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Telefónica de España, SAU

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INVESTOR
CONFERENCE

MADRID 2003

Telefonica

Safe harbor

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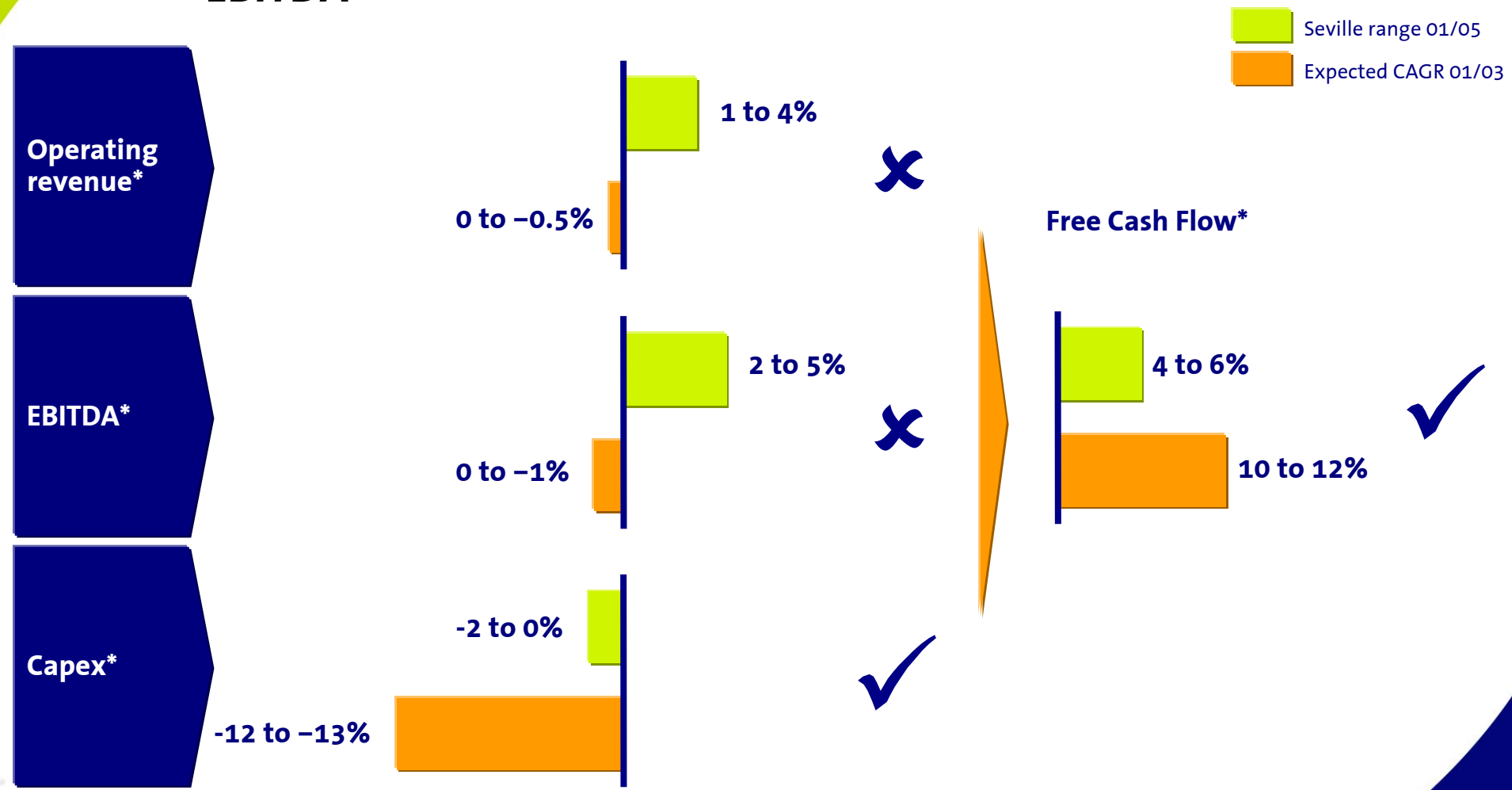
***Commercial innovation
and efficiency
for profitable growth***

Contents

- **We are confident about our future**
Strong delivery to date in a complex environment and more positive outlook
- **We have a clear program that will keep us ahead**
Commercial innovation leveraging on our efficient operational model for profitable growth
- **We will accelerate our performance**
Strengthening our transformation to deliver sound results



We are overachieving the Free Cash Flow commitment announced in Seville though we are below the growth path in Revenues and EBITDA

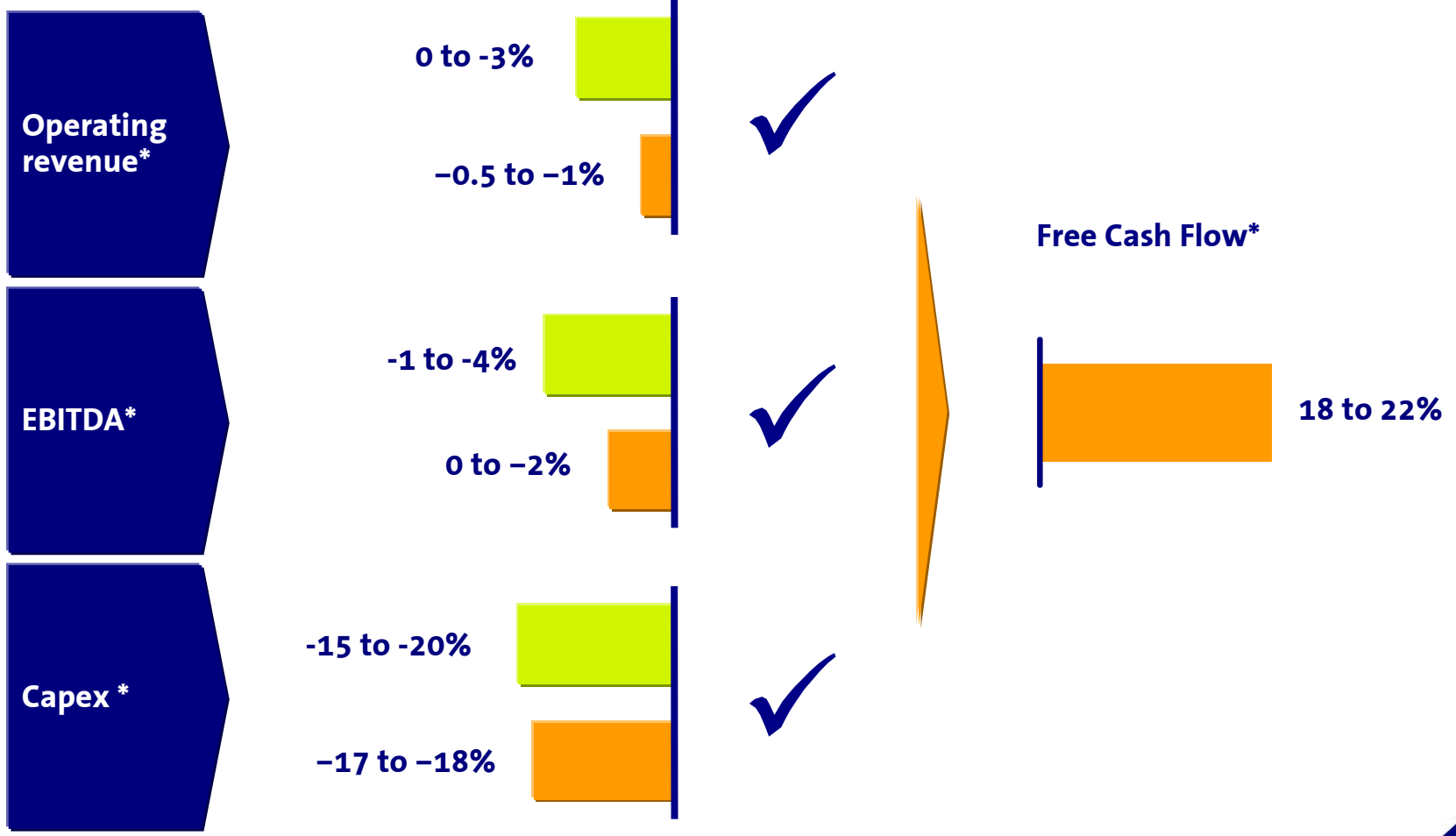


* TdE parent

Note: FCF Seville range: EBITDA – Capex – net financial expenses – taxes
 FCF expected: EBITDA – Capex – redundancy payments

We are in the upper part of the guidance communicated for 2003

■ Guidance 02/03
■ Expected growth 02/03



* TdE Group
 Note: FCF expected: EBITDA – Capex – redundancy payments

These results have been achieved in a tougher environment than expected

Environment

Regulation

To date (Dec 01-Sept 03)

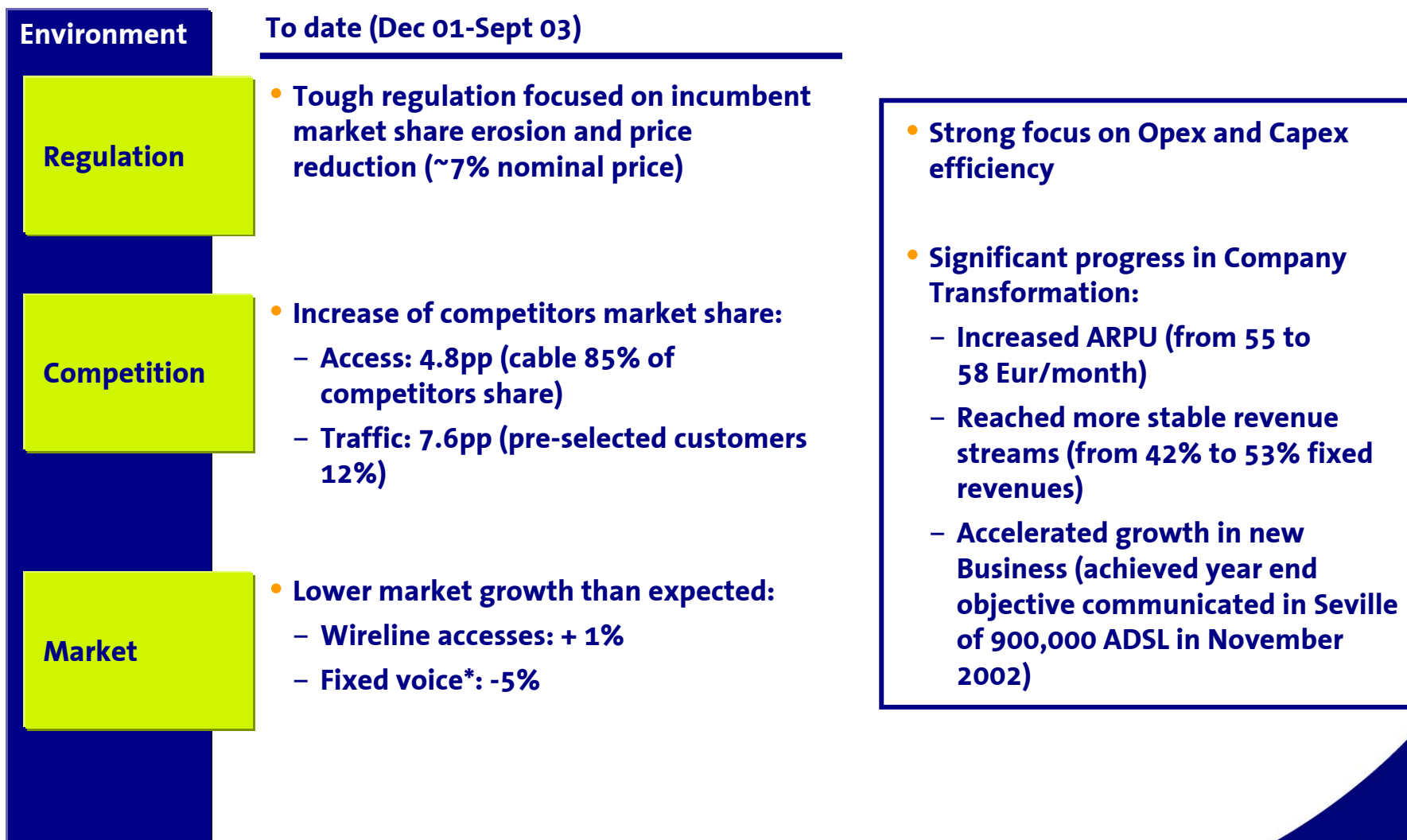
- Tough regulation focused on incumbent market share erosion and price reduction (~7% nominal price)

A highly demanding regulatory environment has significantly affected our results

| | Average European Scenario | Spanish Scenario | | |
|-----------------------------|--|--|--|--|
| Universal Service | <ul style="list-style-type: none"> • Compensation Fund • Scope | <ul style="list-style-type: none"> • Implemented in several countries • Limited obligation* | <ul style="list-style-type: none"> • Not implemented • Obligation to provide most requests | Extra costs |
| Traditional Services | <ul style="list-style-type: none"> • Price-cap structures (CPI-X) • Discount Plans • Time to win-back pre-selected clients • Introduction of different traffics to pre-selection | <ul style="list-style-type: none"> • x=2%/4% in 2001-2003 • Generally approved • No time constraints • Slow introduction | <ul style="list-style-type: none"> • x=9%, 8% , 4% in 2001-2003 • Generally rejected (during 2H02 and 1Q03) • At least four months • Fast introduction | Lack of commercial flexibility |
| BB | <ul style="list-style-type: none"> • Price regulation | <ul style="list-style-type: none"> • Wholesale prices in some countries | <ul style="list-style-type: none"> • Retail and wholesale prices based on "retail minus" | |
| Wholesale | <ul style="list-style-type: none"> • Interconnection model • Virtual loop | <ul style="list-style-type: none"> • Not including capacity interconnection for voice • Not implemented (except in Ireland and UK) | <ul style="list-style-type: none"> • Time and capacity based, volume discount and wholesale flat rates • Approval under process | Impact of capacity interconnection model |

* No obligation to attend unreasonable or highly cost request

These results have been achieved in a tougher environment than expected



* Cumulative 3Q02 – cumulative 3Q03

These results have been achieved in a tougher environment than expected

| Environment | To date (Dec 01-Sept 03) | Looking forward |
|-------------|--|--|
| Regulation | <ul style="list-style-type: none"> • Tough regulation focused on incumbent market share erosion and price reduction (~7% nominal price) | <ul style="list-style-type: none"> • New regulatory environment fostering innovation and investment |
| Competition | <ul style="list-style-type: none"> • Increase of competitors market share: <ul style="list-style-type: none"> – Access: 4.8pp (cable 85% of competitors share) – Traffic: 7.6pp (pre-selected customers 12%) | |
| Market | <ul style="list-style-type: none"> • Lower market growth than expected: <ul style="list-style-type: none"> – Wireline accesses: + 1% – Fixed voice*: -5% | |

* Cumulative 3Q02 – cumulative 3Q03

Regulatory evolution will offer new growth opportunities for the industry

Regulatory changes

Universal Service fund

- Open a possible implementation of Universal Service fund

Commercial flexibility

- Tacit regulatory approval of new plans for voice services after 21 days from requirement

Pricing liberalization process

- 2004:
 - CPI-4%
 - Monthly fee increase of 4.35% excluded from price-cap
 - More than 10 liberalized services: IN services, ISDN, international circuits, ...
 - Pricing freedom for retail ADSL
- 2005: Retail pricing freedom (ensuring universal service affordability)

Review of interconnection conditions

- Time and capacity interconnection tariff rebalancing, aligning Spanish scenario with Europe

We are confident about our future

| Environment | To date (Dec 01-Sept 03) | Looking forward |
|-------------|--|--|
| Regulation | <ul style="list-style-type: none"> • Tough regulation focused on incumbent market share erosion and price reduction (~7% nominal price) | <ul style="list-style-type: none"> • New regulatory environment fostering innovation and investment |
| Competition | <ul style="list-style-type: none"> • Increase of competitors market share: <ul style="list-style-type: none"> – Access: 4.8pp (cable 85% of competitors share) – Traffic: 7.6pp (pre-selected customers 12%) | <ul style="list-style-type: none"> • Less aggressive competition: <ul style="list-style-type: none"> – More consolidated competitors focused on return on investment – Decreasing pricing pressure |
| Market | <ul style="list-style-type: none"> • Lower market growth than expected: <ul style="list-style-type: none"> – Wireline accesses: + 1% – Fixed voice*: -5% | <ul style="list-style-type: none"> • More favorable economic environment |

- Upgrade our **commercial model** to become a more market driven Company
- Consolidate our increasingly efficient **operational model**

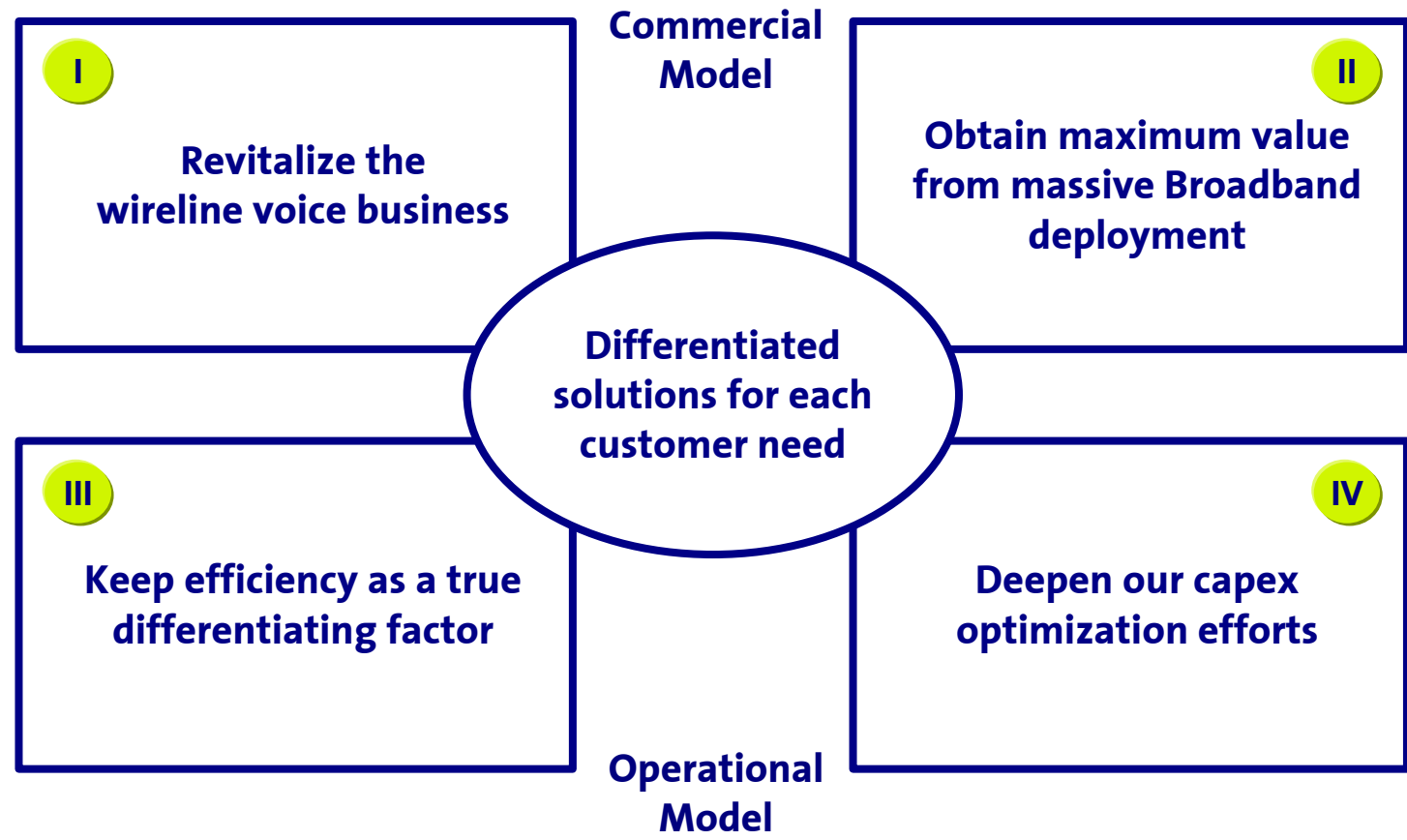
* Cumulative 3Q02 – cumulative 3Q03

Contents

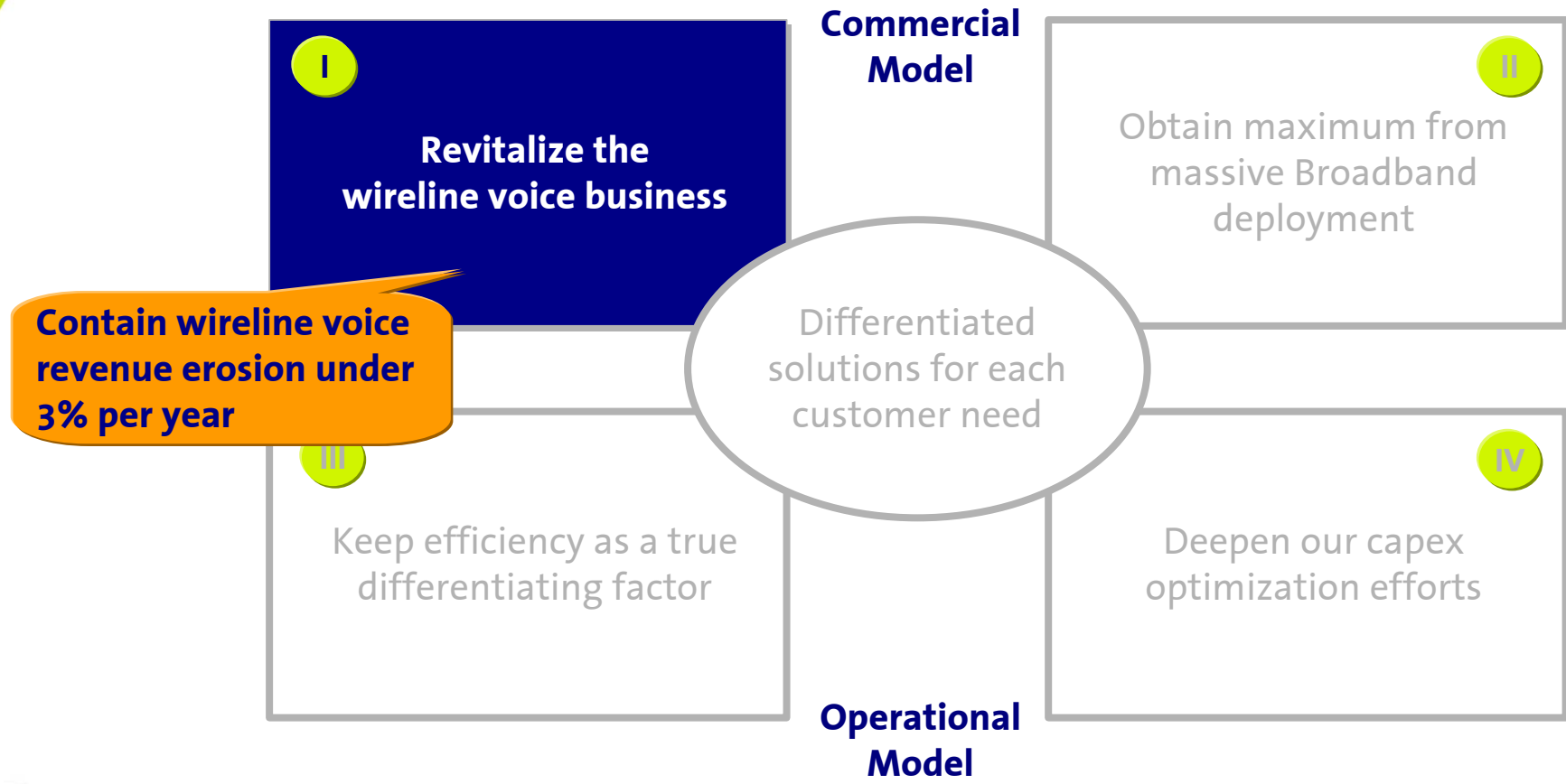
- **We are confident about our future**
Strong delivery to date in a complex environment and more positive outlook
- **We have a clear program that will keep us ahead**
Commercial innovation leveraging on our efficient operational model for profitable growth
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Strengthening our transformation to deliver sound results



We have a clear program structured around four major priorities that will keep us ahead



We have a clear program structured around four major priorities that will keep us ahead

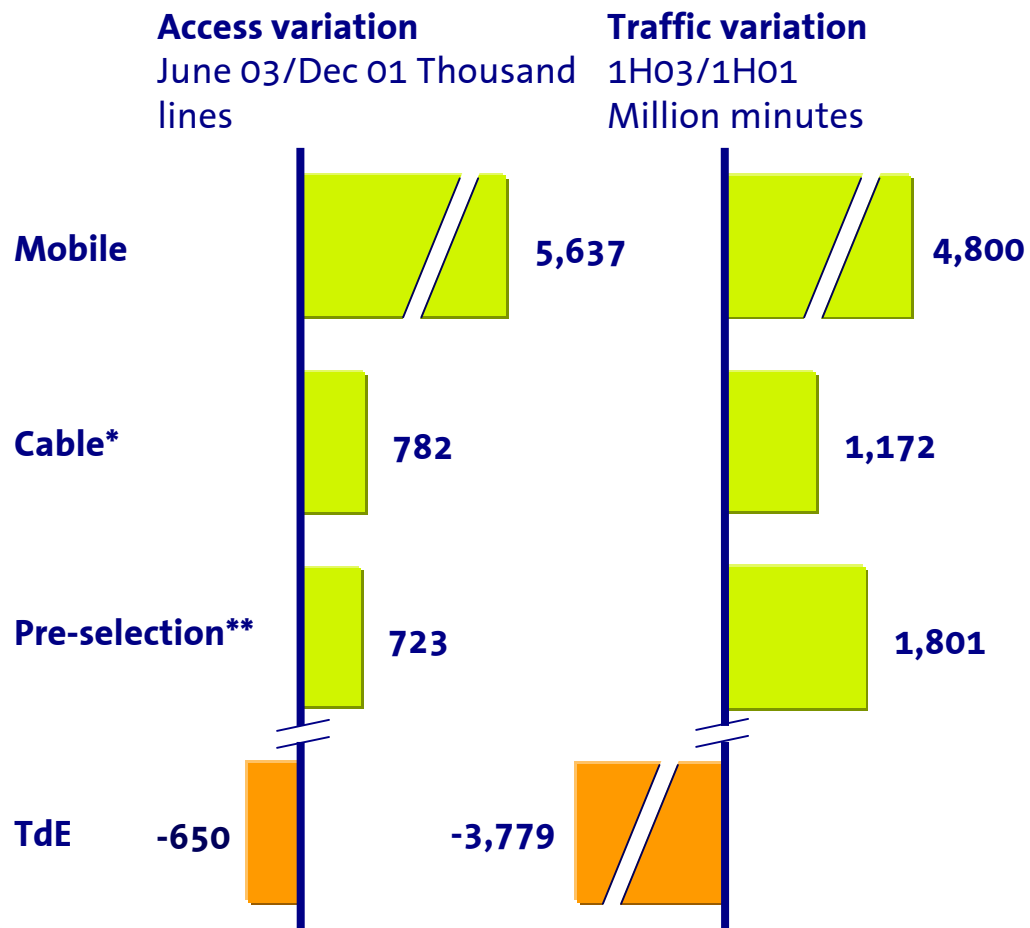


Note: Revenues not including wholesale

We are observing a shift in the market trend of access and traffic

Like other European incumbents TdE has suffered access and traffic erosion ...

... however we foresee a moderation in this trend



- Mobile penetration already over 85%
- Internet penetration upside will help to protect wireline access
- Limited growth potential: 45% of total households passed by cable and 27% of them connected
- Slowdown of investment (-44% 02/01)***
- More focus on return on investment than on growth
- More regulatory freedom for commercial actions

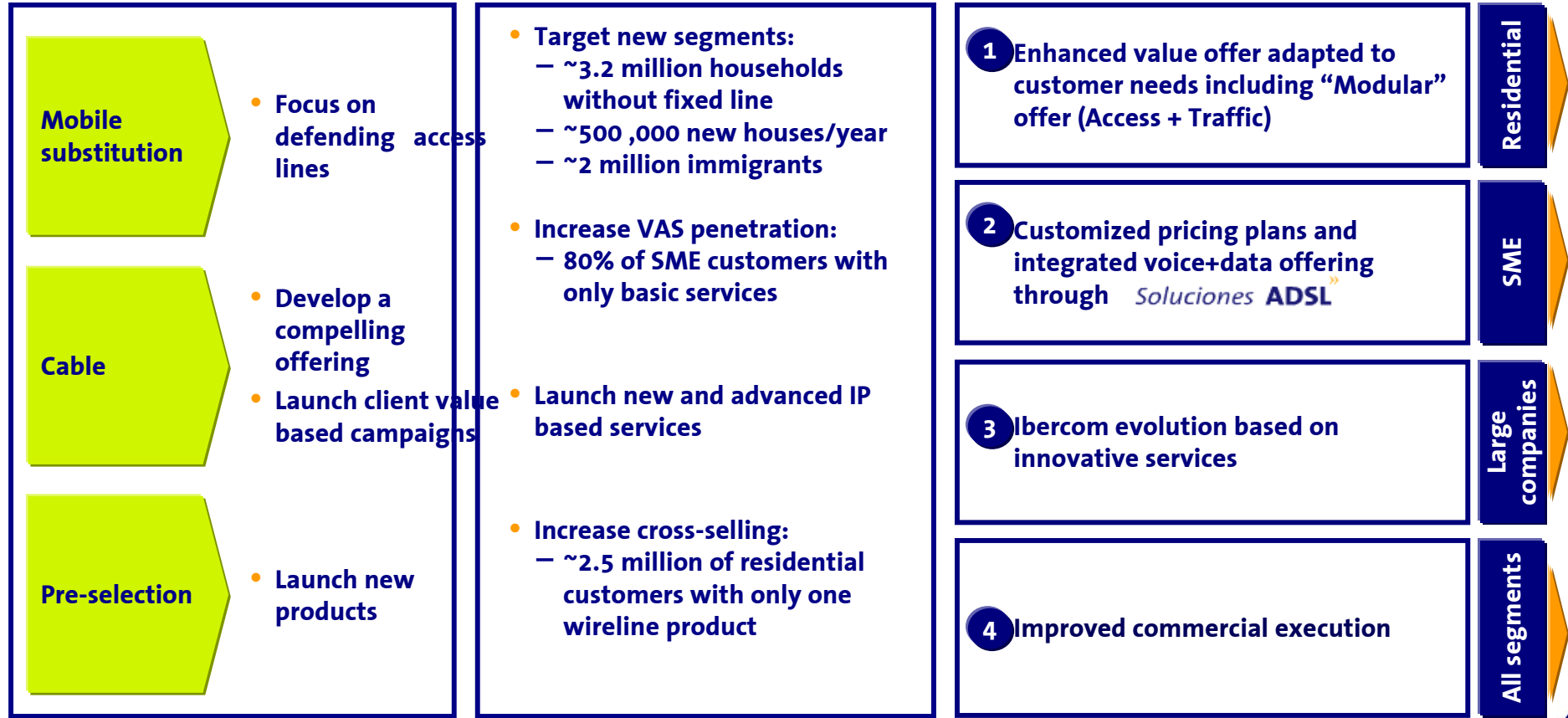
* Traffic figures include other direct accesses
 ** Traffic figures include prefix calls
 *** CMT 2002 annual report

In this context, we are taking differentiated actions to revitalize the wireline voice business

Defend against main threats...

... and capture new opportunities...

...with actions differentiated by segment



ADSL will reinforce our defense strategy against mobile substitution and cable (ADSL reduces customer churn by 65%)

1 For the Residential segment we are upgrading our offering adapted to different customer needs

| Broader catalogue | Product example | Potential | Other products |
|--------------------------|---|---|---|
| Flexible access | <ul style="list-style-type: none"> Line for foreign residents (prepaid) On/off for holiday residents | <ul style="list-style-type: none"> 2 million foreign residents in Spain (only ~10% have fixed line) 1 million holiday residences without fixed line | <ul style="list-style-type: none"> Shared line for rental houses Secondary line for young people Prepaid line with no monthly fee |
| Traffic products | <ul style="list-style-type: none"> New Internet flat rates | <ul style="list-style-type: none"> 3.6 million PC-users not using Internet | <ul style="list-style-type: none"> Predefined amount of minutes (Magreb, Latin America, ...) Special prices per minute paying a monthly fee |
| Advanced VAS | <ul style="list-style-type: none"> Conventional SMS | <ul style="list-style-type: none"> 4 million SMS per month expected in 2004 | <ul style="list-style-type: none"> Premium SMS (Televoting, distribution, ...) Mundo ADSL integrated messaging |
| Innovative handsets | <ul style="list-style-type: none"> Cordless "Famitel" with SMS | <ul style="list-style-type: none"> ~70% residences with wired telephone | <ul style="list-style-type: none"> "Domo" with speaker |
| "Modular" offer | <ul style="list-style-type: none"> "Easy" Module: <ul style="list-style-type: none"> Access 300 minutes for local calls 5 to 10% discount in other calls | <ul style="list-style-type: none"> Simplify customer purchasing | <ul style="list-style-type: none"> "City " "Country" "SoHo " "SoHo +" "SoHo country" |
| Access + traffic modules | | | |

2 For SME, we are developing a customized and compelling offering

Customized plans for the specific needs of every customer

Price segmentation

- **Flat rates:** For local and national calls
- **Minute bundles:** Predefined amount of minutes for a specific period of time
- **Tariff options:** Special prices per minute for a monthly fee

Renovate pricing schemes of 100% of SME

Integrated voice + data + VAS solution for a simplified and broad coverage of different needs

From a fragmented product offering...

- Internet access
- Voice products
- PABX
- LAN



...to a complete integrated solution based on monthly fee

Soluciones ADSL >> Equipos

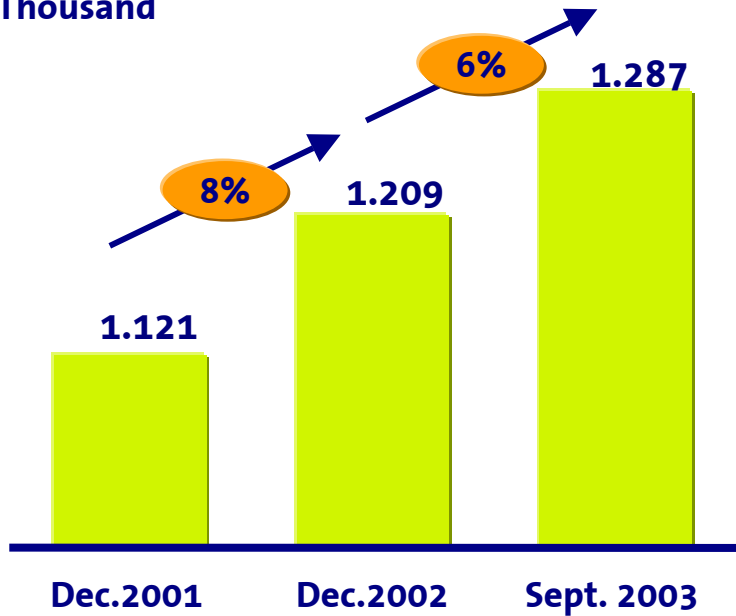
- ADSL access
- Voice options
- VoIP VPN
- IP LAN/PBX
- LAN cabling and installation
- PC configuration
- Maintenance of service, CPE, cabling and LAN

Migrate 10% of SME customers to *Soluciones ADSL >> Equipos* by 2006

3 For large companies we are going to continue growing based on our Ibercom voice solution

Ibercom today (Voice VPN corporate solution)

Number of Ibercom lines
Thousand



Ibercom future evolution

- Move to an integrated IP based solution:
 - Integrated voice + data VPN
 - Advanced IP VAS (Directory, Unified messaging, Click-to-dial, ...)
- Extend the target market:
 - Smaller corporate sites
 - Medium enterprises

- Customer base loyalty increase through IP solutions
- Gain new Ibercom customers by targeting new segments

Solid base to capture IP opportunities

4 Moreover, we have set the basis to enhance our commercial execution in all segments

More client oriented company

| From... | ...to |
|-----------------|-------------------------------|
| Product factory | Customer focused organization |



Better tools for client management

- Launch of specific commercial actions for different segments: Customer value, Churn risk



Stronger commercial capabilities

- Incorporate 25% new commercial employees in 4 years
- Tailored training program for 25% of commercial employees in 4 years

Recent pilot campaigns...

- A** Churn anticipation
 - Loyalty program focused on high-value high-risk customers (~35% success rate)
- B** Churn contention
 - Recurring program focused on high-value customers attempting disconnection (~45% retention of customers contacted)
- C** Cross-selling
 - Smaller and more targeted campaigns focused on high value customers (sales increased by 50% in 6 months)

...to roll out in the future

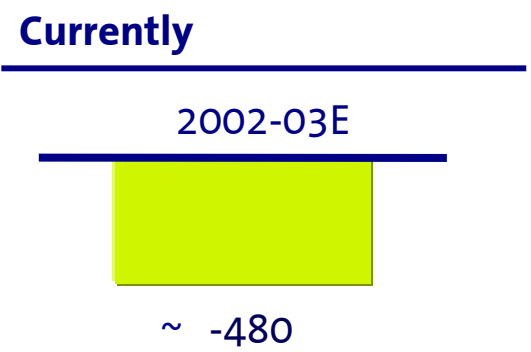
Reduce high-value customer disconnections attempts by 25%

Manage 100% of disconnection attempts with 50% success rate over customers contacted

Achieve 10% success rate over customers contacted

These actions will mitigate revenue erosion in wireline voice business

Access lines net loss per year
Thousand



Going forward

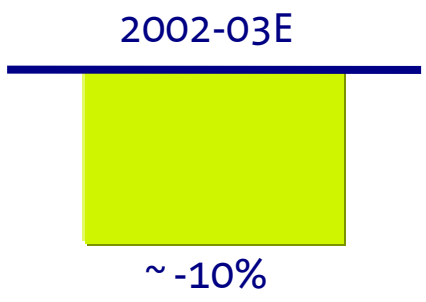
- Contain access lines decrease by 50%

Traffic loss per year
Percentage



- Contain traffic loss by 35%

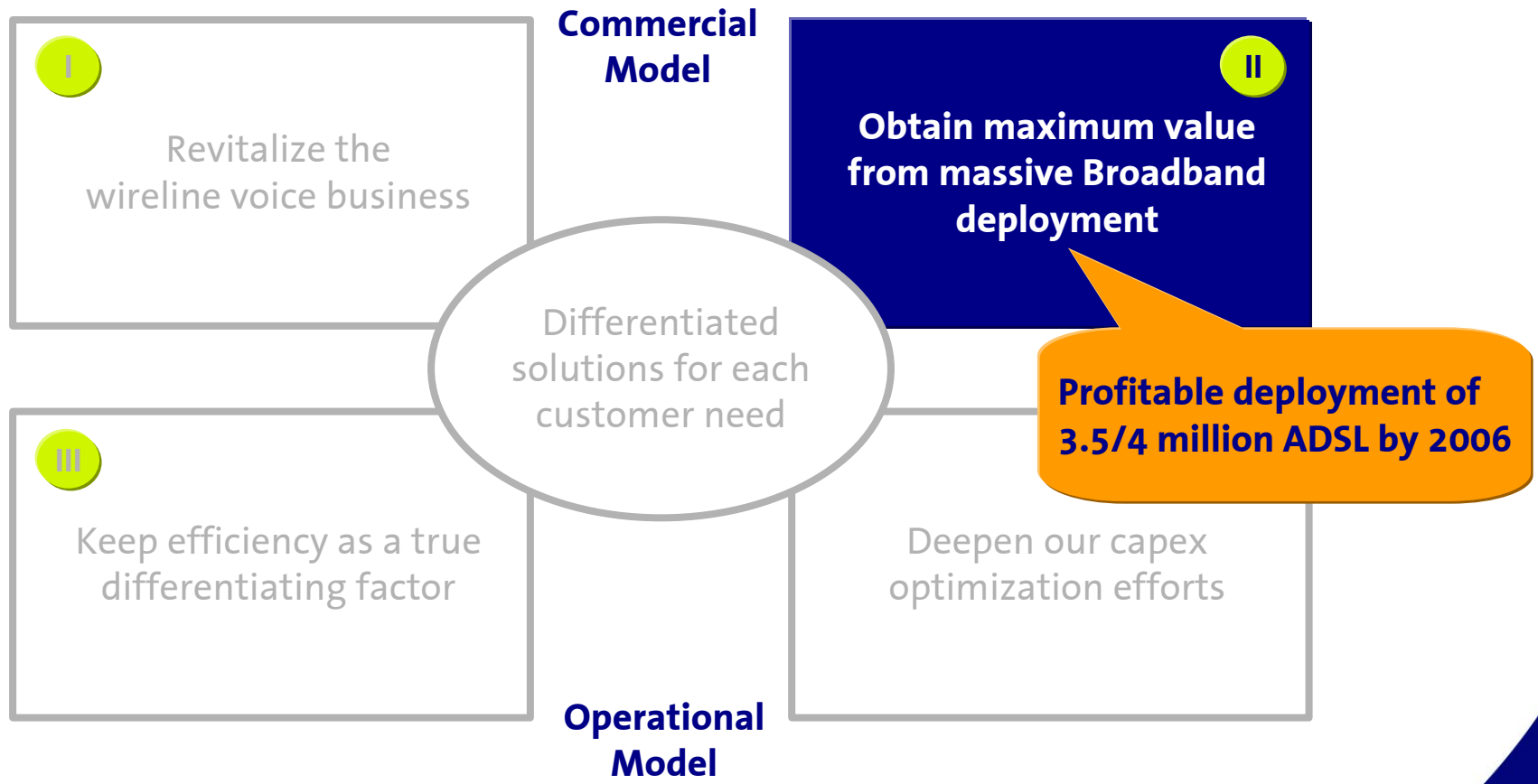
Nominal traffic price reduction per year
Percentage



- Slowdown of nominal price decline

Strong focus on wireline voice revenues, containing erosion under 3% per year

We have a clear program structured around four major priorities that will keep us ahead

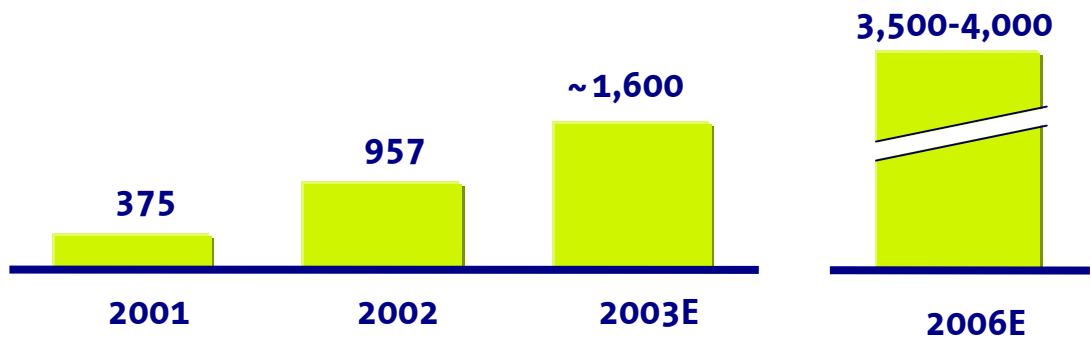


We have set ambitious goals in Broadband, reinforcing its role as key engine of profitable growth

Strong and profitable growth achieved...

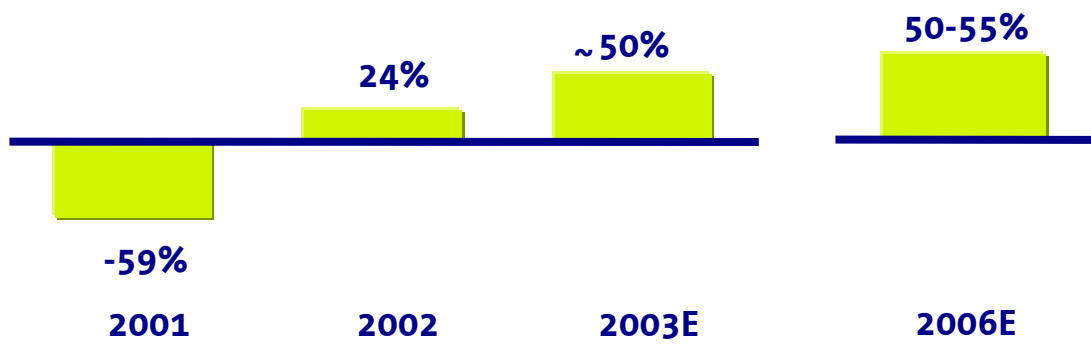
... planning to continue this trend in the future

ADSL lines
Total market.
Thousand



- Massive ADSL deployment plan: 3.5-4 million customers in 2006
- Solid base for our defense against cable and mobile substitution

ADSL Gross Margin* over revenues
Percentage



- Continue with profitable growth, already reached in 2002 anticipating our strategic milestone
- The results are better than foreseen in our original business case (expected FCF break-even in 2004)

* Gross Margin= Revenues – direct costs (help desk, internet connection, IP network maintenance, operation maintenance, marketing, installation, modem, communication and others)

To achieve our ambitious goals we face a different starting point in each segment

Business

Total ADSL
Thousand



ADSL penetration*



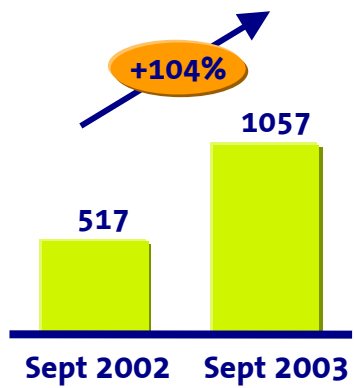
Total ARPU (Retail ADSL)
Eur/month



VAS penetration**



Residential



ADSL penetration*



VAS penetration**



- Very positive evolution of ADSL penetration
- Growing ARPU showing:
 - Higher average speed
 - Higher VAS ARPU

- Still limited penetration due to some barriers:
 - ADSL price
 - Perception of narrow range of applications
 - PC penetration
- Stable retail ARPU, based mainly in connectivity

* Over business sites for Business segment. Over households (including SoHo) for Residential segment

** Number of lines with at least one VAS over retail ADSL

Therefore, we plan to implement a differentiated strategy per segment

Enhanced value proposition

Business

Maintain competitive pricing schemes

+

Evolve our VAS offering

- VAS to maximize value per customer

Residential

Launch innovative pricing schemes

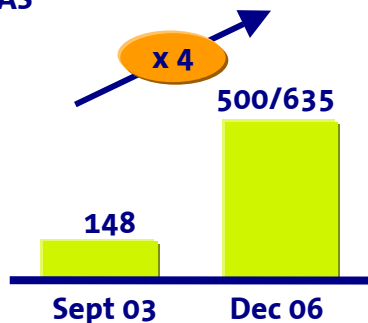
+

Develop a distinctive VAS catalogue over PC and other devices

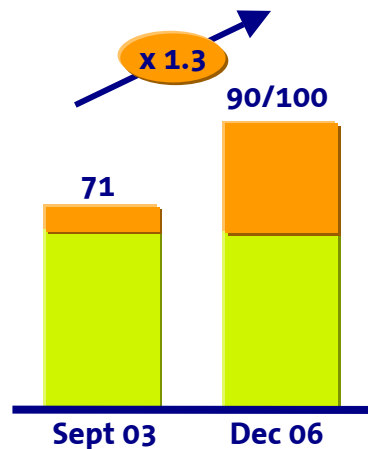
- Pricing schemes and VAS to:
 - Achieve massive deployment
 - Maintain total ARPU

For the Business segment, we will maximize value per customer through a compelling VAS offering

Number of VAS
Thousand



Total ARPU
Eur/Month



VAS

Connectivity

Strong results from our current VAS offer

Soluciones ADSL[»]

- CPE and Security**
 - 36,000 maintenance services
 - 8,400 safe lines (anti-virus, firewall, ...)
- IP VPN**
 - 32,000 SME sites and remote accesses
- Business Management Applications***
 - 45,500 business applications provided on ASP mode
- WiFi Zone**
 - 40 WiFi zones and 100 already ongoing

Focus on extracting customer value evolving Soluciones ADSL

- Continue current strategy
 - Monthly fee based pricing
 - “Try and buy” commercialization
- Deepen in the “IT-on-demand” concept:
 - Horizontal applications (procurement, HR, accounting, network back-up...)
 - Vertical applications (retailing, ...)
 - Support services (consulting, PC and LAN maintenance...)
 - Equipment: PC, servers and basic software
- Add mobility: increase WiFi LAN penetration
- Establish third party agreements (Onix, Intel, Cisco ...)

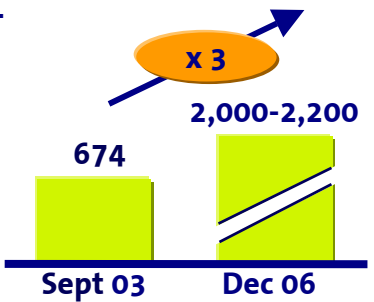
- From:
 - 43% VAS penetration
 - 0.6 VAS per customer

- To:
 - 93% VAS penetration
 - 1.5 VAS per customer

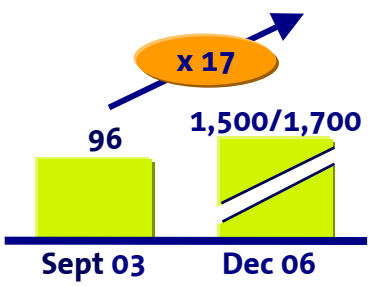
* Intranet, web, e-commerce, CRM

For the Residential segment, we will achieve massive deployment through new pricing schemes and a compelling VAS offering

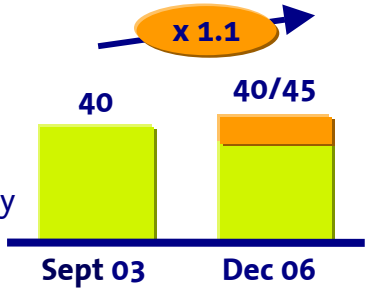
Retail ADSL
Thousand



Number of VAS
Thousand



Total ARPU
Eur/Month



VAS

Connectivity

Alternative pricing schemes already in place

- Time-based pricing schemes developed by Terra (new customers market share doubled)

Leverage on new pricing schemes based on:

- Time
- Bandwidth
- Downloading

First results form our recent VAS launches

“Safe ADSL access”

- 10,000 customers (parental control, anti-virus, firewall,...)

PC content aggregator

- 40,000 customers already using mundo **ADSL**»

Interactive TV

- 19% of *imagenio*» customers buying VoD twice a month

Domotic

- 10,000 WiFi clients
- ADSL modem ready for WiFi

Consolidate the development of the “digital home”

- Supply faster and safer access
- Commercialize, install and maintain home infrastructure and devices
- Supply services, content and applications for PC, TV, consoles and other devices
- Customized offer for different communities: children, students, remote workers, etc.
- Alliances with content/application leaders (McAfee, Sony, ...)

- From:
 - 6% ADSL penetration
 - 12% VAS penetration
 - 0.1 VAS per customer

- To:
 - 25% ADSL penetration
 - 44% VAS penetration
 - 1.2 VAS per customer

ADSL and VAS will be the source of growth of the wireline business

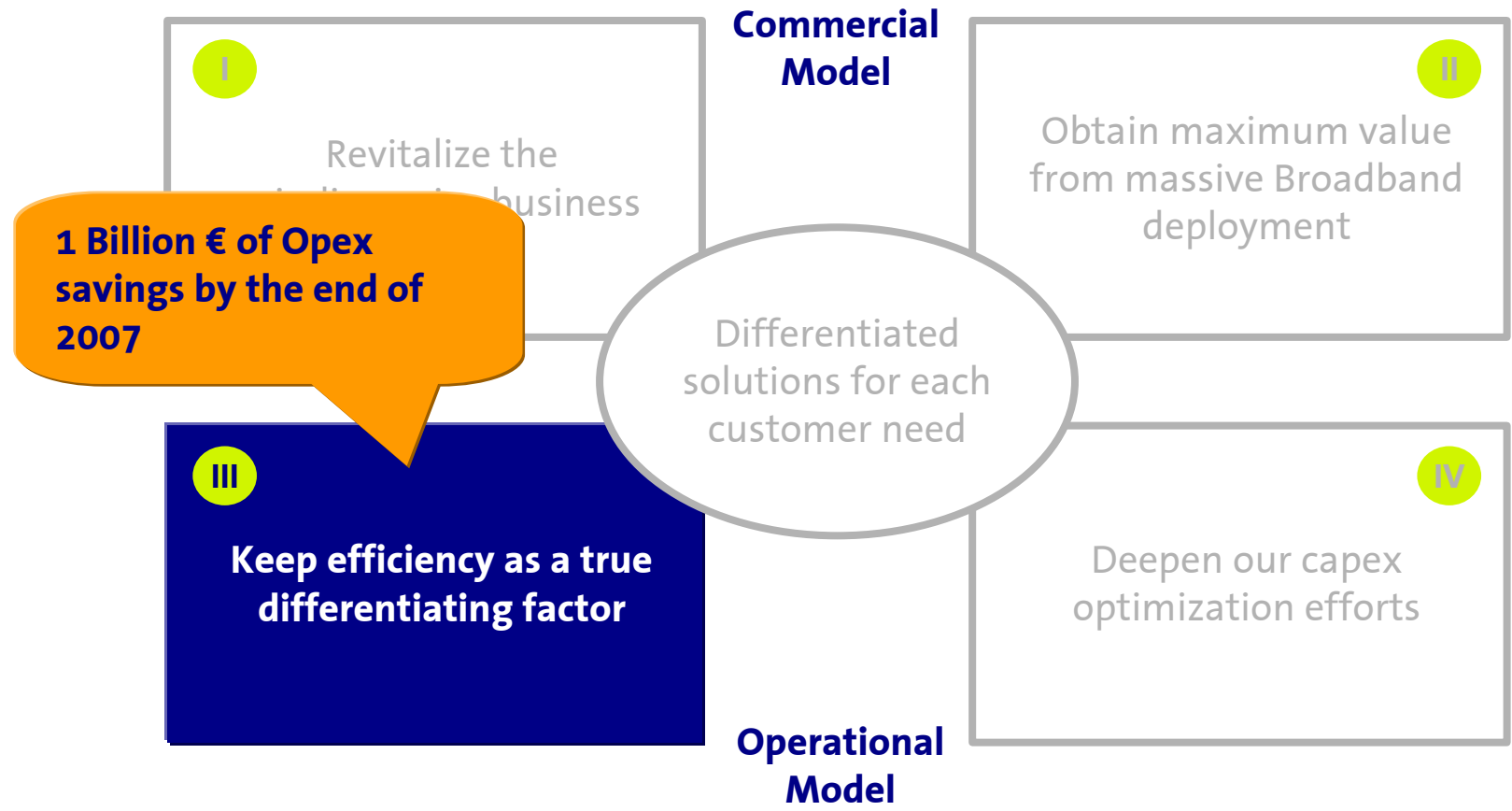
Massive ADSL deployment
3.5/4 Million ADSL



Increasing ARPU through VAS
Eur 52-54 month

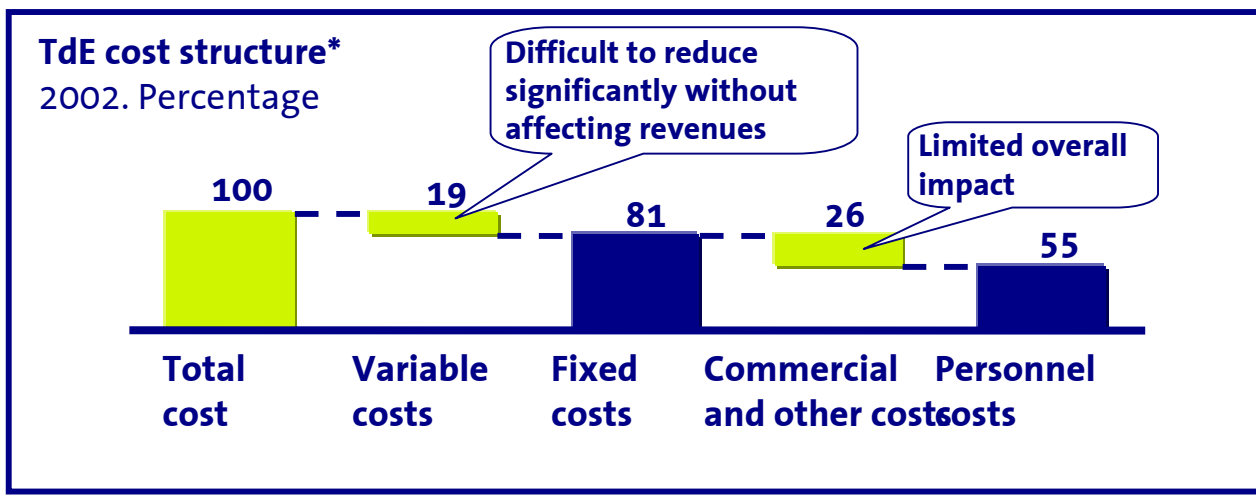
**ADSL profitable growth offsets
wireline voice erosion**

We have a clear program structured around four major priorities that will keep us ahead



Our personnel reduction efforts are key to becoming a more efficient and flexible company

Key lever to improve efficiency



Change enabler for a new operational model

- Less hierarchical and flexible organization
- Renovated processes and “simpler ways of doing”
- More customer oriented

* Net of interconnection costs

We have been working on an integrated efficiency Program with significant results in place

Redundant employees 03-05

Transform ways of operating

1 Technical area program (Optima)

Lean and 6-σ :

- Faults repaired per FTE (+30 to +40%)
- Lead time per failure (-20%)



~ 3,050

2 Support activities program

- Processes redesign
- Optimization of support functions

4,400

Leverage on new technologies

3 e-Company transformation

- 150.000 customer orders on-line (1H03)
- 18.200 employees access e-domus every day
- 100% of distributors order on-line
- 615 suppliers connected on line

~ 150

4 IT systems renewal

- More flexible and customer oriented systems
- Simplification of number of systems (from 150 to 20)

~ 700

5 Network technologies innovation

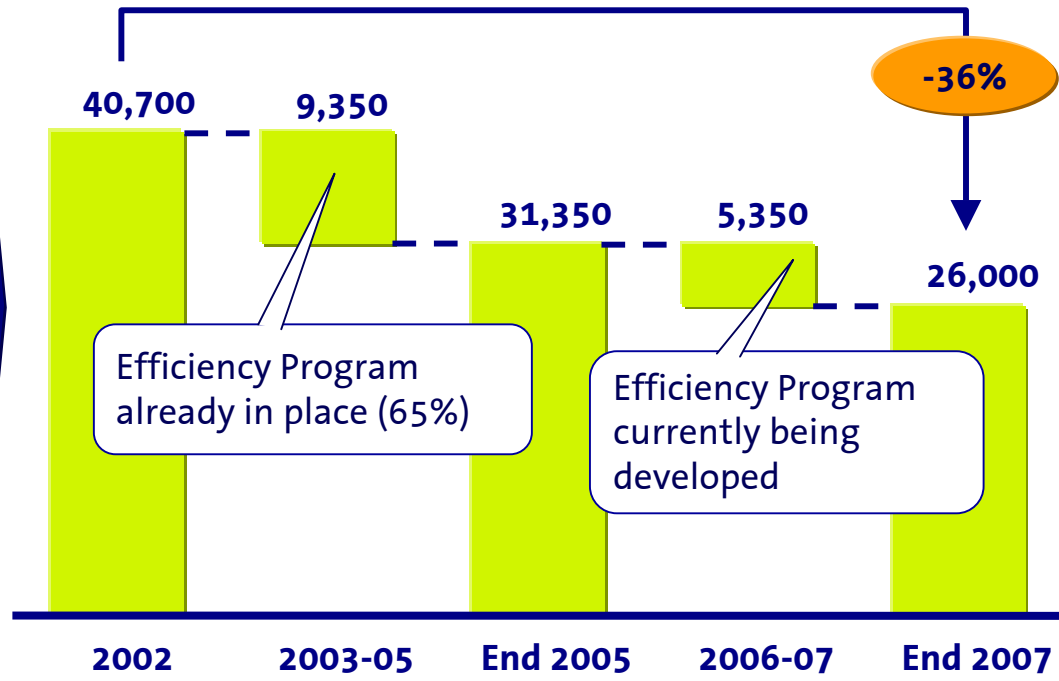
- Higher automation at O&M national center
- Optimization of "field" work centers (more than 160 centers will be closed)

~ 1,050

Efficiency program already in place for 9,350 employees

So we are now ready to become a more efficient and flexible company

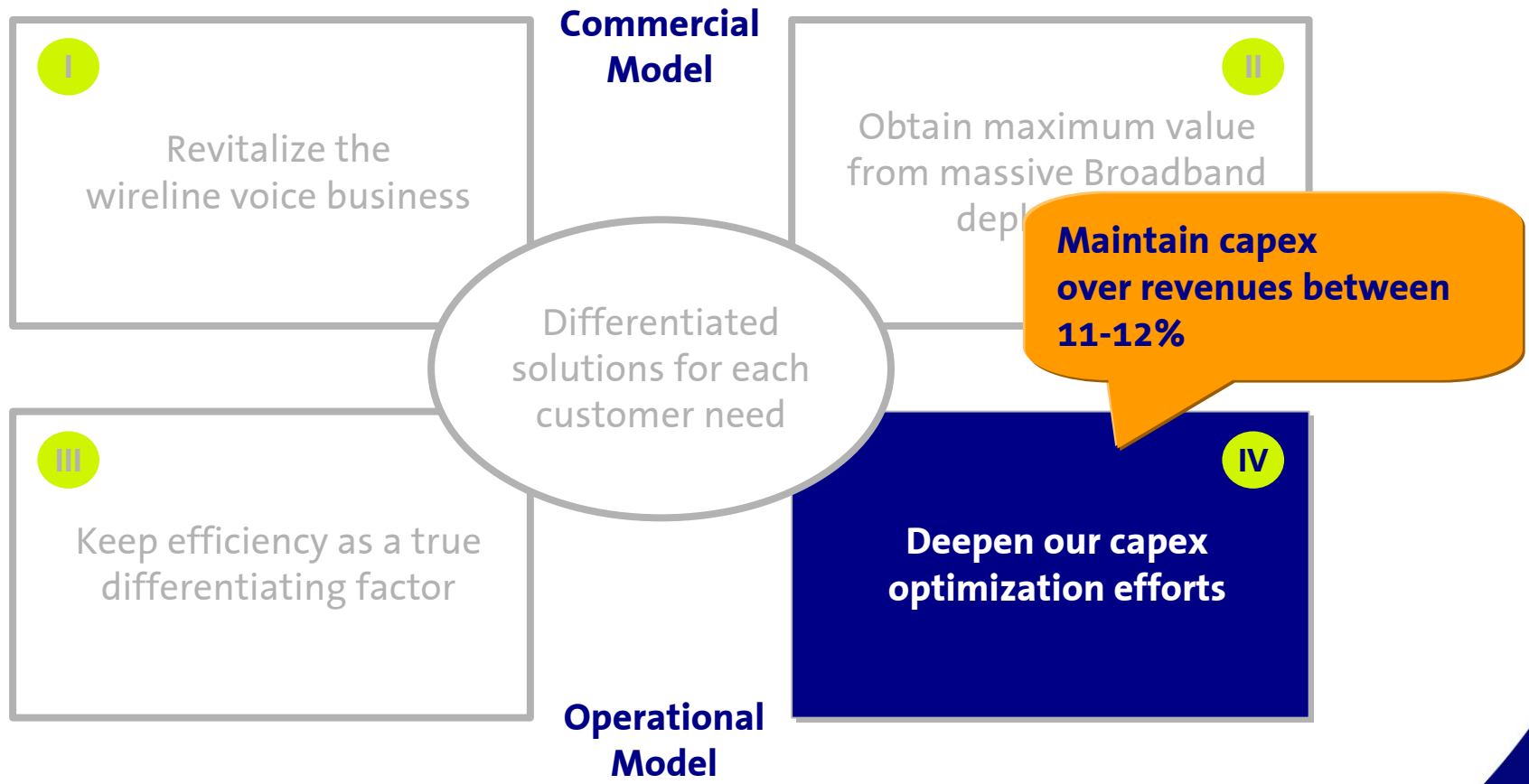
Workforce reduction (employees)



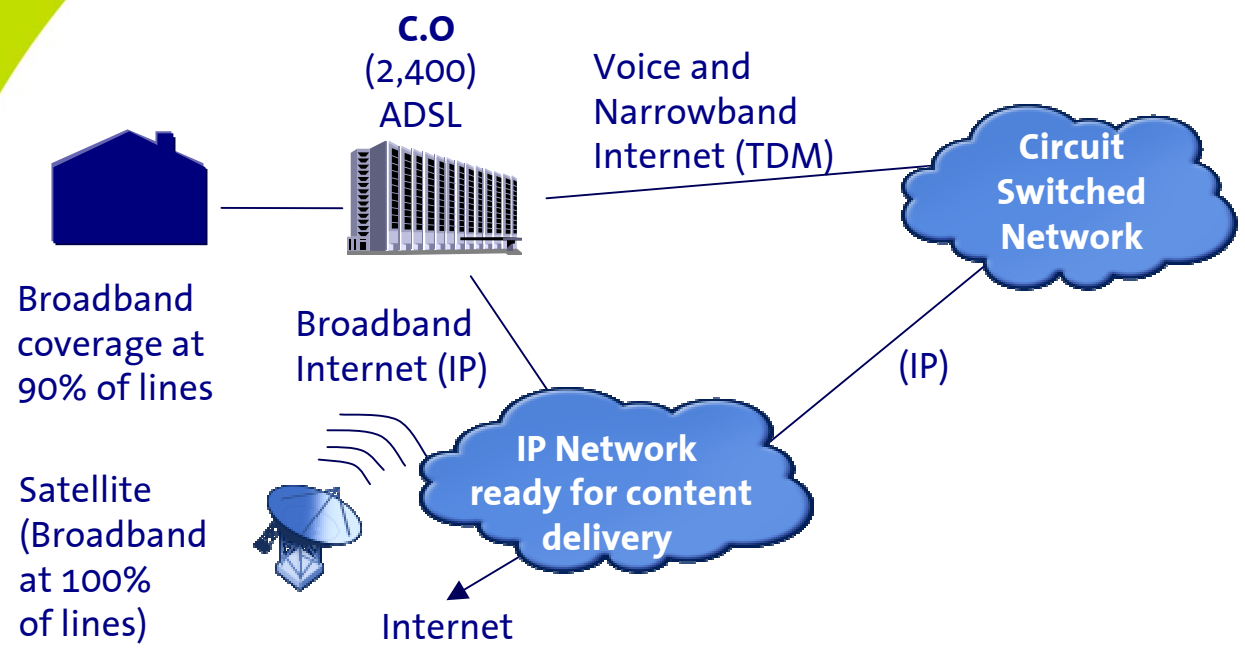
- Launch of a plan for net reduction of 14,700 employees in the next five years without external cost increase
- Leveraging on a new collective agreement:
 - Functional mobility
 - Category consolidation
 - Increased timetable flexibility
 - Moderate wage increase (real CPI)

- 1 billion of Opex savings will be captured by the end of 2007
- The effort will allow us to strengthen our Company Transformation:
 - Simplified structure (-35%)
 - More dynamic organization
 - More client oriented company (+25% new commercial employees in 4 years)

We have a clear program structured around four major priorities that will keep us ahead



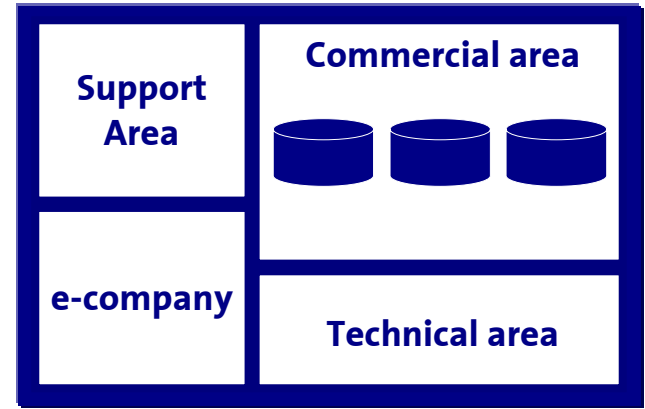
We have in place a very advanced infrastructure that is ready for the future



Broadband coverage at 90% of lines

Satellite (Broadband at 100% of lines)

IT Systems



Internet and Broadband revenue generation

- Approximately 90% Broadband coverage
- IP network ready for content delivery already represents more than 50% of total traffic

Traditional revenue generation

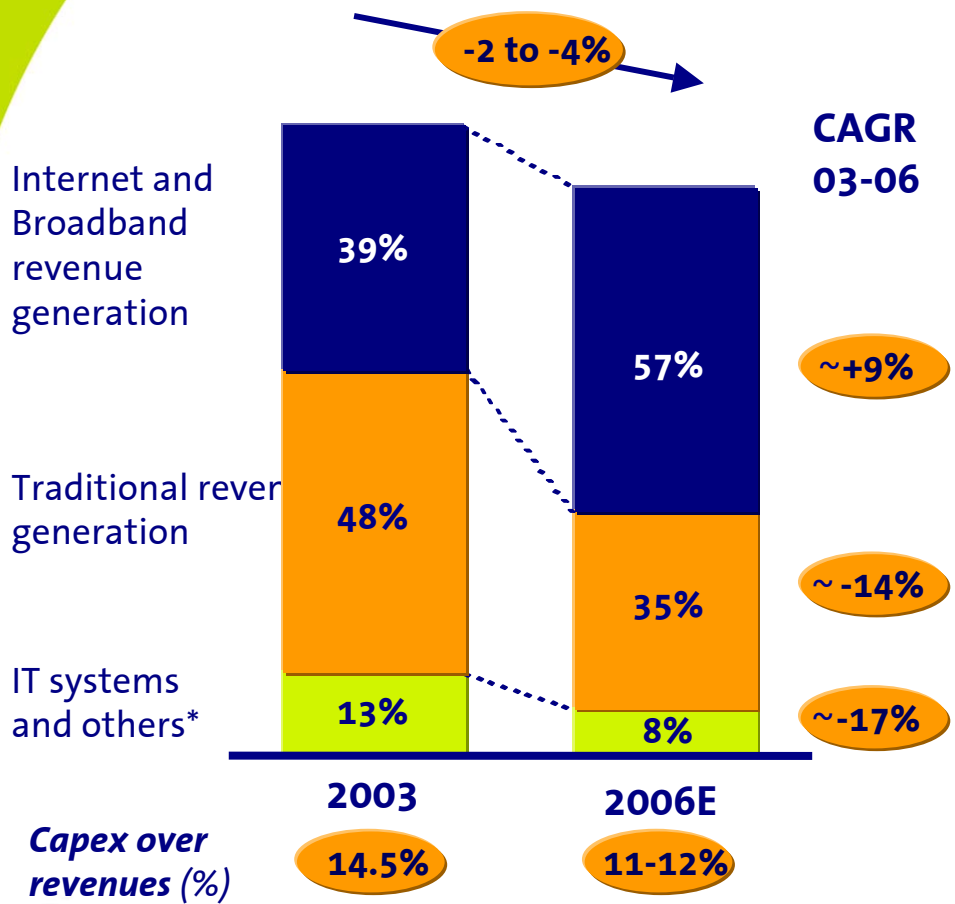
- Capacity needs already covered in the context of traditional traffic stagnation

Efficiency programs

- Renovated IT systems at more than 80% by the end 2003

Going forward, we plan to continue reducing Capex in a sustainable way

Parent Company



Clear initiatives looking forward

- ① Optimization of incremental investment for massive deployment
 - 1M additional ADSL (+50%) by 2006 would increase Broadband Capex by only ~20%
- ② Frozen Traditional network investment
 - 15-20% more traffic in 2006 will not increase Capex
- ③ Capex reduced due to completion of major efforts
 - IT systems renewal will be finished by 2004

Gradual approach to network evolution

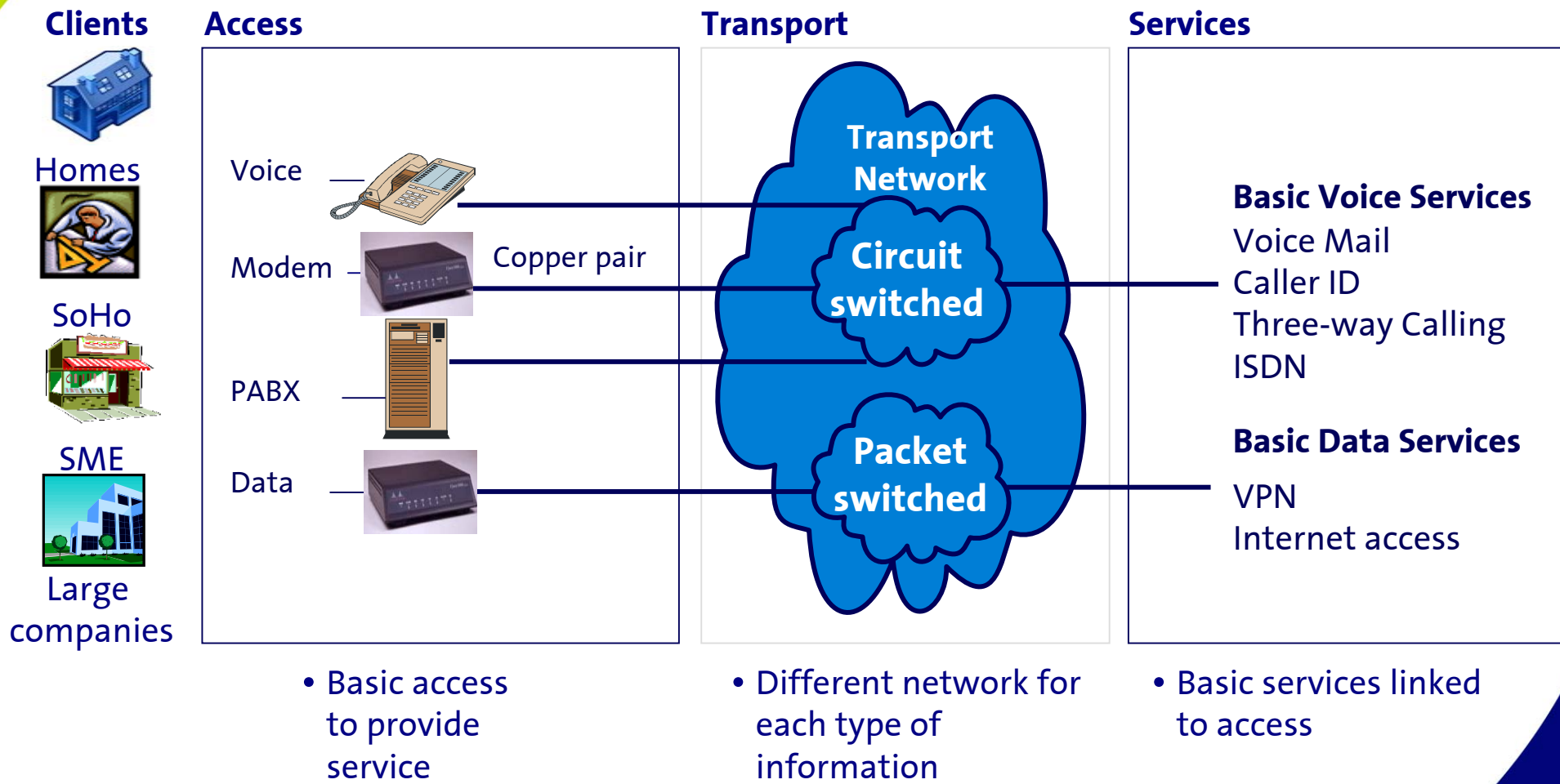
* Real state efficiency plan

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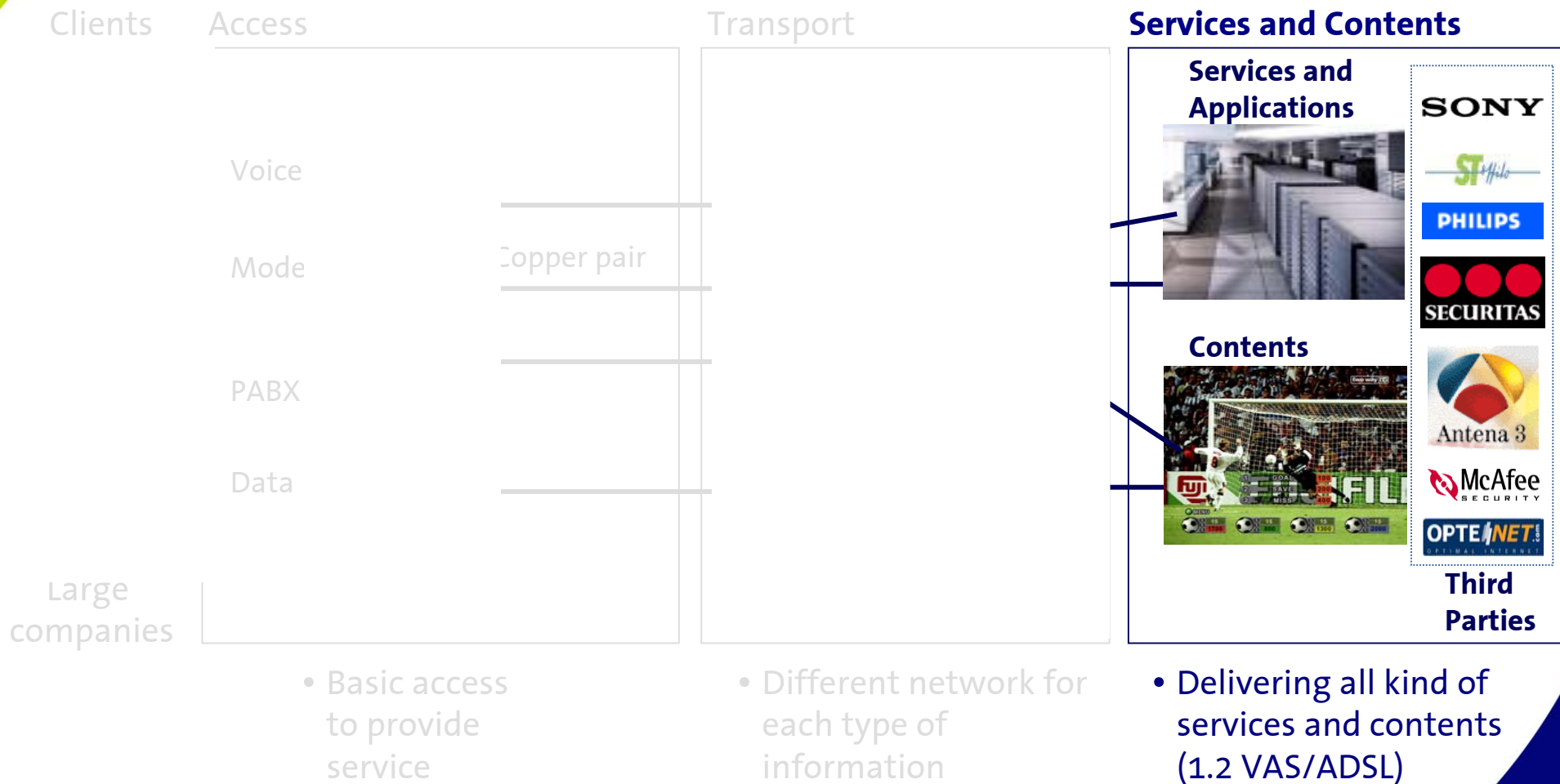
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Through this four-priority program we are significantly transforming our company



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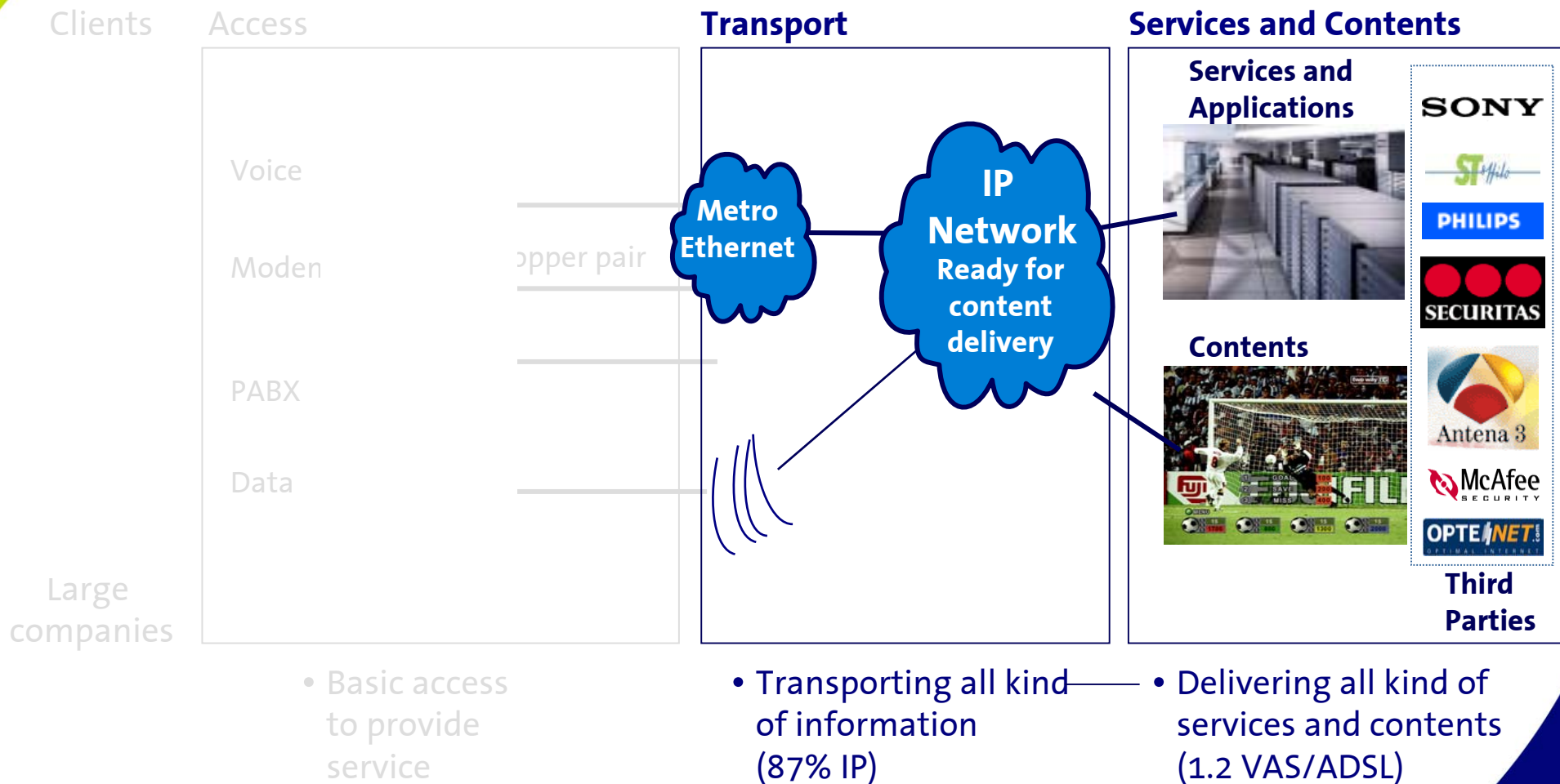


Third Parties

- SONY
- ST Offsets
- PHILIPS
- SECURITAS
- Antena 3
- McAfee SECURITY
- OPTE/NET.com

Note: Figures refer to 2006

Through this four-priority program we are significantly transforming our company

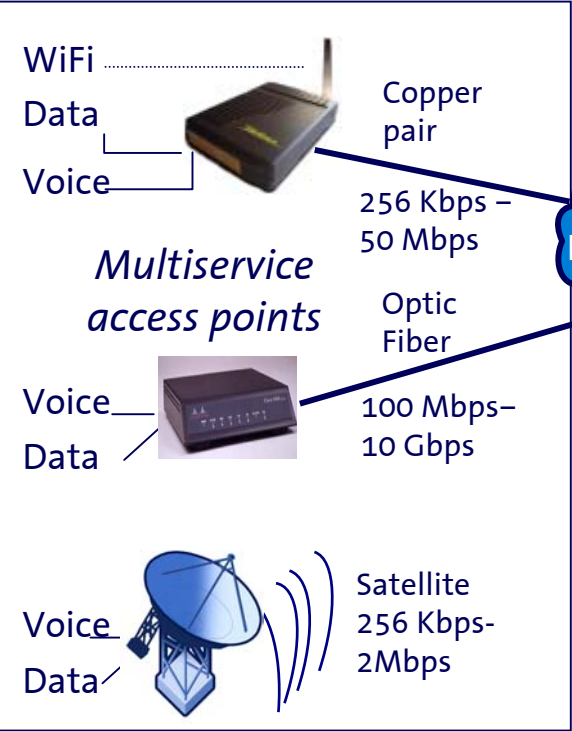


Note: Figures refer to 2006

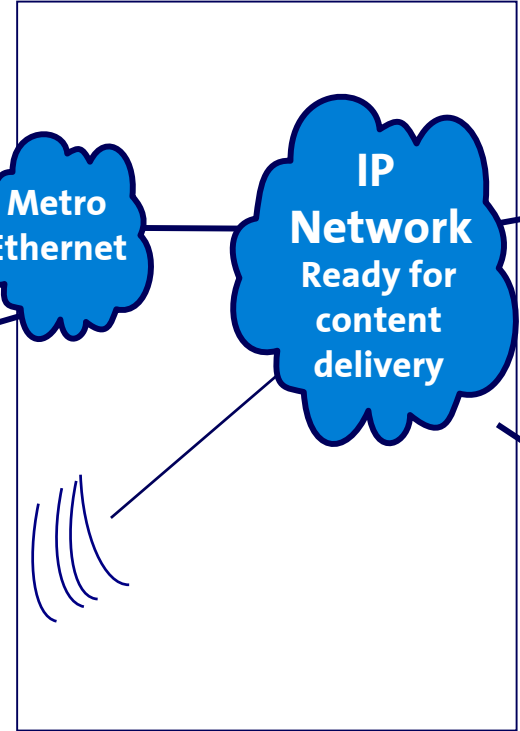
Through this four-priority program we are significantly transforming our company

Clients

Access



Transport



Services and Contents



- Adding value to access (25% BB)

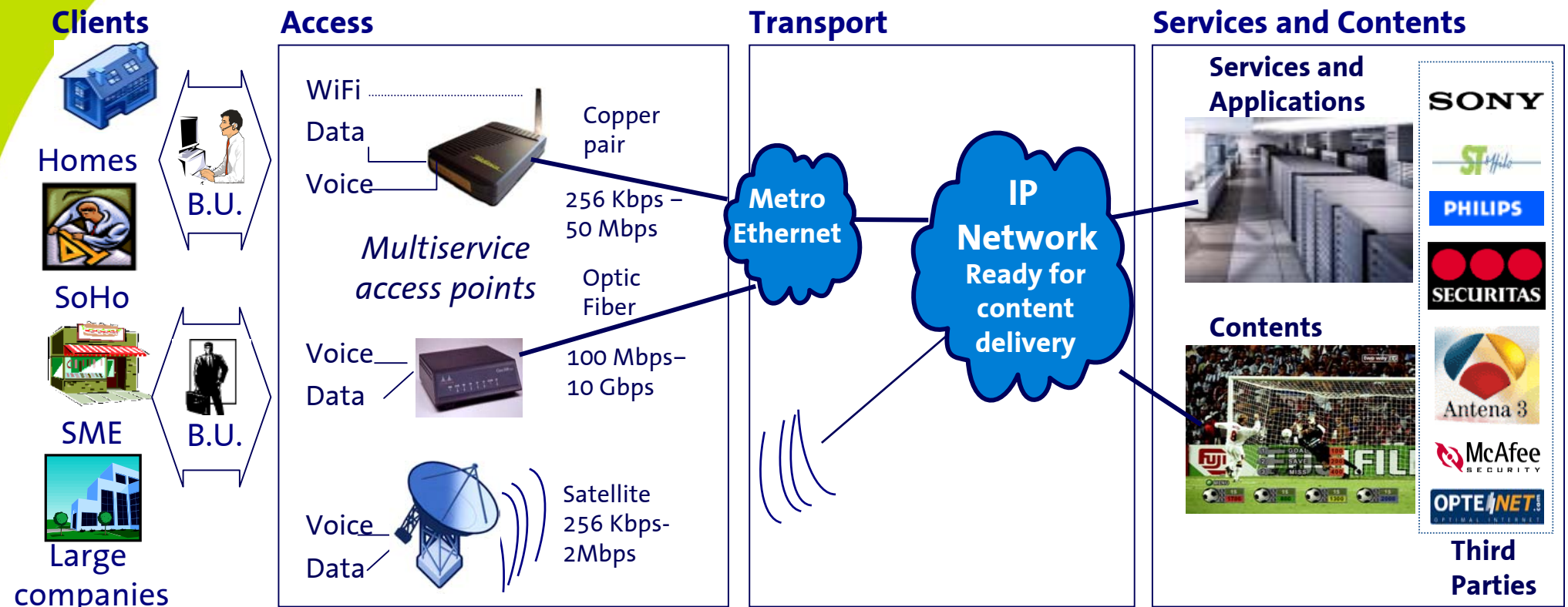
- Transporting all kind of information (87% IP)

- Delivering all kind of services and contents (1.2 VAS/ADSL)

companies

Note: Figures refer to 2006

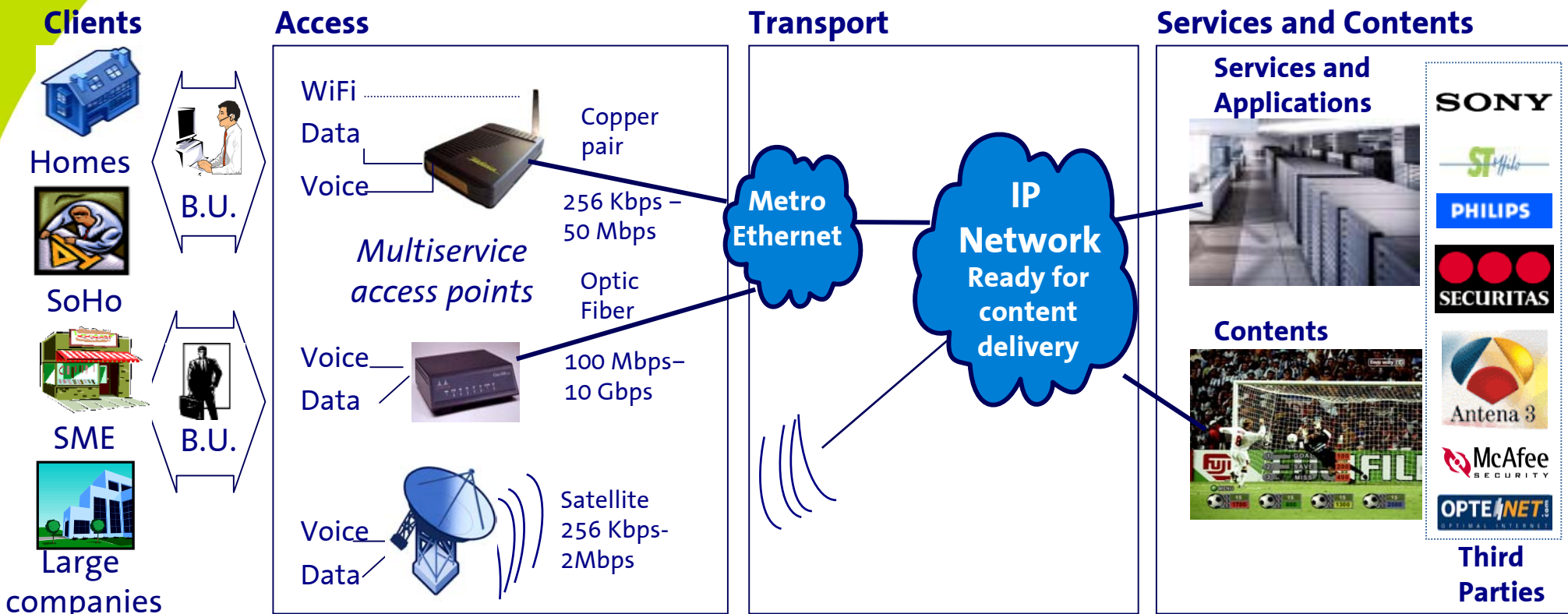
Through this four-priority program we are significantly transforming our company



- Being very close to customers (95% customer satisfaction)
- Adding value to access (25% BB)
- Transporting all kind of information (87% IP)
- Delivering all kind of services and contents (1.2 VAS/ADSL)

Note: Figures refer to 2006
BU= Business Unit

Through this four-priority program we are significantly transforming our company



- Being very close to customers (95% customer satisfaction)
- Adding value to access (25% BB)
- Transporting all kind of information (87% IP)
- Delivering all kind of services and contents (1.2 VAS/ADSL)
- Becoming more efficient and flexible (~670 lines per employee)

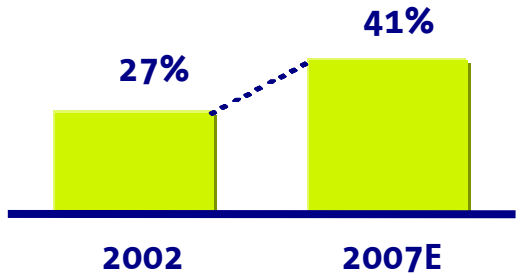
Note: Figures refer to 2006
BU= Business Unit

This transformation makes our company more commercial and leaner

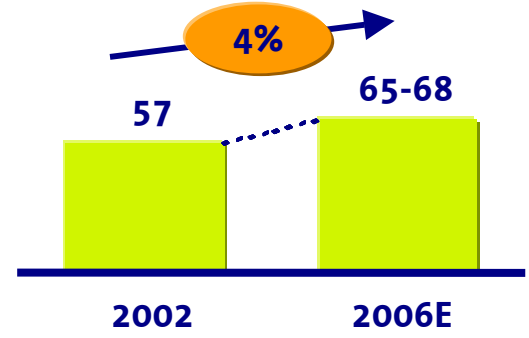


Stronger commercial focus

Reinforce our commercial focus
Commercial employees



Extract more value from customers
Total ARPU. Euro/month

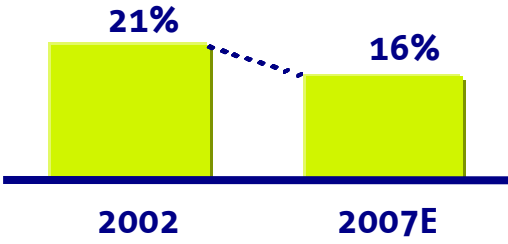


Fixed revenues

| Year | Fixed revenues (%) |
|-------|--------------------|
| 2002 | 52% |
| 2006E | 60-62% |

Leaner operating model

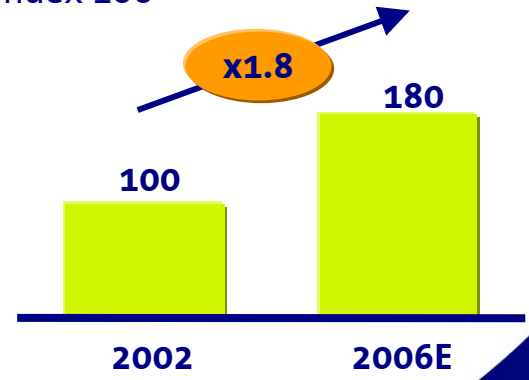
Become less personnel intensive
Personnel cost/operating revenues



Total employees

| Year | Total employees |
|-------|-----------------|
| 2002 | 40,700 |
| 2007E | 26,000 |

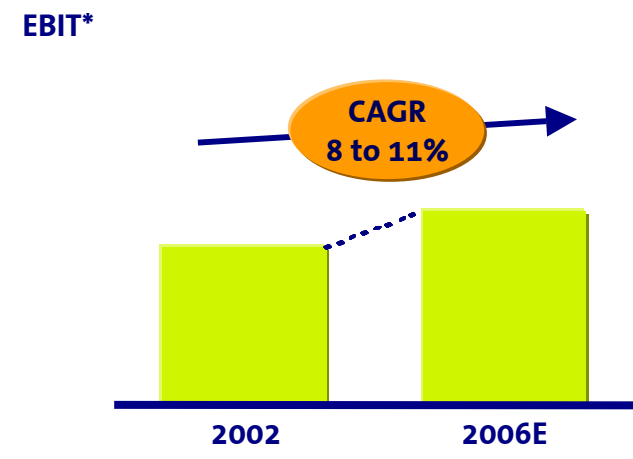
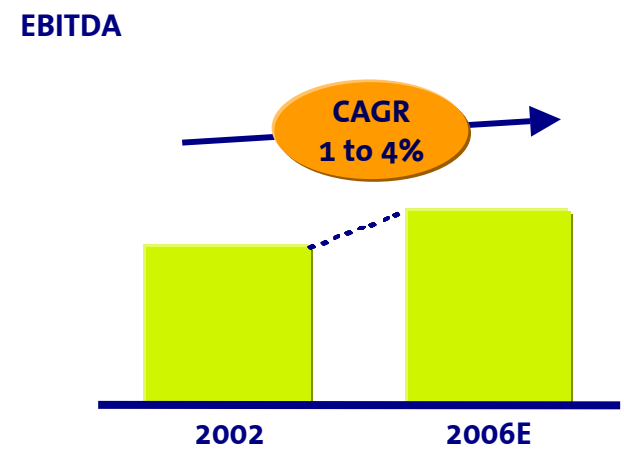
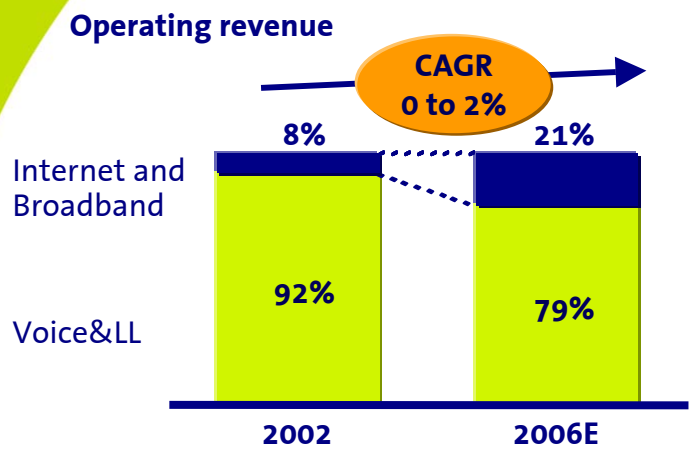
Increase asset turnover
2002=Index 100



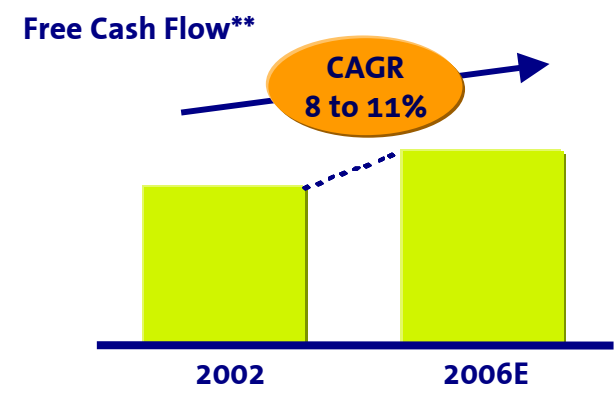
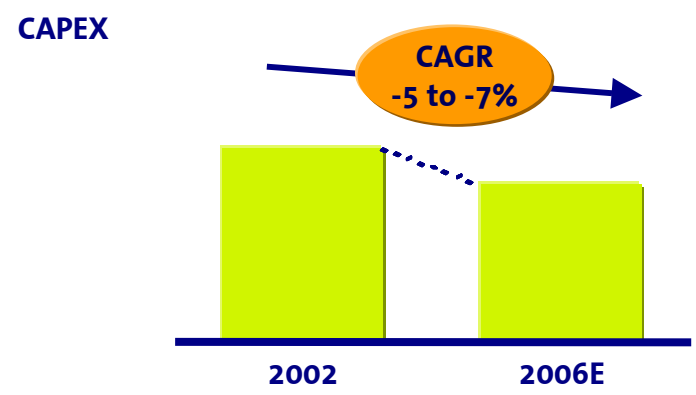
This solid base will allow us to accelerate our performance

TdE Parent Company

 CAGR



EBITDA margin
 2002: 44%
 2006E: 45-48%



CAPEX over revenues
 2002: 17.4%
 2006E: <12%

* EBIT= EBITDA – depreciation and amortization

** FCF= EBITDA – Capex – redundancy payments

Note: Internet and BB and Voice&LL revenues including wholesale business

In summary, we are setting the basis to deliver sound results

Ambitious targets...

Contain wireline voice revenue erosion under 3% per year

Profitable deployment of 3.5-4 million ADSL by 2006

1 billion of Opex savings by the end of 2007

Maintain Capex over revenues between 11-12%

...will transform our company...

Stronger commercial focus

Leaner operating model

...to deliver profitable growth

FCF +8 to 11% per year

FCF= EBITDA – Capex – redundancy payments

Telefónica
