Santiago Fernández Valbuena
Chief Financial Officer
Telefónica S.A.

THIRD INVESTOR CONFERENCE

MADRID 2003

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Safe harbor

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Finance at Telefónica:
for us, WACC means We Are Careful with Capital

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Contents

1. Managing For Cash-flows

1.1 GENERATION

- FCF Generation
- Regional Sources

1.2 DISTRIBUTION RATIONALE

FIRM COMMITMENTS

- Shareholder Remuneration
- Solvency Protection

STRATEGIC FLEXIBILITY

- Business Expansion
- Financial Flexibility

A Strong Cash Flow For The Period 2003-2006...

OPERATING FREE CASH FLOW*

- Client focus & commercial excellence to drive top line growth
- Build-up of a cost efficient model
- Optimizing Capex for lower capital intensity

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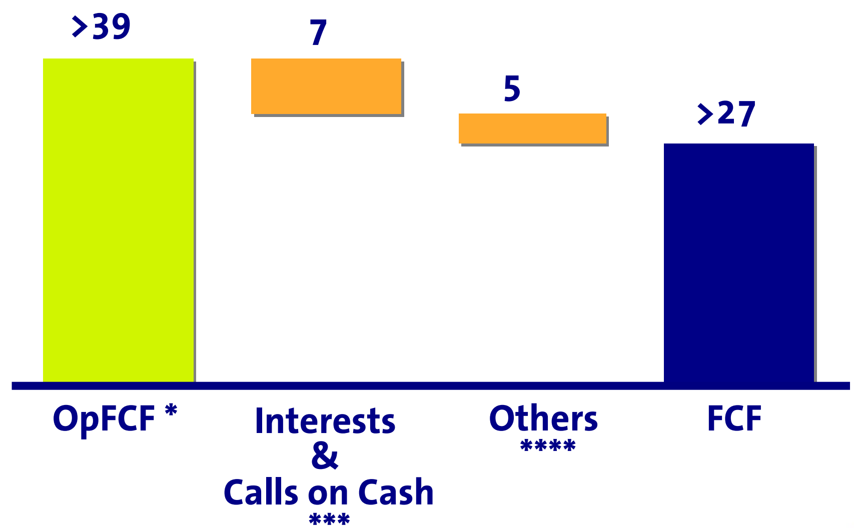
NON-OPERATING OUTFLOWS

- Financial expenses
- Cash Taxes
- Minorities
- Working capital
- Calls on cash flow

FREE CASH FLOW GENERATION 2003-2006 **

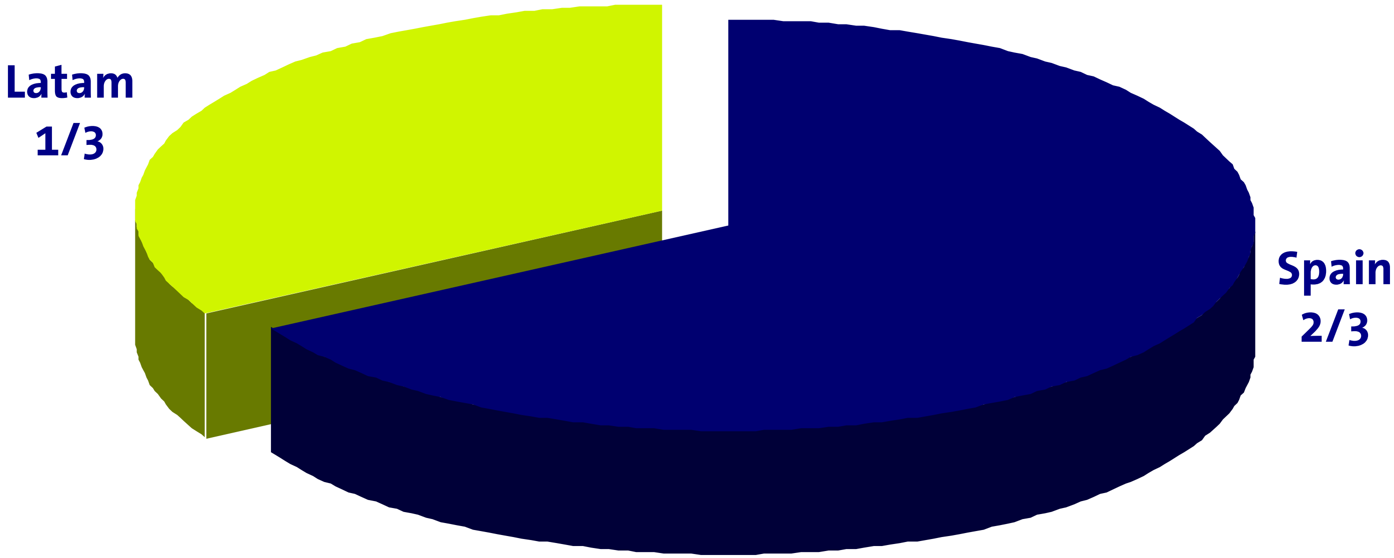
(€ Bn., 2002 constant exchange rates)



* EBITDA-CAPEX
** Before Financial Investments. Excluding forex and changes in consolidation
*** Assuming limited debt reduction
**** Cash Taxes, Minorities and Working Capital

...Which Is Well Balanced By Geographies

2003-2006 FREE CASH FLOW BREAKDOWN BY GEOGRAPHY *



- Spain more than covers our 03-06 firm commitments.
- We have proven our active management of Latam exposure.

* Constant Exchange Rates as of 2002

Our Rationale For 2003-2006 Cash-flows Distribution

TWO BASIC PRINCIPLES...

- **TO FULLY DELIVER ON OUR FIRM COMMITMENTS**
- **TO KEEP STRATEGIC FLEXIBILITY TO GROW OUR BUSINESSES**

...TO ACHIEVE OUR FOUR PRIORITIES

1. **SHAREHOLDER REMUNERATION**
2. **SOLVENCY PROTECTION FOR A "SINGLE A" RATING**
3. **BUSINESS LONG TERM EXPANSION**
4. **FINANCIAL FLEXIBILITY**

ON-GOING RECIRCULATION

Cash Flow generation is:

- **Contingent upon fulfilment of Strategic Plan, sensitive to:**
  - Business risks and opportunities: Demand, costs, competition, capex needs.
  - Financial markets developments: cost of capital.
  - Major technological changes and business opportunities.
- **Sensitive to changes in Exchanges Rates.**

FIRM COMMITMENTS AND SIZE ALLOCATIONS FOR THE USE OF CASH-FLOW MUST BE BALANCED AGAINST THESE ITEMS.

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Our Track Record Shows We Are Delivering On All Four Priorities

Priority	Means	Results
SHAREHOLDER REMUNERATION	• Cash dividends • Share buy-backs	• 0.4€ per share until 2006 • 101 Million shares cancelled in 2003
SOLVENCY PROTECTION FOR "SINGLE A" RATING	• Debt reduction • Notional funding of non-debt commitments	• 9 Billion € debt reduction since 2001 • Targeting pre-retirees and Redundancy Program
BUSINESS LONG TERM EXPANSION	• Add-on acquisitions • Minority buy-outs • Capex acceleration	• TCO in Brazil • Terra Lycos tender offer • Capex acceleration in Mexico
FINANCIAL FLEXIBILITY	• 2002 devaluations drained 1.3 Bn.€ of OpFCF *	• Crisis management • Liquidity reserve • Debt savings due to Fx

* EBITDA-CAPEX

Our Approach To The Destination Of 03-06 Cash-flows (I)

WE HAVE FIRM COMMITMENTS IN EXCESS OF € 15 Bn

SHAREHOLDER REMUNERATION

≅ 7.4 Bn.€

- Cash dividends.
- Share buy-backs.

- 1.2 Bn.€ to be paid in 2003.
- 2 Bn.€ a year from 2004 to 2006.
- 200 Million € executed in 1H03.

SOLVENCY PROTECTION FOR SINGLE A RATING *

≅ 7.9 Bn.€

- We have cash commitments for 7.9 Billion€:
  - ✓Gross NPV 98 Redundancy Program of 3.5 Bn.€
  - ✓ Guarantees of 0.8 Bn.€
  - ✓Gross NPV of Expected 03 Redundancy Program of 3.6 Bn.€

... Fully funding NPV of cash commitments would leave (net debt + cash commitments)/ EBITDA in the 1.4x-1.7x region in 2006

* subject to prospective risks and Rating Agencies opinion

Our Approach To The Destination Of 03-06 Cash-flows (II)

€ in Bn.

TO FULLY DELIVER ON OUR FIRM COMMITMENTS

SHAREHOLDER REMUNERATION	7.4
SOLVENCY PROTECTION FOR "SINGLE A" RATING	7.9

≅ 50% of FCF allocated to "hard" commitments

TO KEEP STRATEGIC FLEXIBILITY TO GROW OUR BUSINESSES

BUSINESS EXPANSION	> 11.7
FINANCIAL FLEXIBILITY	

TOTAL	>27

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Our Approach To The Destination Of 03-06 Cash-flows (III)

KEEPING STRATEGIC FLEXIBILITY ABOVE 11.5 Bn.€ TO ACCOMMODATE

SELECTIVE BUSINESS EXPANSION BASED ON **AND** **FINANCIAL FLEXIBILITY COULD PROVIDE ROOM FOR eg:**

- Complementarity to core businesses.
- Target selection based on cash flow generation capabilities.

- A 50% value loss of Latam currencies

plus

- A 10% drop of average 04-06 Non-Latam EBITDA below its 2003 level.

2. Our 3-d Balance Sheet

THREE DIMENSIONS

2.1 ASSETS → Discount Rates

2.2 LIABILITIES → Debt Management

2.3 RISKS → Derivatives Management

ASSETS

- Help establish required rates of return for new investments, both for equity and debt.
- Follow WACC parameters in the industry and take them into account.

LIABILITIES

- Rating Target.
- Debt Size and Repayment period.
- Maturity, Currency.

RISKS

- Currency Risk.
- Sovereign Risk.
- Refinancing Risk.
- Maturity, Currency.

2.1 Assets

- Creating value for shareholders means investing in businesses/projects with expected returns higher than WACCs.
- We provide a consistent framework for project evaluation and return assessment setting WACC parameters by business and region.
- We can contribute to value creation with balance sheet management by bringing WACCs lower:
    - Leveraging to bring WACC lower within the A rating constraint.
    - Extracting diversification benefits from financial exposures to help bring risk premia lower.

2.2 Liabilities

RATING TARGET: COMFORTABLE SINGLE A TO CREATE VALUE

Creating Shareholder Value via Leverage:

- Lower cost of funds means lower WACC.
- Sensible Leverage ratios ensure sustainability.

Creating Shareholder Value via Availability of Funds:

- A comfortable single A rating ensures smooth and timely access to capital markets.
- Business opportunities not to be constrained by lack or cost of financing.

Creating Shareholder Value via Crisis Protection:

- Crisis costs not always reflected in WACC.
- Crisis hit unexpectedly, widen credit spreads or require highly dilutive right issues.
- Legal, Advisory and Financing Fees are not negligible.

Creating Shareholder Value via Financial Discipline:

- Fundamental Assessment of Solvency.
- Stable benchmarking of projects and acquisitions.

Items Included In Total Debt

Figures in million euros

	Dec 2002	Jun 2003	+ Expected New Workforce Redundancy Program
NET FINANCIAL DEBT	**22,533**	**19,991**	
Guarantees (IPSE, AVS)	776	776	
Net pre-retirement commitments	3,557	3,266	
2003-2007 ERE	0	0	3,600
COMMITMENTS	**4,333**	**4,042**	**3,600**
TOTAL DEBT+ NPV of Cash Commitments	**26,866**	**24,033**	**27,633**

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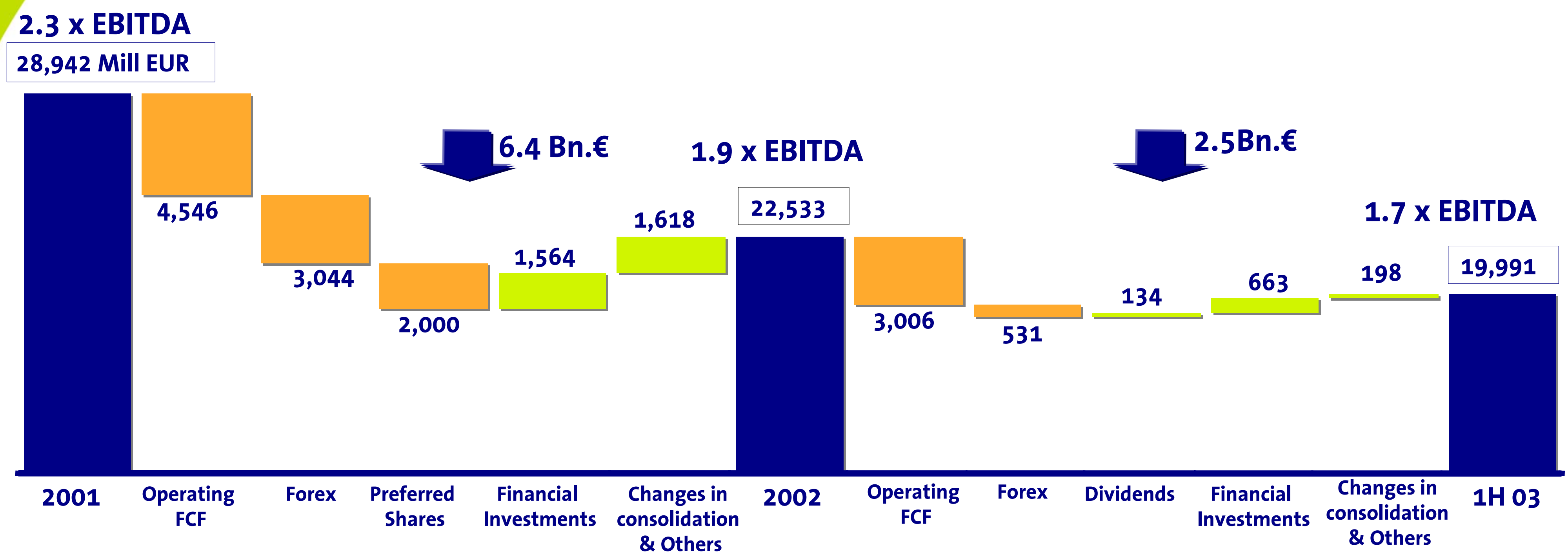
9 Bn Euros Debt Reduction In 2002 & 2003



COMMITMENT TO SINGLE A

- **2002: Achieve Financial net debt < 2 x EBITDA**
- **2003: Achieve Financial net debt + Commitments around 2x EBITDA.**

Making room for 3.6 bn Eur notional NPV of commitments related to workforce reduction in 2003-07

2.3 Risk Management Policy

CURRENCY RISK

- Cash Flow Hedging.
- No FX losses impacting P&L.

SOVEREIGN RISK

- Non-recourse to the parent: Financing at operating company level in Latin America.
- Fund repatriation.

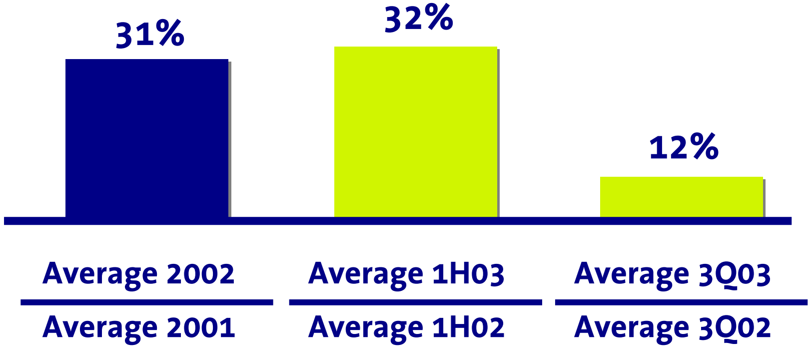
REFINANCING RIKS

- Average Maturity of Debt longer than period needed to pay off debt in full.
- Liquidity sources greater than planned uses for next 12 months.

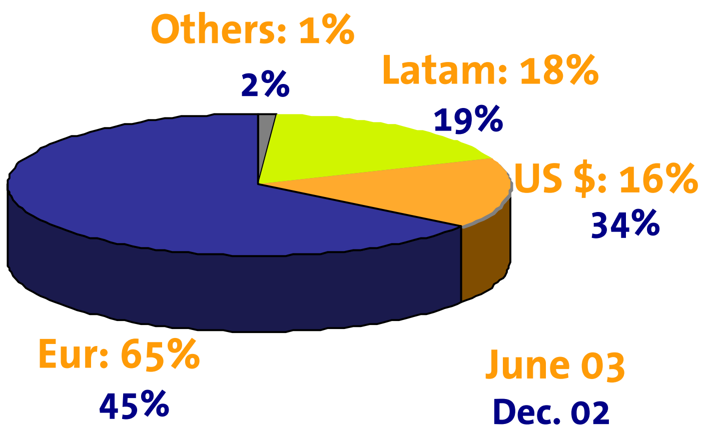
Fx Management: Offsetting Cash-flow Shortfalls With Debt Reduction

LATAM DEPRECIATION vs EURO

Lost Value (Weighted By Ebitda Origin)



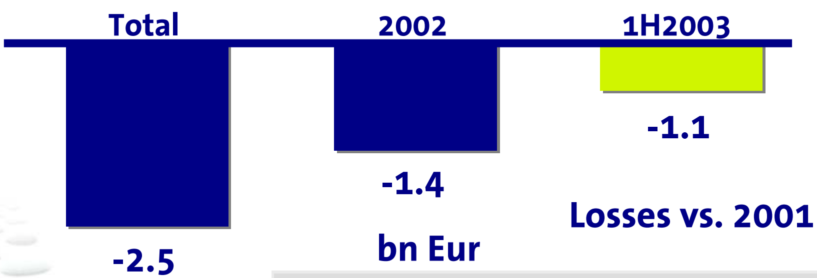
DEBT BY CURRENCIES



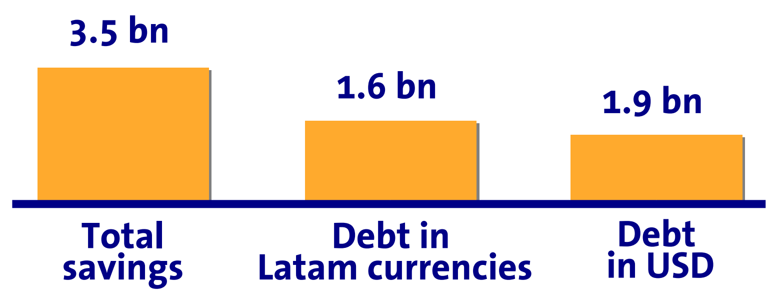
USD debt in Latam fully hedged except in Argentina

14% + 2.3 bn USD put spreads for 2004

CUMULATIVE FX IMPACT ON CASH FLOW (ACTUAL VS 2001 FX RATES)



DEBT REDUCTION DUE TO FX

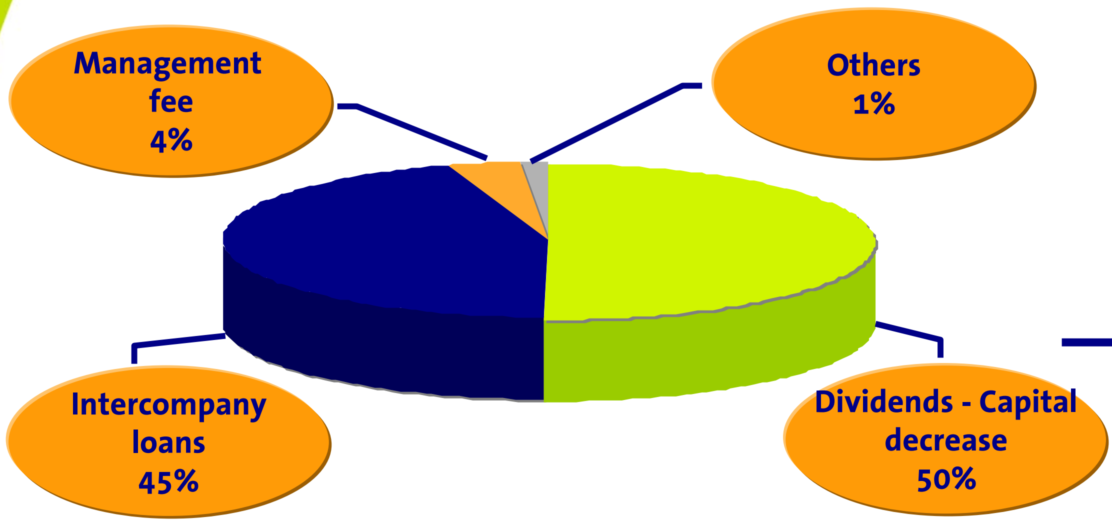


Debt savings more than offset cash-flow shortfall 2002-2003 due to FX depreciation

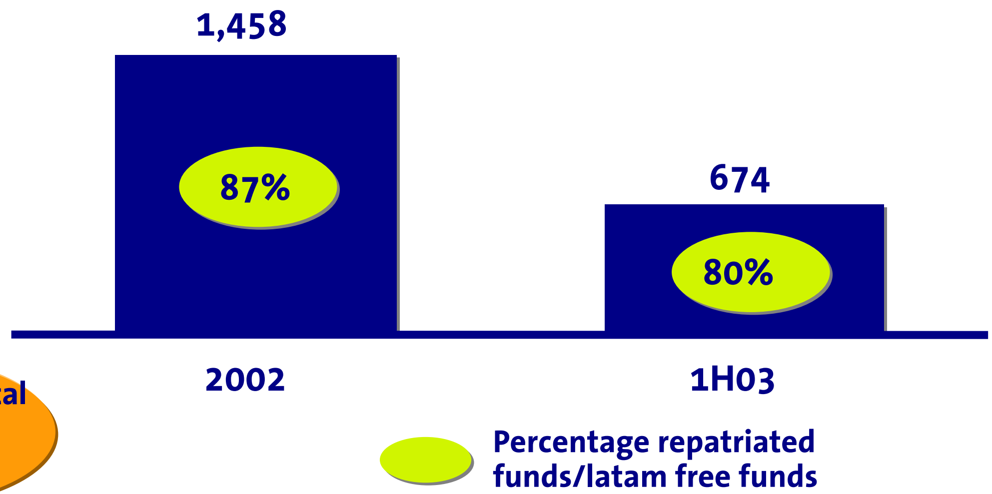
Actively Managing Latin American Risk

1.5 bn USD repatriated from Latam in 2002; 0.7 bn USD in 1H2003.

REPATRIATION VEHICLES 2002 & 1H2003



TOTAL REPATRIATED FUNDS (M USD)



Latam debt (23% of total) non recourse to Parent

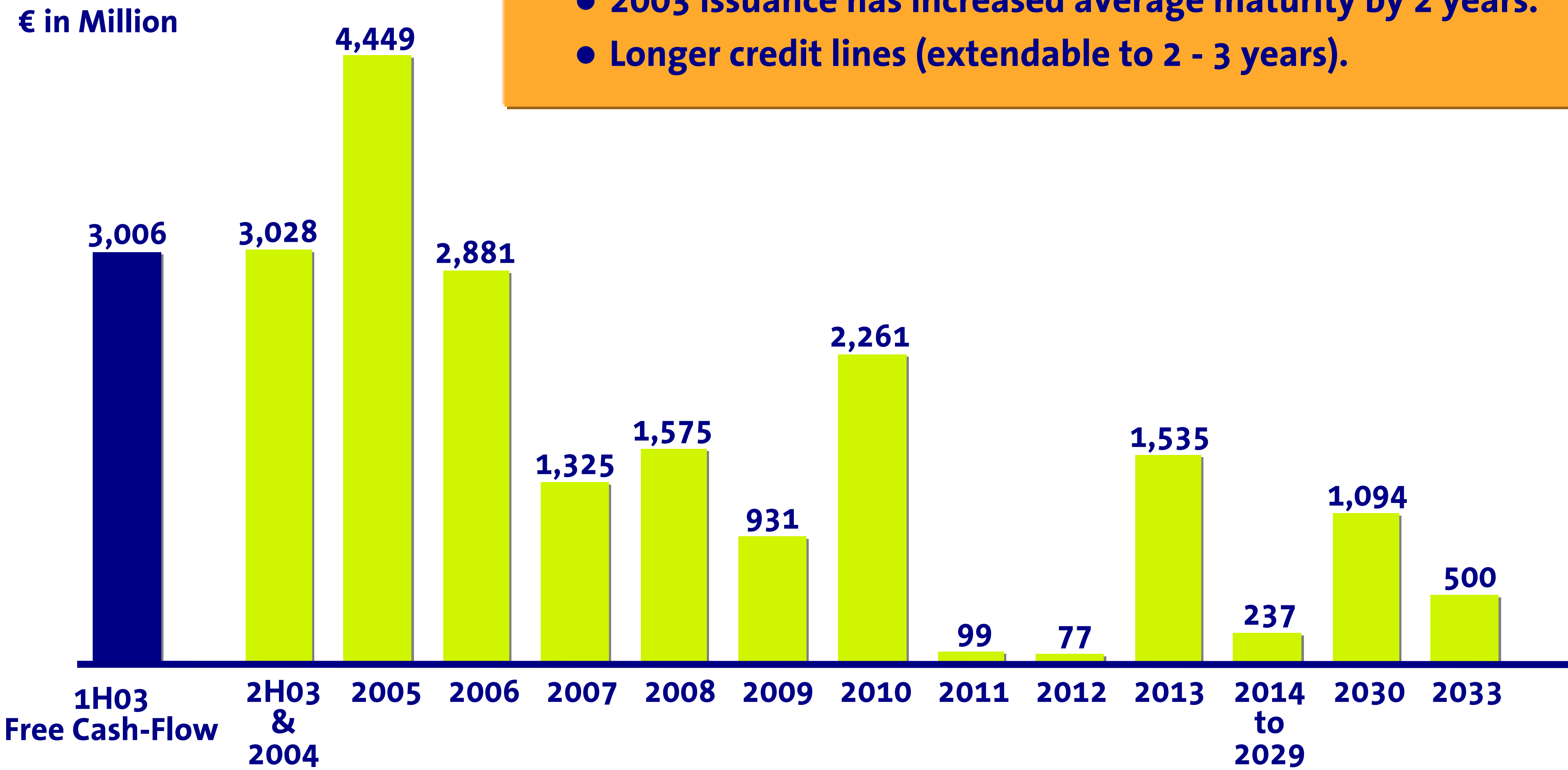
➡ 1 bn USD debt restructured in Argentina (67% acceptance):

- Avoid liquidity problems
- Allow equitative repayment of intercompany and external debt.
- No haircut to bondholders, just 3 years extension and 15% payment upfront.

Low Refinancing Risk

Average net financial debt maturity 6.3 years (June 03)

- **2003 issuance has increased average maturity by 2 years.**
- **Longer credit lines (extendable to 2 - 3 years).**



- **Net maturities in 2003 & 2004 equal to cash-flows generated in one semester.**
- **Close to 5bn Eur undrawn committed credit lines.**

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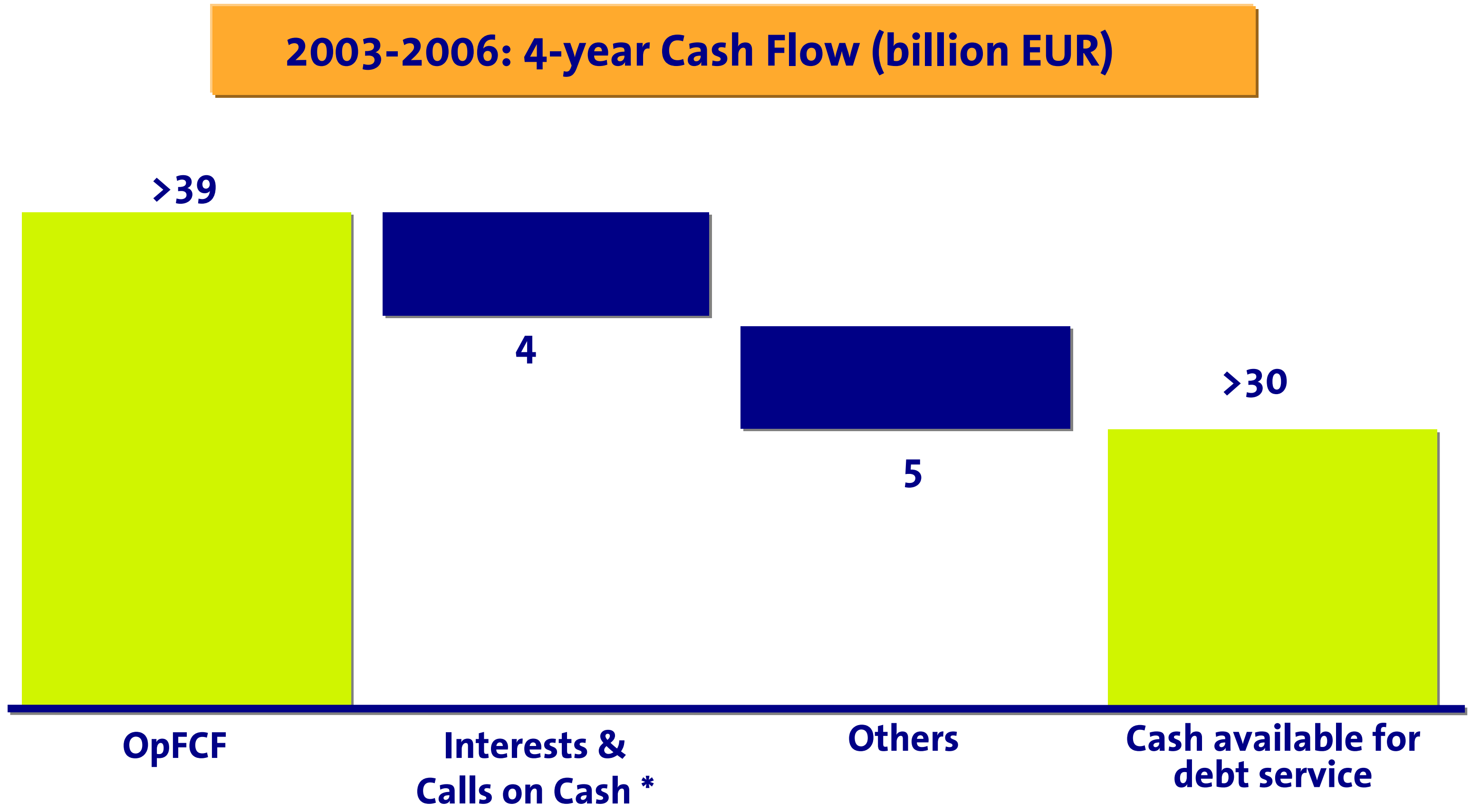
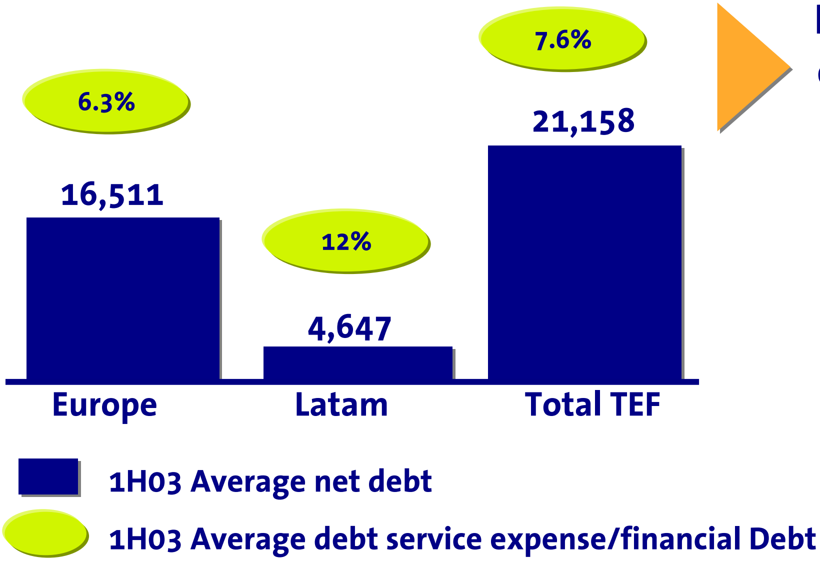
Telefónica Could Fully Pay Its Debt In 4 Years



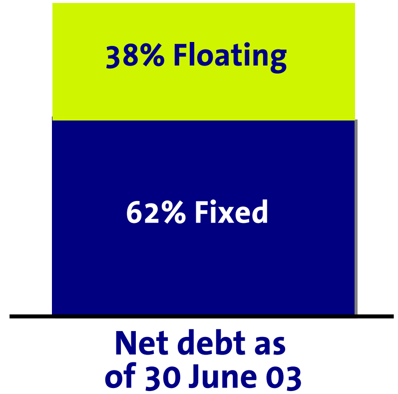
Debt maturity longer than time needed for full repayment

* Interests calculated assuming free cash-flow is used to reduce debt.

Net Financial Expenses: Balance Between Conservatism And Active Management



Debt financial expenses of 802 mill EUR in 1H03



- Average interest expense in 1H03 of 7.6%, due to conservative liability management :
  - Longer maturities with a positive yield curve raise unit cost of debt and widen credit spreads.
  - Local Funding in Latam significantly more costly than in EUR/USD.
- Nevertheless, active management of currency exposures has materialized in a 267.5 Million € profit in 2003, via currency swaps.

3. Conclusions

3.1 TELEFÓNICA'S FINANCIAL STRENGTH.

3.2 RISKS WE DON´T HAVE.

3.1 Telefónica's Financial Strength

1.- Large Free Cash Flow Generation > 27 Bn.€ (03-06)

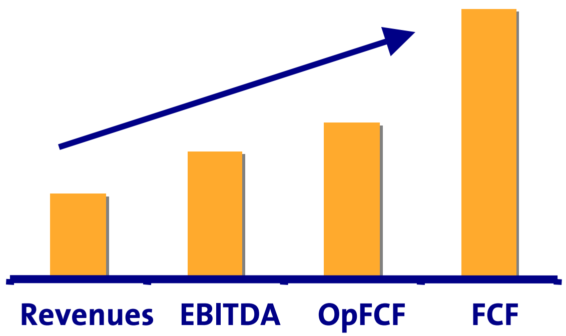
- FCF roughly equal to 50% of Market Capitalization.
- FCF roughly equal to 100% of Net Debt + Expected Commitments.

2.- Current and Expected Cash Consumption fully funded

- 20 Bn.€ Net Debt + 7.9 Bn.€ of Cash Commitments targeted.

3.- Powerful Conversion of OpFCF into FCF to Equity

CAGR 02-06



4.- No Asset Disposals, Business Line Divestitures or Unwinding of Financial Stakes Contemplated.

5.- "Hard" Commitments for FCF Allocation at the Top of the Industry and Clear Recirculation Channels for Excess Cash Flow

3.2 Risks We Don't Have

- **No Extra Liabilities**
  - No Pension Liabilities.
  - No Real Estate Sale & Lease-back (secured off-balance sheet debt).
  - No asset-backed bonds (off-balance sheet).

- **No Pressure on stock trading**
  - Core Shareholder Stability and no government overhang.
  - Liquidity: Telefónica top 3 in ESTOXX in Liquidity: €400M daily.

- **Personnel efficiency fully funded.**

- **No need to sell off assets.**

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