and resell to end-users, and use their brand and distribution channel (for example, Carrefour in Spain).
- “Net adds” means the difference between the customer base at the end of the period and the beginning of a period.
- “Revenues” means net sales and rendering of services.

- “Service revenues” means revenue less revenue from handset sales.
- “Trio bundle” means broadband plus voice service plus IPTV. We measure “trio bundles” in terms of units, where each bundle of broadband, voice service and IPTV counts as one unit.

- “UMTS” means Universal Mobile Telecommunications System.
- “VoIP” means voice over Internet protocol.
- “Wholesale accesses” means accesses we provide to our competitors, who then sell such accesses to their residential and corporate clients.

v

PRESENTATION OF CERTAIN FINANCIAL INFORMATION

In this Annual Report, references to “dollars” or “\$”, are to United States dollars, references to “pounds sterling”, “sterling” or “£” are to British pounds sterling, references to “reais” refer to Brazilian reais and references to “euro” or “€” are to the 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.

Our consolidated financial statements as of and for the years ended December 31, 2007, 2006 and 2005 included elsewhere in this Annual Report including the notes thereto (the “Consolidated Financial Statements”), are prepared in conformity with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”), which do not differ from IFRS as adopted by the European Union. As disclosed, our 2005 financial statements were restated to present the results of operations, of the Telefónica Publicidad e Información, or TPI, group as discontinued operations.

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 in the past 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. Advisers

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 our selected consolidated financial data. It is to be read in conjunction with “Item 5. Operating and Financial Review and Prospects” and the Consolidated Financial Statements. The consolidated income statement and cash flow data for the years ended December 31, 2005, 2006 and 2007 and the consolidated balance sheet data as of December 31, 2006 and 2007 set forth below are derived from, and are qualified in their entirety by reference to, the Consolidated Financial Statements. The consolidated income statement and cash flow data for the year ended December 31, 2004 and the consolidated balance sheet data as of December 31, 2004 and 2005 set forth below are derived from Telefónica, S.A.’s consolidated financial statements, which are not included herein.

Our Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the IASB.

Until December 31, 2004, Telefónica prepared its consolidated financial statements and other interim financial information in accordance with Spanish GAAP.

Pursuant to SEC Release No. 33-8567, "First-Time Application of International Financial Reporting Standards", Telefónica is only required to include Selected Financial Data prepared in compliance with IFRS extracted or derived from the Consolidated Financial Statements for the years ended December 31, 2007, 2006, 2005 and 2004 (earlier periods are not required to be included).

Furthermore, pursuant to SEC Release No. 33-8879, "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP", Telefónica includes Selected Financial Data prepared in compliance with IFRS, without reconciliation to U.S. GAAP.

The basis of presentation and principles of consolidation are described in detail in notes 2 and 3.q., respectively, to our Consolidated Financial Statements.

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As of or for the year ended December 31,
2004 (1) 2005 (1) 2006(1) 2007
(in millions of euros, except share data)

Revenues	29,809	37,383	52,901	56,441
Other income	1,134	1,416	1,571	4,264
Supplies	(7,577)	(9,999)	(16,629)	(17,907)
Personnel expenses	(4,976)	(5,532)	(7,622)	(7,893)
Other expenses	(6,373)	(8,212)	(11,095)	(12,081)
Depreciation and amortization	(5,642)	(6,693)	(9,704)	(9,436)
Operating income	6,375	8,363	9,422	13,388
Share of profit (loss) of associates	(50)	(128)	76	140
Net financial expenses	(1,456)	(1,790)	(2,795)	(2,851)
Net exchange differences	(177)	162	61	7
Net financial income (expense)	(1,633)	(1,628)	(2,734)	(2,844)
Profit before taxes from continuing operations	4,692	6,607	6,764	10,684
Corporate income tax	(1,451)	(1,904)	(1,781)	(1,565)
Profit for the year from continuing operations	3,241	4,703	4,983	9,119

As of or for the year ended December 31,
2004 (1) 2005 (1) 2006(1) 2007
(in millions of euros, except share data)

Profit from discontinued operations after taxes	245	124	1,596	—
Profit for the year	3,486	4,827	6,579	9,119
Minority interests	(310)	(381)	(346)	(213)
Profit for the year attributable to equity holders of the parent	3,176	4,446	6,233	8,906
Weighted average number of shares (thousands)	4,987,751	4,870,852	4,778,998	4,758,707
Earnings per share attributable to equity holders of the parent (euros)(2)(3)	0.637	0.913	1.304	1.872
Earnings per share from continuing operations attributable to equity holders(2)(3)	0.597	0.898	0.973	1.872
Earnings per ADS (euros)(2)(3)	1.910	2.738	3.913	5.615
Weighted average number of ADS (thousands)	1,662,584	1,623,617	1,592,999	1,586,236
Consolidated Balance Sheet Data				
Cash and cash equivalents	914	2,213	3,792	5,065
Property, plant and equipment	23,193	27,993	33,887	32,460
Total assets	60,079	73,174	108,982	105,873
Non-current liabilities	27,743	35,126	62,645	58,044
Equity (net)	12,342	16,158	20,001	22,855
Consolidated Cash Flow Data				
Net cash provided by operating activities	10,131	11,139	15,414	15,551
Net cash used in investing activities	(5,808)	(9,592)	(28,052)	(4,592)
Net cash provided by (used) in financing activities	(3,937)	(435)	14,572	(9,425)
Cash dividends per ordinary share	0.40	0.50	0.55	0.65

- (1) TPI was sold in 2006 and its results of operations for 2006 and the gain we recorded on its sale are included under “Profit from discontinued operations after taxes” for 2006. Figures for 2005 and 2004 have been restated to present TPI’s results under the same caption.
- (2) 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.
- (3) Each ADS represents the right to receive three ordinary shares. Figures do not include any charges of the Depositary.

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 May 13, 2008 was \$1.5509 = €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.

Year ended December 31,	Noon Buying Rate			
	Period end	Average(1)	High	Low
2003	1.2597	1.1411	1.2597	1.0361
2004	1.3538	1.2478	1.3625	1.1801

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2005	1.1842	1.2400	1.3476	1.1667
2006	1.3197	1.2563	1.3327	1.1860
2007	1.4603	1.3797	1.4862	1.2904

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.

2

Month ended	Noon Buying Rate	
	High	Low
November 30, 2007	1.4862	1.4435
December 31, 2007	1.4759	1.4344
January 31, 2008	1.4877	1.4574
February 29, 2008	1.5187	1.4495
March 31, 2008	1.5805	1.5195
April 30, 2008	1.6101	1.5568
May 13, 2008	1.5548	1.5370

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 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 ADSs 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, pounds sterling, Venezuelan bolivar, the Czech koruna (crown), the Mexican peso, the Argentine peso, the Chilean peso, the Colombian peso and the Peruvian nuevo sol). See “Item 11. Quantitative 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 document, prospective investors should carefully consider the risks described below before making any investment decision. 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, results of operations and cash flows 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

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

At December 31, 2007, approximately 33.2% of our assets were located in Latin America. In addition, approximately 36.2% of our revenues from operations for 2007 were derived from our Latin American operations. Our operations and investments in Latin America (including the revenues generated by these operations, their market value and the dividends and management fees expected to be received from them) are subject to various risks related to the economic, political and social conditions of these countries, including risks related to the following:

3

- government regulations and administrative policies may change in an unpredictable and adverse manner;
- 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 or nationalize assets or increase their participation in the economy and companies;
- governments may impose burdensome taxes or tariffs;
- political changes may lead to changes in the business environments in which we operate; and
- economic downturns, political instability and civil disturbances may negatively affect our operations.

In particular, our business may be affected by recent political developments in certain Latin American countries. Certain governments in these countries have announced plans to nationalize or otherwise increase their intervention in various industries. We cannot predict how recent developments and new political conditions in such countries will affect our business and operations.

Our operations are dependent, in many cases, on concessions and other agreements with existing governments. These concessions and agreements, including their renewal, could be directly affected by economic and political instability, altering the terms and conditions under which we operate in such countries.

For a more detailed description of our exchange rate risk and country risk, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and note 16 to our Consolidated Financial Statements.

Our financial condition, results of operations and cash flows 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. 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, or if our banking counterparties fail to deliver on their commitments due to lack of solvency or otherwise, such failure could adversely affect our financial condition, results of operations and cash flows. Also, our other risk management strategies may not be successful, which could adversely affect our financial condition, results of operations and cash flows. For a more detailed description of our financial derivatives transactions, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and note 16 to our Consolidated Financial Statements.

Adverse economic conditions could reduce purchases of our products and services.

Our business is impacted by general economic conditions and other similar factors in each of the countries in which we operate. Adverse economic or other market conditions negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers. Moreover, in the case of an economic downturn, our customers may reduce their spending on information, communications and entertainment services. As a result, our financial condition, results of operations and cash flows may be negatively affected and our

growth targets may not be met.

Failure to generate sufficient cash flow and higher capital expenditure requirements could make us more dependent on external financing. If we are unable to obtain financing, our business may be adversely affected.

The operation, expansion and upgrading of our networks, as well as the marketing and distribution of our services and products require substantial financing. Moreover, our liquidity and capital resource requirements may increase if we participate in other fixed line or mobile license award processes or make acquisitions. We also have major capital resource requirements relating to, among other things, the development of distribution channels in new countries of operations and the development and implementation of new technologies.

If our ability to generate cash flow were to decrease, we might need to incur additional debt to support our liquidity and capital resources requirements for the ongoing development and expansion of our business in the countries where we operate. A decrease in our cash flow and an increase in our leverage could affect our creditworthiness and we may suffer downgrades in our credit ratings by the rating agencies. Deterioration in our ratings could limit or make more difficult and expensive our access to the capital markets to raise funds and restrict our ability to operate our business or to refinance our debt, if needed, which could adversely affect our financial condition, results of operations and cash flows. Moreover, the deterioration of credit market conditions could limit or make more difficult and expensive our access to the capital markets to raise funds. If we have insufficient internal cash flow or we are unable to raise the funds we need at affordable rates, we may be unable to pursue our business plans, which could adversely affect our financial condition, results of operations and cash flows. Approximately €4.4 billion in financial debt matures in 2009, which we would aim to refinance. The cost of refinancing such debt or incurring additional debt may be higher than it was in the past as demonstrated by the current situation in the financial markets. Financial markets currently imply credit spreads on our debt which could be higher than in the past, with our five-year credit default swaps trading between 61 and 185 basis points in 2008 versus an average of 37 basis points in 2007. For a more detailed description of our liquidity risk management, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and note 16 to our Consolidated Financial Statements.

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our joint venture company with Portugal Telecom, SGPS, S.A.

Our mobile business in Brazil is conducted through a 50:50 joint venture company, Brasilcel, N.V., or Brasilcel, which is jointly controlled by us and Portugal Telecom, SGPS, S.A., or Portugal Telecom. As a result of our less than controlling interest in this joint venture, we do not have absolute control over the operations of the venture and there is an inherent risk of deadlock in its management and operations.

As a result, we must generally obtain the cooperation of Portugal Telecom in order to implement and expand upon our business strategies and to finance and manage the joint venture. If this cooperation is not obtained or if there is a deadlock or disagreement among the joint venture partners, we may not realize the expected benefits from this joint venture, including economies of scale and opportunities to achieve potential synergies and cost savings.

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, and we are therefore subject to the effects of actions by our competitors in these markets. 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 mobile industry, subsidize handset procurement; or
- expand and enhance their networks more rapidly.

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;
- a significant or dominant position in the market;
- better strategic alliances;
- larger customer bases; and
- well-established relationships with current and potential customers.

To compete effectively with our competitors, we will need to successfully market 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, 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. In addition, the licensing, construction, operation and interconnection arrangements of our communications systems are regulated to varying degrees by the European Union, national, state, regional and local authorities. Furthermore, we are subject to strict regulation in many of the countries and market segments in which we operate, particularly in many areas of the fixed-line network business.

Regulatory authorities regularly intervene in the offering and pricings of our products and services. They could also adopt regulations or take other actions that could adversely affect us, including revocation of or failure to renew any of our licenses, changes in spectrum allocation, authorizations or concessions to offer services in a particular market, changes in the regulation of international roaming prices and mobile termination rates, introduction of virtual mobile operators, regulation of mobile data services and regulation of the local loop. Such regulatory actions could place significant competitive and pricing pressure on our operations, and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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, broadband and mobile service industries, including by granting new licenses in existing licensed territories in order to permit the entry of new competitors or through the imposition of special rules and obligations to those operators that are said to have a dominant position or significant market power in a certain market. 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 share in many of the countries in which we operate, we could face regulatory actions by national or supranational 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.

Finally, we expect the regulatory landscape to change in Europe as a consequence of the process of review of the common regulatory framework currently in place in the European Union, the approval of which is foreseen for 2009 or 2010, which could result in decreases or increases in the regulatory pressure depending on the type of services and the local competitive environment. We may also face possible new regulatory initiatives in the area of mobile

telecommunications in Europe, including increased regulatory pressure on international roaming tariffs for data and SMS services and on mobile call termination rates.

Additional regulation of wholesale services (for example, access to ducts and dark fiber) in several European countries, including Spain, could result in an increase of competitive pressure on our provision of high-speed fixed telecom services.

For further information regarding the matters discussed above and other aspects of the regulatory environments to which our business are subject, see “Item 4. Business—Information on the Company—Business Overview—Regulation”. Additionally, for a complete description of the material regulatory proceedings we currently face, see “Item 8. Financial Information—Legal Proceedings”.

We operate under license and concession contracts.

Most of our operating companies require licenses, authorizations or concessions from the governmental authorities of the countries in which they operate. The continued existence and terms of our licenses, authorizations and concessions are subject to review by regulatory authorities in each country and to interpretation, modification or termination by these authorities. Moreover, the renewal of these licenses and concessions, as well as the terms and conditions of such renewal, could be directly affected by political and regulatory factors.

The terms of these licenses granted to our operating companies and conditions of the license renewal vary from country to country. License renewal is not usually guaranteed, although most licenses do address the renewal process and terms. As licenses approach the end of their terms, we pursue their renewal as provided by each of the license agreements, though we can not guarantee that we will always complete this process successfully.

Many of these licenses, authorizations 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, authorizations 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 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.

For further information regarding the licenses and concessions of our operating companies see “Item 4. Business—Information on the Company—Business Overview—Regulation”.

The industry in which we operate is subject to rapid technological changes, which requires us to continuously adapt to such changes and to upgrade our existing networks. If we are unable to adapt to such changes, our ability to provide competitive services could be materially adversely affected.

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. 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, results of operations and cash flow.

In particular, we must continue to upgrade our existing mobile 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, or expand and maintain customer service, network management and administrative systems.

Many of these tasks are not entirely under our control and may be affected by applicable regulations. If we fail to execute these tasks 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, results of operations and cash flow.

Spectrum capacity may become a limiting factor.

Our mobile operations in a number of countries may rely on our ability to acquire additional spectrum. The failure to obtain sufficient capacity and spectrum coverage would have a material adverse impact on the quality of our services and our ability to provide new services, which could adversely affect our business, financial condition, results of operations and cash flow.

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 and mobile handsets. 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 adversely 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.

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, which 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. We attempt to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and building security. However, these measures are not effective under all circumstances and cannot avert every action or event that could damage or disrupt our technical infrastructure. Although we carry business interruption insurance, our insurance policy may not provide coverage in amounts sufficient to compensate us for any losses we incur.

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

Over the last few years, the debate about the alleged potential effects of electromagnetic fields on human health has, in many cases, hindered the deployment of the infrastructures necessary to ensure quality of service. Institutions and organizations, such as the World Health Organization (WHO), have stated that exposure to the emissions of electromagnetic waves generated by mobile telephony, within the limits established, has no adverse effects on health. In fact, a number of European countries, including Spain, have drawn up complete regulations reflecting the Recommendation of the Council of the European Union dated July 12, 1999. These add planning criteria for new networks, thus ensuring compliance with the limits on exposure to radio frequencies.

Whether or not other research or studies conclude there is a link between radio-frequency emissions and health, popular concerns about radio-frequency emissions may discourage the use of mobile communication devices and may result in significant restrictions on both the location and operation of cell sites, either or both of which could have a detrimental impact on our mobile companies and, as a result, on our financial condition, results of operations and cash flows. While we are not aware of any evidence confirming a link between radio-frequency emissions and health problems, and we continue to comply with good practices codes and relevant regulations, we can provide no assurance of what future medical research may suggest.

Developments in the telecommunications sector have resulted, and may in the future result, in substantial write-downs of the carrying value of certain of our assets.

We review on an annual basis, or more frequently where the circumstances require, the value of each of our assets and subsidiaries, to assess whether those carrying values can be supported by the future cash flows expected to be derived from such assets, which, in some cases, include expected synergies considered in the acquisition cost. Whenever we consider that due to changes in the economic, regulatory, business or political environment, our goodwill, intangible assets or fixed assets may be impaired, we consider the necessity of performing certain valuation tests, which may result in impairment charges. The recognition of impairments of tangible, intangible and financial assets results in a non-cash charge on the income statement, which could adversely affect our results of operations.

For more information, see “Item 5. Operating and Financial Review and Prospects—Critical Accounting Policies and Estimates—Accounting for long-lived assets, including goodwill”.

Other Risks

We are involved in disputes and litigation with regulators, competitors and third parties.

We are party to lawsuits and other legal, regulatory and antitrust proceedings in the ordinary course of our business, the final outcome of which is generally uncertain. Litigation and regulatory proceedings are inherently unpredictable. An adverse outcome in, or any settlement of, these or other proceedings (including any that may be asserted in the future) could result in significant costs to us. Such disputes and litigation (or settlements thereof) may have a material adverse effect on our business, financial condition, results of operations and cash flows. Moreover, our involvement in these disputes or proceedings may adversely affect our reputation.

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 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 through one of the world’s largest and most modern telecommunications networks;
- mainly focused on providing fixed and mobile telephony services; and
- present principally in Spain, Europe and Latin America.

The following significant events occurred in 2007:

- In April 2007, Telefónica O2 Europe, Plc, our wholly owned subsidiary, sold 100% of the share capital of the U.K. company, Airwave O2, Ltd., or Airwave, for £1,932 million (equivalent to €2,841 million at the transaction date).
- On April 28, 2007, we, together with our partners Assicurazioni Generali, S.p.A., Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A. and Sintonía, S.A., entered into a co-investment agreement and shareholders’ agreement which established the terms and conditions of our acquisition of an indirect shareholding in Telecom Italia, S.p.A., or Telecom Italia, through an Italian company, Telco, S.p.A., or Telco, in which we have a 42.3% interest. Both agreements were modified on October 25, 2007 to include the Assicurazioni Generali Group companies, and the shareholders’ agreement was further amended on November 19, 2007.

Through a series of transactions throughout 2007, Telco increased its holdings in Telecom Italia to 23.6%, giving us an indirect holding of 9.98% in the voting shares of Telecom Italia (6.88% of the dividend rights) for €2,314 million. For a more complete description of this transaction, see “Item 10.C. Additional Information—Material Contracts”.

- In May 2007, we signed an agreement to sell our 99.7% stake in Dutch company Endemol Investment Holding, B.V., or Endemol, to a consortium owned by Mediacinco Cartera, S.L., Cyrte Fond II, B.V. and G.S. Capital Partners VI Fund, L.P., for €2,629 million.

- In October 2007, our Brazilian subsidiary Telecomunicações de São Paulo, S.A., or Telesp, completed the acquisition of 100% of the Brazilian company NavyTree Participações, S.A., for €361 million.

Business areas

We have implemented a regional, integrated management model based on three business areas, with each area in charge of the fixed and mobile telephone business within its borders:

- Telefónica Spain: oversees the fixed and mobile telephone, broadband, Internet, data, broadband TV, valued added services activities and their development in Spain and mobile telephone services in Morocco.
- Telefónica Europe: oversees the fixed and mobile telephone, broadband, Internet, broadband TV, value added services and data businesses in the United Kingdom, Germany, the Isle of Man, Ireland, the Czech Republic and Slovakia.
- Telefónica Latin America: oversees the fixed and mobile telephone, broadband, Internet, broadband TV, data and value added services businesses in Latin America.

In 2007 we also had certain other businesses, some of which involved media and call center activities.

- Telefónica Contenidos: audio-visual media and content in Europe, Latin America and the United States; and
- Atento: call centers in Europe, Latin America and North Africa.

The following chart shows the organizational structure of the principal subsidiaries of the Telefónica Group at December 31, 2007, including their jurisdictions of incorporation and our ownership interest.

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- (1) Ownership in Telefónica Móviles España, S.A.U. is held directly by Telefónica, S.A.
- (2) 85.5% representing voting interest.
- (3) Ownership in Telefónica International Wholesale Services. S.L. (Spain) is held 92.51% by Telefónica, S.A. (Spain) and 7.94% by Telefónica Datacorp, S.A.U (Spain).
- (4) Ownership in O2 (Europe) Ltd. is held directly by Telefónica, S.A.

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 group's portfolio of businesses;
- provide cohesion within the group; and
- foster synergies among the group's subsidiaries.

Our principal executive offices are located at Distrito C, Ronda de la Comunicación, s/n, Las Tablas, 28050 Madrid, Spain, and our registered offices are located at Gran Vía, 28, 28013 Madrid, Spain. Our telephone number is (+34) 900 111 004.

Capital Expenditures and Divestitures

Our principal capital expenditures excluding acquisitions during the three years ended December 31, 2007 consisted of additions to property, plant and equipment and additions to intangible assets. In 2005, 2006 and 2007, we invested €5,469 million, €8,010 million and €8,027 million, respectively.

Year ended December 31, 2007

Capital expenditures increased by 0.2% to €8,027 million in 2007 from €8,010 million in 2006 principally related to our investments in Spain in our growing Internet and broadband businesses, with significant investments related to ADSL and IP services, such as Imagenio, our IPTV business. In Latin America capital expenditures were directed toward satisfying increased customer demand in our fixed line business (particularly in broadband and TV) and increasing coverage and capacity of our second generation, or GSM, networks and acquiring spectrum in Venezuela, Brazil and Panama to expand coverage and guarantee service quality in areas where traffic is heaviest. In 2007, capital expenditures in Europe decreased primarily as a result of O2 Germany bringing forward capital investment from 2007 into 2006 as part of our build out of our third mobile generation, or 3G, network.

Year ended December 31, 2006

In 2006, capital expenditures increased by 46.4% from 2005, impacted by the acquisition of the O2 Group in 2006 and principally due to expenditures relating to investment in broadband networks in Spain and Latin America in response to the need to bring higher capacity and new services to households, triggered by higher-than-forecast customer and market growth. We also made expenditures associated with a faster roll out of 3G networks, mainly in Germany. In order to meet growing traffic and customer needs, investments were also made in GSM in Latin America (mainly Brazil).

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, our headquarters in Madrid, and the capital expenditures of Cesky Telecom which we have consolidated since July 2005.

Financial Investments and Divestitures

Our principal financial investments in 2007 were made by Telefónica (€2,314 million for the acquisition of indirect shareholding in Telecom Italia). Our principal financial divestitures in 2007 were the sale of Airwave and Endemol (£1,932 million (equivalent to €2,841 million at the transaction date) and €2,629 million, respectively).

Our principal financial investments in 2006 were made by Telefónica (€23,554 million for the acquisition of O2 plc, or O2). Our principal financial divestitures in 2006 were the sale of TPI and a 6.6% stake in Sogecable, S.A., or Sogecable, for €1,816 million and €330 million, respectively.

Our principal financial investments in 2005 were made by Telefónica (€3,663 million for the acquisition of Cesky Telecom and €1,266 million for the acquisition of 4.97% of O2 through open market purchases), and Telefónica

Internacional, S.A. (€424 million for the acquisition of 5.0% of China Netcom Group Corporation (Hong Kong) Limited's, or CNC's, outstanding shares through open market purchases). Our principal financial divestiture in 2005 was the sale of a 25% interest in Endemol, N.V.

Public Takeover Offers

The principal public takeover offers which occurred in 2005, 2006 and 2007 were the following:

12

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

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 23, 2006, we made our tender offer for O2 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's issued share capital. With the acquisition of over 90% of O2 shares solicited in the offer, we implemented the procedures set out in the U.K. Companies Act to require compulsory sale of the remaining O2 shares which were not tendered pursuant to the offer. The aggregate acquisition cost was €26,135 million. We consolidate O2 in our Consolidated Financial Statements as from February 1, 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 from the Czech government in an auction as part of a privatization process. The bid price submitted by Telefónica was 502 Czech crown per share, representing a total value of approximately €2,745.9 million for the Czech government's 51.1% of the share capital of Cesky Telecom. On April 12, 2005, we signed an agreement with the Czech government to purchase its 51.1% stake in Cesky Telecom. As a result of this agreement, we were required to conduct a public tender offer for all of the remaining outstanding shares of Cesky Telecom. Pursuant to the tender offer, we acquired an additional 18.3% interest in Cesky Telecom for approximately €911 million. As of December 31, 2006, we held a 69.4% interest in Cesky Telecom.

On February 23, 2005, our Board of Directors and the Board of Directors of Terra Networks, S.A., or Terra Networks, approved a merger plan which provided for the merger of the two companies. The exchange ratio was set at two of our ordinary shares for every nine ordinary Terra Networks shares. The merger was effected on July 16, 2005.

Recent Developments

The principal events that have occurred since December 31, 2007 are set forth below.

On January 18, 2008, Telefónica Internacional, S.A.U. reached an agreement to acquire, subject to certain conditions, an additional stake equal to approximately 2.22% of the share capital of the Chinese telecommunications company, China Netcom Group Corporation (Hong Kong) Limited, or CNC, which would increase our stake to approximately 7.22%.

On February 27, 2008, we announced the launch of a new share buy-back program for a total amount of 100 million shares, representing approximately 2.095% of our share capital as of that date. The program will be effective during 2008. The execution schedule of the program will be dependent on the pace of cash-flow generation, the share price level and other market conditions, and will be subject to any applicable limitations established by law, regulations or our bylaws. For additional information see "Item 8. Financial Information—Dividend Information" and "Item 11. Quantitative and Qualitative Disclosures about Market Risk—Share price risk".

In March 2008, Telco acquired 0.91% of Telecom Italia's ordinary share capital, and as a result Telco's holding in Telecom Italia's ordinary share capital rose from 23.6% to 24.5%. Our indirect stake in Telecom Italia's ordinary share capital is, therefore, 10.4%.

In 2007, certain companies of the Banco Bilbao Vizcaya Argentaria group exercised a put option requiring us to purchase their 8.65% stake in Atento N.V. On April 1, 2008 the period for the price adjustment associated with such

put option expired, with no adjustment required to the final price paid to the Banco Bilbao Vizcaya Argentaria group of €70 million in 2007. Following our acquisition of the Banco Bilbao Vizcaya Argentaria group's stake, we own 100% of Atento N.V. For more information, see note 5 to our Consolidated Financial Statements.

On April 3, 2008 we obtained the necessary administrative authorizations to give effect to the agreement signed on August 2, 2007 between Telpart Participações S.A., or Telpart, and Vivo for the acquisition of: (i) 22.72% of the total capital of Telemig Celular Participações S.A., the controlling shareholder of Telemig Celular S.A., a mobile telephony operator in the State of Minas Gerais, Brazil; and (ii) 19.34% of the total capital of Tele Norte Celular Participações S.A., the controlling shareholder of Amazônia Celular S.A., a mobile telephony operator in the Brazilian states of Amazonas, Roraima, Amapá, Pará and Maranhão.

In addition, on April 8, 2008, Vivo, through its subsidiary TCO IP, S.A. launched a voluntary tender offer for shares representing up to one third of the free float represented by the preferred stock of Telemig Celular Participações S.A. and its subsidiary company and Telemig Celular S.A. with a price per share of 63.90 reais and 654.72 reais, respectively. This offer was concluded on May 12, 2008, with close to 100% of the preferred shareholders tendering their shares. Furthermore, in accordance with Brazilian securities market legislation, TCO IP, S.A. has launched a mandatory tender offer for all the voting stock in Telemig Celular Participações S.A. and Telemig Celular S.A., with a price per share of 80% of the purchase price of the respective voting stock of these companies.

At the same time, in relation to the other company originally contemplated in the sale and purchase agreement, Tele Norte Celular Participações S.A., on December 20, 2007 Vivo entered into an agreement with TNL PCS S.A. (Telemar Group) undertaking, subject to prior approval by ANATEL (Agência Nacional de Telecomunicações), to sell the shares in Tele Norte Celular Participações S.A. which Telpart undertook to sell to Vivo, on similar terms and conditions to those on which Vivo undertook to purchase those shares. After the relevant administrative authorizations were obtained, the sale was completed on April 3, 2008, simultaneously with the acquisition of Telemig Celular Participações S.A.

On May 9, 2008 we disposed of our 16.79% interest in Sogecable, S.A. pursuant to the takeover bid launched by Promotora de Comunicaciones, S.A (Prisa).

B. Business Overview

Our total accesses increased 12.5% to 228.5 million accesses at December 31, 2007 from 203.2 million accesses at December 31, 2006. Total accesses at December 31, 2007 includes 169.2 million mobile accesses, 42.0 million fixed telephony accesses, 13.0 million Internet and data accesses and 1.7 million pay TV accesses. Additionally, it includes almost 1.4 million unbundled local loop and 0.6 million wholesale ADSL accesses.

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

	2005	At December 31, 2006 (in thousands)	2007
Fixed telephony accesses (1)	40,859.0	42,340.7	41,974.2
Internet and data accesses	11,002.6	12,170.9	12,968.4
Narrowband accesses	5,166.9	3,997.7	2,532.9
Broadband accesses (2)	5,653.0	7,974.8	10,277.8
Other accesses (3)	182.7	198.4	157.7
Mobile accesses	99,124.0	145,125.1	169,219.7
Pay TV	683.2	1,064.0	1,748.1
Final clients accesses	151,668.8	200,700.7	225,910.3
Unbundled local loop	441.7	962.2	1,396.5
Shared UL	279.0	527.7	776.4
Full UL	162.7	434.5	620.1
Wholesale ADSL (4)	1,330.1	1,288.6	575.5
Other (5)	55.6	228.6	656.0
Wholesale accesses	1,827.4	2,479.4	2,628.0
Total accesses	153,496.2	203,180.2	228,538.3

(1)

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PSTN (including public use telephony) x1; ISDN basic access x1; ISDN primary access; 2/6 access x30.
Company's accesses for internal use.

- (2) ADSL, satellite, fiber optic, cable modem and broadband circuits.
- (3) Remaining non-broadband final client circuits.
- (4) Includes unbundled lines by Telefónica Deutschland.
- (5) Circuits for other operators.

Our Services and Products

Fixed business

The principal services we offer in our fixed businesses in Spain, Europe and Latin America are:

- **Traditional fixed telecommunication services.** Our principal traditional fixed telecommunication services include PSTN lines; ISDN accesses; 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; business-oriented value-added service; intelligent network services; leasing and sale of terminal equipment; and telephony information service.
- **Internet and broadband multimedia services.** Our principal Internet and broadband multimedia services include narrowband switched access to Internet; Internet service provider service; portal and network services; retail and wholesale broadband access through ADSL, LMDS and satellite technologies; residential-oriented value-added services (including instant messaging, concerts and video clips by streaming, e-learning, parental control, firewall, anti-virus, content delivery, personal computer sales); television services such as Imagenio, our IPTV business, cable television and satellite television; companies-oriented value-added services, like puesto integral o puesto informático, which includes ADSL, computer and maintenance for a fixed price, and VoIP services.
- **Data and business-solutions services.** Our data and business-solutions services principally include leased lines; virtual private network, or VPN, services; fiber optics services; the provision of hosting and application, or ASP, service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management, or CGP, and desktop services and system integration and professional services.
- **Wholesale services for telecommunication operators.** Our wholesale services for telecommunication operators principally include domestic interconnection services, international wholesale services, leased lines for other operators' network deployment and local loop leasing under the unbundled local loop regulation framework.

Mobile business

We offer a wide variety of mobile and related services and products to consumer and business customers. Although the services and products available vary from country to country, the following are our principal services and products:

- **Mobile voice services.** Our principal service in all of our markets is mobile voice telephony, which has gained increased usage as a result of our increased customer base and increased market penetration rates.
- **Value added services.** Customers in most of our markets have access to a range of enhanced calling features including voice mail, call hold, call waiting, call forwarding and three-way calling.
- **Mobile 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. We also provide mobile broadband connectivity and Internet access. Through mobile Internet access, our customers are able to send and receive e-mail, browse web pages, download games, purchase goods and services in m-commerce transactions and use our other data services.

- Wholesale services. We have signed network usage agreements with three MVNOs (Ono, Fonyou and El Corte Inglés). As of December 31, 2007, only Ono was operating.
- Corporate services. We provide business solutions, including mobile infrastructure in offices, private networking and portals for corporate customers that provide flexible on-line billing. Telefónica Móviles España, S.A.U., or Telefónica Móviles España, offers corporate services through Movistar Corporativo, and other advanced solutions for data, developed for specific sectors.
- Roaming. We have roaming agreements that allow our customers to use their handsets when they are outside of our service territories, including on an international basis.
- Fixed wireless. We provide fixed voice telephony services through mobile networks in (by number of accesses at December 31, 2007), Venezuela, Argentina, Peru, Morocco, Mexico, Ecuador, El Salvador, Guatemala and Nicaragua.
- Trunking and paging. In Spain and Guatemala, we provide digital mobile services for closed user groups of clients and paging services.
- M-payment. Through our subsidiary, Telefónica Móviles España, and together with Vodafone España, Orange and financial institutions and payment processing companies, we have a 13.36% interest in Mobipay España, a company incorporated to develop micro-payments. We also have a 50% interest in Mobipay International, a company incorporated to expedite payments through mobile phones in an international setting. Banco Bilbao Vizcaya Argentaria, S.A. is the other 50% shareholder in Mobipay International.

The following sections provide a description of the main markets in which we operate. Customer information on the markets in which we operate, including our market share based on accesses, are estimates that we have made based on annual reports and press releases made public by our competitors or information from local regulators in the respective markets.

Telefónica Spain Operations

Telefónica Spain's total accesses increased 5.0% to 46 million accesses at December 31, 2007 from 44 million accesses at December 31, 2006. Total accesses at December 31, 2007 includes 23 million mobile accesses, 15.9 million fixed telephony accesses, 5.3 million Internet and data accesses and 0.5 million pay TV accesses. Additionally, it includes 1.4 million unbundled local loop and 0.5 million of wholesale ADSL accesses.

Telefónica Spain provides fixed and mobile telephony services in Spain and mobile telephony services in Morocco.

Telefónica Spain - Fixed business

Telefónica Spain provides fixed telephony services in Spain through the operator Telefónica de España.

Operations

The following table shows the development of Telefónica de España's Spanish telecommunications network since 2005:

	2005	At December 31, 2006	2007
		(in thousands)	
Fixed telephony accesses	16,135.6	15,949.9	15,898.0
Internet and data accesses	4,400.5	4,842.0	5,279.3
Narrowband accesses	1,614.9	1,040.5	660.8
Broadband accesses	2,720.7	3,742.7	4,571.6
Other accesses	64.9	58.8	47.0
Pay TV accesses	206.6	383.0	511.1
Final clients accesses	20,742.6	21,174.9	21,688.4
Unbundled local loop	434.8	939.0	1,353.9
Shared UL	279.0	527.7	776.4
Full UL	155.7	411.3	577.6
Wholesale ADSL	721.9	586.4	499.3
Other	7.4	6.4	6.0
Wholesale accesses	1,164.1	1,531.8	1,859.2
Total accesses	21,906.7	22,706.7	23,547.6

The total Spanish fixed telephony market grew by an estimated 1.9% in 2007 in terms of number of accesses. Telefónica Spain's fixed telephony accesses decreased by 0.3% to 15.9 million accesses at December 31, 2007 from December 31, 2006. Net fixed telephony accesses losses in 2007 were 51,901, down substantially from the 185,696 recorded in 2006.

Estimated net adds in the total Spanish broadband market decreased by 18.9% to 1.4 million net adds in 2007 from 1.7 million net adds in 2006. The total Spanish fixed broadband Internet access market stood at an estimated 8.1 million accesses as of December 31, 2007. Telefónica Spain's Internet broadband accesses increased by 22.1% to 4.6 million accesses at December 31, 2007 from 3.7 million accesses at December 31, 2006.

The estimated market share of unbundled local loops in the total Spanish broadband Internet access market increased to almost 17% (14% in 2006). Unbundled local loops at December 31, 2007 amounted to 1,353.9 million accesses of which 57.3% were shared access loops.

Telefónica Spain's total wholesale ADSL accesses decreased by 14.9% to 0.5 million accesses at December 31, 2007 from 0.6 million accesses at December 31, 2006, mainly because of the migration to unbundled local loop.

In 2007, Telefónica Spain continued to increase its presence in the pay TV market with a growth in its customer base to 0.5 million accesses at December 31, 2007. As a result of the growth in its customer base, Telefónica Spain increased its estimated market share to approximately 13% at December 31, 2007, compared to 10% at December 31, 2006.

Since 2005 Telefónica Spain has bundled ADSL products with other products in Duo bundles, which include voice services, and Trio bundles, which include voice and IPTV services. The total number of Duo and Trio bundles increased by 38% to 3.8 million units at December 31, 2007 from 2.7 million units at December 31, 2006. At December 31, 2007, over 80% of Telefónica Spain's broadband accesses are included as part of a Duo or Trio bundle compared to 70% at December 31, 2006.

Sales and marketing

One of our main priorities is to satisfy customer needs and increase customer loyalty by improving the quality of our customer service and offering a wide range of integrated telecommunications services. 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 employed by Telefónica Spain, 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;
 - Telefónica stores (Tiendas Telefónica) where customers can test and buy the products we market;
- the Telefónica “virtual” store, accessible by Internet, which offers the ability to order and purchase online the majority of services and products we offer; 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 2007 our commercial strategy focused on increasing sales of Duos and Trios and mobiles through flat rate plans and fixed-to-mobile call bonuses with different offers depending on market segments. In addition, in 2007 we continued with the development of our product portfolio, especially in broadband services.

In the business segment, we promoted the concept of Puesto de Trabajo which is a package of services designed to meet the voice services, data and IT needs for small- and medium-sized businesses.

In 2007 in the consumer segment we enhanced our IPTV offering with new features such as “Past TV”, which allows users to digitally record and view television programs.

Competition

The level of competition faced by Telefónica Spain in 2007 was similar to prior years, with most competitor activity directed at residential markets through product offerings bundling broadband service and voice calling plans. Telefónica Spain’s principal competitors in the fixed telephony market fall within three main categories:

- cable operators, such as the Spanish nationwide cable operator ONO, offering trio bundles, and regional cable operators;
- ULL operators, such as Orange and Ya.com (both directly and/or indirectly owned by France Telecom), Jazztel and Tele2 (which was acquired in 2007 by Vodafone); and
 - large-business oriented operators, such as British Telecom and Colt, offering voice and data VPNs.

Telefónica Spain’s estimated market share during 2007 was as follows:

- fixed telephony accesses market share amounted to approximately 81% of retail accesses (down from approximately 82.5% in 2006);
- broadband market share amounted to approximately 56% of retail accesses (approximately the same as in 2006); and
- pay TV market share amounted to approximately 13% of the market in terms of accesses (up from approximately 10% in 2006).

Network and technology

Telefónica Spain has made significant investments to develop its broadband access business through ADSL technology, strongly increasing the coverage and the development of Imagenio, our IPTV service. Additionally Telefónica Spain has begun deploying a new fiber access network, or FTTX, which currently offers only limited coverage.

Telefónica Spain - Mobile business (Spain)

Telefónica Spain provides mobile services in Spain through the operator Telefónica Móviles España.

Operations

The Spanish mobile market exceeded 50.7 million accesses at December 31, 2007, which represented a penetration rate of 111%, an increase of more than six percentage points from December 31, 2006. The Spanish mobile market has shown growth as a result of a decline of mobile handset prices and per minute call rates, and the success of pre-pay calling plans, with strong competition in number portability and pressure on pricing, including termination rate reductions, along with the entry of new competitors such as MVNOs.

The following table presents selected statistical data relating to the operations of Telefónica Spain's mobile business:

	At or for the year ended December 31,		
	2005	2006	2007
Total mobile accesses (in millions)	19.9	21.5	22.8
Pre-pay accesses (in millions)	9.2	9.3	9.2
MOU (minutes)	150	156	161