

TELEFONICA S A  
Form 20-F  
April 29, 2011

As filed with the Securities and Exchange Commission on April 29, 2011

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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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, 2010  
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
OR
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

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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(Name, Telephone, E-Mail and/or Facsimile number and Address of Company Contact Person)

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

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Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value €1.00 per share* American Depositary Shares, each representing one Ordinary Share	New York Stock Exchange New York Stock Exchange
Guarantees** by Telefónica, S.A. of the \$1,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2011; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$850,000,000 Floating Rate Guaranteed Senior Notes Due 2013; \$1,200,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$1,250,000,000 Fixed Rate Notes Due 2015; \$900,000,000 Fixed Rate Guaranteed Senior Notes Due 2015; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$1,000,000,000 Fixed Rate Notes Due	New York Stock Exchange

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2019; \$1,400,000,000 Fixed Rate Guaranteed Senior Notes Due 2020; \$1,500,000,000 Fixed Rate Guaranteed Senior Notes Due 2021; \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U.

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

\*\*Not for trading, but only in connection with the listing of the \$1,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2011; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$850,000,000 Floating Rate Guaranteed Senior Notes Due 2013; \$1,200,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$1,250,000,000 Fixed Rate Notes Due 2015; \$900,000,000 Fixed Rate Guaranteed Senior Notes Due 2015; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$1,000,000,000 Fixed Rate Notes Due 2019; ; \$1,400,000,000 Fixed Rate Guaranteed Senior Notes Due 2020; \$1,500,000,000 Fixed Rate Guaranteed Senior Notes Due 2021; \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U. (a wholly-owned subsidiary of Telefónica, S.A.)

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, 2010 was:

Ordinary Shares, nominal value €1.00 per share: 4,563,996,485

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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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 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

If this is an annual report indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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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, 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 “will,” “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 telecommunications 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 telecommunications sectors 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 business 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 (particularly in Latin America) in which we operate or have material investments that may affect demand for our services;
- changes in currency exchange rates, interest rates or in credit risk in our treasury investments or in some of our financial transactions;
  - general economic conditions in the countries in which we operate;
  - existing or worsening conditions in the international financial markets;
  - the actions of existing and potential competitors in each of our markets;



- the impact of current, pending or future legislation and regulation in countries where we operate;
- failure to renew or obtain the necessary licenses, authorizations and concessions to carry out our operations;
  - the potential effects of technological changes;

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- the impact of limitations in spectrum capacity;
- failure of suppliers to provide necessary equipment and services on a timely basis;
- the impact of unanticipated network interruptions;
- the effect of reports suggesting that radio frequency emissions cause health problems;
- the impact of impairment charges on our goodwill and assets as a result of changes in the regulatory, business or political environment; and
  - 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.

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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 and are quoted through the Automated Quotation System under the symbol “TEF.” They are also listed on various foreign stock exchanges such as the London, Buenos Aires and Tokyo stock exchanges. American Depositary Shares (“ADSs”), each representing the right to receive one ordinary share, are listed on the New York Stock Exchange 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 Receipts (“BDRs”), each representing the right to receive one ordinary share, are listed on the São Paulo Stock Exchange and are issued under a deposit agreement with Banco Bradesco, S.A., as Depositary. On March 30, 2011, we initiated a plan to cancel the BDR Program and delist our securities from the São Paulo Stock Exchange. We expect that the BDR Program cancellation and delisting process will be completed in the second half of 2011.

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.

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 us. 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:
  - 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).
    - 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. “Naked ADSL” allows customers to subscribe for a broadband connection without a monthly fixed line fee.
    - Pay TV: includes cable TV, direct to home satellite TV, or DTH, and Internet Protocol TV, or IPTV.
  - Mobile accesses: includes accesses to mobile network for voice and/or data services (including connectivity). Mobile broadband includes internet access from devices used to make voice calls and smartphones (mobile internet), and internet access from devices that complement fixed broadband, such as PCCards/dongles, and enable large amounts of data to be downloaded on the move (mobile connectivity). In 2009 in order to align the criteria for the key performance indicators of our mobile operations, the definition of mobile accesses (and, therefore, of total accesses) was revised to include machine-to-machine accesses. Mobile accesses are categorized into contract and

prepay accesses. In addition, we revised the accounting criteria for pre-pay mobile accesses at Telefónica O2 Czech Republic and Telefónica O2 Slovakia to conform to the accounting criteria for pre-pay mobile accesses throughout the Group. In order to count a pre-pay mobile access, such access must have been active in the most recent three months prior to counting, through a revenue-generating event for our Group from whatsoever source. As a result of both revisions, we restated 2008 mobile accesses.

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- 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”).
  - Wholesale ADSL: means wholesale asymmetrical digital subscriber line.
  - Other: includes other circuits for other operators.

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 accesses 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, migrations and changes in types of contracts.
  - “Customer revenue” means service revenue less interconnection revenue.
- “Duo bundle” means broadband plus voice and/or TV service. We measure “duo bundles” in terms of units, where each bundle of broadband and voice service counts as one unit.
- “Digital Dividend” refers to the amount of spectrum that will be freed up in the switchover from analogue to digital terrestrial TV.
- “FTTx” is a generic term for any broadband network architecture that uses optical fiber to replace all or part of the metal local loop typically used for the last mile of telecommunications wiring.
  - “Final client accesses” means accesses provided to residential and corporate clients.
  - “Gross adds” means the gross increase in the customer base measured in terms of accesses 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.
- “IT”, or information technology, is the acquisition, processing, storage and dissemination of vocal, pictorial, textual and numerical information by a microelectronics-based combination of computing and telecommunications.
  - “LMDS” means local multipoint distribution service.

- “LTE” means Long Term Evolution, a wireless access technology.
- “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.
- “M2M”, or machine to machine, refers to technologies that allow both wireless and wired systems to communicate with other devices of the same ability.
- “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. Over the past several years, we have experienced strong growth in mobile accesses related

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primarily to data services (such as accesses related to machine-to-machine and mobile broadband devices). Such growth in mobile accesses related to data services limits the use of MOU as an indicator of usage as it increases the total number of mobile accesses in the relevant period without any corresponding increase in the number of voice minutes related to such accesses for the relevant period. As a result, we no longer publish MOU for years after 2008 and instead publish traffic evolution in absolute minutes of use.

- “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.
- “Net adds” means the difference between the customer base measured in terms of accesses at the end of the period and the beginning of a period.
  - “Revenues” means net sales and revenues from rendering of services.
  - “Service revenues” means revenues less revenues from handset sales.
- “Traffic” means voice minutes used by our customers over a given period, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic (free minutes included in commercial promotions) is included. Traffic not associated with our mobile customers (roaming-in; MVNOs; interconnection of third parties and other business lines) is excluded. To arrive at the aggregate traffic for a given period, the individual components of traffic are not rounded.
  - “Trio bundle” means broadband plus voice service plus TV. We measure “trio bundles” in terms of units, where each bundle of broadband, voice service and TV 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 services over such accesses to their residential and corporate clients.

In this Annual Report we make certain comparisons in local currency or on a “constant euro basis” or “excluding foreign exchange rate effects” in order to present an analysis of the development of our results of operations from year-to-year without the effects of currency fluctuations. To make comparisons on a local currency basis, we compare financial items in the relevant local currency for the periods indicated as recorded in the relevant local currency for such periods. To make comparisons on a “constant euro basis” or “excluding foreign exchange rate effects,” we convert the relevant financial item into euros using the prior year’s average euro to relevant local currency exchange rate. In addition, we present certain financial information excluding the effects of Venezuela being considered a hyperinflationary economy in 2010 and 2009 by eliminating all adjustments made as a result of such consideration.

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PRESENTATION OF CERTAIN FINANCIAL INFORMATION

In this Annual Report, references to “US dollars,” “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 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 December 31, 2009 and 2010, and for the years ended December 31, 2008, 2009 and 2010 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”).



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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 certain 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, 2008, 2009 and 2010 and the consolidated statement of financial position data as of December 31, 2009 and 2010 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 years ended December 31, 2006 and 2007 and the consolidated statement of financial position data as of December 31, 2006, 2007 and 2008 set forth below are derived from Telefónica, S.A.’s consolidated financial statements for such years, which are not included herein.

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

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

	As of or for the year ended December 31,				
	2006(1)	2007	2008	2009	2010
	(in millions of euros, except share data)				
Revenues	52,901	56,441	57,946	56,731	60,737
Other income	1,571	4,264	1,865	1,645	5,869
Supplies	(16,629 )	(17,907 )	(17,818 )	(16,717 )	(17,606 )
Personnel expenses	(7,622 )	(7,893 )	(6,762 )	(6,775 )	(8,409 )
Other expenses	(11,095 )	(12,081 )	(12,312 )	(12,281 )	(14,814 )
Depreciation and amortization	(9,704 )	(9,436 )	(9,046 )	(8,956 )	(9,303 )
Operating income	9,422	13,388	13,873	13,647	16,474
Share of profit (loss) of associates	76	140	(161 )	47	76
Net financial expense	(2,795 )	(2,851 )	(2,821 )	(2,767 )	(2,537 )
Net exchange differences	61	7	24	(540 )	(112 )
Net financial income (expense)	(2,734 )	(2,844 )	(2,797 )	(3,307 )	(2,649 )
Profit before taxes from continuing operations	6,764	10,684	10,915	10,387	13,901
Corporate income tax	(1,781 )	(1,565 )	(3,089 )	(2,450 )	(3,829 )
Profit for the year from continuing operations	4,983	9,119	7,826	7,937	10,072
Profit from discontinued operations after taxes	1,596	—	—	—	—
Profit for the year	6,579	9,119	7,826	7,937	10,072
Non-controlling interests	(346 )	(213 )	(234 )	(161 )	95
Profit for the year attributable to equity holders of the parent	6,233	8,906	7,592	7,776	10,167
Weighted average number of shares (thousands)	4,778,999	4,758,707	4,645,852	4,552,656	4,522,228
Basic and diluted earnings per share from continuing operations attributable to equity holders (euros)(2)	0.97	1.87	1.63	1.71	2.25
Basic and diluted earnings per share attributable to equity holders of the parent (euros)(2)	1.30	1.87	1.63	1.71	2.25
Earnings per ADS (euros)(2)(3)	1.30	1.87	1.63	1.71	2.25
Weighted average number of ADS (thousands) (3)	4,778,999	4,758,707	4,645,852	4,552,656	4,522,228
Cash dividends per ordinary share (euros)	0.55	0.65	0.90	1.00	1.30
<b>Consolidated Statement of Financial Position Data</b>					
Cash and cash equivalents	3,792	5,065	4,277	9,113	4,220
Property, plant and equipment	33,887	32,460	30,545	31,999	35,797
Total assets	108,982	105,873	99,896	108,141	129,775
Non-current liabilities	62,645	58,044	55,202	56,931	64,599
Equity (net)	20,001	22,855	19,562	24,274	31,684
Capital stock	4,921	4,773	4,705	4,564	4,564
<b>Consolidated Cash Flow Data</b>					
Net cash from operating activities	15,414	15,551	16,366	16,148	16,672
Net cash used in investing activities	(28,052 )	(4,592 )	(9,101 )	(9,300 )	(15,861 )
Net cash (used in) from financing activities	14,572	(9,425 )	(7,765 )	(2,281 )	(5,248 )

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- (1) Telefónica Publicidad e Información, S.A. (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.
  - (2) The per share and per ADS computations for all periods presented have been presented using the weighted average number of shares and ADSs, respectively, 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) Until January 20, 2011, each ADS represented the right to receive three ordinary shares. Since January 21, 2011, each ADS represents the right to receive one ordinary share. The above figures have been restated accordingly. Figures do not include any charges of the Depositary.

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## 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 22, 2011 was \$1.4545 =€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,	Period end	Noon Buying Rate		
		Average(1)	High	Low
2006	1.3197	1.2661	1.3327	1.1860
2007	1.4603	1.3797	1.4862	1.2904
2008	1.3919	1.4698	1.6010	1.2446
2009	1.4332	1.3955	1.5100	1.2547
2010	1.3269	1.3261	1.4536	1.1959
2011 (through April 22, 2011)	1.4545	1.3840	1.4585	1.2944

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Source: Federal Reserve Bank of New York.

(1) The average of the Noon Buying Rates for the euro on the last day reported of each month during the relevant period.

Month ended	Noon Buying Rate	
	High	Low
October 31, 2010	1.4066	1.3688
November 30, 2010	1.4224	1.3036
December 31, 2010	1.3395	1.3089
January 31, 2011	1.3715	1.2944
February 28, 2011	1.3794	1.3474
March 31, 2011	1.4212	1.3813
April 30, 2011 (through April 22, 2011)	1.4585	1.4211

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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, the Venezuelan Bolivar fuerte (see “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Classification of Venezuela as a hyperinflationary economy” and “Item 5. Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Devaluation of the Venezuelan bolivar”), the pound sterling, the Czech koruna (crown), the Argentine peso, the Chilean peso, the Peruvian nuevo sol, the Mexican peso and the Colombian peso).

B. Capitalization and Indebtedness

Not applicable.

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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 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 flow could be materially adversely affected by any of these risks, and investors could lose all or part of their investment.

Risks Relating 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, 2010, approximately 50.6% of our assets were located in our Latin America segment. In addition, approximately 42.9% of our revenues for 2010 were derived from our Latin American segment operations. At December 31, 2010, 56.4% of Latin America assets and 42.7% of Latin America revenues were derived from our operations in Brazil. Our business is thus particularly sensitive to any of the risks relating to Latin America discussed in this section to the extent they arise or manifest themselves in Brazil. 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 therefrom) are subject to various risks linked to the economic, political and social conditions of these countries, including risks related to the following:

- government regulation or administrative policies may change unexpectedly and negatively affect our interests in such countries;
- currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- the effects of inflation or currency depreciation may result in certain of our subsidiaries having negative equity, which would require them 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 economic conditions and business environment in which we operate; and
  - economic downturns, political instability and civil disturbances may negatively affect our operations.

In addition, our operations are dependent, in many cases, on concessions and other agreements with existing governments in the countries in which we operate. 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.

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

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 and the impact of changes in interest rates, as well as the impact of changes of credit risk in our treasury investments (in cash and cash equivalents) or in some of our financial

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transactions. 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 and interest rate fluctuations or if our 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 flow. Also, our other risk management strategies may not be successful, which could adversely affect our financial condition, results of operations and cash flow. Finally, if the rating of our counterparties in treasury investments or in our structured financial transactions deteriorates significantly or if any of such counterparties were to fail in its obligations to us, we may suffer a loss of value in our investments, incur unexpected losses and assume additional financial obligations under these transactions, and such failure could adversely affect our business, financial condition, results of operations and cash flow.

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. The current uncertainty about an economic recovery may negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers. Additional factors that could influence customer demand include access to credit, unemployment rates, consumer confidence and other general macroeconomic factors. Specifically, in this respect the continuation of the economic situation in Spain, according to the forecasts contained in the Spanish economic ministry’s Stability Program for 2009-2013, could have an adverse affect on the Telefónica Group’s results in Spain. In addition, other related effects of the financial crisis could impact our business, including insolvency of key suppliers or customers. A loss of customers or a reduction in purchases by our current customers could have a material adverse effect on our business, financial condition, results of operations and cash flow and may therefore negatively affect our ability to meet our growth targets.

Existing or worsening conditions in the international financial markets may limit our ability to carry out our business plan.

The development and distribution of our services as well as the operation, expansion and upgrading of our networks, 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, whether due to an economic crisis or otherwise, we may need to incur additional debt or raise other forms of capital to support our liquidity and capital resource requirements for the ongoing development and expansion of our business.

The state of international financial markets in terms of liquidity, cost of credit, access and volatility continues to be affected by current uncertainties surrounding the pace of economic recovery, the health of the international banking system and increasing concerns regarding burgeoning public deficits in certain countries, among other factors. Worsening conditions in the international credit markets due to any of these factors may make it more difficult and more expensive to refinance our financial debt or to incur additional debt.



In addition, our capacity to raise capital in the international capital markets would be impaired if our credit ratings were downgraded, whether due to decreases in our cash flow or otherwise. Further, current market conditions may make it more difficult to renew our unused bilateral credit facilities, 35% of which as of December 31, 2010 are scheduled to mature prior to December 31, 2011. The current financial situation may also make it more difficult and costly for us to launch a rights issue to our current shareholders or to raise additional equity capital if further funds were needed for pursuing our business plans.

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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: