



Villa D'Este (Italia)

April 19th, 2002

*Telefonica*

**BUILDING VALUE:**  
Driving business and financial performance  
for continued earnings growth

**José María Alvarez-Pallete**  
CFO of Telefónica Group

## ***Safe harbour***

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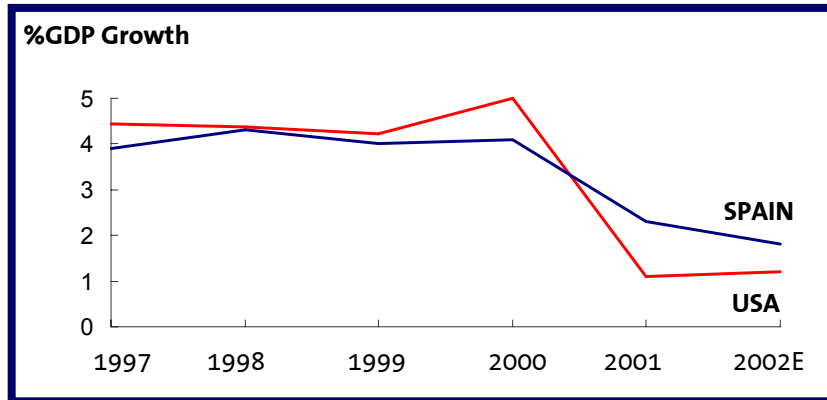
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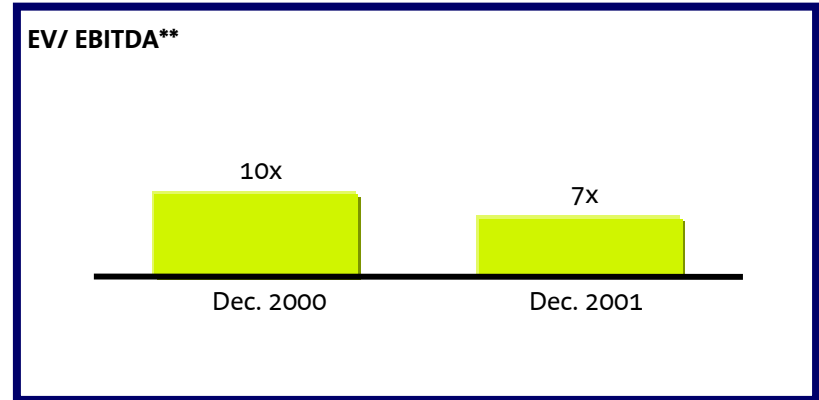
- **STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT**
- STRATEGY: OPERATIONAL KEY DRIVERS ...
  - Accelerating performance of core businesses
  - Capturing our natural growth potential
  - Focusing to turn around non-performing businesses
  - Strengthening our “one company” model
- ... COMBINED WITH FINANCIAL MANAGEMENT AND DISCIPLINE
- THESE DRIVERS TRANSLATE INTO A SET OF MANAGEMENT COMMITMENTS
- CONCLUSIONS

# Telecom sector is facing a tough economic environment ...

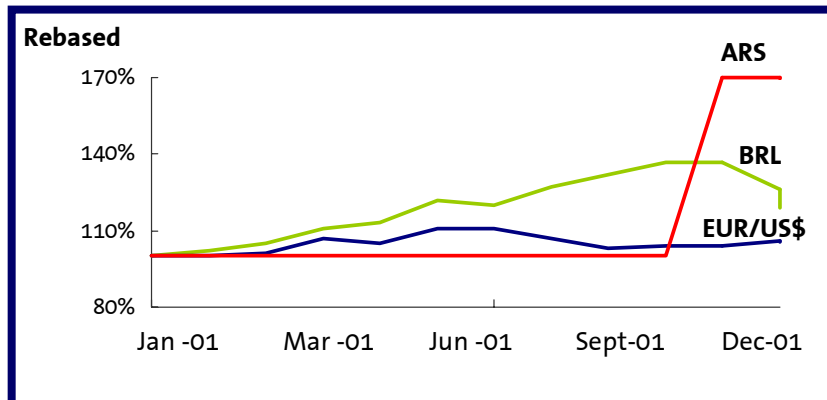
## General economic slow down



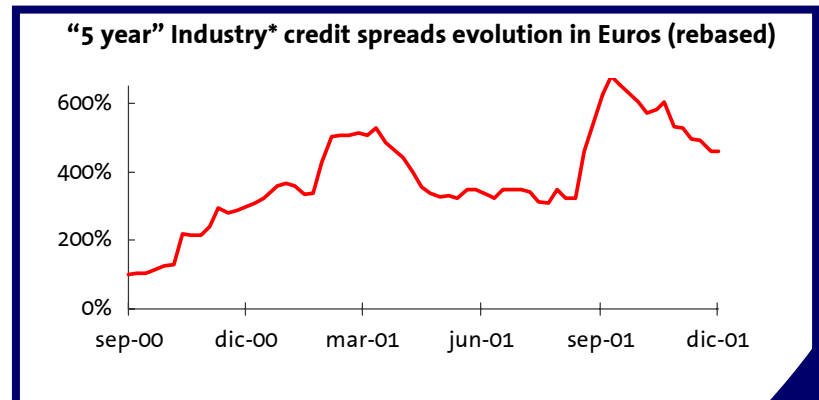
## Change in expectations for telecom sector



## Exchange rate evolution



## Difficulties refinancing corporate debt



\* Weighted average credit spread over 5yr IRS (interest rate swap) of DT 6/7/2005, TEF 21/9/2005, FT 10/11/2005, BT 15/2/2006

\*\* Average EV/EBITDA ratios of Deutsche Telekom, Telecom Italia, France Telecom and British Telecom

Source: Datastream, Multex Estimates

# ***...Strong fundamentals and solid growth platforms will become key differentiators***

## **Challenging economic environment**

- Financing restrictions
- Impact on demand
- Slow recovery expected

## **Challenging telecom sector environment**

- Increasing saturation in developed markets
- Slowdown in demand growth
- Unfinished regulatory framework
- Efficiency improvements increasingly difficult

**Environment remains uncertain and highly demanding for telecom companies**

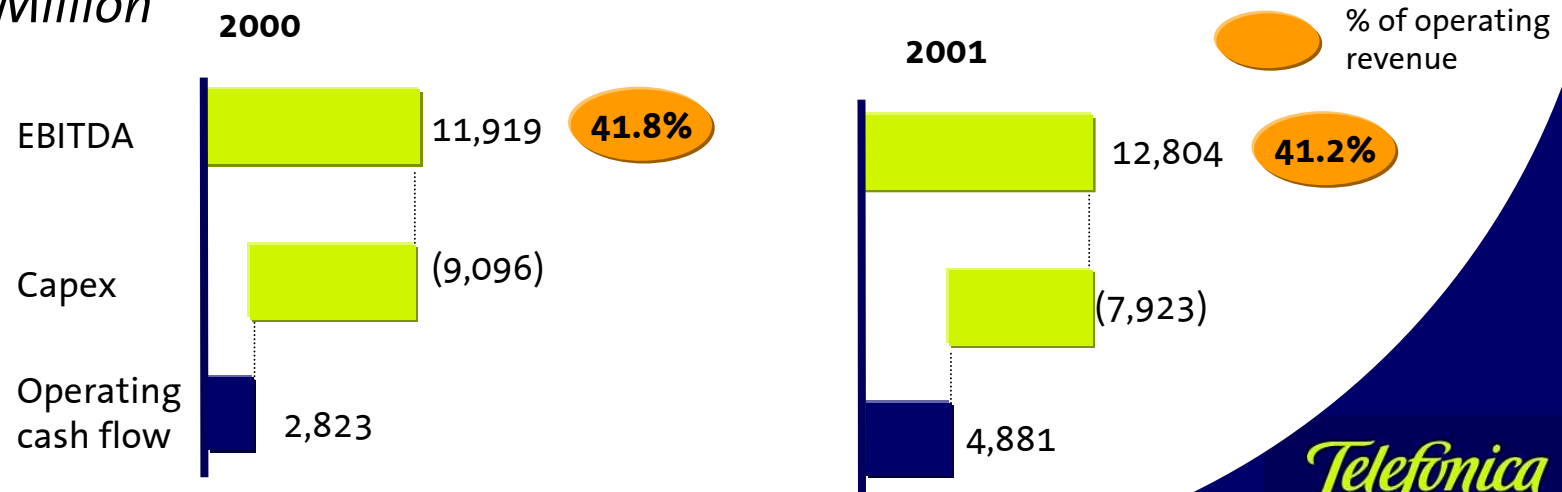
## **Key differentiating factors among integrated telcos:**

- Strong fundamentals
- Solid growth platform

## Telefónica has delivered strong results...

<i>Euro Million</i>	<u>2001</u>	<u>2000</u>	<u>% Change</u>
<b>Operating revenues</b>	<b>31,053</b>	<b>28,486</b>	<b>9.0</b>
<b>EBITDA</b>	<b>12,804</b>	<b>11,919</b>	<b>7.4</b>
<b>Operating profit</b>	<b>5,430</b>	<b>4,958</b>	<b>9.5</b>
Argentinean peso devaluation to 1.7	(529)	-	n.a.
Amortization of goodwill	(842)	(501)	68.1
<b>Income before taxes</b>	<b>2,034</b>	<b>2,868</b>	<b>(29.1)</b>
<b>Net income</b>	<b>2,107</b>	<b>2,505</b>	<b>(15.9)</b>

*Euro Million*



*Telefonica*

## ***...Capitalizing in its unique position***

- ✓ **We have delivered on earnings**
- ✓ **We have optimized efficiency, showing strong EBITDA margins**
- ✓ **We have achieved capital allocation and Capex discipline**
- ✓ **We have a solid and diversified client base and revenue streams**
- ✓ **We have developed new growth platforms**
- ✓ **We are well positioned to capture profitable growth ahead**

**Important achievements to date ...**

**... rather than restating our achievements,  
we would like to review how Telefónica will  
deliver earnings growth**

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- STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT
- **STRATEGY: OPERATIONAL KEY DRIVERS ...**
  - Accelerating performance of core businesses
  - Capturing our natural growth potential
  - Focusing to turn around non-performing businesses
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## ***Four drivers to support our future performance***

**Accelerating  
performance of  
core business**

- **Continuous improvement in core businesses**
  - Enhance Commercial focus
  - Improve efficiency
  - Optimize capital base
  - Work towards a fair regulatory framework

**Capture our  
natural growth  
potential**

**Turning around  
non-performing  
businesses**

**Strengthen our  
“one company”  
model**

# Accelerating performance of core businesses

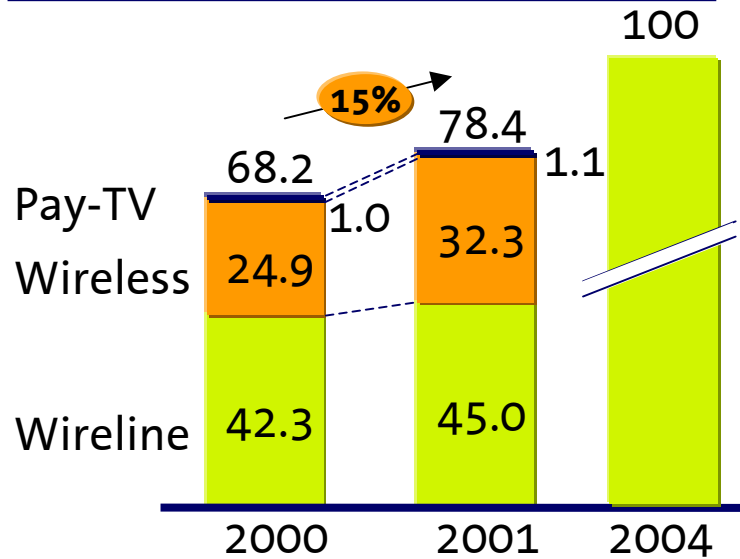
Enhance commercial focus

Actively managing our customer base

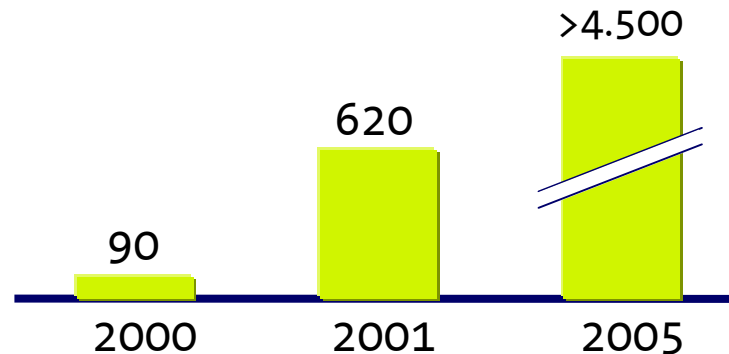
Developing new products and services (innovation)

Adapting our distribution model

N° of total customers (millions)



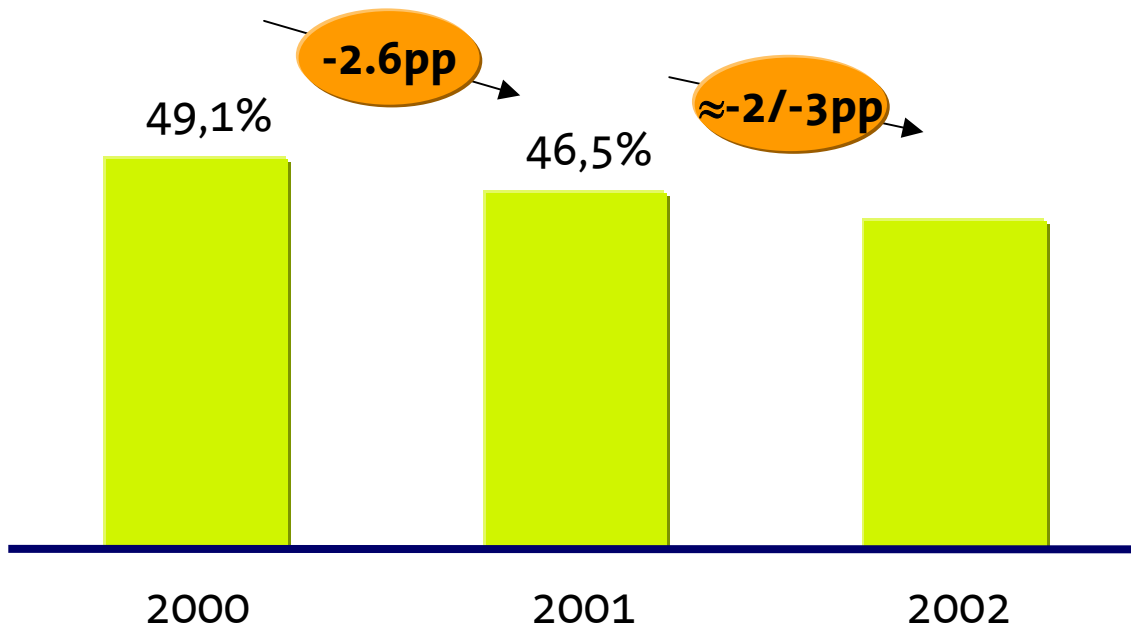
Spain + Latam  
Thousands of DSL lines



# Accelerating performance of core businesses

Improve efficiency

$$\text{Manageable Cost Efficiency} = \frac{\text{Discretionary costs}^*}{\text{Net Revenues}^{**}}$$



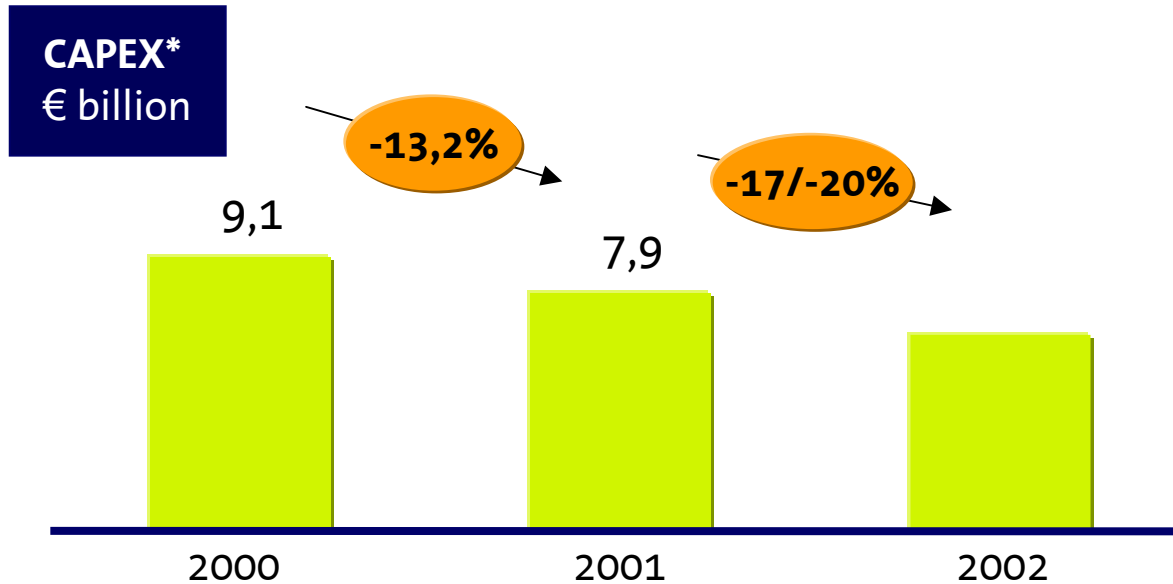
Continuous effort in manageable costs efficiency in 2001 with ambitious objectives for 2002

\* Includes personnel and external services

\*\* Revenues less cost of sales (purchases, interconnection expenses, provisions and tributes)

# Accelerating performance of core businesses

Selective CAPEX to optimize capital base



- **Significant effort to control CAPEX compatible with organic business growth...**
  - 19% CAPEX reduction in TdE's traditional business
  - 7.9% CAPEX reduction in Telefónica Latam
  - Significant CAPEX rationalization in Telefónica Móviles, especially in Spain
- **...and aggressive investments to develop growth businesses**
  - ADSL expansion in Spain
  - Achievement of “metas” in Brazil
- **In line with a multi-year effort to improve EBIT**

## *Four drivers to support our future performance*

**Accelerating  
performance of  
core business**

**Capture our  
natural growth  
potential**

- **Extracting the full potential of our existing customer base**
  - Broadband and Wireless Data
- **Expanding our customer base**
  - Brazil and Mexico

**Turning around  
non-performing  
businesses**

**Strengthen our  
“one company”  
model**

# ***Extracting the full potential of our existing customer base***

## *Translating the Broadband opportunity into revenues and earnings*

- 1 Closing the penetration gap in Broadband access infrastructure**
  - Ambitious but realistic objectives for 2005: more than 4.5 million DSL connections in Spain & Latam
- 2 Developing a full and compelling service offering for the residential segment**
  - “Imagenio” in its pilot phase, adding Multimedia Interactive Services (VoD) to traditional telephony
- 3 Evolving towards end-to-end solutions for our business customers, to capture additional value**
  - “eBA” for the development of a complete and customized “end-to-end” industry specific solutions for corporations
- 4 Refocusing our media assets to address the content opportunity and capture the value for Telefónica**
  - New Multiplatform Unit, to centralize content acquisition and development, and identify opportunities for intragroup synergies

# Expanding our customer base

*Brazil: we have the best platform for growth*

Brazil. Million Reais

2001 revenues\*

12.816

Traditional  
wireline  
business

34%

Long distance  
wireline

18%

Broadband  
+Data

20%

Mobile

16%

Other

11%

2005E revenues

>20,000

- Full contribution of new adds
- Tariff rebalancing
- Increased fixed to mobile traffic

- New growth opportunities opened by anticipation of “metas”
- Offer long distance service to current clients, both in Sao Paulo (450-550 M R\$ revenue increase during 2002) and outside of Sao Paulo (250-300 M R\$)

- Current ADSL penetration in line with developed countries (1,6%)
- Priorities for 2002 include reduction of OPEX and increasing ARPU in SMEs
- New opportunities for increasing market share in corporates

- Present in highest growth regions
- Additionally, joint venture with PT opens up new markets and generates significant synergies

\* Proforma (including Teleleste)

Telefonica

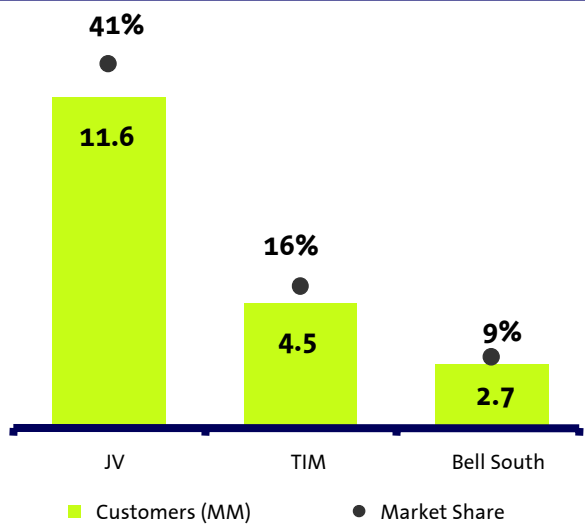
# Expanding our customer base

## Brazil: TEM-PT JV to lead the market

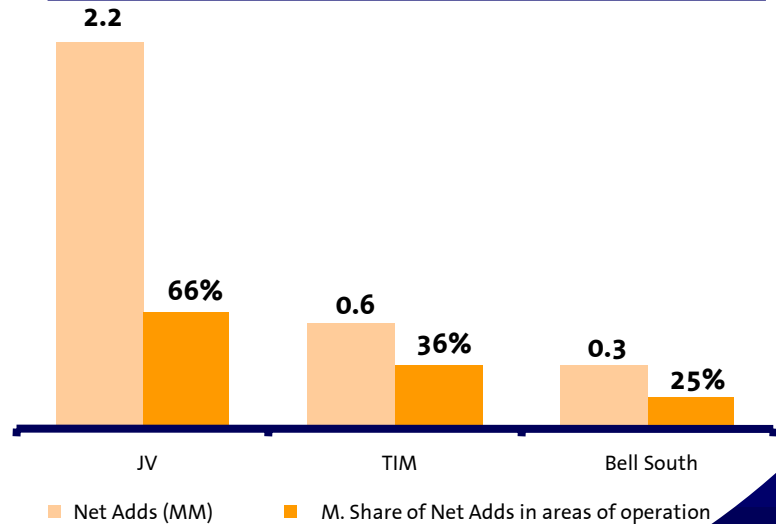
Aggregated figures <sup>1</sup>	2000A	2001A
Customer base (MM)	9,395	11,601
Market share in area of operations	60%	60.8%
Revenues (MM Reais)	5,634	6,291
EBITDA (MM Reais)	1,747	1,931
EBITDA margin	31%	30,7%
Connections/employee	1,243	1,752

**Brazilian average ~ 900**

### #1 wireless operator in Brazil (01E)



### Outperforming competitors (01E)

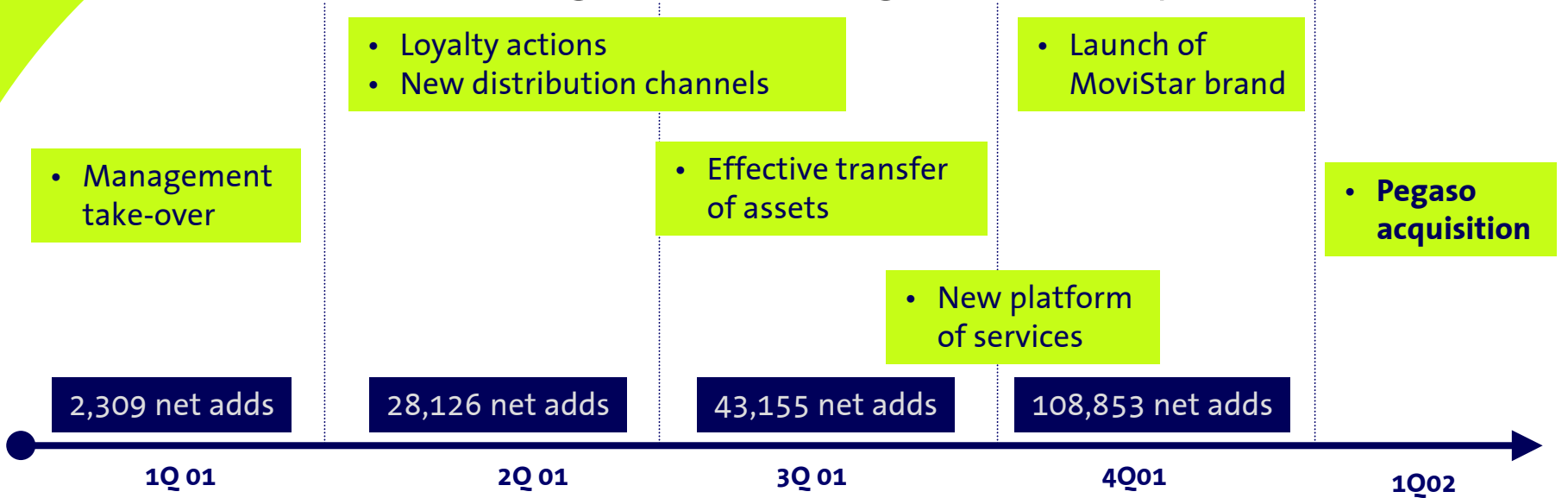


<sup>1</sup>Includes Telesp Celular, Global Telecom, TeleSudeste Celular, Celular CRT & TeleLeste Celular



# Expanding our customer base

Mexico: becoming the second largest wireless operator



**CURRENT OPERATIONS** (1Q 01 - 2Q 01)      **2002-2005**      **PEGASO** (3Q 01 - 1Q 02)

- Customer base expansion
- Consolidate brand positioning
- Enhanced commercial offer
- New IT systems
- Improved operating efficiency & productivity

**+**

- Network in the high growth areas
- Immediate access to Mexico D.F. (20MM POPs)
- Nationwide PCS licenses with optimal spectrum allocation
- Solid distribution network: >3,500 POS
- Seamless nationwide roaming agreement with the US & Mexico

**BECOMING THE UNIQUE REAL ALTERNATIVE TO THE INCUMBENT OPERATOR**



## *Four drivers to support our future performance*

**Accelerating performance of core business**

**Capture our natural growth potential**

**Turning around non-performing businesses**

- **UMTS: manage options & limit financial exposure**
- **Monitor T.Data in countries where we are incumbent**
- **Refocus media assets to maximize value**

**Strengthen our “one company” model**

## ***UMTS strategy: Germany***

*Managing our options while limiting our financial exposure*

### **CONSERVATIVE ROLL-OUT OF GSM/GPRS**

- Soft commercial launch as a MVNO targeted at specific segments
- Transparent, flexible, simple & competitive pricing offer
- Multichannel distribution strategy

### **BUILD UP + SHARE UMTS NETWORK**

- G3G will own 50% of 1 of the 3 strongest UMTS networks to be built in Germany

### **NON RECOURSE VENDOR FINANCING**

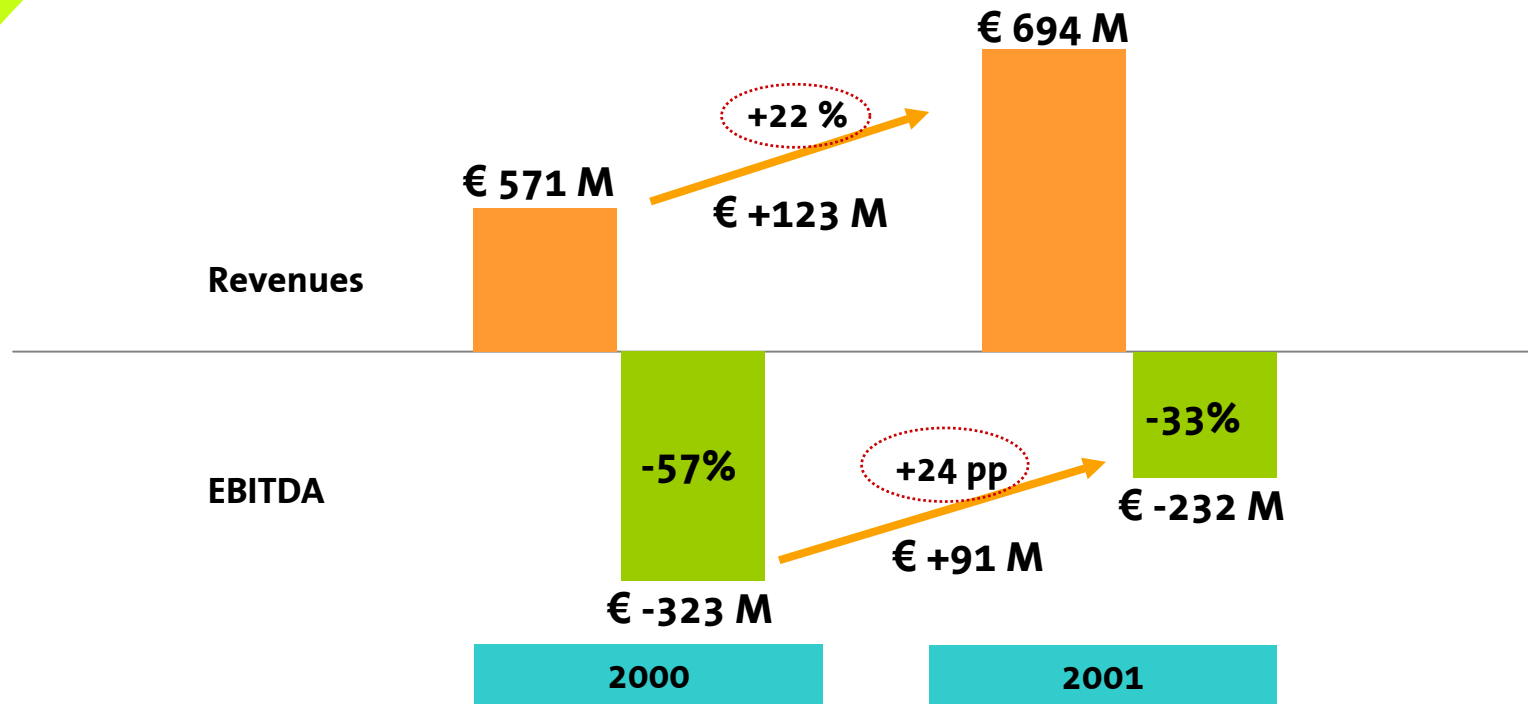
- 500-600 Million € already signed
- Potential additional external financing

**FINANCIAL CAP 2002-2003 (\*) : 800-900 MM€**

(\*) EBITDA losses + Capex - Non recourse vendor financing

## Terra Lycos

A key profitable long term player in the industry



- Consistently delivering growth (+22 YoY) and improving profitability (+24pp YoY)
- New diversified revenue streams (IMS, OBP, Geographical diversification)
- Cost management efficiency (€ 103 M cost out in 2001)
- Solid financial position: € 2.2 bn (Dec 01)
- Strong organization: management team and processes
- Telefónica: a unique strategic partner

# Admira

*Refocusing Admira to capture the value of our media assets*

**Focus on  
efficiency**

**Unlock  
strategic  
value**

- Consolidate a coherent traditional media, advertising-based group



- Assess potential asset restructuring, or divestitures when Telefónica is not the natural owner



- Develop Admira's content business to support and benefit from broadband development in Telefónica



## *Four drivers to support our future performance*

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**Strengthen our  
“one company”  
model**

- **Consolidate our “one company model”**

# Strengthening our “one company” model

## Multibusiness working sessions

- Group and country Committees
- Focused task forces
- Competence Centers

**Share best practices and align priorities**

## Structured horizontal processes

- Finance and treasury
- Planning/Control
- Procurement
- Brand management
- IT architecture

**Optimize critical resources**

## Centralization of non-core areas and growth initiatives

- Efficiency improvement in non-core areas
- Multi-business growth initiatives

**Capture synergies**

**VALUES THAT STRENGTHEN OUR COMMON CULTURE**

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# ***Telefónica consistently pursues excellence within its financial management***

## **Manage risk proactively**

- Expertise in risk management
- Continuous evaluation of macroeconomic situation
- Cover different hedging needs with different tools

## **Manage accounting quality**

- Quality of assets
- Restructuring effort in previous years
- Transparency

## **Manage the balance sheet efficiently**

- Best financial profile in spite of turmoil
- No refinancing risk in 2002
- Debt level at the “efficient frontier”: strong single “A”

## **Manage costs**

- Optimize cost of capital
- Efficient support processes

## ***Manage risk proactively***

*Risk management has been a key element to weather the current Latin American environment ...*

**Telefónica  
has a diversified  
portfolio**



**Continuous  
evaluation of  
macroeconomic  
situation**

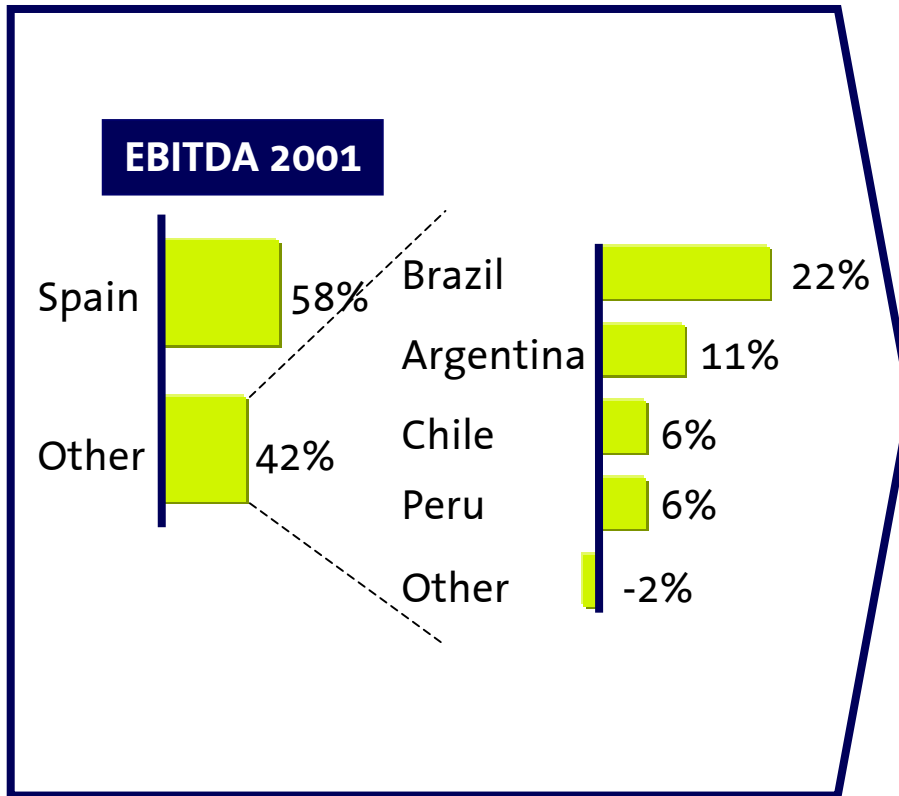


**Top class  
hedging  
capabilities**

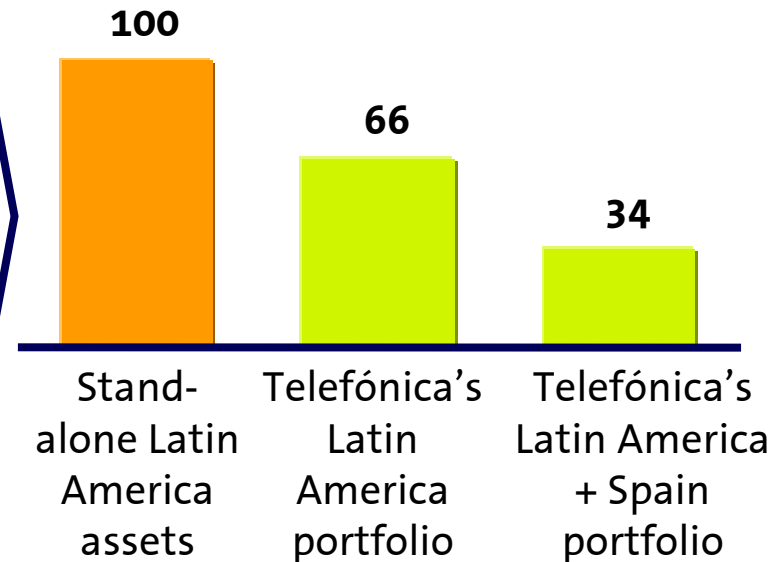
- Geographic diversification limits overall portfolio volatility
- Equity financed acquisitions share FX risk with seller
- Evaluate macroeconomic trends through a global team of macroeconomists supported by local experts
- Use Telefónica's deep network in Latin America to gain insight on economic situation and future developments
- Periodic top management and board reviews of situation in key geographies
- Launch "deep reviews" when needed (i.e. early 2001) to modify local business plans and prepare hedging plans
- Use accounting hedges to reduce FX balance sheet exposure
- Match FX cash flow exposures with cash hedges

## Manage risk proactively

... based on our geographic diversification, together with an active hedging policy ...



## US\$ EBITDA Standard Deviation\* (rebased)

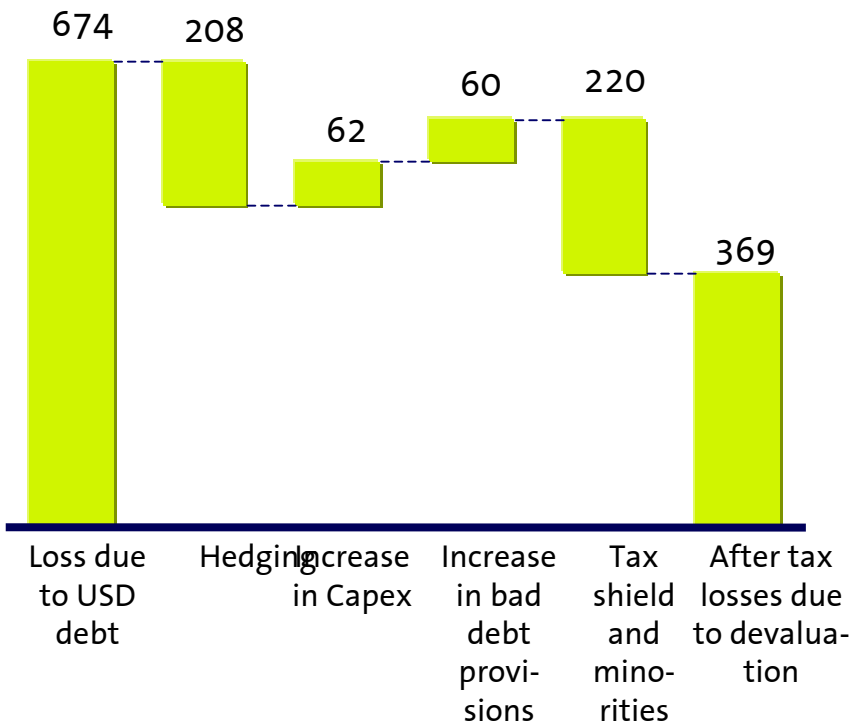


\*1990-2001

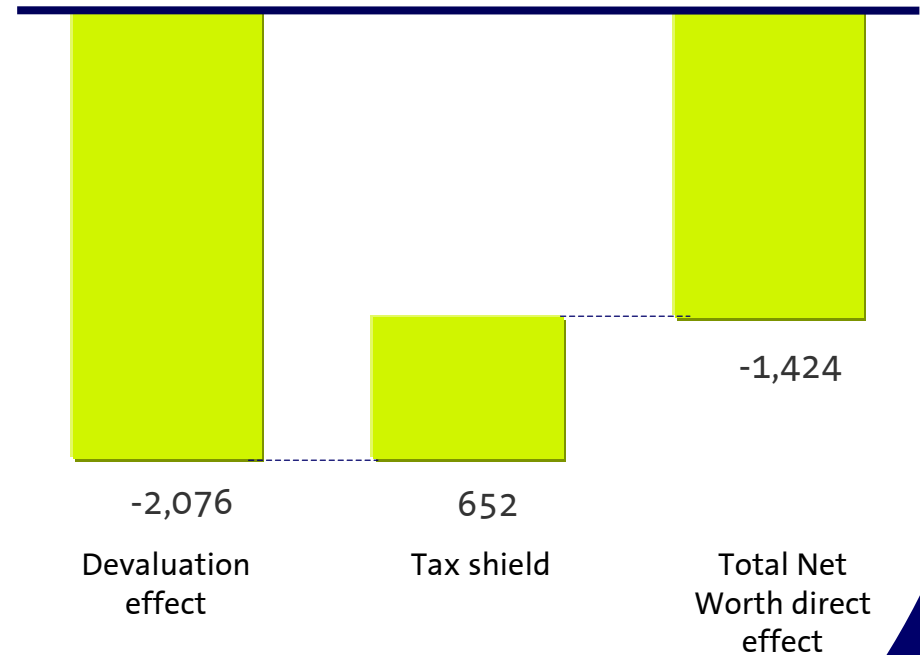
# Manage risk proactively

... help us to mitigate the effects of the crisis in Arg. in 2001 ...  
Euro Million

## Income statement effect\*



## Net Worth effect\*

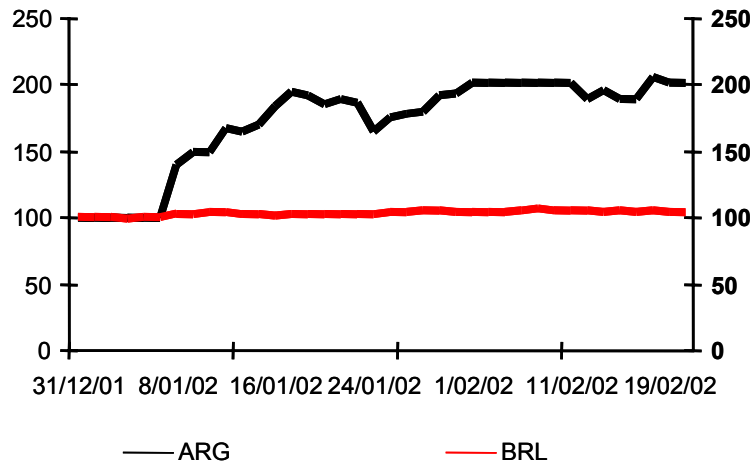


\* ARS/USD = 1.7

## Manage risk proactively

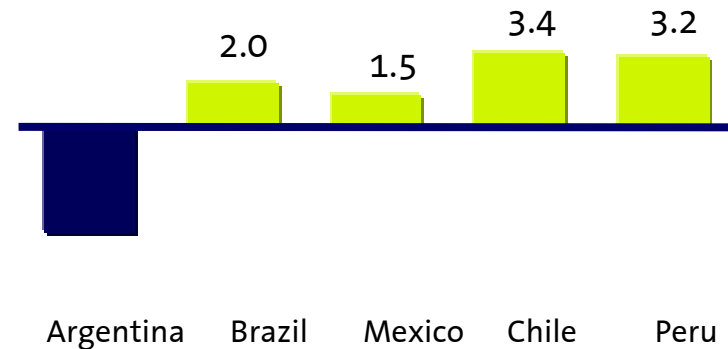
*We have protected our exposure in the rest of the region, although markets do believe in decoupling...*

### Exchange rates indexed



**Brazilian Real is not correlated with Argentinean Peso**

### 2002 GDP Growth



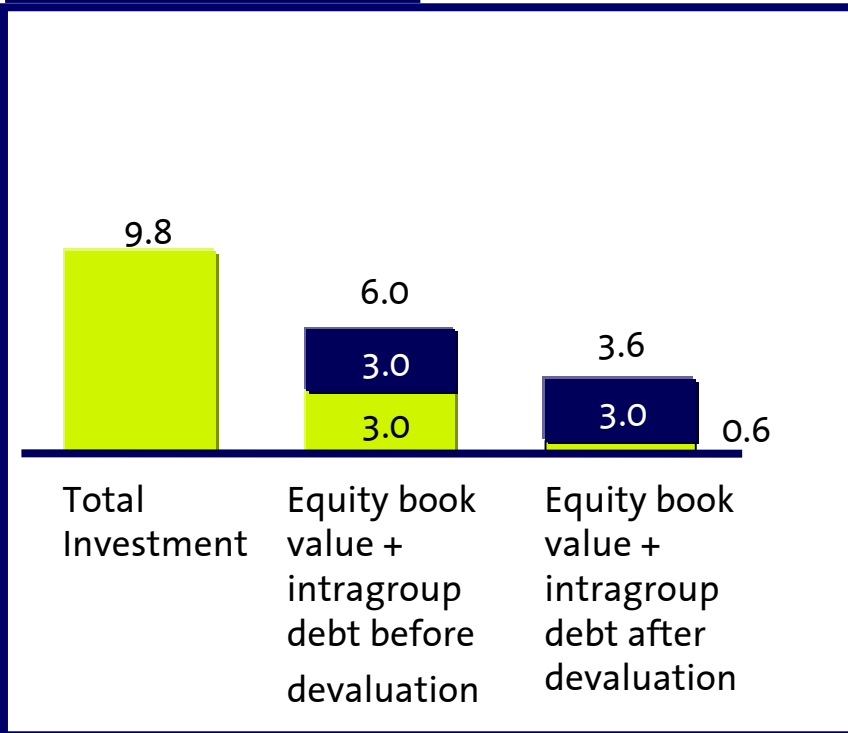
**Economic crisis in Argentina is not expected to affect the rest of the region**

## Manage risk proactively

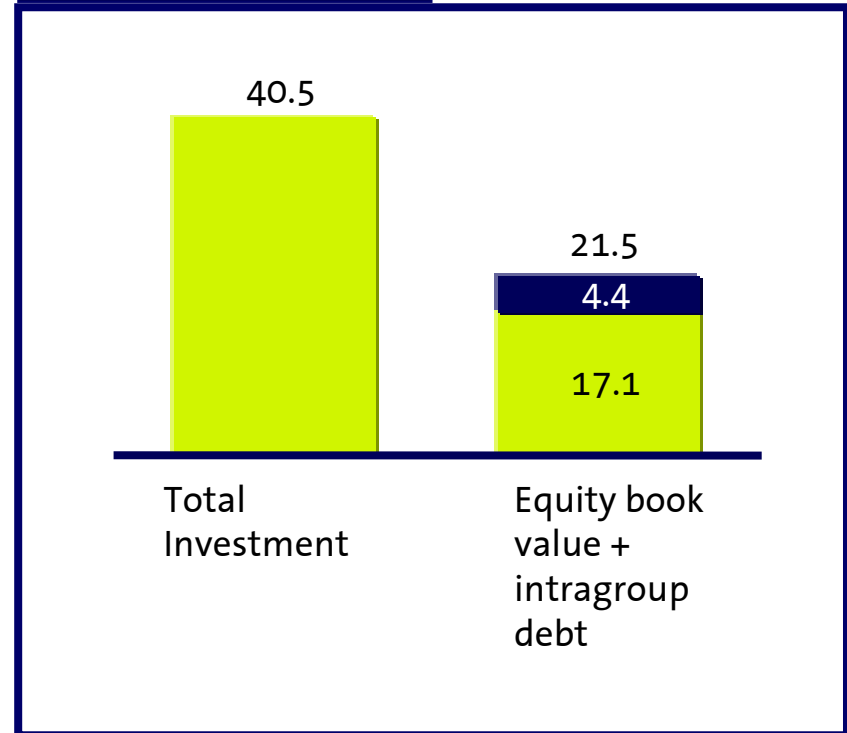
...using different hedging tools to cover both accounting and cash risks (Euro Billion)

Net Worth  
Intra-group debt

### Argentina




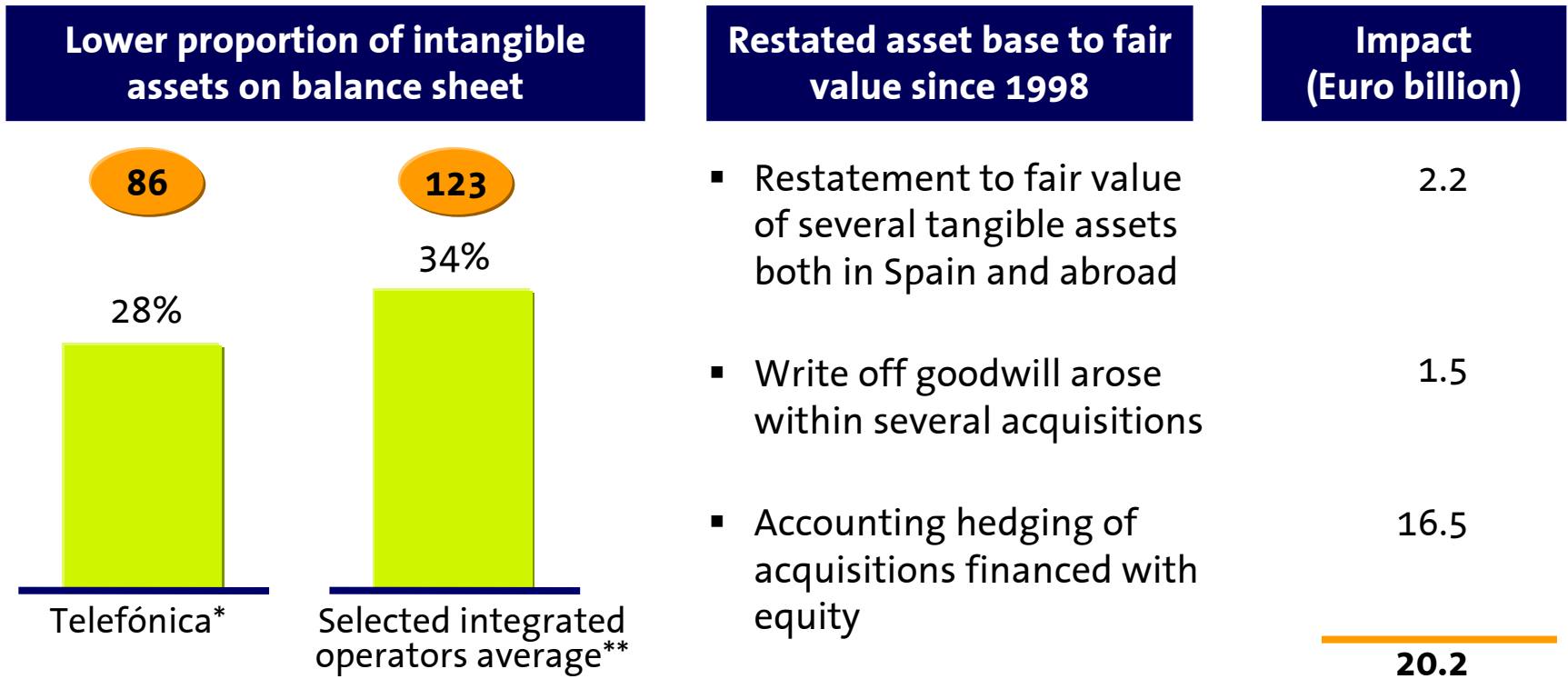
### Latin-America



# Manage accounting quality

*Our healthy asset base sets us apart in a sector whose assets are under scrutiny*

 Total assets (Euro billion)



**AND WE FOLLOW PRUDENT ACCOUNTING PRACTICES AND TOTAL TRANSPARENCY**

\* Under proportional consolidation method

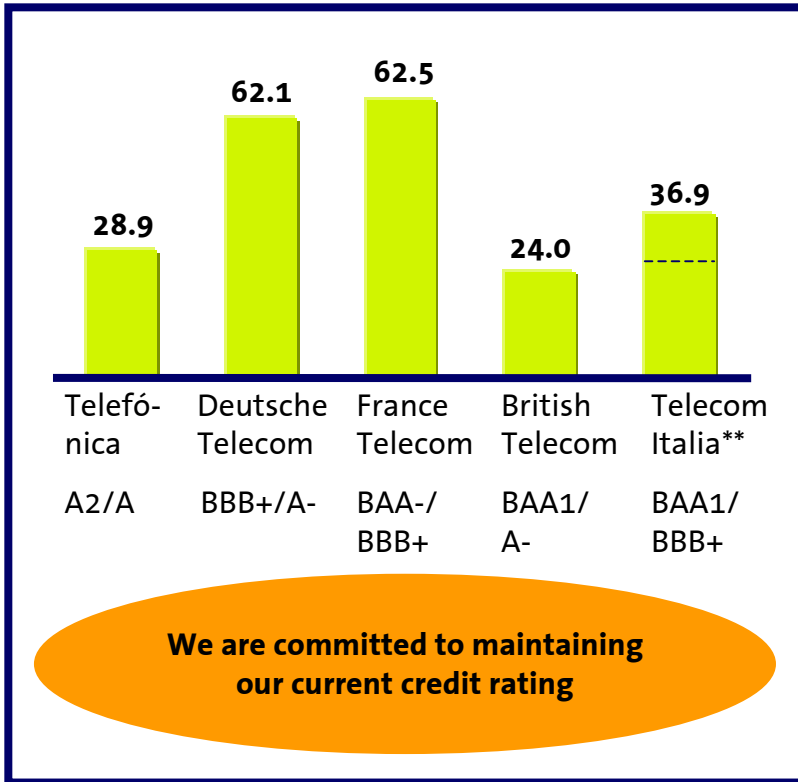
\*\* Telecom Italia (incl. Olivetti), France Telecom, British Telecom (incl. MM02), Deutsche Telekom

Source: ABN AMRO

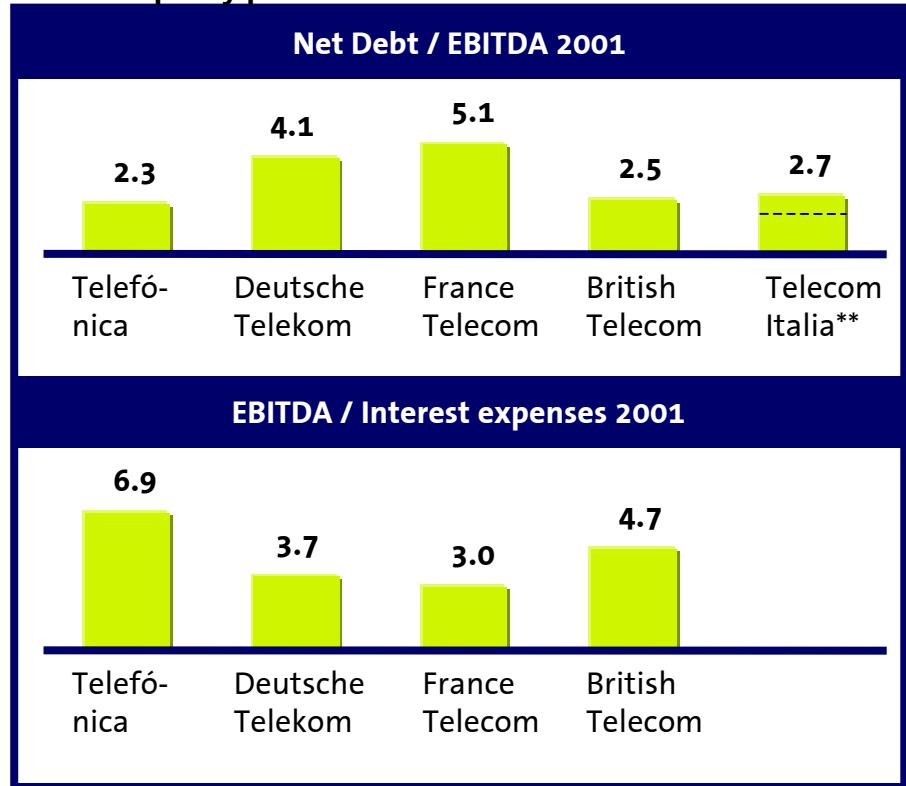
# Manage the balance sheet efficiently

Telefónica enjoys the best financial position among the large integrated European operators

Net debt position and rating\* (Euro billion)



Debt capacity position



- Single A, optimal within the current economic context
- Balanced debt structure by currency, maturity and interest rate
- Only European telco with 2002 needs fully refinanced

\* Moody's/Standard and Poors

\*\* Including Olivetti net debt

Source: Annual Reports, SSSB, ABN Amro

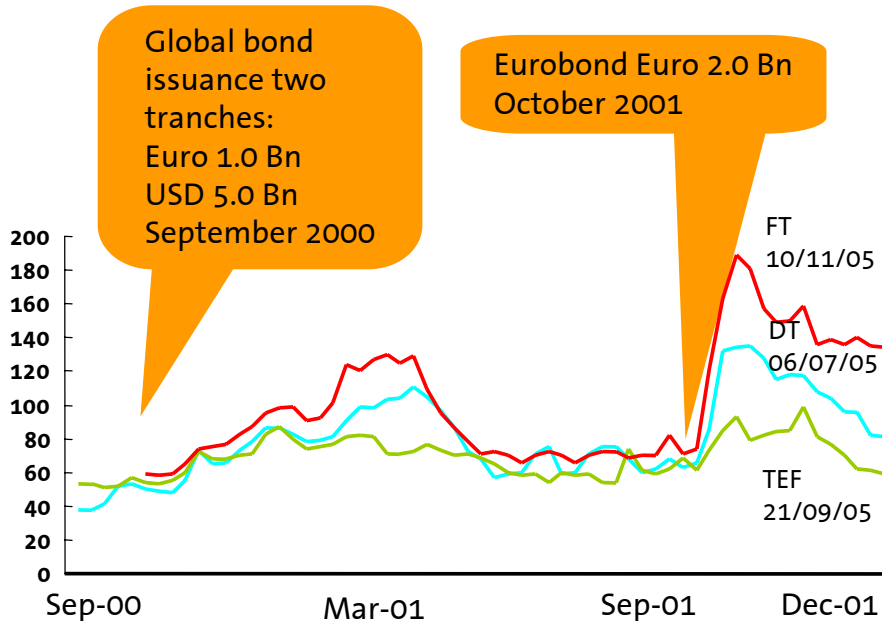


# Manage the balance sheet efficiently

Sound debt levels that we manage to refinance even within difficult market conditions

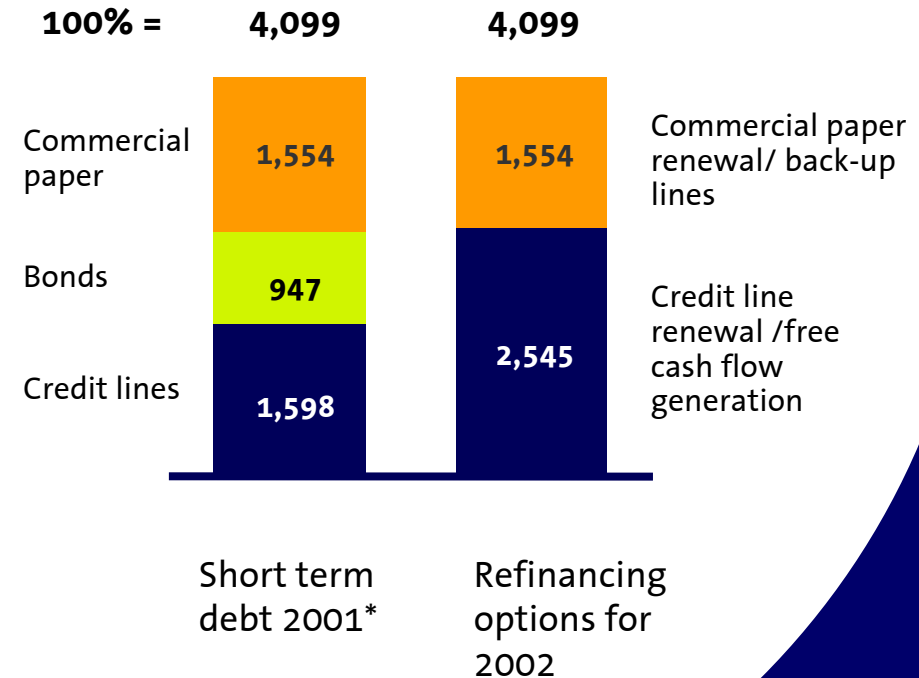
Euro Million

## “5 year” credit spreads evolution in Euros Spread over IRS in B.P.



\*Net maturity until 31/12/2002  
Source: Bloomberg

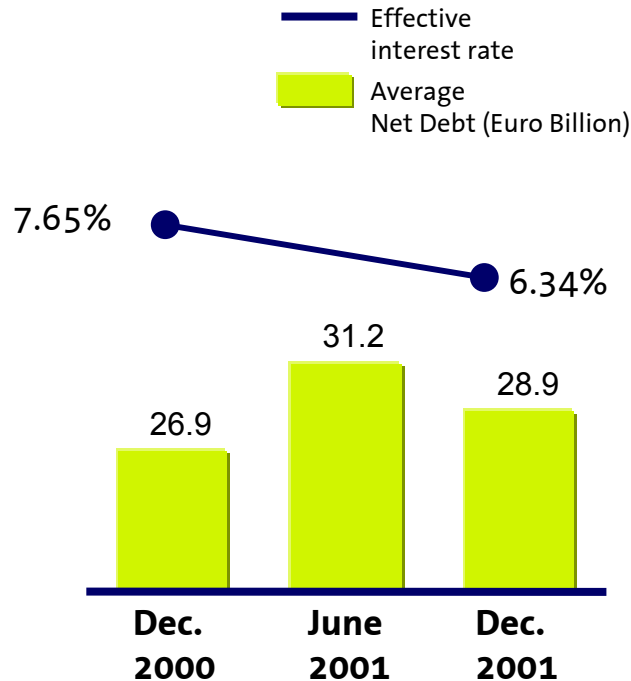
## Telefónica’s short term debt refinancing



# Manage costs

*Telefónica has achieved significant savings in financial expenses*

## Interest rate management



## Intragroup financing

- Helps to maintain rating in the “A” level by reducing structural subordination
- Allows privileged access to cash flows from subsidiaries
- Reduces FX accounting risk in the income statement (not in net worth)
- Average financing balance of USD 2,382 million

**Savings of approx.  
€ 500 million in  
2001**

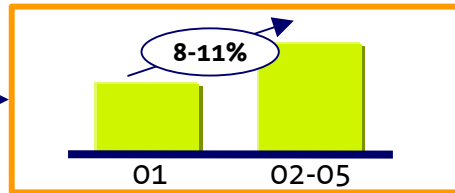
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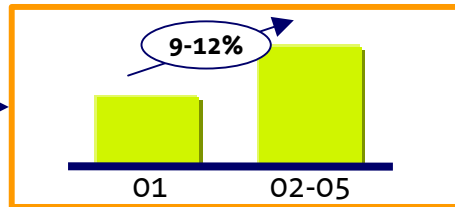
# Going forward we have set specific commitments to increase our profitability ...

Well diversified operating profit growth

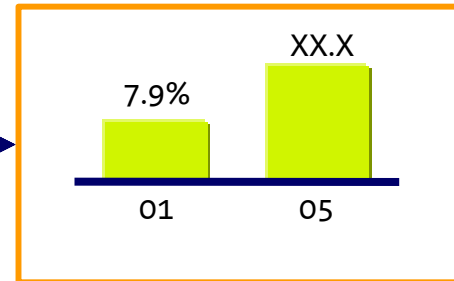
Solid and well diversified revenue growth



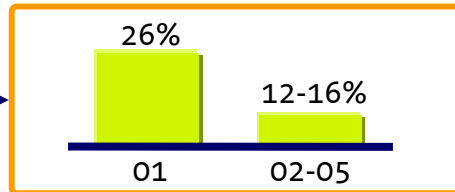
Well balanced growing EBITDA



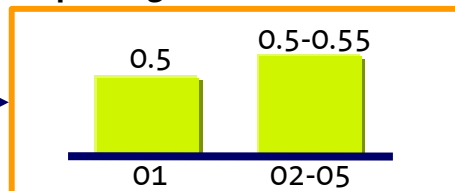
Improve return over capital employed



Reinforcing capital discipline  
Capex over revenues



Improving asset turnover



Optimized capital employed

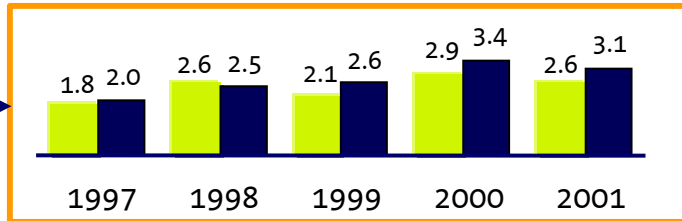
- Commitments built into business plans of the different units and tracked regularly to ensure compliance
- Continuous tracking and reporting of ROCE by business

# ... While continuing to enhance our cost of capital

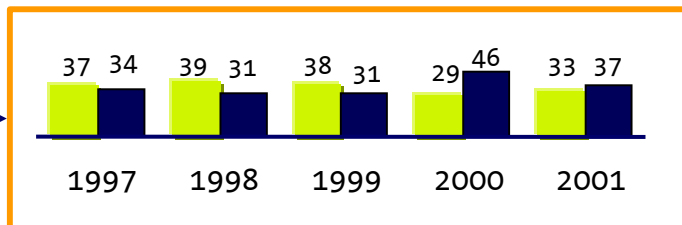
Percentage

Efficient cost of equity

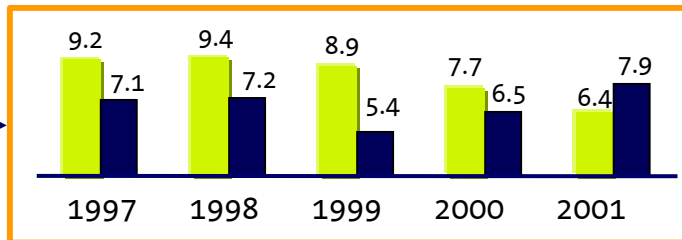
**Limit operational and financial risk**  
Share price standard deviation



**Optimize capital structure at efficient frontier**  
Net debt/total assets



**Improve cost of debt**  
Effective interest rate



■ Telefónica  
■ Selected Peers' average\*

- Long term sustainable EBITDA margin
- Diversified regulatory risk
- Geographically diversified cash flow sources

- Optimal position at efficient frontier for debt

- Tax management
- Monitoring interest rate and FX management
- Treasury management

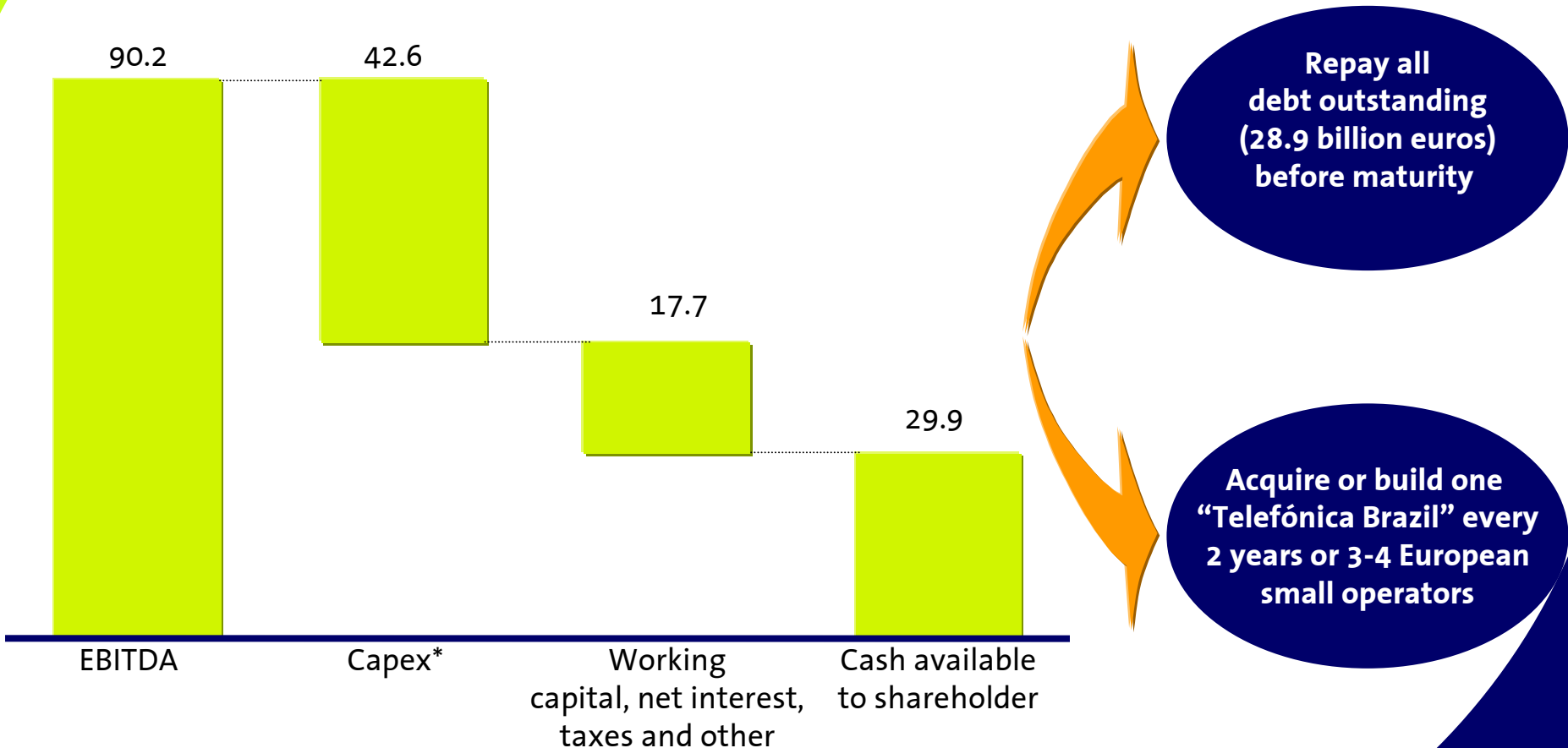
\* Average of Deutsche Telekom, Telecom Italia, France Telecom and British Telecom  
Source: Datastream, analyst estimates

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- STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT
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- ... COMBINED WITH FINANCIAL MANAGEMENT AND DISCIPLINE
- THESE DRIVERS TRANSLATE INTO A SET OF MANAGEMENT COMMITMENTS
- **CONCLUSIONS**

***In summary, our strong operating performance and financial management provides unique flexibility when considering opportunities ...***

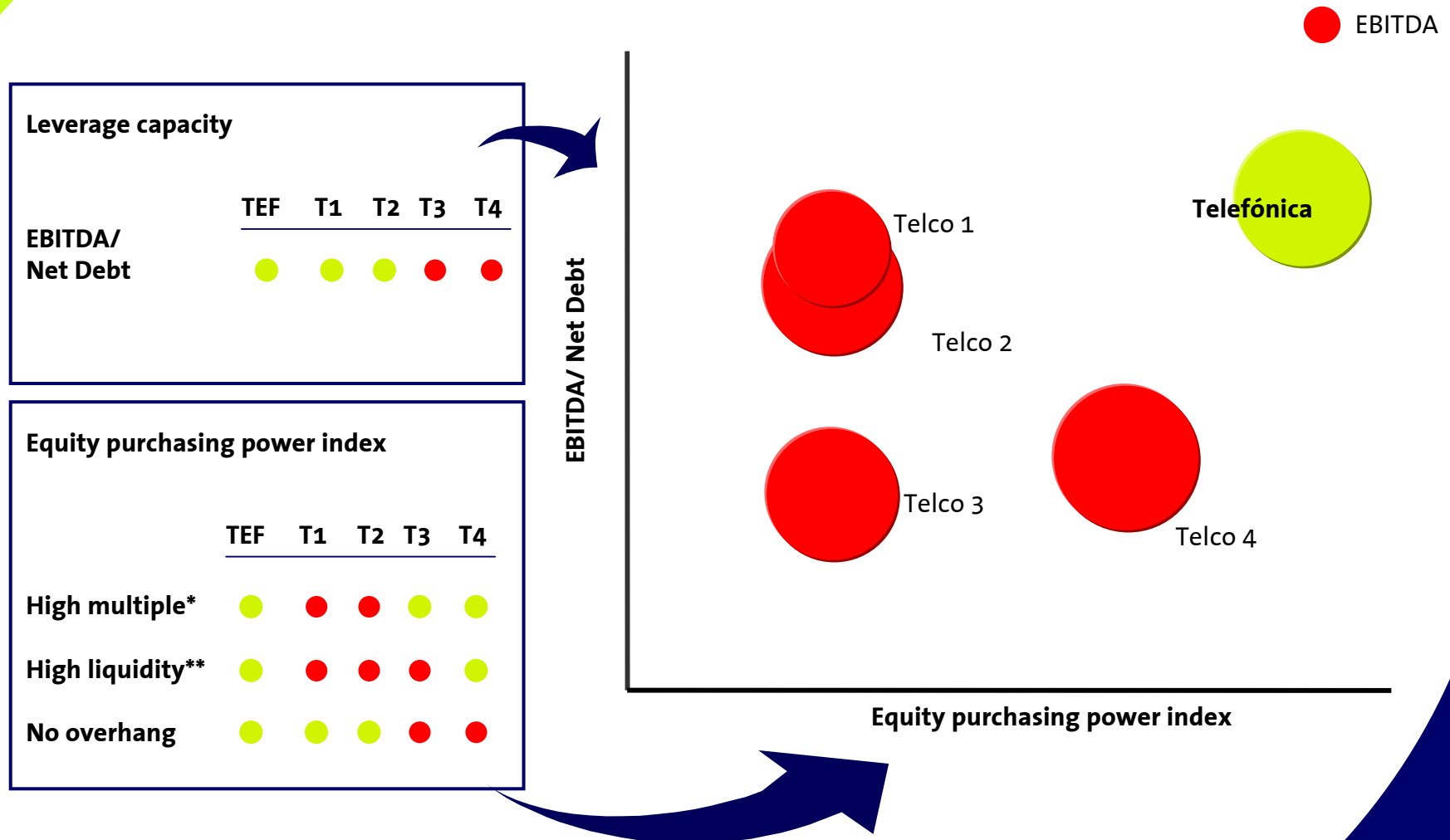
*2002-2007. Cumulative cash flow. Euro Billion*



Capex excluding UMTS licenses

Source: Analysts estimates

# ... And makes Telefónica the European large operator with more degrees of freedom



\*High multiple defined as higher than 7x EV/EBITDA trading multiple  
 \*\*High liquidity defined as more than € 300 Million daily equity turnover  
 Source:Telefónica estimates, Multex estimates, Bloomberg, ABN Amro



## **CONCLUSIONS**

- ✓ **We continued to show strong underlying operating performance in 2001**
- ✓ **We are building on our strong fundamentals and solid growth platforms**
- ✓ **We are committed to financial management and discipline**
- ✓ **We have strengthened our one company model**
- ✓ **Our commitments will deliver tangible results in terms of return over capital employed and cash flow generation**
- ✓ **Our solid operating & financial position enhance our strategic flexibility to capture profitable growth**

***Building Value: Driving business and financial performance for continued earnings growth***

*Telefónica*

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