

TELEFONICA S A  
Form 20-F  
July 09, 2004  
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As filed with the Securities and Exchange Commission on July 9, 2004.

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# SECURITIES AND EXCHANGE COMMISSION

## FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

Commission file number: 1-9531

# TELEFÓNICA, S.A.

(Exact name of registrant as specified in its charter)

KINGDOM OF SPAIN

(Jurisdiction of incorporation or organization)

Gran Vía, 28, 28013 Madrid, Spain

(Address of principal executive offices)

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

Title of each class

Name of each

exchange on which registered

**Ordinary Shares, nominal value 1.00 per share\***  
**American Depositary Shares, each representing three**

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**New York Stock Exchange**  
**New York Stock Exchange**

**Ordinary Shares**

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

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

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

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The number of issued shares of each class of stock of Telefónica, S.A. at December 31, 2003 was:

**Ordinary Shares, nominal value 1.00 per share: 4,955,891,361**

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

**Yes x    No "**

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

**Item 17 "    Item 18 x**

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

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

the effect on our results of operations of the introduction of competition in the Spanish telecommunications market and our other principal markets;

trends affecting our financial condition or results of operations;

acquisitions or investments which we may make in the future;

our capital expenditures plan;

supervision and regulation of the Spanish telecommunications sector and in other countries where we have significant operations;

our strategic partnerships; and

the potential for growth and competition in current and anticipated areas of our business.

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

changes in general economic, business, or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services;

changes in currency exchange rates and interest rates;

the impact of current, pending or future legislation and regulation in Spain, other countries where we operate and the European Union;

the actions of existing and potential competitors in each of our markets;

the outcome of pending litigation; and

the potential effects of technological changes.

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

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

As used herein:

"Telefónica", "Telefónica Group" and terms such as "we", "us" and "our" mean Telefónica, S.A. and its consolidated subsidiaries unless the context otherwise requires;

"Telefónica de España" means Telefónica de España, S.A., our subsidiary that conducts our fixed line telecommunications services business in Spain, and its consolidated subsidiaries;

"Telefónica Móviles" means Telefónica Móviles, S.A., our subsidiary that conducts our worldwide wireless communications services business, and its consolidated subsidiaries;

"Telefónica de Contenidos" means (formerly known as "Admira") Telefónica de Contenidos, S.A. and Corporación Admira Media, S.A., our subsidiaries that conduct our worldwide audiovisual content and media business, and their consolidated subsidiaries;

"Telefónica Latinoamérica" means Telefónica Internacional, S.A., our subsidiary that conducts our fixed line telecommunications business in Latin America, and its consolidated subsidiaries;

"Telefónica Empresas" (formerly "Telefónica Data") means Telefónica Data Corp, S.A., our subsidiary that conducts our worldwide data transmission business, and its consolidated subsidiaries; and

"Terra Lycos" and the "Terra Lycos Group" mean Terra Networks, S.A., our subsidiary that conducts our worldwide Internet-related business, and its consolidated subsidiaries.

**PRESENTATION OF CERTAIN FINANCIAL INFORMATION**

In this Annual Report, references to "dollars" or "\$" are to United States dollars 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. We historically published our financial statements in Spanish pesetas ("pesetas" or "Pts"). Beginning January 1, 1999, we began publishing our financial statements in both Spanish pesetas and euro.





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**PART I**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS**

**A. DIRECTORS AND SENIOR MANAGEMENT**

Not applicable.

**B. ADVISORS**

Not applicable.

**C. AUDITORS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. SELECTED FINANCIAL DATA**

The following table presents selected consolidated financial data of Telefónica, S.A. You should read this table in conjunction with Item 5 Operating and Financial Review and Prospects and the Consolidated Financial Statements included elsewhere in this annual report. The consolidated income statement data for each of the three years in the period ended December 31, 2003 and the consolidated balance sheet data as of December 31, 2003 and 2002 set forth below are derived from, and are qualified in their entirety by reference to, the Consolidated Financial Statements and notes thereto included in this annual report. The consolidated income statement data for each of the two years in the period ended December 31, 2000 and the consolidated balance sheet data as of December 31, 2001, 2000 and 1999 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 Spanish GAAP, which differ in certain respects from U.S. GAAP. Please refer to note 25 to our consolidated financial statements for a discussion of these differences.

The basis of presentation and principles of consolidation are described in detail in note 2 to our consolidated financial statements.

At and for the year ended December 31,					
	1999	2000	2001	2002	2003
(in millions of euro, except per share and per ADS data)					
<b>INCOME STATEMENT DATA</b>					
<b>Amounts in accordance with Spanish GAAP:</b>					
Revenues from operations	22,957.0	28,485.5	31,052.6	28,411.3	28,399.8
Other operating revenues <sup>(1)</sup>	199.2	266.7	254.7	297.6	288.9
Internal expenditures capitalized	835.0	899.1	730.4	496.7	530.3
Increase (decrease) in inventories (net)	74.5	112.3	(103.9)	(18.1)	(135.5)
<b>Total revenues</b>	<b>24,065.7</b>	<b>29,763.6</b>	<b>31,933.8</b>	<b>29,187.5</b>	<b>29,083.5</b>
Goods purchased	(4,093.1)	(6,045.2)	(7,111.9)	(6,953.6)	(6,276.6)
External services and local taxes	(3,975.6)	(5,786.1)	(5,534.3)	(4,976.7)	(5,082.7)
Personnel expenses	(4,411.5)	(5,111.7)	(5,390.3)	(4,793.8)	(4,641.3)
Provision for depreciation and amortization	(6,108.8)	(6,960.8)	(7,374.0)	(6,692.4)	(6,274.2)
Trade provisions	(565.8)	(761.1)	(1,023.8)	(645.6)	(420.6)
Other operating expenses	(134.3)	(140.7)	(69.3)	(93.7)	(60.3)
<b>Total operating costs before financial expenses and goodwill amortization</b>	<b>(19,289.1)</b>	<b>(24,805.6)</b>	<b>(26,503.6)</b>	<b>(24,155.7)</b>	<b>(22,755.7)</b>
<b>Operating profit</b>	<b>4,776.6</b>	<b>4,958.0</b>	<b>5,430.2</b>	<b>5,031.8</b>	<b>6,327.9</b>

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	At and for the year ended December 31,				
	1999	2000	2001	2002	2003
(in millions of euro, except per share and per ADS data)					
Amortization of goodwill and reversal of negative goodwill	(194.3)	(500.6)	(841.6)	(665.4)	(442.5)
Financial income (expense)	(1,490.4)	(1,611.8)	(1,608.4)	(1,589.3)	(1,555.9)
Exchange gains (losses), net	434.3	(248.5)	(782.7)	(632.3)	495.8
Income (losses) from associated companies	(3.9)	(161.4)	(376.5)	(527.9)	(212.6)
<b>Profit from ordinary activities</b>	<b>3,522.3</b>	<b>2,435.7</b>	<b>1,821.1</b>	<b>1,616.8</b>	<b>4,612.2</b>
Extraordinary revenues	2,029.4	4,302.3	1,167.1	474.6	1,167.2
Losses on fixed assets	(235.6)	(239.9)	(233.0)	(9,614.6)	(55.3)
Extraordinary expenses	(5,348.7)	(3,630.5)	(721.3)	(7,078.0)	(2,361.6)
<b>Income (loss) before tax and minority interest</b>	<b>(32.6)</b>	<b>2,867.6</b>	<b>2,033.9</b>	<b>(14,601.1)</b>	<b>3,362.5</b>
Corporate income tax	758.0	(242.2)	(198.1)	3,228.7	(913.4)
Minority interest	(655.7)	(120.6)	271.0	5,795.6	(245.5)
<b>Net income</b>	<b>69.6</b>	<b>2,504.8</b>	<b>2,106.8</b>	<b>(5,576.8)</b>	<b>2,203.6</b>
Net income per share <sup>(2)</sup>	0.02	0.59	0.43	(1.13)	0.45
Weighted average number of shares (thousands)	3,823,536	4,269,839	4,916,564	4,948,037	4,960,125
Net income per ADS <sup>(2)(3)</sup>	0.05	1.76	1.28	(3.38)	1.35
Weighted average number of ADSs (thousands)	1,274,512	1,423,280	1,638,855	1,649,346	1,653,375
<b>Amounts in accordance with U.S. GAAP:</b>					
Total revenues	21,190.4	27,326.1	31,577.2	28,912.6	27,708.4
Income (loss) before tax	(367.2)	1,561.9	(6,707.0)	(8,606.5)	3,798.4
Corporate income tax	921.4	294.1	(475.3)	3,392.0	(1,112.3)
<b>Net income</b>	<b>554.2</b>	<b>1,856.0</b>	<b>(7,182.3)</b>	<b>(5,214.5)</b>	<b>2,686.1</b>
Net income per share <sup>(2)(4)</sup>	0.14	0.44	(1.46)	(1.05)	0.54
Net income per ADS <sup>(2)(3)(4)</sup>	0.43	1.30	(4.38)	(3.16)	1.63
<b>BALANCE SHEET DATA</b>					
<b>Amounts in accordance with Spanish GAAP:</b>					
Cash	186.1	765.6	621.9	517.5	336.4
Property plant and equipment	35,754.9	38,721.9	36,606.1	27,099.7	24,315.8
Total assets	64,114.0	92,377.3	86,422.6	68,041.3	62,075.2
Total long term debt	17,788.3	24,692.9	27,692.4	21,726.1	18,495.4
Total shareholders' equity	14,544.7	25,930.5	25,861.6	16,996.0	16,756.6
<b>Amounts in accordance with U.S. GAAP:</b>					
Cash	239.2	678.7	619.6	517.5	336.4
Property, plant and equipment	30,079.1	38,277.9	35,563.2	25,282.7	27,718.4
Total assets	59,306.5	108,017.1	91,041.1	67,226.6	61,667.8
Total long term debt	15,385.0	20,618.5	27,771.2	21,778.0	18,310.0
Total shareholders' equity	16,926.5	44,357.8	31,769.8	16,989.3	17,291.4
<b>CASH FLOW DATA</b>					
<b>Amounts in accordance with Spanish GAAP:</b>					
Net cash provided by operating activities	7,758.9	8,996.9	8,828.8	8,814.6	9,191.1
Net cash used in (provided by) investing activities	(9,600.9)	(17,719.5)	(9,895.4)	(5,780.2)	(5,171.7)
Net cash used in (received from) financing activities <sup>(5)</sup>	2,332.0	14,320.9	(1,321.1)	(2,101.1)	(4,178.9)
<b>Amounts in accordance with U.S. GAAP:</b>					
Net cash provided by operating activities	6,661.7	16,370.1	8,995.8	9,019.5	9,558.7

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Net cash used in (provided by) investing activities	7,633.3	(25,572.6)	(9,528.5)	(5,585.4)	(5,462.8)
Net cash used in (received from) financing activities <sup>(5)</sup>	(1,839.9)	14,689.4	(1,347.0)	(2,082.0)	(4,220.0)

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<sup>(1)</sup> Includes internal expenditures capitalized and increase in inventories (net).

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- (2) The per share and per ADS computations for all periods presented have been adjusted to reflect the stock split and stock dividends which occurred during the periods presented and after the close of the 2002 period but before issuance of the financial statements.
- (3) Each ADS represents the right to receive three ordinary shares. Figures do not include any charges of the Depositary.
- (4) U.S. GAAP earnings per share and per ADS have been computed using the weighted average number of shares outstanding for each period.
- (5) Includes net cash outflow for capital expenditures and for investments in affiliates.

**Exchange Rate Information**

Effective January 1, 1999, the following 11 European Union member states adopted the euro as a common currency: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. They also established fixed conversion rates between their respective sovereign currencies and the euro. On January 1, 2001, Greece joined the European Economic and Monetary Union. The exchange rate at which the Spanish peseta has been irrevocably fixed against the euro is Ptas 166.386 = 1.00. On January 1, 2002, the participating member states began issuing new euro-denominated bills and coins for use in cash transactions. As of March 1, 2002, the participating member states have withdrawn the bills and coins denominated in their respective currencies from circulation, and they are no longer legal tender for any transactions. The Noon Buying Rate for the euro on July 8, 2004 was \$.8071 = 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 <sup>(1)</sup>	High	Low
1999	1.01	1.06	1.18	1.00
2000	0.9388	0.9207	1.0335	0.8270
2001	0.8901	0.8909	0.9535	0.8370
2002	1.0485	0.9495	1.0485	0.8594
2003	1.2597	1.1411	1.2597	1.0361

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.

Month ended	Noon Buying Rate	
	High	Low
December 31, 2003	1.2597	1.1956

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January 31, 2004	1.2853	1.2389
February 28, 2004	1.2848	1.2426
March 31, 2004	1.2431	1.2088
April 30, 2004	1.2358	1.1802
May 31, 2004	1.2000	1.1801
June 30, 2004	1.2320	1.2006
July 2004 (through July 8)	1.2390	1.2158

*Source: Federal Reserve Bank of New York.*

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

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

Our consolidated results are affected by fluctuations between the euro and the currencies in which the revenues and expenses of some of our consolidated subsidiaries are denominated (principally the Brazilian real, the Argentine peso, the Chilean peso, the Peruvian nuevo sol, the Mexican dollar and the U.S. dollar). 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 annual report on Form 20-F, prospective investors should carefully consider the risks described below before making any investment decisions. The risks described below are not the only ones that we face. Additional risks not currently known to us or that we currently deem immaterial may also impair our business operations. Our business, financial condition or results of operations could be materially adversely affected by any of these risks, and investors could lose all or part of their investment.

#### **Risks Related to Our Business**

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

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

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



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difficulties in developing and introducing new technologies;

declining prices for some of our services;

the effect of adverse economic trends on our principal markets;

the effect of foreign exchange fluctuations on our results of operations;

difficulties in obtaining applicable government, shareholder and other approvals;

difficulties in entering into key contracts with third parties;

the effect of increased competition;

our ability to establish and maintain strategic relationships;

difficulties in integrating our acquired businesses;

the effect of future acquisitions on our financial condition and results of operations;

difficulties in securing the timely performance of independent contractors hired to engineer, design and construct portions of our network;

the potential lack of attractive investment targets;

difficulties in attracting and retaining highly skilled and qualified personnel; and

the effect of unanticipated network interruptions.

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

At December 31, 2003, approximately 40.6% of our assets were located in Latin America. In addition, approximately 33.3% of our revenue from operations for 2003 was derived from our Latin American operations. Our foreign operations and investments in Latin America are subject to various risks, including risks related to the following:

government regulations and administrative policies may change quickly;

currencies may be devalued or may depreciate (such as the Brazilian real and the Argentine peso, which experienced negative trends in 2002) or currency restrictions and other restraints on transfer of funds may be imposed;

governments may expropriate assets;

governments may impose burdensome taxes or tariffs;

political changes may lead to changes in the business environments in which we operate;

our operations are dependent on concessions and other agreements with existing governments;

economic downturns, political instability and civil disturbances may negatively affect our operations; and

Republic of Argentina bonds remain in default and this may influence measures taken by its government affecting business development in the private sector.

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

For example, our operations in Argentina were affected by the devaluation of the Argentine peso, the adverse macroeconomic conditions in Argentina and the related legislative measures adopted by the Argentine Government in past years. During 2003 the Argentine economy began to recover. However, the effects from the economic crisis continue to affect the results of operations and financial condition of Telefónica de Argentina and Telefónica Comunicaciones Personales. In addition, the Argentine economic and social situation has quickly deteriorated in the past and may quickly deteriorate in the future, and we cannot assure you if, or when, the Argentine economy will begin to experience sustained growth.

The Public Emergency Law enacted in response to the economic crisis provides that any rate and tariff index clauses or any other index mechanism incorporated in the agreements executed by the Argentine government, including those agreements with telecommunication service providers, are void and not applicable. The Public Emergency Law indicates that rates and tariffs must be established in pesos using a Ps.1.00 per U.S.\$1.00 exchange rate. Any increase in inflation will result in a further decrease of Telefónica de Argentina's fixed line revenues in real

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terms, as tariffs are not adjusted for inflation, which could have a material adverse effect on our results of operations and financial conditions. Telefónica de Argentina is in the process of renegotiating the tariffs it charges customers for fixed line telephone service with the Argentina government. No assurance can be given that the outcome of these negotiations will be favorable to Telefónica de Argentina.

Additionally, Telefónica Comunicaciones Personales, pursuant to Argentine law (Decree 214/2002), is currently in a negative net asset position. Although current Argentine law allows companies to maintain this negative net asset position until December 2004 without the need to establish a positive net asset position, it is uncertain whether the government of Argentina will extend this exception beyond December 2004. Should this exception fail to be extended and if Telefónica Comunicaciones Personales is not capitalized by Telefónica Móviles it could be subject to a dissolution proceeding by the Argentine authorities and could lose its license.

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

We are exposed to various types of market risk in the normal course of our business, including the significant 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. Our risk management strategies may not be successful, however, which could adversely affect our financial condition and results of operations.

In particular, in order to limit our exposure to Latin American currency exchange rate fluctuations, we use financial derivatives and other instruments. 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 Latin American currency exchange rate fluctuations, such failure could adversely affect our financial condition and results of operations. For a more detailed description of our financial derivatives transactions, see Item 11 Quantitative and Qualitative Disclosures About Market Risk .

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

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

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

The risk of disagreement or deadlock is inherent in jointly controlled entities, and there is the risk that decisions against our interests will be made and that we may not realize the benefits from our joint ventures, including economies of scale and opportunities to realize potential synergies and cost savings. Our joint venture partners may choose not to continue their partnerships.

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

We may enter into acquisition transactions in order to, among other things, provide services in countries in which we do not currently have operations or enhance our product portfolio, as we have done in recent years. If we make any such acquisitions, those acquisitions (including those already completed) may expose us to certain risks, including the following:

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the difficulty of assimilating the operations and personnel of the acquired entities;

the potential disruption to our ongoing business caused by senior management's focus on the acquisition transactions;

our failure to incorporate successfully licensed or acquired technology into our network and product offerings;

the failure to maintain uniform standards, controls, procedures and policies; and

the impairment of relationships with employees as a result of changes in management and ownership.

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

*Telefónica Móviles' expected acquisition of BellSouth's wireless operations in Latin America and Telefónica Móvil Chile may require us to increase our capital resources and financing requirements.*

On March 5, 2004, Telefónica Móviles entered into a stock purchase agreement with BellSouth Corporation, or BellSouth, to acquire 100% of BellSouth's interests in its wireless operations in Argentina, Chile, Peru, Venezuela, Colombia, Ecuador, Uruguay, Guatemala, Nicaragua and Panama. Telefónica Móviles expects to finance this acquisition by cash generated from its operating activities as well as debt provided by us. Furthermore, on May 18, 2004 the Board of CTC accepted a binding offer from Telefónica Móviles S.A. for the acquisition of 100% of the shares of Telefónica Móvil Chile, S.A., a subsidiary of CTC.

In addition to the financing required for these acquisitions, our capital resource requirements might increase in order to upgrade and integrate the networks of these operators. We may be required to further increase our debt or divert funds from our existing operations to invest in these new acquisitions, which could have a material adverse on our revenues and overall results of operations.

*We may be adversely affected by unanticipated network interruptions.*

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

## **Risks Relating to Our Industry**

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

We face significant competition in all of the markets in which we operate. Governmental authorities in many of the countries in which we operate continue to grant new licenses and concessions to new market entrants, which will result in increased competition in those countries and markets. In addition, technological developments are increasing cross-competition in certain markets, such as between wireless providers and fixed line telephony operators.

Regulatory policies of many of the countries in which we operate generally favor increased competition in most of the segments of our markets, especially in the fixed line and wireless services industries, including by granting new licenses in existing licensed territories in order to permit the entry of new competitors. These regulatory policies are likely to have the effect, over time, of reducing our market share in the markets in which we operate. For example, Spanish telecommunications regulators have attempted to promote competition in fixed line

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telecommunications services through policies that favor other fixed line telecommunications operators. Regulations introduced in recent years in Spain have allowed other operators to locate their equipment in or adjacent to our exchanges (i.e., local loop unbundling) and have made it easier for our customers to route some or all of their calls over our competitors' networks (i.e., carrier pre-selection). Additional regulatory changes resulting in increased competition could have a further adverse effect on our business, results of operations, financial condition and prospects.

In addition to this, because we hold leading market shares in many of the countries in which we operate, we could face regulatory actions by national or, in Europe, European Union antitrust or competition authorities if it is determined that we have prevented, restricted or distorted competition. These authorities could prohibit us from making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on us, which, if significant, could harm our financial performance and future growth.

For a complete description of the regulatory proceedings we currently face please see [Item 8 Financial Information Legal Proceedings](#) .

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As a result of these policies, we may lose market share in Spain and in other markets where we are the incumbent operator.

In addition, we are subject to the effects of actions by our competitors in the markets where we have operations. These competitors could:

offer lower prices, more attractive discount plans or better services and features;

develop and deploy more rapidly new or improved technologies, services and products;

bundle offerings of one type of service with others;

in the case of the wireless industry, subsidize handset procurement; or

expand and enhance more rapidly their networks.

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

greater name recognition;

greater financial, technical, marketing and other resources;

larger customer bases; and

well-established relationships with current and potential customers.

To compete effectively with our competitors, we will need to 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 and could become subject to more burdensome regulation, which could adversely affect our businesses.***

As a multinational telecommunications company, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. Furthermore, the licensing, construction, operation and interconnection arrangements of our communications systems are regulated to varying degrees by national, state, regional, local and supranational authorities, such as the European Union. These authorities could



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adopt regulations or take other actions that could adversely affect us and our companies, including revocation of any of our licenses or concessions to offer services in a particular market, failure to renew a license or concession, modification of the terms of a license or concession or the granting of new licenses or concessions to competitors. Increased or significant changes in the regulation of the activities of our operating companies, including the regulation of rates that may be charged to customers for services, could have a material adverse effect on our company. New regulations could also increase the costs of regulatory compliance.

Our business could be negatively impacted by the consequences of any of these factors and our financial condition and results of operations could be adversely affected as a result.

### ***We operate under license and concession contracts.***

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

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In this sense, Telefónica del Perú has requested a renewal of the existing contract to provide telecommunication services, which expires in 2019, for an additional five-year period. On June 2004, the Peruvian government notified Telefónica del Perú of its recommendation not to renew the concession contract for such additional period. If this request is denied (Telefónica del Perú has fifteen calendar days to respond) then Telefónica del Perú may petition for the additional five-year extension period from 2019 to 2024 in December 2008. Proposed regulation in Argentina would grant the Argentine government the power, until year-end 2004, to renegotiate all of the existing telecommunications contracts with license holders.

In addition, many of these licenses and concessions are revocable for public interest reasons. The rules of some of the government regulatory authorities having jurisdiction over our operating companies require us to meet specified network build-out requirements and schedules. In particular, our existing licenses and concessions typically require that we satisfy certain obligations, including minimum specified quality, service and coverage conditions and capital investment. Failure to comply with obligations in a given license area could result in the imposition of fines or revocation or forfeiture of the license for that area. In addition, the need to meet scheduled deadlines may cause our companies to expend more resources than otherwise budgeted for a particular network build-out.

Operating in Latin American countries encompass different risks, including the possibility of a material modification to the applicable regulatory framework, a denial of our requests to extend the validity of our operating subsidiaries' telecommunication licenses and possible political changes, economic downturns or mounting social unrest as evidence in Argentina and Peru.

***The industry in which we conduct our business is subject to rapid technological changes and such changes could have a material adverse effect on our ability to provide competitive services.***

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

***Our business depends on the upgrading of our existing networks.***

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

upgrade the functionality of our networks to permit increased customization of services;

fill in coverage gaps and increase coverage in building some of our markets;

expand and maintain customer service, network management and administrative systems; and

upgrade older systems as new technologies become available.

Many of these tasks are not entirely under our control. If we fail to successfully execute them, 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 results of operations.

*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 upgrade 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 further increase if we participate in other fixed line or wireless license award processes

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or make acquisitions in other countries. We also have major capital resource requirements relating to, among other things, the following:

acquisition or construction of networks and of additional network capacity for existing networks;

development of new services and products;

development of distribution channels in new countries of operations; and

development and implementation of new technologies.

If our ability to generate cash flow were to decrease, we might need to incur a significant amount of debt to support our capital resource requirements for the ongoing development and expansion of our business. Our ability to raise capital is also related to our stock price and the liquidity of the equity markets. Adverse trends in these areas could prevent us from raising capital. If we have insufficient internal cash flow or we are unable to borrow the amounts we need at affordable rates or we cannot raise equity, we may be unable to pursue our business plans. We cannot assure you that future conditions in the equity and financial markets will not adversely affect our ability to finance our operations.

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

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

***The wireless industry may be harmed by reports suggesting that radio frequency emissions cause health problems and interfere with medical devices.***

Media and other reports have suggested that radio frequency emissions from wireless handsets and base stations may cause health problems. If consumers harbor health-related concerns, they may be discouraged from using wireless handsets. These concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation. We cannot assure you that further medical research and studies will refute a link between the radio frequency emissions of wireless handsets and base stations and these health concerns. Government authorities could increase regulation of wireless handsets and base stations as a result of these health concerns or wireless companies, including Telefónica Móviles, could be held liable for costs or damages associated with these concerns, which could have an adverse effect on our business. In Spain, for example, Telefónica Móviles is required by law to test and certify the emissions of its base stations in or close to populated areas. For the year ended 2003, such tests have confirmed lower emission levels than those required by regulations. If in the future Telefónica Móviles fails to comply fully with these standards, it could be subject to claims or regulatory actions.

## **Other Risks**

***We face risks associated with litigation.***

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

***We will be obliged to adopt new accounting standards in 2005 that will impact our financial reporting.***

We currently prepare our financial statements in accordance with Spanish GAAP, and prepare a reconciliation of certain items to U.S. GAAP as required by SEC regulation. According to the European Union legislation in force, company groups listed in European Union stock markets must apply from

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January 1, 2005 the International Financial Reporting Standards (IFRS) adopted by the European Union in preparing their consolidated financial statements.

Applying these standards to our financial statements may imply a change in the presentation of our financial information, since the financial statements will include more components and additional disclosure will be required. Additionally, there will be a change in the valuation of certain items. Regarding the former, the Telefónica Group is currently making a qualitative and quantitative analysis of the main differences, although at this moment it is not possible to determine the exact impact that this new regulation will entail compared to Spanish GAAP. Furthermore, not all IFRS are legally binding at present and therefore the final impact may be different depending on which IFRS are finally adopted by the European Union.

### **ITEM 4. INFORMATION ON THE COMPANY**

#### **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

##### **Overview**

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

a diversified telecommunications group which provides a comprehensive range of services in Spain and Latin America through one of the world's largest and most modern telecommunications networks;

the leading provider of fixed line public voice telephone services, wireless communications services, Internet access services and data transmission services in Spain;

one of the largest telecommunications operators in Latin America, with operations principally in Brazil, Argentina, Chile, Peru, Mexico, El Salvador, Guatemala and Puerto Rico; and

a leading Spanish multinational corporation.

At December 31, 2003, we had approximately 43.7 million access lines in service and 54.7 million wireless subscribers. In addition, we have 0.4 million pay television subscribers. We had a total of approximately 98.7 million clients at December 31, 2003, more than half of which are in Latin America.

The following table reflects the development of our customer base since 2001.

<b>At December 31,</b>	<b>% change</b>
<b>2002 vs. 2003</b>	

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	2001	2002	2003 <sup>(1)</sup>	
	(in thousands)			
Lines in service (thousands) <sup>(2)</sup>	43,008.9	43,145.9	43,723.5	1.3
In Spain	18,669.6	18,705.6	19,084.1	2.0
In other countries	24,339.3	24,440.2	24,639.4	0.8
Mobile telephony clients (thousands) <sup>(3)</sup>	32,256.3	43,943.3	54,691.7	24.5
In Spain	16,793.5	18,412.0	19,660.6	6.8
In other countries	15,462.8	25,531.3	35,031.1	37.2
Total <sup>(4)</sup>	75,606.9	87,429.2	98,778.3	13.0

<sup>(1)</sup> Beginning on January 1, 2003, we have retroactively introduced a modification in our calculation formula for the lines in service. This criteria will apply to the following equivalencies: PSTN (x1), basic ISDN (x2), primary ISDN (x30), 2/6 digital access for switchboards and Ibercom x30) and ADSL (x1). PSTN, or Public Switched Telephone Network, are lines that offer basic telephony services. ISDN, or integrated service digital networks, are lines that allow the integration of voice, data and video services through two 64Kbits channels. ADSL, or assymetrical digital subscriber lines, are lines that allow for voice and high speed data transmission. This new criteria introduces a difference in the manner in which we account for ISDN primary access and of the 2/6 access for switchboards and Ibercom, which will be multiplied by the number of access channels (30) instead of the extensions using it.

<sup>(2)</sup> Includes all the lines in service of Telefónica de España, Telefónica CTC Chile, Telefónica de Argentina, Telefónica del Perú, Telesp, CanTV, Telefónica Móviles El Salvador, Telefónica Móviles Guatemala and Telefónica Deutschland.

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- (3) Includes all the clients of Telefónica Servicios Móviles España, MediTelecom, Telefónica Móvil Chile, TCP Argentina, Telefónica Móviles Perú, Brasilcel, NewCom Wireless Puerto Rico, Telefónica Móviles Guatemala, Telefónica Móviles El Salvador, Telefónica Móviles México and CanTV Celular.
- (4) Includes all pay television subscribers of Cable Mágico in Peru. After the merger between Vía Digital and Sogecable, the TV-platform clients are not included for 2001 (806,400) and 2002 (775,000).

In January 2000, we announced a reorganization of our business along global business lines to enhance our strategic and competitive position globally and in each of these business lines. As part of this reorganization, our Board of Directors formed two new global business divisions, Telefónica Móviles and Telefónica Data. Some or parts of some of our then-existing lines of business were combined with other business lines in connection with the reorganization. As a result of this reorganization, our group is now organized according to six principal lines of business, each of which is headed by an operating subsidiary that is under our direct control. These six principal lines of business are:

fixed line telecommunications services in Spain conducted through Telefónica de España;

worldwide wireless communications services conducted through Telefónica Móviles;

fixed line telecommunications services in Latin America conducted through Telefónica Latinoamérica;

worldwide corporate data transmission conducted through Telefónica Empresas;

worldwide Internet-related services conducted through Terra Lycos; and

worldwide audiovisual content and media conducted through Telefónica de Contenidos.

In addition, we have several other lines of business, including:

publishing, development and sale of advertising in telephone directories conducted through Telefónica Publicidad e Información, S.A.; and

operation of contact centers in Europe (Spain), Latin America and Northern Africa (Morocco) conducted through Atento N.V.

We may create new business lines in the future.

During 2003, we implemented certain measures to further simplify our business lines. The measures taken in 2003 include most notably the approval in September of the inclusion of the Telefónica Empresas business line, which was organized to include Telefónica Data, Telefónica Soluciones and Telefónica International Wholesale Services, in the Spain and Latin America fixed line business lines. In 2003, we also restructured Telefónica de Contenidos and Admira. This reorganization, which was completed in December 2003, also includes a greater involvement of the Terra Networks business line within our Spain and Latin America fixed line business lines. Additionally, we also created a new subsidiaries unit, which will include Telefónica Publicidad e Información, Endemol and Telefónica de Contenidos, and a holding company



with a more streamlined structure.

The following chart shows the organizational structure of the principal subsidiaries of the Telefónica Group at December 31, 2003, including their jurisdictions of incorporation and our ownership interest.

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In addition, we operate as a holding company and our objectives are:

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

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

## **B. BUSINESS OVERVIEW**

### **Fixed-Line Telecommunications Services in Spain Telefónica de España**

Our fixed line telecommunications services in Spain are managed by Telefónica de España. The principal services offered by Telefónica de España are:

Traditional fixed line telecommunication services, including:

- PSTN (public switched telephone network) lines;
- ISDN (integrated services digital network) access, which provides high-speed transmission of voice and data through existing fixed line infrastructure;
- Public telephone services including street phone booths and other facilities in locations such as airports, train stations, hotels and shops;
- Local service, domestic long distance, and international long distance communications services;

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Supplementary services and value added services, such as (i) call waiting, (ii) call forwarding, (iii) three-party service, (iv) voice and text messaging, (v) information services and (vi) conference-call facilities;

Intelligent network services, such as (i) free-phone service, (ii) televoting, (iii) premium rate services, (iv) universal number and (v) virtual private networks;

Ibercom: a wide range of advanced corporate communications services, based on the customer's premises located switches and network facilities; and

Leasing and sale of terminal equipments, ranging from basic telephones to PABXs (private automatic branch exchanges).

Internet and broadband services, including:

Narrowband switched access to Internet, including a range of pay per use and flat rate choices;

Telefónica.net: ISP (Internet Service Provider) services;

Broadband access, through ADSL (asymmetrical digital subscriber line) and satellite technologies;

Residential-oriented value added services, such as (i) instant messaging, (ii) video-streaming, (iii) e-learning, (iv) parental control, (v) firewall and (vi) anti-virus;

Business-oriented value added services, such as (i) intranet, (ii) web, (iii) e-commerce, (iv) e-business and e-administration developing and (v) managing services; and

Multimedia, under the trade name Imagenio, covering TV, Video on Demand, Internet access and a wide range of leisure services.

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Data services. Business-solutions services, including:

Leased circuits;

VPN (virtual private network) services, including X-25, ATM (Asynchronous transfer mode) and Frame Relay;

Hosting and ASP (Application service provider) services;

Management services and value added services; and

Outsourcing services.

Wholesale services for telecommunication operators, including:

Domestic Interconnection services;

International wholesale services;

Leased lines for other operators network deployment;

Co-location of operators infrastructures; and

Local loop leasing, under the unbundled local loop regulation framework.

## ***Operations***

The following table shows the development of Telefónica de España's domestic telecommunications network and growth in usage of that network since 2001:

	At December 31,		
	2001	2002	2003 <sup>(1)</sup>
Lines in service (thousands)	18,669.6	18,705.6	19,084.1
Lines (RTB)	16,094.7	15,470.2	15,061.0
Growth of analog lines (%)	(1.7)	(3.9)	(2.6)
Equivalent ISDN basic accesses	1,620.4	1,752.1	1,827.0
Equivalent ISDN primary accesses (thousands of miles)	466.1	413.9	426.6
2/6 digital accesses for switchboards and Ibercom	112.6	112.3	109.0

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ADSL connections (thousands)	375.8	957.2	1,660.5
Fixed-lines per each 100 inhabitants (total market) <sup>(2)</sup>	46.7	45.9	45.6
Average time for the provision of the PSTN service (days)	7.7	10.1	10.9
Lines in service per employee	457.0	460.1	541.9
Average consumption per line (minutes/day)	21.1	22.1	21.8
Average consumption growth per line (%)	26.4	4.7	(1.4)
Internet users (thousands)	3,109	3,045	2,938
Growth of outgoing international traffic (%)	18.4	(22.4)	(1.4)
Growth of incoming international traffic (%)	24.4	(5.1)	3.4
Basic telephony lines set up (thousands)	17,238.1	16,347.3	15,974.7
Digitalization degree (%)	86.8	89.15	92.6
Coaxial cable (km)	4,756	2,468	2,457
Optical fiber cable (km)	58,156	60,932	64,934
Copper cable in interurban links (km)	57,095	56,753	56,492
Copper cable in subscriber networks <sup>(3)</sup>	68,563	69,148	69,854

<sup>(1)</sup> Beginning on January 1, 2003, we have retroactively introduced a modification in our calculation formula for the lines in service. This criteria will apply to the following equivalencies: PSTN (x1), basic ISDN (x2), primary ISDN (x30), 2/6 digital access for switchboards and Ibercom x30) and ADSL (x1). PSTN, or Public Switched Telephone Network, are lines that offer basic telephony services. ISDN, or integrated service digital networks, are lines that allow the integration of voice, data and video services through two 64Kbits channels. ADSL, or asymmetrical digital subscriber lines, are lines that allow for voice and high speed data transmission. This new criteria introduces a difference in the manner in which we account for ISDN primary access and of the 2/6 digital access for switchboards and Ibercom, which will be multiplied by the number of access channels (30) instead of the extensions using it.

<sup>(2)</sup> Includes homogeneous lines in total market.

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- (3) Thousands of kilometers par. (Transmission cables in the subscriber networks contain a variable number of conducting filaments, which are insulated from each other and grouped in pairs. Each such pair is called a par .)

In 2003, voice and Internet traffic continued to decrease as a result of weak market conditions in the Spanish telecommunications sector and loss of market share by Telefónica España due to increased competition. The number of minutes consumed in 2003 decreased by 3.6% to 138,174 million from 143,345 million in 2002. The decrease in minutes consumed in 2003 was mainly due to an 1.4% decrease in the average duration per call to 21.8 minutes per line per day in 2003 compared to 22.1 minutes per line per day in 2002. Outgoing traffic, which includes voice and Internet calls accounted for 60.9% of Telefónica de España's total traffic in 2003. Outgoing traffic decreased by 12.6% to 84,180 million minutes in 2003, compared to 96,312 million minutes in 2002. Incoming traffic, which also includes voice and Internet calls, accounted for 39.1% of Telefónica de España's total traffic in 2003. Incoming traffic increased by 14.8% to 53,993 million minutes in 2003, compared to 47,033 million minutes in 2002. During 2003, calls from fixed to wireless telephones increased 2.2% to 5,856 million minutes in 2003 from 5,729 million minutes in 2002. Calls for Internet access decreased by 18.9% to 27,701 million minutes in 2003 from 34,172 million minutes in 2002; local calls decreased 13.7% to 29,704 million minutes in 2003, from 34,436 million minutes in 2002; provincial calls decreased 6.2% to 8,308 million minutes in 2003 from 8,855 million minutes in 2002; interprovincial calls decreased 9.1% to 6,903 million minutes in 2003 from 7,598 million minutes in 2002; and international outgoing calls decreased 1.4% to 1,669 million minutes in 2003 from 1,693 million minutes in 2002. With respect to value added services, the number of voice mails used increased by 4.4% to 11,548,881, compared to 11,064,941 in 2002. Subscribers to caller identification increased by 27.9% to 6,816,593, compared to 5,329,383 in 2002. The number of text messages managed through fixed line telephones increased to 23,100,517, of which 13,532,521 were sent from fixed line telephones and 9,567,996 were sent from mobile telephones.

During 2003, Telefónica de España continued offering different discount plans targeted to the different client profiles. As of December 2003, the number of discount plan subscribers increased to 3,760,291, of which 173,474 corresponded to the combined plans ( planes combinados ) launched in November 2003.

### ***International Traffic***

Revenues from international outgoing traffic decreased by 9.8% in 2003 compared to 2002 due to a 1.4% decrease in the number of minutes used, and to a 8.1% reduction of the average price. International incoming traffic increased by 3.4% million minutes as a result of the entrance to fixed and mobile operators, while total revenue per minute also decreased during the year.

### ***Digitalization***

With respect to infrastructure, once the digitalization of 92.6% of the local exchanges was achieved, the upgrading of all remaining telephone exchanges was completed and as a result, Telefónica de España was able to provide basic digital services, such as itemized billing, to 100% of its customers. The high degree of digitalization of Telefónica de España's network also enables it to provide a broad range of digital services to satisfy customer demands. Telefónica de España's international switching exchanges and domestic and international transmission links are 100% digitalized.

Telefónica de España has, throughout 2003, continued to make progress in the Internet and broadband business. As a result of Telefónica de España's dedicated commitment to ADSL technology, as of the end of 2003, clients of this service in Spain numbered 1,660,450 representing a 73.5% increase compared to 2002. Of the total number of ADSL clients, 1,070,330 were retail ADSL clients, representing a 76.5% increase in retail ADSL clients compared to 2002.

Throughout the year, value added services were in high demand, with 418,002 services sold. Total ADSL solutions amounted to 101,727 of which 89,982 refer to business services. Of these business services, 35,220 are Net Lan (remote access), which allow customers to create their own private virtual network. The ADSL integral maintenance service (a maintenance service that includes labor and replacement of damaged equipment) has been successful with 20,737 units as of the end of the year. This positive trend is expected to continue. Likewise, campaigns in order to market other value added services for wireless ADSL, Wi-Fi, are being intensified.



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### ***Spain***

#### ***Regulation***

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

The supply of telecommunications services, which is our main activity, is highly regulated in the different countries where we operate. Detailed hereunder is the basic legal framework for telecommunications in Spain.

#### **Overview**

In order to strengthen free competition throughout its member states, the European Union approved a new regulatory framework in 2002. This framework is composed of a series of legal measures aimed at strengthening competition in the electronic communications industry within the European Union and requires that member states' regulatory frameworks be modified accordingly to comply with the European Union's telecommunications regulatory framework within a determined period.

In compliance with the obligation to enact this new European legal framework, the Spanish Parliament enacted Law 32/2003 (dated November 3, 2003, the new General Telecommunications Law), governing general telecommunications. This law replaces Law 11/1998 and any other provisions of equal or inferior jurisdiction that were contrary to the provisions set forth in the new law.

The purpose of the General Telecommunications Law is to advance the liberalization of the provision of services and the installation and exploitation of electronic communications networks, and in this regard satisfy the principle of minimal government intervention. Accordingly, the provision of these services and the ability to exploit such networks is granted as a matter of law. In this regard, the law confirms the need to avoid *ex ante* control by the regulator as a fundamental principle, removing the current regime of authorizations and licenses and substituting them with *ex post* controls, through market analyses mechanisms necessary to determine the existence of effective competition. Furthermore, in the absence of effective competition, a series of obligations are imposed upon the operator with significant market power. Within this new regulatory framework, the national regulatory authority shall have a leading role in the implementation of the *ex-post* controls.

The General Telecommunications Law will be implemented through a series of new rules and regulations, which are currently in their preliminary stages. Until the new rules and regulations are enacted, existing provisions will remain in force provided they are not contrary to the new General Telecommunications Law.

#### ***The State Contract***

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Since 1991, we have provided telecommunications services through the contract signed with the Spanish government on December 26, 1991. Law 11/1988 set forth the transformation of B1 license concessions requested by Telefónica de España on August 27, 1998. Finally, on August 1, 2003, the Council of Ministers agreed to the transformation of the Telefónica de España concession contract.

However, the first transitory provision of the General Telecommunications Law requires that with regard to existing licenses: all licenses and authorizations awarded for the exploitation of electronic communication networks and the provision of related services shall extinguish following the coming into force of this law. All holders of existing licenses and authorizations shall not be affected, provided that they meet the requirements set forth in the first paragraph of article 6.1 of the General Telecommunications Law .

### *Fixed telephony*

Despite the early development stages of this new regulatory framework, Telefónica de España is considered a market dominant operator in the provision of fixed line telephony services and leasing of circuits. For several years, including 2003, Telefónica de España has been declared a dominant operator in these two markets. As a market dominant operator, Telefónica de España has certain obligations regarding interconnection and access to public networks and the supply of universal service, as well as other obligations to provide public service.

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### *Mobile telephony*

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

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

### *Internet*

Spanish legislators have attempted to remove legal uncertainties existing over the Internet as a transmission vehicle for diffusion and exchange of all kinds of information. In this way, Law 34/2002 sets forth the concept of "information society services" which incorporates, among others, the purchase of goods and services through electronic means and the supply of information through the Internet.

### *Service quality*

The service quality parameters are established through a ministerial order, dated October 14, 1999, and through the universal service quality ministerial order, dated December 21, 2001. This regulatory framework sets forth the quality standards for telecommunications services, including fixed telephony, mobile telephony and Internet access.

### *Tariff rebalancing*

Following an investigation procedure, the European Commission filed a claim against the Kingdom of Spain, in the European Court of Justice, for breach of community standards with regard to tariff rebalancing prior to the opening of the free competition market. In the January 7, 2004 ruling, the European Court of Justice limited itself to declaring that the Kingdom of Spain was in breach of the obligations incumbent upon it by virtue of the community directives, as it had not adopted the legal, regulatory and administrative provisions necessary to correct the rating imbalance that occurred with liberalization.

### *Regulatory authorities*

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

The Spanish Government;

The senior and directive bodies of the Ministry of Economy on issues of price regulations (Government Deputy Commission for Financial Affairs);

The Communications State Secretary for the Information Society, a member of the Ministry of Industry, Tourism and Trade;

The Telecommunications Market Commission; and

The State radio-communications agency.

### **Fixed telephony**

Telefónica de España S.A.U., as an incumbent operator in the fixed telephony market, is subject to specific regulation and this manifests itself in the different business areas where it operates.

### *Licenses and Concessions*

Under the new General Telecommunications Law, anyone interested on the exploitation of a telecommunication network or on the provision of a electronic communication service, should notified it to the TMC, previously to the beginning of the activity. TMC will register the telecommunication operator in the Operator Registry.

Therefore all the licenses and authorizations for the exploitation of telecommunications networks or for the provision of electronic communications services are extinguished after the new General Telecommunications Law comes into force. Nevertheless, the right to occupy public and private property and numbering should carry on according to the specific regulation.

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### *Licenses and Concessions*

Under the new General Telecommunications Law, anyone interested in the exploitation of a telecommunications network or in the provision of electronic communication services should notify the Telecommunications Market Commission prior to the commencement of the activity. The Telecommunications Market Commission will register the telecommunication operator in the Operator Registry.

All the licenses and authorizations for the exploitation of telecommunications networks or for the provision of electronic communications services are extinguished after the new General Telecommunications Law comes into force. Nevertheless, the right to occupy public and private property and numbering should carry on according to the appropriate regulation.

### *Interconnection*

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

Currently, in accordance with the General Telecommunications Law, until the telecommunications markets are defined and their analysis carried out by the Telecommunications Market Commission the interconnection offer reference (RIO) applies. The purpose of RIO is to establish the general, technical and financial conditions through which Telefónica de España interconnects with other operators. The applicable regulations demand that prices charged by Telefónica de España be cost oriented and be included in the aforementioned RIO.

The first reference interconnection offer by Telefónica de España was approved by the Ministry of Infrastructure on October 29, 1998 and later modified on August 9, 2001.

On July 10, 2003, the Telecommunications Market Commission modified the RIO, and on March 31, 2004, the Telecommunications Market Commission approved a new resolution modifying the existing RIO with respect to the compensation to be paid for toll-free calls placed from public pay-telephones.

### *Network access*

The General Telecommunications Law sets forth that the Telecommunications Market Commission can impose obligations on an electronic communications public network operator obligating it to allow other operators to access its network. The Telecommunications Market Commission can establish the technical or operating requirements to ensure normal performance of the network.

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In the same way as with the interconnection obligations, an operator may be declared to have significant market power, which would impose information transparency obligations, non-discrimination, separation of accounts, access to specific network resources and price controls.

Through Royal Decree 7/2000, governing urgent measures in the telecommunications sector, the unbundling of the local loop was established. The Spanish Government set the conditions that, from January 2001, the dominant operators of fixed-telephone public networks must provide shared access to the local loop, with the prices set by the Government's Deputy Commission for Financial Affairs.

Through Royal Decree 3456/2000, the regulations of the local loop were set forth. These regulations establish the conditions through which access to the local loop by the fixed-telephone network of dominant operators.

The Telecommunications Market Commission, on March 31, 2004, modified the local loop offer for 2004, which lowered the monthly rental fees charged for access to the local loop.

### *Selection of operator*

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

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The Royal Decree 1651/1998, regulated matters concerning call-to-call operator selection, pre-assignment of operator and safekeeping of numbers by subscribers, irrespective of the operator that provides the service. Royal Decree 7/2000, governing urgent measures, set forth a calendar for the implementation of pre-assignment in metropolitan calls.

Customers may keep their telephone number when changing access operators as long as they do not change their physical location.

## **Public service obligations**

### *Universal service*

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

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

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

The current obligation of Telefónica de España to provide the universal service is imposed until 2005.

To finance the universal service, the General Law on Telecommunications stipulates that the Spanish Telecommunications Market Commission will determine whether the net cost to provide universal services implies an unfair burden for the operators required to provide that service. The Telecommunications Market Commission has issued several resolutions relating to Telefónica de España's net costs for the provision of the universal service. The Spanish Telecommunications Market Commission has indicated Telefónica de España does not have a right to be compensated by the other operators, as there is no competitive disadvantage. The Telecommunications Market Commission has not yet created the Fondo Nacional de Servicio Universal. The Spanish Telecommunications Market Commission's resolution, dated March 25, 2004, recognized the existence of a net cost of 110.0 million for Telefónica de España as a result of providing the universal service, but recognized no compensation as the amount was not considered an undue burden.

## **Competition**

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

In the public fixed line telephone services sector, the entrance of new competitors was initiated in June of 1997 with the concession to Retevisión of a license to provide public fixed line telephone services in the national territory. Retevisión began operations in January 1998.

In May 1998, the consortium Lince, comprised of France Telecom and Editel, S.A., a consortium which includes Multitel Cable, S.A. and Ferrovial Telecomunicaciones, received the third license for the provision of fixed line telephone services in Spain. Lince commenced operations in December 1998 under the trade name Uni2.

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

During 2002, as part of the reorganization process undertaken by the Auna Group, the second telecommunications provider of the country, Retevisión, merged with Aunacable (a cable operator for the Auna Group). The new name of this fixed line telephone company in Spain is Auna Telecomunicaciones S.A. The main partners of the Auna Group are Endesa, Santander Central Hispano, Unión Fenosa and ING, together with several savings banks.



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In July 2001, France Telecom reached an agreement with the rest of the Lince consortium partners to acquire the Lince group. As a result, it now owns 100% of the company Uni2, which, together with Al-Pi Telecomunicaciones (a 75% subsidiary of Uni2 that serves corporate clients and professionals in Catalonia), comprises the Uni2 group.

Jazztel, a company created in July 1998, had a shareholding structure at March 2004, comprised of funds managed by Espírito Santo Bank, ING, Fidelity Investments and stock exchange.

### *Pricing rules*

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

Consequently, the Spanish government's Deputy Commission for Financial Affairs, at the proposal of the Ministries of Economy and of Science and Technology, approved this new price framework, which would be valid until December 31, 2003 through another CDGAE agreement, dated April 19, 2001.

On September 25, 2003, the CDGAE approved a new price regulatory framework for 2004.

This new regulatory framework provides greater flexibility for the introduction of new services and allows different pricing alternatives, which favors competition and innovation.

The most important aspects of the current price regulatory framework are the following:

Price-caps for the following basic telephony services: local, provincial, interprovincial, international long distance and fixed-to-mobile communications, monthly subscription fees for individual telephone lines and circuits, monthly rental fees for leased circuits and maritime mobile telecommunications service.

Increase for monthly rental fees for individual telephone lines could not exceed 4.35% for 2004.

Internet access calls, service packages, price plans, discount programs and new services may be commercialized following a 21-day notification to the Ministry of Economy and Ministry of Industry, Trade and Tourism, the Telecommunications Market Commission and the Consumer and Users Council prior to initiation of sales.

All other tariffs associated with fixed-telephone service are liberalized, except for the 11818 information services and the public telephone call rates.

The following table displays the tariff variation for the previous price regulatory framework.

<b>Concept</b>	<b>Variation</b>
Local	0.0%
Provincial	(34.4%)
Interprovincial	(45.6%)
International	(34.7%)
Fixed-to-Mobile	(28.5%)
Information service	29.4%
Monthly rental fee	36.2%
Subscription fee	(53.4%)

**Table of Contents***Prices for main services*

The tariffs for electronic telecommunication services are provided below, at the year-end 2003. These are the nominal prices set by Telefónica de España in accordance with the new price regulatory framework.

	At December 31,		
	2001	2002	2003
<b>Tariffs</b>	(in euro, without taxes)		
<b>Subscription fee</b>			
Individual lines and trunk lines	95.00	59.50	59.50
Integrated Service Digital Network			
Primary access	3,606.07	3,606.07	3,606.07
Basic access	168.28	168.28	168.28
<b>Monthly subscription fee</b>			
Individual telephone line <sup>(1)</sup>	10.47	11.67	12.61
Integrated Service Digital Network			
- Primary access	342.58	342.58	342.58
- Basic access <sup>(2)</sup>	22.84	22.84	23.78
Digital circuit 64KB/s of 4 km	249.26	236.24	236.24

<sup>(1)</sup> From April 1, 2004 the fee shall be 13.1684.

<sup>(2)</sup> From April 1, 2004 the fee shall be 24.5143.

The following table displays the applicable rates for local, provincial and interprovincial traffic.

	Initial connection charge  (euro cents)	Exemption (seconds without additional cost; only a flat rate is charged)	Three minute call <sup>(1)</sup> <sup>(4)</sup>  (euro cents)	
			Peak <sup>(2)</sup>	Off peak <sup>(3)</sup>
Local	6.85	160	7.65	7.18
Provincial	8.33	0	19.85	16.25
Interprovincial	8.33	0	28.67	19.67

<sup>(1)</sup> Call establishment fee included.

<sup>(2)</sup> For local calls between 8 a.m. and 6 p.m. Monday to Friday. For provincial and interprovincial between 8 a.m. and 8 p.m. Monday to Friday.

<sup>(3)</sup> Other times and public holidays.

<sup>(4)</sup> Billing in seconds.

The following table displays the applicable rates from fixed-line to mobile calls. The first minute is billed in full, and subsequent minutes are billed per second.

At December 31, 2003			
	Initial connection charge	Tariff A <sup>(1)</sup>	Tariff B <sup>(2)</sup>
	(euro cents)	(euro cents per minute)	
Telefónica Móviles España (Moviline)	6.85	18.26	10.60
Telefónica Móviles España (Movistar)	6.85	18.26	10.60
Vodafone	6.85	18.26	10.60

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	<u>Initial connection charge</u>	<u>Tariff C<sup>(3)</sup></u>	<u>Tariff D<sup>(4)</sup></u>	<u>Tariff E<sup>(5)</sup></u>
	(euro cents)		(euro cents per minute)	
<b>Amena</b>	6.85	21.28	20.80	11.85

<sup>(1)</sup> Tariff A: Monday to Friday from 8 a.m. to 8 p.m.

<sup>(2)</sup> Tariff B: Monday to Friday from midnight to 8 a.m. and from 8 p.m. to midnight. Weekends and public holidays during the whole day.

<sup>(3)</sup> Tariff C: Monday to Friday from 8 a.m. to 8 p.m.

<sup>(4)</sup> Tariff D: Monday to Friday from 8 p.m. to 10 p.m.

<sup>(5)</sup> Tariff E: Monday to Friday from midnight to 8 a.m. and from 10 p.m. to midnight. Weekends and public holidays during the entire day.

The following table shows the applicable tariffs for international long-distance traffic:

Fixed line to fixed line calls:

	<u>Initial connection charge</u>	<u>Flat rate for a three minute call</u>
	(euro cents)	
<b>Western European Countries <sup>(1)</sup></b>	11.87	47.87

<sup>(1)</sup> Germany, Austria, Belgium, Denmark, Finland, France, Greece, Ireland, Italy, Luxembourg, Holland, Portugal, United Kingdom, Sweden, Andorra, Monaco, San Marino, Vatican, Switzerland and Liechtenstein.

Fixed-line to mobile calls:

	<u>Initial connection charge</u>	<u>Flat rate for a three minute call</u>
	(euro cents)	
<b>Western European Countries <sup>(1)</sup></b>	11.87	116.87

<sup>(1)</sup> Germany, Austria, Belgium, Denmark, Finland, France, Greece, Ireland, Italy, Luxembourg, Holland, Portugal, United Kingdom, Sweden, Andorra, Monaco, San Marino, Vatican, Switzerland and Liechtenstein.

Fixed-line to fixed-line or mobile calls:

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	<u>Initial connection charge</u>	<u>Flat rate for a three minute call</u>
		(euro cents)
Iceland and Norway	11.87	86.87
Rest of Europe <sup>(1)</sup> and part of North Africa <sup>(2)</sup>	11.87	104.87
Byelorussia, Macedonia and Tunisia	11.87	116.87
United States	11.87	47.87
Canada and part of the Caribbean	11.87	116.87
Bolivia, Colombia and Paraguay	11.87	134.87
Puerto Rico and Dominican Republic	11.87	71.87
Rest of Latin America <sup>(3)</sup>	11.87	146.87
Rest of America	11.87	176.87
Japan and Australia	11.87	206.87
Rest of the World	11.87	from 176.87 to 371.87

<sup>(1)</sup> Czech Republic, Slovakia, Faeroe Isles, Hungary, Malta, Poland, Albania, Bosnia, Bulgaria, Croatia, Cyprus, Slovenia, Estonia, Latvia, Lithuania, Moldavia, Rumania, Russia, Turkey, Ukraine and Yugoslavia.

<sup>(3)</sup> Morocco, Libya, Algeria and Western Sahara.

<sup>(4)</sup> Argentina, Brazil, Costa Rica, Chile, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panamá, Peru, Venezuela.

The ORDER PRE/2085/2003, ordered the publication of the CDGAE agreement dated July 10, 2003. This order modified the maximum surcharge to be applied to calls made from public telephones, which was set at 51.56%, against the 35% that the previous price regulating framework had established.

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The following table displays the tariffs charged by Telefónica de España at year-end 2003 in comparison with other European operators. Applicable rates during normal business hours have been used.

	<u>Telefónica de España</u>	<u>Deutsche Telecom</u>	<u>France Telecom</u>	<u>Telecom Italia</u>	<u>BT (UK)</u>
			(in euro)		
Residential monthly rental fee	12.62	13.50	10.87	12.14	12.67
Business monthly rental fee	12.62	13.50	13.10	16.50	19.47

	<u>During Business Hours</u>				
	<u>Telefónica de España</u>	<u>Deutsche Telecom</u>	<u>France Telecom</u>	<u>Telecom Italia</u>	<u>BT (UK)</u>
			(in euro)		
3 minute calls					
Local	0.08	0.10	0.13	0.10	0.14
Long-distance national	0.28	0.31	0.27	0.33	0.29

Source: Eurodata, Tarifica and operators.

## Interconnection prices

The prices set for switched traffic are:

	<u>Interconnection prices in access and termination</u>	
	<u>Peak<sup>(1)</sup></u>	<u>Off peak<sup>(2)</sup></u>
	(euro cents per second)	
Local	0.71	0.42
Metropolitan	0.95	0.57
Single transit	1.05	0.63
Double transit	2.14	1.29

<sup>(1)</sup> Monday to Friday 8 a.m. to 8 p.m.

<sup>(2)</sup> Weekends and public holidays and Monday to Friday from 8 p.m. to 8 a.m.

The prices for transit services are:

	Prices of transit services	
	Peak <sup>(1)</sup>	Off peak <sup>(2)</sup>
	(euro cents per second)	
Unicentral	0.15	0.09
National	1.21	0.73
National with local ext.	1.60	0.96
Intranodal transit	0.44	0.26

<sup>(1)</sup> Monday to Friday 8 a.m. to 8 p.m.

<sup>(2)</sup> Weekends and public holidays and Monday to Friday from 8 p.m. to 8 a.m.

The prices for interconnection by capacity mode are:

	Prices of interconnection by capacity	
	Price per 64 Kbps circuit <sup>(1)</sup>	Price per Mbps link <sup>(2)</sup>
	(euro per month)	
Local	44.20	1,326.11
Metropolitan	62.32	1,869.63
Single transit	73.77	2,213.00
Double transit	106.20	3,186.00

<sup>(1)</sup> Kilobytes per second.

<sup>(2)</sup> Megabytes per second.



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The Telecommunications Market Commission Resolution dated March 31, 2004 approved the modification of the local loop offer for 2004. The prices are the following:

Unbundled and shared sign-up.

<b>Unbundled access</b>		
	<b>Sign-up fee</b>	<b>Monthly fee</b>
	<b>(euro)</b>	
Pair sign-up fee	22.37	11.35
Sign up fee for vacant pair terminated in a building with connection in accordance with RDL 1/1998 (ICT) requiring a single bridge in the main registration.	36.14	11.35
Sign up fee for vacant pair terminated in a building with connection in accordance with RDL 1/1998 (ICT) requiring a second bridge at the distribution point	41.42	11.35

<b>Shared access</b>		
	<b>Sign-up fee</b>	<b>Monthly fee</b>
	<b>(euro)</b>	
Pair sign-up with co-location	30.13	3
Pair sign-up with remote co-location	36.04	3

Indirect access sign-up:

	<b>Without splitter installation</b>	<b>With installation of plain old telephone services splitter</b>	<b>With installation of ISDN splitter</b>
	<b>(euro)</b>		
Indirect access sign-up	41.30	82.21	132.25
Change from shared access to indirect access	32.89	64.24	114.29
Change of operator in indirect access	18.43	49.78	99.82
Simultaneous change of operator and dial-up connection speed in indirect access	24.41	55.77	105.81
Disconnection in indirect access	26.66		

Monthly rental fee according to modes:

Form	Subscription fee
	(in euro)
D	22.66
A	26.51
B	44.99
J	72.00
C	90.34
K	125.00
L	200.00
M	280.00

#### Customer Service

In order to adequately respond to the new competitive environment, we have undertaken considerable efforts to improve the quality of our customer service, which we consider as one of our top priorities. We have segmented our customers so that the specific needs of each segment may be served best. In addition, we have increased our contact center capacity to focus more on customer service. In connection with our efforts to improve customer service and meet the needs of our customers, in 2003 we introduced a series of new products and services.

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Most notably, we introduced Wi-Fi hot spots, which allow customers to have wireless Internet access, additional internal company services and the TV Imagenio service, a service launched in 2004 which allows customers to have access to video on-demand, and other home-entertainment services. We have continued to develop products previously introduced, most notably, Short Messaging Service from fixed telephony as well as our combinados consumer plans that combine access and traffic, allowing each client to optimize its consumption according to calling destination and calling time profile. The most relevant products developed in 2003 are ADSL connectivity, which exceeded 1,660,000 access lines as of year-end 2003, as a consequence of the development of value added services, especially ADSL solutions.

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

A 24-hour personal customer service line for purchasing any type of product and service and handling customer queries;

The Tiendas Telefónica (Telefónica stores) where customers can test and buy all of the products marketed by Telefónica;

Telefónica's virtual store, accessible by Internet, which offers the ability to order and purchase online all of the services and products offered by Telefónica; and

A sophisticated customer service system for companies, that ranges from a telephone helping line, which for small companies is based on client portfolio criteria, to the creation of equipment for customer care and multidisciplinary activity sectors sales or individual company sales, for big clients.

### **Telefónica Telecomunicaciones Públicas (TTP, formerly known as Cabinas Telefónicas, S.A., Cabitel)**

TTP is a wholly owned subsidiary of Telefónica de España, S.A., which focuses on the commercialization, installation, management and maintenance of public telephony as well as the advertising use of any base, outlet or service capable of supporting this activity.

### **Telefónica Cable**

Telefónica Cable operates in the ADSL environments, through the Imagenio project, providing digital television, digital audio, broadband Internet through both television and PC, and video on demand. As of year-end 2002, it did not receive revenues from these activities.

### **Telyco Group**

The Telyco group is comprised of the two following entities.

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Telyco S.A.U. is a wholly owned subsidiary of Telefónica de España, S.A., which supplies commercially, distributes and commercializes telecommunications equipment directly through its stores and authorized dealers, as well as engaging in wholesale distribution. Telyco has a commercial network that covers Spain through its direct channels (stores and direct sale) and indirect channels (associated commercial group Telyco stores and wholesale channel).

Telyco Maroc S.A. is a 54% owned subsidiary of Telyco S.A.U. located in Morocco, which supplies mobile telephone products to Medi Telecom.

### **Telefónica Soluciones Sectoriales**

The Telefónica Soluciones Sectoriales group is comprised of the two following entities:

Telefónica Soluciones Sectoriales, a wholly owned subsidiary of Telefónica de España, S.A., serves as an investment vehicle for information technology and telecommunications projects through shareholdings in related companies. Additionally, participates on the boards of trustees of five foundations.

During 2003, Telefónica Soluciones Sectoriales acquired 100% of Interdomain from Telefónica Data España. Interdomain's main activity is related to recording Internet domains at a national and international level.

**Table of Contents****Worldwide Wireless Communications Services Telefónica Móviles**

We conduct our worldwide wireless operations principally through Telefónica Móviles. Telefónica Móviles is a leading provider of wireless communications services in Spain and Latin America in terms of managed customers. Telefónica Móviles estimates, based on information made public by its competitors, local regulatory authorities and data collected from interconnection fees charged and paid, that its is the fifth largest global provider of wireless communication services based upon managed customers at December 31, 2003. Managed customers include all our customers from all operators in which Telefónica Móviles holds an economic participation (including TCO for 2003) and the customers from its managed operations in Chile and Puerto Rico. After its acquisition of BellSouth's Latin America wireless operations, Telefónica Móviles, estimates, based on information made public by its competitors, local regulatory authorities and data collected from interconnection fees charged and paid, that it will become the fourth largest global provider of wireless communication services in terms of total managed customers. Telefónica Móviles offers a broad range of wireless services, including voice services, enhanced calling features, international roaming, wireless internet and data services, wireless intranets and other corporate services.

At December 31, 2003, Telefónica Móviles provided wireless services through its operating companies and joint ventures, to approximately 52 million managed customers in territories with a population of approximately 408 million. Telefónica Móviles has operations in Spain, Mexico, Peru, El Salvador, Guatemala, Argentina and, through its joint ventures with Portugal Telecom, it also provides wireless communication services in Brazil and Morocco. In addition, it manages operations in Puerto Rico on our behalf and wireless operations in Chile.

Telefónica Móviles' strategy is to focus on increasing its profitability and cash flow in the medium term by optimizing its investments and operating efficiencies while assessing the potential for growth in new markets and reinforcing its market leadership position in Spain and Latin America. Telefónica Móviles will continue to analyze the possibility of selective acquisitions and strategic agreements that complement its business. For example, such agreements that it has entered into include the acquisition of TCO in 2003 and the acquisition of BellSouth's Latin American wireless operations in 2004. Telefónica Móviles believes that growth in its markets will be driven by (i) increased customer usage of its wireless services, including both voice and data services, (ii) the introduction of new wireless data and Internet services, and (iii) increased penetration rates in its Latin American markets.

Telefónica Móviles also has licenses to provide UMTS services, or Universal Mobile Telephone System and is one of the most commonly accepted 3G (third generation) standard in the world. It allows wireless multimedia voice and data transmission speeds of up to 384 kbps, in Switzerland through its wholly owned subsidiaries, in Germany through its 57.2% interest in the Group 3G UMTS Holding GmbH consortium, or Group 3G, and in Italy through its 45.59% interest in the IPSE 2000 consortium. Telefónica Móviles has, however, restructured its operations in these countries. See Item 5 Operating and Financial Review and Prospects Operating Results Overview Presentation of Financial Information Other Events Affecting the Comparison of our Results .

The following table provides a summary overview of our operating companies and those companies in which we have non-controlling minority interests.

Country	Name of Company	Service Territory	Ownership Interest at December 31, 2003 <sup>(1)</sup>	Population (in millions)	Total Customers at December 31, 2003 (in millions)
Spain	Telefónica Móviles de España	Nationwide	92.4%	43	19.7
Brazil	Brasilcel, N.V. <sup>(2)(3)</sup>		46.2%	130	20.7

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Mexico	Telefónica Móviles Mexico <sup>(4)</sup>	Nationwide	85.0%	103	3.5
Peru	Telefónica Móviles Perú	Nationwide	90.6%	27	1.5
Argentina	Telefónica Comunicaciones Personales	Nationwide	90.5%	38	1.8
El Salvador	Telefónica Móviles El Salvador	Nationwide	83.5%	7	0.2

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Country	Name of Company	Service Territory	Ownership Interest at December 31, 2003 <sup>(1)</sup>	Population (In Million)	Total Customers at December 31, 2003 (In Million)
Guatemala	Telefónica Centroamérica Guatemala	Nationwide	92.4%	12	0.1
Morocco	Medi Telecom	Nationwide	29.7%	30	2.1
Chile	Telefónica Móvil <sup>(5)</sup>	Nationwide	43.6%	16	2.3
Puerto Rico	NewComm Wireless Services <sup>(6)</sup>	Intra island	49.9%	4.0	0.2
<b>Total</b>			n.a.	390.8	52.1

(1) Represents the ownership interest of the Telefónica Group.

(2) Jointly controlled and managed by Telefónica Móviles and Portugal Telecom. As of December 31, 2003, Brasilcel, Telefónica Móviles joint venture established with Portugal Telecom, holds 86.19% of Tele Sudeste Celular, 50.54% of Celular CRT, 27.70% of Tele Leste Celular, 65.12% of Telesp Celular Participações, S.A. and 28.87% of Tele Centro Oeste Celular Participações, S.A. Through its 50% interest in Brasilcel, as of December 31, 2003, Telefónica Móviles indirectly holds 43.10% of Tele Sudeste, 25.27% of Celular CRT, 13.85% of Tele Leste Celular, 32.56% of Telesp Celular Participações, S.A. and 9.40% of Tele Centro Oeste Celular Participações, S.A.

(3) Joint venture with Portugal Telecom that includes 100% of the assets of the Brazilian mobile companies transferred to Telefónica Móviles (Tele Sudeste Celular, Celular CRT, Tele Leste Celular and Telesp Celular) and Portugal Telecom (Telesp Celular and Global Telecom). Tele Sudeste Celular and Celular CRT were fully consolidated as of December 31, 2000 and December 31, 2001, respectively, and Tele Leste Celular was included in Telefónica Móviles combined financial statements in these periods under the equity method. Brasilcel's balance sheet was proportionally consolidated in its combined financial statements as of December 31, 2002 and the results for the whole year of Tele Leste Celular, Tele Sudeste Celular and Celular CRT were fully consolidated in the combined statement of operations until this transfer was made on December 27, 2002.

(4) Telefónica Móviles México, S.A. de C.V. holds interests in 100% of Baja Celular Mexicano, 90.0% of Movitel del Noroeste, 100% of Telefónica Celular del Norte, 100% of Celular de Telefónica, S.A. de C.V. and 100% of Pegaso PCS. Through its 92.0% interest in Telefónica Móviles México, S.A. de C.V., as of December 31, 2002, Telefónica Móviles indirectly holds 92.0% of Baja Celular Mexicano, 82.8% of Movitel del Noroeste, 92.0% of Telefónica Celular del Norte, 92.0% of Celular de Telefónica, S.A. de C.V. and 92.0% of Pegaso PCS.

(5) Startel, which operates under the trade name Telefónica Móvil, is a subsidiary of Compañía Telecomunicaciones de Chile, in which we held a 43.6% interest at December 31, 2003 through Telefónica Latinoamérica. Startel's operations are managed by Telefónica Móviles.

(6) Our interest is in the form of a note convertible into up to 49.9% of the capital stock of NewComm Wireless Services, subject to the receipt of necessary U.S. regulatory authorizations. NewComm Wireless Services operations are managed by Telefónica Móviles.

**Services and Products**

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

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*Wireless Voice Services.* Telefónica Móviles' principal service in all of its markets is wireless voice telephony, which has gained increased usage as a result of Telefónica Móviles' increased customer base and increased market penetration rates. Accordingly, Telefónica Móviles is also able to offer new services such as those detailed below.

*Value Added Services.* Customers in most of Telefónica Móviles' markets have access to a range of enhanced calling features including voice mail, call hold, call waiting, call forwarding and three-way calling.

*Wireless Internet.* As part of Telefónica Móviles' strategy to become a leader in the wireless Internet sector, it offers Internet access in an increasing number of areas, mainly through the e-moción brand, which allows its clients to access a wide range of mobile Internet services through voice, WAP or GPRS. GPRS, or general packet radio service, is the natural evolution of GSM towards 2.5G, allowing wireless voice and higher-speed data transmission.



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WAP, or wireless application protocol, is a standard protocol allowing for wireless Internet access. Telefónica Móviles operators in Brazil, Argentina, Peru, El Salvador, Guatemala, Morocco and Puerto Rico have launched MoviStar-emoción or services similar in content under other brands, such as Vivo ao Vivo in Brazil. Through wireless Internet access, Telefónica Móviles 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. Current data services offered include short messaging services, or SMS, and Multimedia Messaging Services, or MMS, which allows customers to send messages with images, photographs and sounds. Customers may also receive selected information, such as news, sports scores and stock quotes. Telefónica Móviles also provides wireless connectivity for devices such as laptops and personal digital assistants. Technological advances, which include the development of GPRS and UMTS, facilitate the development of these services by increasing the speed at which data is transmitted, and making it possible to expand the offer of services and reduce their cost. Telefónica Móviles launched GPRS services in Spain for customers in 2001, and in Brazil and Peru it launched CDMA 1XRTT services during 2002 and 2003. CDMA 1XRTT, or code division multiple access, is a broadband transmission system for wireless networks allowing for speeds of up to 144 Kbits/s.

*Corporate Services.* Telefónica Móviles provides business solutions, including wireless infrastructure in offices, private networking and portals for corporate customers that provide flexible on-line billing. Telefónica Móviles España offers corporate services through MoviStar Corporativo 2000, and other advanced solutions for data, developed for specific sectors. In addition, as of February 13, 2004, Telefónica Móviles España offers its corporate customers Oficin@ Movistar UMTS, the first third generation service offered in Spain by a mobile operator offering high-speed data transmission of up to 384 kbits/s.

*Roaming.* Telefónica Móviles has roaming agreements that allow its customers to use their handsets when they are outside of their service territories, including on an international basis. In 2002, Telefónica Móviles extended international roaming services to pre-paid customers. It has also implemented intelligent network technology using the CAMEL standard for its customers in Spain. This allows Telefónica Móviles customers to use their mobile telephones in European countries where a roaming agreement has been reached as if they were in their home country, for example, by not having to dial customary roaming prefixes. In Brazil, Mexico and Argentina, Telefónica Móviles roaming agreements allow its customers to make and receive calls throughout the national territories of these countries.

*Trunking and Paging.* In Spain and Guatemala, Telefónica Móviles provides digital wireless services for closed-user groups of clients and paging services.

*M-payment.* Through Telefónica Móviles subsidiary Telefónica Móviles España, and together with Vodafone España, Amena and many other financial institutions and processing companies, Telefónica Móviles has an interest of 13.33% in MobiPay España, a company incorporated to develop micro-payments. Telefónica Móviles also has a 36.05% interest in MobiPay International, aimed at expediting payments through mobile phones in an international setting. In addition, on February 26, 2003 Telefónica Móviles announced its participation in the new MPSA (Mobile Payment Services Association). The association, which is composed of Vodafone, Orange, T-Mobile and Telefónica Móviles, will operate under the brand name Simpay. For further information see Wireless Internet and Data Initiatives M-Payment.

*Other Services.* Telefónica Móviles also has the technology available to provide other value added wireless services such as location-based services and telematics. Location-based services permit the precise location of the handset to be determined by its networks, which will permit users to receive and access information specific to such location. Telefónica Móviles believes that this technology will be widely used in fleet management, logistics and security monitoring. Telematics applications permit the delivery of data to machines, such as automobiles and vending machines.

***Telefónica Móviles Operations***

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

Spain;

Morocco; and

Latin America.

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Telefónica Móviles has operations in Spain, Mexico, Peru, El Salvador, Guatemala and Argentina, and through its joint ventures with Portugal Telecom, it also provides wireless communication services in Brazil and Morocco. In addition, Telefónica Móviles manages operations in Puerto Rico and, on our behalf, our wireless operations in Chile. At December 31, 2003, Telefónica Móviles provided wireless services through its operating companies and joint ventures to approximately 52 million managed customers and its licenses and concessions covered markets with over 408 million people.

The following section provides a description of the markets in which Telefónica Móviles operates and includes information on its market share by geographic location. Customer information on the wireless markets in which Telefónica Móviles operates, including its market share, are estimates that Telefónica Móviles has based on information made public by its competitors or by local regulators in the respective markets. With respect to its operations in Morocco, this information is also based on data collected from interconnection fees charged and paid in this market.

**Spain**

Telefónica Móviles offers wireless services in Spain through Telefónica Móviles España, the leading wireless operator in Spain in terms of total number of customers at December 31, 2003. Telefónica Móviles España had approximately 19.7 million customers at December 31, 2003, representing an estimated 52.4% market share.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles operations in Spain:

	<b>Year ended December 31,</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>
Total customers (in millions at period end)	16.8	18.4	19.7
Pre-paid customers (in millions at period end)	11.5	11.9	11.7
Population in service territory (in millions at period end)	42	42	43

*Source: Telefónica Móviles*

Our group has offered wireless services in Spain since 1982 with the launch of analog wireless services under the brand MoviLine. Digital wireless services, using GSM 900 MHz technology, were launched in 1995 under the MoviStar brand name, which has since become one of the most widely recognized brands in Spain. GSM, or global standard for mobile, is one of the most widely used standard systems for wireless communication. In 1997, Telefónica Móviles España launched the first pre-paid wireless service in Spain under the MoviStar Activa brand name, and, in January 1999, Telefónica Móviles España launched the GSM 1800 MHz service. In March 2000, having achieved the highest rating in the award process, Telefónica Móviles España was awarded a third generation wireless, or UMTS, license covering the Spanish national territory for 131 million.

*Market*

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With an estimated population of approximately 43 million people, Spain is the fifth largest wireless market in Western Europe with approximately 37.5 million wireless customers at December 31, 2003. This customer base represents a penetration rate of 88%. The Spanish market grew 12% in 2003.

The Spanish wireless market has shown increasing growth as a result of a decline of wireless handset prices and per minute call rates, and the introduction of pre-paid tariffs. At December 31, 2003, Telefónica Móviles España had approximately 19.7 million customers, which includes approximately 1.2 million customers added during 2003, a 7% increase of its total customer base compared to 2002.

Telefónica Móviles España believes that, to date, it has been successful in preserving and expanding its advantage in terms of absolute numbers of customers and quality of average customer in terms of minutes of usage. Telefónica Móviles España estimates that its outgoing traffic market share is higher than its customer market share.

### *Network and Technology*

Telefónica Móviles España's licenses and concessions in Spain permit it to operate digital networks and analog networks. Since December 31, 2003, however, Telefónica Móviles España has not operated an analog network. Telefónica Móviles España also holds one of four nationwide licenses for UMTS services in the country.

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

Telefónica Móviles España's licenses entitle it to 40 MHz of spectrum in the 900 MHz band and 2x24.8 MHz of spectrum in the DCS 1800 MHz band. Under the terms of its UMTS license, Telefónica Móviles España is authorized to operate using two paired, or two-way, 15 MHz channels plus one unpaired, or one-way, 5 MHz channel.

In 2001, 2002 and 2003, Telefónica Móviles España invested in the aggregate approximately 1,821 million in building out and enhancing its networks in Spain, developing its technological platforms and information systems. At December 31, 2003, Telefónica Móviles España's digital network in Spain, which consisted of more than 115 switching centers and more than 15,000 base stations, provided coverage to approximately 99% of the population. The amounts invested in 2001, 2002 and 2003 have been used to enhance the quality of its coverage of high-density areas, to permit more intensive use of its wireless services within buildings in an urban environment, further enhancing the appeal of wireless communications and to introduce new technologies. Also, in 2003, Telefónica Móviles España continued to roll-out its UMTS network, complying with its obligations under its UMTS license. In October 2003 it was the first mobile operator in Spain to launch a pre-commercial service based on UMTS technology. In addition, as of February 13, 2004, Telefónica Móviles España offers to its corporate customers Oficin@ Movistar UMTS, the first third generation service offered in Spain by a mobile operator offering high-speed data transmission up to 384 kbits/s.

The Spanish wireless market has been receptive to new wireless services, such as SMS and wireless Internet. In 2001, Telefónica Móviles España launched GPRS, which increases the speed and efficiencies of existing GSM networks, allowing for the introduction of new services. In 2002, Telefónica Móviles España launched multi-media messaging service or, MMS, which allows customers to send and receive messages combining color photographs and images with voice, sound, animations or text. Photographs can be taken with handsets that have MMS capacity and integrated cameras and then attached to music or a voice messages and sent to others. The introduction of MMS in Spain has brought customers closer to the potential of third generation, or 3G, services while still utilizing existing technology such as GPRS. With the roll-out of MMS, Telefónica Móviles España continues to demonstrate its commitment to be a leader in the roll-out of innovative technology in Spain. In line with its commitment with technological innovation and with making the most innovative services available to its clients, in 2003, Telefónica Móviles España developed the following various new services and data applications:

In June 2003, Telefónica Móviles España, under a general collaboration agreement with NTT DoCoMo, became the first operator in the Spanish market to provide i-mode navigation service as part of its e-moción brand. i-mode is a proprietary, packet-based information service, which allows access to internet services for mobile phones. i-mode is one of the most successful mobile services and technologies worldwide, and is characterized by ease in navigation and by the wide diversity of its contents. Telefónica Móviles España estimates that 170,000 of its customers became users of this service in six months.

The GPRS technology developed significantly in 2003. Telefónica Móviles España estimates that its revenues have increased six-fold since 2002 and it has become one of the most widely accepted services with its customers.

In 2003, multimedia messaging services, or MMS, became more widely accepted. Almost one half of the handsets sold by Telefónica Móviles España in 2003 were equipped with MMS technology. Furthermore, at December 31, 2003 over 500,000 of its customers were users of this service.

With regard to the corporate and professional segment, Telefónica Móviles España is continually developing applications that will improve corporate management. For example, Telefónica Móviles España recently introduced Oficin@ Movistar UMTS, which offers third generation services to corporate customers.

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The introduction of data and non-voice services to the customers by Telefónica Móviles España was facilitated by the strategy of launching TSM handsets, which are self-branded handsets marketed in Spain since April 2003. These TSM handsets provide advanced options and capabilities to our customers at a reasonable price. Telefónica Móviles España has provided a range of self-branded handsets that meet the specific needs of each

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market segment allowing for advanced technologies such as i-mode, MMS and GPRS to be more easily accessible to our customers.

In general, Telefónica Móviles España's strategy is to use a variety of suppliers based on the quality and rates of their services and products. In Spain, Ericsson, Motorola and Nokia have supplied the majority of Telefónica Móviles España's GSM and GPRS network. Ericsson supplied the majority of the infrastructures for the first phase of the roll-out of its UMTS Network, and Ericsson and Siemens are supplying the infrastructure for the second phase of the roll-out.

### *Sales and Marketing*

Since Telefónica Móviles España began providing wireless services in Spain, its sales and marketing strategy has been to generate increased brand awareness, customer growth and increased revenues. As the Spanish market continues to mature, Telefónica Móviles España's focus has been shifting from customer acquisition to management of its customer relationships and continuation of profitable growth through customer loyalty and new products and services.

Telefónica Móviles España utilizes all types of marketing channels, including television, radio, exterior signage, telemarketing, direct mail and Internet advertising. Telefónica Móviles España also sponsors a leading motorcycle grand prix racing team and cultural and sporting events in order to increase its brand recognition. Its advertising emphasizes its image as the market leader and characteristics such as quality, convenience and reliability, with specific campaigns based on price or new product offerings. For example, campaigns for its pre-paid service, Movistar Activa, emphasize the simplicity and mobility of the pre-paid service with a focus on the younger segment of the market. For its contract customers, Telefónica Móviles España markets Movistar Plus, which emphasizes exclusivity and value with specific offers of new services, and a loyalty program based on points earned.

For purposes of sales and distribution, Telefónica Móviles España divides the Spanish market into the consumer market and business market. At December 31, 2003, Telefónica Móviles España had approximately 10,000 points of sale for the consumer market. In addition, Telefónica Móviles España uses approximately 100 points of sale that are owned by our Group.

In the wireless business sector, Telefónica Móviles España uses its distributors to market to small and medium sized enterprises and uses its own corporate sales force to target large business customers. Telefónica Móviles España offers a variety of plans, ranging from volume discounts to specifically tailored service contracts.

Telefónica Móviles España offers several different pricing options for wireless services. At December 31, 2003, more than 40% of Telefónica Móviles España's total customer base are contract customers, and 60% are pre-paid (Movistar Activa).

In 2003, in order to stimulate demand from its customers, Telefónica Móviles España continued encouraging customer migration from its pre-paid plans to its contract plans, in line with the process that started in March 2002, when the contract plans of Telefónica Móviles España no longer contained a monthly fee, instead they required a minimum usage commitment. In 2003, more than 1.1 million pre-paid customers migrated to contract plans which had a significant impact on its contract customer mix in 2003, as compared to 2002.

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The competitive tariffs of and quality of services provided by Telefónica Móviles España, along with its success in encouraging migration to its contract plans, have led to improvement in the usage and spending pattern of its customers. Minutes of usage, or MOU, per customer in Spain increased by 10% in 2003 compared to 2002. Total traffic also increased to 37,700 million minutes, a 18.2% increase compared to 2002. In addition, data and content services are becoming increasingly important methods by which wireless customers in Spain communicate. In 2003, over 9,300 million SMS crossed over the network of Telefónica Móviles España, an 11% increase when compared to 2002. Moreover, approximately 33% of SMS using the Telefónica Móviles España network involved the access of a content service.

As a result, in 2003, average revenue per user, or ARPU, in Spain has changed its annual trend. ARPU has increased on an annual basis for the first time in Telefónica Móviles España's history. Telefónica Móviles España's ARPU in 2003 increased by 3.7% to 29.7, compared to 2002. Revenue from data services in Telefónica Móviles España was 544 million in 2003 and ARPU from data services was 3.7 in 2003, an increase of 8.8% compared to 2002. The increase in ARPU from data services was primarily due to a substantial growth of non-SMS data



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services, which gave rise to an increase in non-SMS related revenues, out of total data revenues, of 5 percentage points.

In addition to its improved performance, Telefónica Móviles España has also reduced costs in order to take full advantage of its economies of scale. Accordingly, the amount spent by Telefónica Móviles España to acquire and retain customers as a percentage of net sales was 7.1%, a decrease of 0.8 percentage points from 2002. This decrease was despite the substantial increase in commercial activity (the sum of new customer additions, customer migrations and handset upgrades) in 2003.

*Regulation*

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

All the licenses and authorizations for the exploitation of telecommunications networks or for the provision of electronic communications services are extinguished after the new General Telecommunications Law comes into force. Nevertheless, the acquisition of radio-electric spectrum rights, the right to occupy public and private property and numbering should carry on according to the appropriate regulation.

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

Concession Type (licenses)	Concession Duration	Ending Date	Extension Period
GSM 900	15 years	February 3, 2010	5 years
DCS 1800	25 years	July 24, 2023	5 years
UMTS	20 years	April 18, 2020	10 years
Paging	20 years	April 24, 2020	10 years

*Interconnection.* Because Telefónica Móviles has been classified by the Telecommunications Market Commission as a market dominant operator in the wireless and interconnection markets, Telefónica Móviles España must provide cost oriented interconnection rates on a non-discriminatory transparent and proportional basis based on objective criteria. Prices must be set in accordance with the cost orientation principle. The technical and financial conditions under which the dominant operators provide interconnection services to itself or to its subsidiaries must be offered under the same conditions to the other operators. This obligation principally relates to the quality of services, delivery schedule and the terms and conditions for the provision of interconnection services. Likewise,

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Telefónica Móviles España must provide relevant information on the technical and functional specifications of the interconnection points to any operator that requests interconnection.

Every year Telefónica Móviles España must file separate accounts with the Telecommunications Market Commission for its interconnection related activities. The accounts must include the interconnection services that Telefónica Móviles España provided to itself and to its subsidiaries or affiliates as well as the services provided to other operators.

The mobile telephony operators that are dominant in the Spanish interconnection market, which are Telefónica Móviles España, Vodafone España, S.A. and Retevisión Móvil, S.A., must file externally audited costs with the Ministry of Economy and the Ministry of Industry, Trade and Tourism and to the Telecommunications Market Commission, once a year.

The Telecommunications Market Commission initiated a procedure on September 11, 2003 to determine Telefónica Móviles España's termination interconnection prices. On December 18, 2003, the Telecommunications Market Commission established the average maximum price for Telefónica Móviles España's interconnection termination service at 0.145 per minute, beginning on January 31, 2004.

### *Number Safekeeping*

Since November 2000, mobile telephony users are able to keep their telephone number whenever they switch mobile operators.

### *Tariffs*

The mobile operators that provide mobile telephone services may generally set the tariffs they charge to their clients. However, the General Telecommunications Law provides the Government's Deputy Commission for Financial Affairs the faculty to set transitorily maximum and minimum prices, as well as fixed prices. The Government's Commission has not regulated rates of digital wireless services to date.

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

### *Virtual mobile operators*

Virtual mobile operators are mobile operators who do not own a network and who may provide mobile telephony service through voluntary non-discriminatory access agreements with mobile operators who own existing networks. On March 20, 2002, the Official State Gazette (B.O.E) published the ministerial order which regulates virtual mobile operators ( VMO ).

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A VMO must inform the Telecommunications Market Commission of their contracts with other operators before offering services over their networks. A VMO does not have any coverage obligation nor the right to occupy public and private property or share infrastructure with other operators. The CMT has attributed several VMO licenses in 2002.

### *Competition*

Telefónica Móviles de España currently has two competitors in the Spanish market for wireless communications service: Vodafone España, a subsidiary of Vodafone PLC, and Retevisión Móvil S.A., which operates under the trade name Amena.

In early 2000, the Spanish government awarded four third generation wireless, or UMTS, licenses, which cover the entire country of Spain. We were awarded one of these licenses, while the others were awarded to Retevisión Móvil, Vodafone and the Xfera consortium.

### **Morocco**

Telefónica Móviles provides wireless services in Morocco through Medi Telecom, S.A., in which it holds a 32.18% interest and shares management responsibilities with Portugal Telecom, which holds a 32.18% interest in Medi Telecom as well. Medi Telecom is also owned by local minority shareholders. Medi Telecom is the second largest wireless operator in Morocco with approximately 2.06 million customers at December 31, 2003, representing approximately 43% of the market. Medi Telecom commenced offering wireless services in Morocco in March 2000, eight months after it was awarded a GSM license covering the Moroccan national territory.

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Telefónica Móviles has entered into a shareholders' agreement with other shareholders of Medi Telecom under which it has the right to appoint the chief executive officer of Medi Telecom. In addition, as of April 2003, the sale or transfer of shares in Medi Telecom triggers a right of first refusal with a priority for Telefónica Móviles and Portugal Telecom. The shareholders' agreement also requires specified majority votes to approve most corporate actions.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Medi Telecom:

	Year ended December 31,		
	2001	2002	2003
Total wireless customers (in millions at period end)	1.1	1.6	2.06
Pre-paid customers (in millions at period end)	1.0	1.5	1.9
Population in service territory (in millions at period end)	29	30	30

*Source: Telefónica Móviles, except population*

*Population: Pyramid Research*

*Licenses*

In July 1999, Medi Telecom was awarded a GSM license in the 900 MHz band. This license allows Medi Telecom to provide wireless services and to use the spectrum and covers all Morocco. The license is valid for a period of 15 years from August 2, 1999 and may be renewed for one five-year period, subject to the fulfillment by the operator, of certain terms and conditions.

*Network and Technology*

Medi Telecom's network in Morocco is based upon the GSM standard. Its license entitles it to 50 MHz spectrum in the 900 MHz band. In 2001, 2002 and 2003, Medi Telecom invested a total of approximately 359 million in building out and enhancing its digital network in Morocco. At December 31, 2003, Medi Telecom's digital network in Morocco consisted of 12 switching centers and 1,616 base stations giving coverage to over 89% of the population. Medi Telecom plans to make new investments to increase the coverage of its network. Medi Telecom has been offering wireless Internet since April 2001.

*Competition*

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

**Brazil**

Telefónica Móviles and Portugal Telecom are 50:50 shareholders in Brasilcel, N.V., or Brasilcel, a joint venture which combines Telefónica Móviles' wireless businesses in Brazil with those of Portugal Telecom. This joint venture is the leading wireless operator in Brazil in terms of total number of customers at December 31, 2003. At December 31, 2003 Brasilcel had a total of 20.7 million customers, of which 4.9 million are contract customers based on information provided by its competitors and regulatory authorities. Brasilcel has an estimated average share in its markets of operations of approximately 56% at December 31, 2003. All of the operating companies participating in the joint venture have been operating under the brand name "Vivo" since April 2003. The licensed areas of Brasilcel include 19 states in Brazil and its federal capital, with a population of approximately 130 million, and covering more than 83% of Brazil's gross domestic product.

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The following table shows the different states where service is provided by Vivo's operators in 2003:

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

The following table presents, at the dates and for the periods indicated, selected statistical data relating to the operations of Vivo:

	<b>Year ended December 31,</b>		
	<b>2001</b>	<b>2002</b>	<b>2003</b>
Population in service territory (in millions at period end)	43	97	130
Total customers (in millions at period end) <sup>(1)</sup>	5.6	13.7	20.7
Pre-paid customers (in millions at period end) <sup>(1)</sup>	3.7	10.1	15.8

Source: Telefónica Móviles, except population data

Population: Pyramid Research

<sup>(1)</sup> Total customers and pre-paid customers in 2003 reflect the customers of Brasilcel, including TCO from May 2003. Total customers and pre-paid customers for 2002 and 2001 reflect the customers of Tele Leste Celular, Tele Sudeste Celular, Telesp Celular and Celular CRT.

In 2003, Vivo has consolidated its leadership position, with a client base of approximately 20.7 million clients at year-end December 31, with an estimated market share of 56% in its areas of operations and of 45% in Brazil.

#### *Licenses and Concessions*

On December 4, 2002, ANATEL authorized the contribution to Brasilcel, of the wireless assets in Brazil of both Portugal Telecom and Telefónica Móviles and allowed the migration of Brasilcel's operators to a new licensing regime, Personal Mobile Service, or the SMP regime. Accordingly, Brasilcel's operators replaced all their old licensing titles with new SMP authorization titles. The old licensing titles were concessions granted under the Cellular Mobile Service, or the SMC regime. The new SMP authorizations include the right of providing cellular services for an unlimited period of time but restrain the right of using the spectrum according to the schedules listed in the old licensing titles (Celular CRT until 2007, Telerj Celular until 2005, Telesp Celular until 2008, Telebahia Celular and Telergipe Celular until 2008 and Telesp Celular until 2008). Spectrum rights may be renewed only once for a 15- year period.

*Regulation*

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

*Interconnection.* Resolution 40/98 approved the general interconnection regulations. Interconnection is mandatory for all telecommunications operators. Conflicts arising from the negotiations between operators are resolved through the arbitration by Anatel.

Existing regulations determine that operators that offer general public services (fixed line services, personal mobile services (SMP), specialized mobile services – trunking and cable TV) must publish the terms and conditions for the interconnection with their networks.

*Rates.* The interconnection rates (access, transit and termination charges) are regulated by Anatel and are adjusted annually in accordance with the Brazilian consumer price index, and discounting a productivity factor.

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The rates that wireless service providers may charge their customers are also regulated by the SMP regime. The SMP regime allows operators to either freely negotiate their interconnection rates with other operators or apply a maximum rate fixed by Anatel, and reviewed annually. In addition, under the SMP rules, the retail rates charged to customers for fixed-to-mobile calls cannot be less than the sum of the interconnection fees charged on the fixed and mobile calls.

### *Network and Technology*

The licenses granted to the companies integrated in Brasilcel allow operations in CDMA 1XRTT and TDMA networks. Vivo offers both analog and digital services in the band of 800 MHz. CDMA 1XRTT, or code division multiple access, is a broadband transmission system for wireless networks allowing for speeds of up to 144 Kbits/s. TDMA, or time division multiple access, is a digital mobile phone technology that allows several calls to share a single channel without interfering with one another. We believe Vivo has differentiated itself in Brazil by offering more innovative and advanced products and services, in part because of their new networks with the high technological capacity of CDMA 1XRTT. This technology facilitates data transmission at speeds of 144 Kbytes per second and provides a significant competitive advantage for Vivo. The companies of Vivo that offered services in CDMA Networks (Telesp Celular, TeleSudeste Celular, Global Telecom y TeleLeste Celular) have upgraded their networks by the layout of CDMA-1XRTT, and the companies which offered services based on TDMA Networks (Celular CRT and TCO) are selectively overlaying CDMA-1xRTT. In 2003, there has been a significant increase of CDMA 1XRTT coverage, reaching 101 cities at year-end.

In 2003 the growth trend in the usage of data services was assisted by the increase in SMS and WAP enabled handsets. Vivo continued to lead the development and innovation of data services in Brazil, exploiting the competitive advantage of its CDMA 1XRTT network in respect to its competitors.

During the 2001, 2002, and 2003 Vivo invested approximately 601 million in the development of the networks of its companies in Brazil, fundamentally the layout of the CDMA 1XRTT network.

### *Sales and Marketing*

In 2003 the launching of Vivo as the single brand of operations for Brasilcel in Brazil was announced. The consolidation of a unified commercial model for the whole country centered on the Vivo brand substituting the different brands under which the different companies offered their services in their respective states. The commercial strategy of Vivo is to increase its customer base, as well as revenues, by retaining customers and maintaining their distribution channels. Loyalty programs have been established for both contract and prepaid customers. Under the programs, contract customers accrue the right to a handset upgrade based on the revenues generated by such customers. Additionally, prepaid clients have access modern handsets at a competitive price. The launching of the Vivo brand was accompanied by other measures designed to contribute to the success of the commercial strategy. For example, Vivo improved the management of its distribution channels, which consisted of 7,500 points of sale at the national level in 2003. Additionally, Vivo prepaid customers were provided access to a wide range of points of recharges. The recharges can also be made by electronic transfers through the commercial banking network.

As of December 31 2003, approximately 23% of Vivo's customers were contract clients and the remaining 77% were prepaid customers.

### *Competition*



The growth of the Brazilian market has been considerable during the past years while being accompanied by an increase in competition due to the introduction of two new competitors (TIM and Oi) and the expansion of Claro. TIM, Oi and Claro, together with Vivo represent the principal operators in Brazil.

## **Peru**

Telefónica Móviles provides wireless services in Peru through Telefónica Móviles, S.A.C., or Telefónica Móviles Perú. Telefónica Móviles Perú is the leading wireless operator in Peru with approximately 1.5 million customers at December 31, 2003. Telefónica Móviles Perú has approximately 52% of the market share.

In March 2001, as a preliminary step in the transfer of our wireless operations in Peru to Telefónica Móviles, we transferred an approximately 16.5% interest in Telefónica del Perú S.A.A. to Telefónica Móviles in exchange for 65,939,564 ordinary shares of Telefónica Móviles. In accordance with the resolution of the shareholders of Telefónica del Perú to divide the company along business lines, Telefónica del Perú spun off its

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wireless operations in June 2001 in the form of shares of Telefónica Móviles, S.A.C. and its data operations. Telefónica Móviles agreed with other members of the Telefónica Group who were shareholders of Telefónica del Perú to exchange, following such spin-offs, the shares of such data operations that they received in its spin-off, as well as the shares they held in Telefónica del Perú, for the shares in Telefónica Móviles, S.A.C. that they received in its spin-off. Following the spin-off and share exchanges, and additional share purchases, Telefónica Móviles holds indirectly a 97.97% interest in Telefónica Móviles, S.A.C. and do not hold any interest in such data operations or Telefónica del Perú.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles Perú. Telefónica Móviles began consolidating Telefónica Móviles Perú in our combined financial statements as of January 1, 2001.

	Year ended December 31,		
	2001	2002	2003
Total customers (in millions at period end)	1.1	1.2	1.5
Pre-paid customers (in millions at period end)	0.9	1.0	1.2
Population in service territory (in millions at period end)	26	26	27

*Source: Telefónica Móviles, except population*

*Population: Pyramid Research*

The predecessor entity of Telefónica Móviles Perú commenced offering wireless services in Peru in 1993 with the launch of analog wireless services. In April 1997, the Telefónica Group launched the first pre-paid wireless service in Peru. In September 1997, the Telefónica Group launched digital wireless service in Peru under the Movistar brand name, which has since become one of the most widely recognized brands in Peru.

*Regulation*

The Telecommunications Act (Texto Único Ordenado de la Ley de Telecomunicaciones) approved in 1993 (DS 13-93-TCC), and the General Regulations approved in 1994 (DS 6-94-TCC 1994), are the legal framework for the telecommunications sector in Peru.

In 1991, Telefónica del Perú's government-owned predecessor, Compañía Peruana de Teléfonos S.A., was granted a license for the provision of wireless services in Lima and Callao. Entel Peru S.A. was granted a license in 1992 for the provision of wireless service nationwide. In 1995, Entel Peru was merged into Compañía Peruana de Teléfonos and the surviving entity changed its name to Telefónica del Perú. Each license is valid for a term of 20 years. They expire on May 24, 2011 and February 1, 2012, respectively. Each license may be renewed for twenty year periods by filing an application at least two years prior to the expiration date. The renewal process is based on the fulfillment by Telefónica del Perú of certain terms and conditions.

*Interconnection.* Telefónica Móviles Perú is obliged to interconnect with other concession holders who request access to the network. Interconnection rates can be negotiated among wireless operators in Peru. Nevertheless, there is a maximum rate fixed by OSIPTEL for termination rates of local calls. This rate is calculated by OSIPTEL based on market information and projections.

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*Rates.* Rates charged by wireless providers to their customers have been subject to a free tariff regime supervised by the Organization for Supervision of Private Investment in Telecommunications. Operators freely establish their rates for telephone calls by fixed line users to wireless service, and vice versa. Currently, the two tariffs in force are the wireless user pays and the calling party pays. In February 1999, however, the Organization for Supervision of Private Investment in Telecommunications issued a resolution stating that rates applicable to communications between the users of fixed line services and the users of wireless services were then under review, and that until this review was complete, existing rates could not be increased. Thereafter, the Organization for Supervision of Private Investment in Telecommunications authorized a 6.21% and a 4% increase in the rates applicable to calls made from fixed and public telephones, respectively, to wireless users.

Interconnection rates can be negotiated among wireless operators in Peru. Nevertheless, there is a maximum rate fixed by OSPITEL for termination rates of local calls. This rate is calculated by OSPITEL based on market information and projections.

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### *Network and Technology*

Telefónica Móviles Perú operates both analog and digital networks. Its digital network is based upon the CDMA/CDMA 1xRTT standard. It has roaming agreements enabling Telefónica Móviles Perú's contract customers to make and receive calls in over 155 countries, including most of the Americas.

Telefónica Móviles Perú's licenses entitle it to 25 MHz of spectrum in the 800 MHz band.

Telefónica Móviles Perú invested approximately \$122 million in building out and enhancing its network in 2001, 2002 and 2003. In 2003, the amounts invested have been used to increase the switching capacity of the network and to roll-out the new CDMA1xRTT network.

At December 31, 2003, Telefónica Móviles Perú's network consisted of the CDMA1xRTT network and the Motorola Analog-Digital Network. The CDMA1xRTT network consisted of 3 switching centers and 230 base stations. The Motorola Analog-Digital Network consisted of 6 dual capacity switching centers, 295 analog base stations and 332 digital base stations.

Telefónica Móviles Perú has been the first wireless operator in Peru to launch CDMA1xRTT technology, which offers its clients a better quality in voice transmission and a higher speed in data transmission. Moreover, this technology permitted the launch of Movistar Multimedia, the platform of access to a wide range of services like video downloads, single- and multi-user games, MMS, chat, ringtones and location services, among others.

### *Competition*

According to Telefónica Móviles' estimates, Telefónica Móviles Perú is the leading operator in the Peruvian market. Telefónica Móviles Perú currently has three competitors in the Peruvian market for wireless communications service: Bell South, which began providing wireless services in 1993, Stet Mobile Holdings which obtained a GSM/PCS license in March 2000 and subsequently launched its services under the TIM brand, and Nextel Peru.

### **Argentina**

Telefónica Comunicaciones Personales S.A. is the second largest wireless operator in Argentina with approximately 1.8 million customers at December 31, 2003, representing approximately 24% of the market share.

In January 2001, as a preliminary step in the transfer to Telefónica Móviles of our wireless operations in Argentina, we transferred to Telefónica Móviles 15.1% of the common stock of Telefónica de Argentina S.A. in exchange for 174,863,364 ordinary shares of Telefónica Móviles. In accordance with the resolution of the shareholders of Telefónica de Argentina S.A. to divide the company along business lines, in November

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2001 Telefónica de Argentina S.A. spun-off its wireless operations in the form of shares of Telefónica Comunicaciones Personales S.A. and its data operations. Telefónica Móviles previously had agreed with other members of the Telefónica Group who were shareholders of Telefónica de Argentina S.A. to exchange, following such spin-offs, the shares of such data operations that Telefónica Móviles received in its spin-off, as well as the shares Telefónica Móviles holds in Telefónica de Argentina S.A., for the shares of Telefónica Comunicaciones Personales that they receive in the spin-off. Following the spin-offs and share exchanges, Telefónica Móviles holds a 97.93% interest in Telefónica Comunicaciones Personales S.A. and does not hold any interest in such data operations of Telefónica de Argentina S.A.

For a discussion of general macroeconomic conditions in Argentina, as well as the impact of the macroeconomic and political crisis in Argentina on our results of operations, see Item 5 Operating and Financial Review and Prospects Presentation of Financial Information Other Events Affecting the Comparability of our Results Economic Situation in Argentina .

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Comunicaciones Personales. Telefónica Móviles began consolidating Telefónica Comunicaciones Personales in its combined financial statements as of January 1, 2001.

	Year ended December 31,		
	2001 <sup>(1)</sup>	2002	2003
Total customers (in millions at period end)	1.8	1.6	1.8
Pre-paid customers (in millions at period end)	1.2	1.1	1.2
Population in service territory (in millions at period end)	37.5	38	38.2

Source: Telefónica Móviles, except population

Population: Pyramid Research

- <sup>(1)</sup> In the fourth quarter of 2001, the fiscal year end of Telefónica Comunicaciones Personales was changed from September 30 to December 31. As a result, our combined financial statements for the year ended December 31, 2001 incorporate the financial statements of Telefónica Comunicaciones Personales for the year 2001 and three months (October to December) of the year 2000. Previously, our combined financial statements incorporated the financial statements of Telefónica Comunicaciones Personales according to Telefónica Comunicaciones Personales' fiscal year, which ran from October 1 to September 31. This change does not give rise to material differences.

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Telefónica Comunicaciones Personales provides wireless services in each of Argentina's three service regions: Greater Buenos Aires; Southern Argentina; and Northern Argentina. In Greater Buenos Aires, the Telefónica Group commenced offering analog wireless services in 1993 under the Miniphone brand name through a company that it owned jointly with Telecom Argentina, an affiliate of France Telecom and Telecom Italia. In 1994, Miniphone launched digital wireless services in Greater Buenos Aires. In 1999 Telefónica Comunicaciones Personales and Telecom Personal divided Miniphone's assets, including customers, between them and entered into an agreement which allows Telefónica Comunicaciones Personales and Telecom Personal to continue to operate in Greater Buenos Aires separately.

In Southern Argentina, the Telefónica Group launched wireless services through Telefónica Comunicaciones Personales in 1996 under the Unifón brand. In October 1997, the Telefónica Group launched pre-paid wireless services in Greater Buenos Aires and in May 1999 in Southern Argentina.

In Northern Argentina, Telefónica Comunicaciones Personales began offering wireless services in May 2000 following receipt of personal communication service, or PCS, licenses covering the three service regions. As a result, Telefónica Comunicaciones Personales is now a nationwide provider of wireless services.

### *Regulation*

The National Telecommunications Law No. 19798 of 1972 (Ley Nacional de Telecomunicaciones) and the specific regulations for each service (including Governmental Decree 264/98) liberalized the telecommunications market in Argentina.

Telefónica Comunicaciones Personales S.A.'s licenses for the provision of wireless services include the following:

PCS licenses and corresponding authorizations for use of spectrum for each of Northern Argentina, Southern Argentina and Greater Buenos Aires;

Licenses and corresponding authorizations for use of spectrum for wireless telephone services for Greater Buenos Aires and Southern Argentina, respectively; and

Licenses for trunking, or closed user group, services for the greater Buenos Aires area and other provinces.

Licenses do not expire, but may be cancelled as the result of an operator's failure to comply with the terms of its license.

An authorization from the Secretariat of Communications allowing for use of spectrum is required before a telecommunications operator may provide wireless services. No wireless service provider may hold a bandwidth of more than 50 MHz in any one service region.

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Telefónica Comunicaciones Personales operating licenses require it to comply with the coverage and service provision undertakings contained in those licenses, but they, in turn, allow Telefónica Comunicaciones Personales to freely set the rates to be charged to its customers, as long as the rates are applied on a non-discriminatory basis.

Licenses granted to mobile cellular radio-communications service, Mobile Telephony Service and Personal Communication Service operators do not preclude them from offering any other telecommunication services on a competitive basis although each of these operators is subject to specific regulations.

*Interconnection.* Interconnection agreements are freely negotiated between operators. If they fail to reach an agreement, each operator may call upon the Secretariat of Communications to determine the terms and conditions of interconnection between the relevant operators.

Operators with significant market power (defined as operators with more than 25% of total gross revenues generated by wireless operations) and market-dominant operators (operators with more than 75% of total

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gross revenues) must provide cost oriented interconnection prices. Market-dominant operators must provide interconnections with other operators through a reference interconnection offer.

The calling party pays system is in the process of being slowly introduced in Argentina. This system has not yet been introduced for mobile-to-mobile calls and for payphone to mobile calls. Nevertheless, mobile companies have signed private agreements beginning in 2003 and pay to each other traffic termination fees from the second quarter of 2003. Resolution 623/2002 established the benchmark rate for fixed-to-mobile termination under the calling party pays system. This benchmark takes into account the weighted average revenues and average traffic for all mobile operators.

*Rates.* Rates charged to customers are not regulated in Argentina.

### *Network and Technology*

Telefónica Comunicaciones Personales operates both analog and digital networks. Its digital network is based upon the TDMA standard. It has roaming agreements enabling its customers to make and receive calls in over 100 countries worldwide.

Telefónica Comunicaciones Personales licenses entitle it to 12.5 MHz of spectrum in the 800 MHz band and 30 MHz of spectrum in the 1900 MHz band in Greater Buenos Aires, 25 MHz of spectrum in the 800 MHz band and 20 MHz of spectrum in the 1900 MHz band in Southern Argentina and 40 MHz of spectrum in the 1900 MHz band in Northern Argentina.

Telefónica Comunicaciones Personales invested a total of approximately 121 million in building out and enhancing its digital network in Argentina in 2001, 2002 and 2003, and anticipates new investments in the future aimed at expanding, on a national scale, the GSM network that it currently owns in the city of Buenos Aires. This GSM network has 122 base stations, and provides roaming-in service for international travelers.

At December 31, 2003, its digital network in Argentina consisted of 38 switching centers and 1,369 base stations giving coverage over 90% of the population. Telefónica Comunicaciones Personales network has dual capacity so that the analog network has the same number of switching centers and base stations as the digital network.

Substantially all of Telefónica Comunicaciones Personales wireless network equipment is provided by Ericsson and it purchases handsets from Ericsson, Nokia and Motorola. Telefónica Comunicaciones Personales entered into a contract with Ericsson to provide it with a wireless digital TDMA standard PCS network, which is compatible with its existing networks in Greater Buenos Aires and Southern Argentina, permitting nationwide access to its services.

### *Competition*



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Telefónica Comunicaciones Personales currently has four competitors in the Argentine market for wireless communications service, each of which provides services on a nationwide basis: Telecom Personal, which is controlled by Telecom Italia through Telecom Argentina, BellSouth's Movicom, CTI Móvil which is controlled by América Móvil, and Nextel, owned by NII Holdings Inc.

### Mexico

Telefónica Móviles holds 92.0% of Telefónica Móviles Mexico, which is Mexico's second largest wireless operator, with over 3.5 million customers. Telefónica Móviles Mexico owns licenses for the entire Mexican territory.

The companies making up Telefónica Móviles Mexico were acquired by Telefónica Móviles in two steps:

- (1) *Acquisition of Northern Operators.* Telefónica Móviles Mexico acquired the four Northern wireless operators (Bajacel, Movitel, Norcel, and Cedetel) from us in July 2001. We acquired such operators from Motorola, Inc. in exchange for an aggregate of \$1,835.5 million in our shares and \$10.5 million in cash and transferred them to Telefónica Móviles in exchange for approximately 203 million of its ordinary shares.
- (2) *Acquisition of Pegaso Telecomunicaciones, S.A. de C.V. and Formation of Telefónica Móviles Mexico.* On April 26, 2002, Telefónica Móviles signed agreements to purchase 65.3% of Pegaso from Sprint, Leap Wireless, Qualcomm and other financial investors. Pegaso owns licenses to operate on a

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nationwide basis. In connection with this agreement, Telefónica Móviles also agreed with the Burillo Group, who held a 34.77% interest in Pegaso at the time of the acquisition, to contribute Telefónica Móviles' interests in Pegaso and its other Mexican operators and the Burillo Group's interest in Pegaso into a new holding company, Telefónica Móviles Mexico.

On September 10, 2002, having obtained authorization from the relevant Mexican authorities, Telefónica Móviles acquired a 65.23% holding in Pegaso for \$92.9 million. In accordance with Telefónica Móviles' agreement with the Burillo Group, on September 10, 2002 Telefónica Móviles contributed its interest in Pegaso and its other Mexican operators (Bajacel, Movitel, Norcel and Cedetel) to Telefónica Móviles Mexico. On the same date the Burillo Group contributed its wireless interests to Telefónica Móviles Mexico.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles' Mexican operators.

	July 1 to December 31, 2001 <sup>(1)</sup>	Year ended December 31, 2002 <sup>(1)</sup>	Year ended December 31, 2003
Total customers (in millions at period end)	1.2	2.4	3.454
Pre-paid customers (in millions at period end)	1.0	2.1	3.214
Population in service territory (in millions at period end)	21.3	102.0	103.3

Source: Telefónica Móviles, except population

Population: Pyramid Research

<sup>(1)</sup> The figures for fiscal year 2001 include only our four Northern Mexican operators. The figures for fiscal year 2002 include our four Northern Mexican operators and Pegaso as from September 10, 2002.

**Regulation**

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

**Regulatory authorities.** The regulatory authorities with terms of reference in the Mexican telecommunications sector are:

the Secretariat of Communications and Transportation (SCT), and

the Federal Telecommunications Commission (COFETEL).

**Licenses and concessions.** In Mexico, authorization to provide mobile telephony services is granted through a concession. Telefonica Moviles's Mexican wireless operating companies have been granted the following concessions to operate mobile telephony services on Band A:

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Baja Celular Mexicana, S.A. de C.V., or Bajacel, operates in Region 1, which consists of the states of Baja California, Baja California Sur and the municipality of San Luis Rio Colorado in the state of Sonora;

Movitel del Noroeste, S.A. de C.V, or Movitel, operates in Region 2, which consists of the states of Sinaloa and Sonora, except for the municipality of San Luis Rio Colorado included in Region 1;

Telefonía Celular del Norte, S.A. de C.V, or Norcel, operates in Region 3, which consists of the states of Chihuahua, Durango and the municipalities of Torreón, Francisco I. Madero, Matamoros, San Pedro and Viesca in the state of Coahuila; and

Celular de Telefonía, S.A. de C.V, or Cedetel, operates in Region 4, which consists of the states of Nuevo León, Tamaulipas and Coahuila, excluding the municipalities of Torreón, Francisco I. Madero, Matamoros, San Pedro and Viesca.

Currently, only one Band A and one Band B service provider may provide mobile telephony services in each region. Each concession is granted for a period of twenty years, and may be renewed for additional twenty year periods subject to the fulfillment by the operator, of certain terms and conditions. The concessions to provide mobile telephony services awarded to the above operating companies each expire in 2010.

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In July 2001 Telefónica Móviles acquired, through Cedetel, a 49% interest in Grupo de Telecomunicaciones Mexicanas, S.A. de C.V., which holds a concession to provide radio link in the 7 GHz band. This concession expires in 2019, and may be renewed for additional twenty year periods.

On April 26, 2002, Telefónica Móviles signed definitive agreements to purchase 65% of Pegaso. In 1998, Pegaso was awarded licenses to provide personal communication services until 2018. This license may be extended for additional twenty year periods, subject to the fulfillment by the operator, of certain terms and conditions.

The concessionaires are subject to general obligations set forth by the Secretariat of Communications and Transportation and the Federal Telecommunications Commission, and to obligations pursuant to each concession concerning quality of service and network expansion and modernization.

*Licenses and concessions.* In Mexico, the authorization to provide mobile telephony services is granted through a concession. Telefonica Moviles s mexican wireless operating companies have been granted the following concessions to operate mobile telephony services on Band A:

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Telefonía Celular del Norte, S.A. de C.V, or Norcel, operates in Region 3, which consists of the states of Chihuahua, Durango and the municipalities of Torreón, Francisco I. Madero, Matamoros, San Pedro and Viesca in the state of Coahuila; and

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

The interconnection tariffs for domestic and international long distance, local telephony and cellular and wireless telephony services under the Calling Party Pays formula have been established by COFETEL, since Telmex and the local and long distance operators have generally been unable to reach agreement for the interconnection rates. In December 2001, however, COFETEL announced that Telmex and various long distance carriers had reached an agreement on the interconnection rates payable by the operators to Telmex for use of its local network, effective as of January 1, 2002. According to COFETEL, the arrangement is in line with the costs of the network used to offer the service and international practices.

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Since May 1, 1999, the Calling Party Pays system (CPP) is applied exclusively to the local service (for services established between exchanges of the same local area) although the user has the option of maintaining the Receiving Party Pays system.

*Rates.* Rates charged to customers are not regulated. They are fixed by wireless operating companies and must be registered with COFETEL. Rates do not enter into force until confirmed by COFETEL.

### *Network and Technology*

Telefónica Móviles Mexico offers both analog and digital networks. Its digital networks are based upon the CDMA and GSM standards. At December 31, 2003, Telefónica Móviles Mexico's digital network in Mexico consisted of 22 switching centers and 3,275 base stations, including both digital and analog base stations giving coverage to more than 40% of the population.

In each of the regions in which Telefónica Móviles Mexico operates, it holds licenses of 20 MHz of spectrum on the 850 MHz band, and 30 MHz and 10 MHz of spectrum on the 1900 MHz band.

The roll-out of Telefonica Móviles Mexico GSM network on a nationwide basis took place during 2003, covering by the end of the year 96 of Mexico's principal cities, exceeding the initial 46 cities expected.

Telefónica Móviles Mexico has invested during 2001, 2002 and 2003 a total of \$660 million, most of all during 2003 on its GSM network.

The suppliers of the GSM network have been Nokia and Ericsson.

### *Competition*

Telefónica Móviles Mexico competes with various operators at a national level, most of which are subsidiaries of larger international telecommunications companies. The principal competitor of Telefónica Móviles Mexico is Telcel. The other competitors of Telefónica Móviles Mexico are: Iusacell, Unefon, and Nextel.

### **Chile**

On May 18, 2004, the Board of Telefónica CTC Chile, S.A., or CTC, accepted a binding offer from Telefónica Móviles, S.A. for the acquisition of 100% of the shares of Telefónica Móvil Chile, S.A., a subsidiary of CTC. The price offered by Telefónica Móviles for the purchase of 100% of the shares of Telefónica Móvil Chile, S.A. is U.S.\$1,007 million. Telefónica Móviles will assume the outstanding debt of Telefónica Móvil

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Chile, S.A., which, as of March 31, 2004, accrued to the amount of U.S.\$243 million.

The acquisition is conditioned upon the approval of the transaction by the Extraordinary Shareholders Meeting of CTC. CTC is 43.6% owned by the Telefónica Group. Telefónica Móviles has been managing Telefónica Móvil Chile, S.A. since 2000.

Our Chilean wireless operator, which operates under the trade name Telefónica Móvil, had approximately 2.3 million customers at December 31, 2003, which, according to Telefónica Móvil's estimates based on information provided by its competitors and regulatory authorities, accounted for 30.4% of the overall mobile telephony market. Since the launch of its GSM services in April 2003, Telefónica Móvil estimates it has approximately 422,000 GSM customers, approximately 19% of its total customers.

The following table presents, at the dates and for the period indicated, selected statistical data relating to Telefónica Móvil.

	Year ended December 31,		
	2001	2002	2003
Total customers (in millions at period end)	1.6	1.8	2.3
Pre-paid customers (in millions at period end)	1.2	1.4	1.8
Population in service territory (in millions at period end)	15.5	15.2	15.4

*Source: Telefónica Móviles, except population*

*Population: Pyramid Research*

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### *Regulation*

Telefónica Móvil holds the following licenses:

Concession for the provision of wireless telecommunications services in the 800 MHz band:

For Metropolitan Region and Region V, the concession is granted for a thirty year period from November 11, 1998, and may be renewed for successive thirty year periods at the request of the holder.

For regions I to IV and regions VI to XII, the concession is granted for a thirty year period from August 3, 1989, and may be renewed for successive thirty year periods at the request of the holder.

Concession for the provision of wireless telecommunications services in the 1900 MHz band:

For the provision of wireless service nationwide in 1885-1890 MHz and 1965-1970 MHz band; and in 1865-1870 MHz and 1945-1950 MHz band. The concession is granted for a thirty year period from November, 16, 2002, and may be renewed for successive thirty year periods at the request of the holder.

*Interconnection.* The Telecommunications Law requires that holders of public telecommunications service licenses to interconnect their networks to other networks providing the same type of service. This requirement is intended to ensure that subscribers and users of public services are able to communicate with each other, both inside Chile and abroad. The same requirement applies to holders of intermediate service licenses, who are required to interconnect their networks to the local telephone network. Subtel sets the applicable tariffs for services provided through the interconnected networks, in accordance with the procedures established in Section 25 of the Telecommunications Law. The structure, level and indexing of these interconnection rates are fixed by a tariff decree by the Chilean Ministries of Economy and Transport and Telecommunications.

The tariffs are set every five years. On February 13, 2004, the new Tariff Decree No. 37 for Telefónica Móviles interconnection charges for the period 2004-2009 became effective. This Tariff Decree stipulates three time slots defined as peak reduced and night .

*Rates.* Calling Party Pays was implemented on February 23, 1999. Under this tariff structure, local telephone companies pay to mobile telephone companies an access charge for calls placed from fixed networks to mobile networks. Local telephone companies may pass this interconnection charge on to their customers. Under this tariff structure, local telephone companies pay to mobile telephone companies an access charge for calls placed from fixed networks to mobile networks. Under the CCP system, a fixed network customer calling a mobile telephone pays the local telephone company a rate comprised of a local tranche that is part of the basic local telephone service plus a fee for interconnecting from the fixed network to the mobile network. Mobile telephone customers can choose not to have the CPP tariff structure apply to their mobile-telephone accounts and thus continue to pay for incoming calls.



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On February 22, 2003, Subtel established the final technical and economic basis for the new mobile interconnection tariff setting process for the 2004-2009 five-year period.

The new interconnection charges, effective since February 13, 2004, for Telefónica Móvil have decreased by an average of 27.4% for the period 2004-2009 with respect to the average tariffs in Chilean pesos as of December 31, 2002.

### *Network and Technology*

Telefónica Móvil maintains a fully digitalized nationwide TDMA mobile network of 25 MHz in the 800 MHz frequency. In 2003, it continued to make improvements to this network's quality and coverage of voice services nationwide.

In addition, in 2002, Telefónica Móvil acquired through a bidding process two nationwide bands of 10 MHz each in the 1900 MHz mobile frequency (PCS), which it is developing with GSM/GPRS technology. In April 2003, Telefónica Móvil launched its GSM service, which has the benefit of operating over the only GSM/GPRS network covering the entire length of Chile.

In 2003, with the addition of this new network, Telefónica Móvil began to deploy new services such as multimedia messaging (Móvil Image), game downloads (Móvil Game) and ring-tone downloads (Móvil Music). Also, in July 2003, a new data transmission service, the GPRS mobile Internet was launched. The installation of the new EDGE (Enhanced Data Rates for Global Evolution) high-speed data network, initiated in October, made Chile the fourth country worldwide and the first country in the Region that is able to provide its clients with third generation (3G) services, thus permitting the advancement of the provision of 3G services.

The new network extended the roaming services to more than 140 countries and since December 2003, Telefónica Móvil's contract clients can use the GPRS roaming service in Spain, allowing them access to the data service when they are abroad.

### *Competition*

Telefónica Móvil currently has three competitors in the Chilean market for wireless communication service: Entel PCS, Bell South and Smartcom.

### **Central America**

Telefónica Móviles provides wireless services in El Salvador and Guatemala through TES Holdings, S.A. and TCG Holding, S.A., respectively. These holding companies hold its interests in Telefónica Móviles El Salvador, S.A. de C.V., and Telefónica Centroamérica Guatemala, S.A. de C.V., Telefónica Móviles' operators in these two countries.

Telefónica Móviles manages Telefónica Móviles El Salvador and Telefónica Centroamérica Guatemala in exchange for an annual fee of 9% of operating profits of each operating company.

In August 2001, Telefónica Móviles entered into an agreement with Mesotel de Costa Rica, S.A., a subsidiary of Mesoamérica Telecom, to acquire its direct and indirect interests in Telefónica Móviles El Salvador, Telefónica Centroamérica Guatemala, Telca Gestión, S.A. and Telca Gestión Guatemala, S.A., and other companies in which Telefónica Móviles had shared holdings, in exchange for approximately 21.9 million of Telefónica Móviles ordinary shares. In January 2002 Telefónica Móviles amended this agreement and acquired one-third of Mesotel de Costa Rica, S.A.'s interests in exchange for 7.3 million of Telefónica Móviles ordinary shares. The remaining two-thirds were transferred by Group Mesotel in July 2002 for the remaining 14.6 million of Telefónica Móviles ordinary shares. Telefónica Móviles subsequently holds through TES Holdings S.A. and TCG Holdings S.A. a 90.3% indirect interest in Telefónica Móviles El Salvador and a 100% indirect interest in Telefónica Centroamérica Guatemala.

#### **El Salvador**

Telefónica Móviles provides wireless services in El Salvador through Telefónica Móviles El Salvador, the second largest of the four wireless operators in El Salvador, with approximately 248,000 customers at December 31, 2003, representing 24% of the market. Telefónica Móviles indirectly holds a 90.3% interest in Telefónica Móviles El Salvador.

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The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles operations in El Salvador:

	Year ended December 31,		
	2001	2002	2003
Net revenues from operations (euro in millions) <sup>(1)</sup>	118	112	96
Total customers (at period end)	238,605	230,856	247,520
Pre-paid customers (at period end)	91,293	160,266	186,309
Population in service territory (in millions at period end)	6.3	6.5	6.6
<i>Source: Telefónica Móviles, except population</i>			

*Population: Pyramid Research*

<sup>(1)</sup> Includes both fixed line and wireless operations.

Telefónica Móviles El Salvador commenced offering digital wireless services in El Salvador in December 1998 under the Movistar brand name. In addition to wireless services, Telefónica Móviles El Salvador also provides Internet, cable TV and telephone services through Telefónica Multiservicios, a joint venture between Telefónica Móviles El Salvador and Amnet, an international communications provider in El Salvador. Telefónica Móviles El Salvador may enter in the future into an agreement with us or our affiliates providing for the spin-off or transfer to it of all of the non-wireless assets that Telefónica Móviles El Salvador holds in El Salvador.

Concessions for the provision of telecommunications services are granted for a thirty year period. The concession may be renewed for successive thirty year periods. Telefónica El Salvador holds a concession to provide public telephone service, including wireless services throughout El Salvador until January 1, 2028.

Concessions for use of spectrum are granted for terms of twenty years and may be renewed for successive twenty year periods. Telefónica Móviles el Salvador holds the following concession for use of spectrum:

a concession to use 25 MHZ of spectrum in the 800 MHz B band; and

a concession to use the following frequencies for multi-channel connections, including the delivery of wireless services: 5 GHZ, 11 GHZ; and 23 GHZ.

A concession may be revoked only when a concession holder does not supply telecommunications services within two years after the concession has been granted or if it commits three serious infractions described in the relevant law within a period of three years. Concessions may be canceled upon the expiration of the concession term, however, filing a new application with the General Superintendency of Electricity and Telecommunications may