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Safe harbour

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Telefonica

Building value: financial performance and flexibility

Key messages

- **Strong financial performance in 2001**
- **Sound financial management and flexibility**
- **Commitments to build value**

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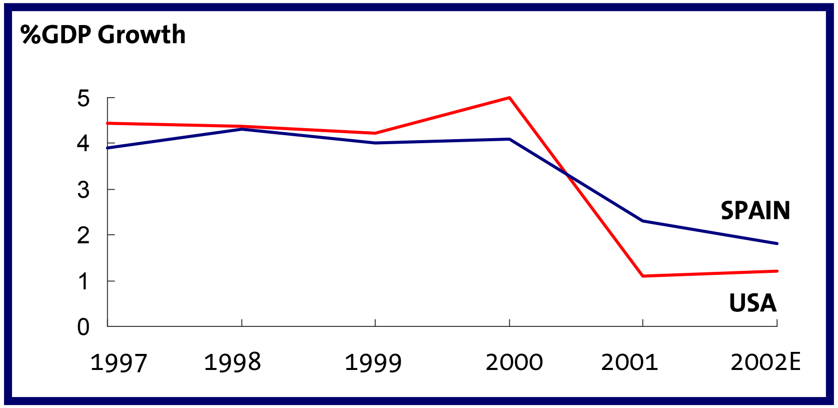
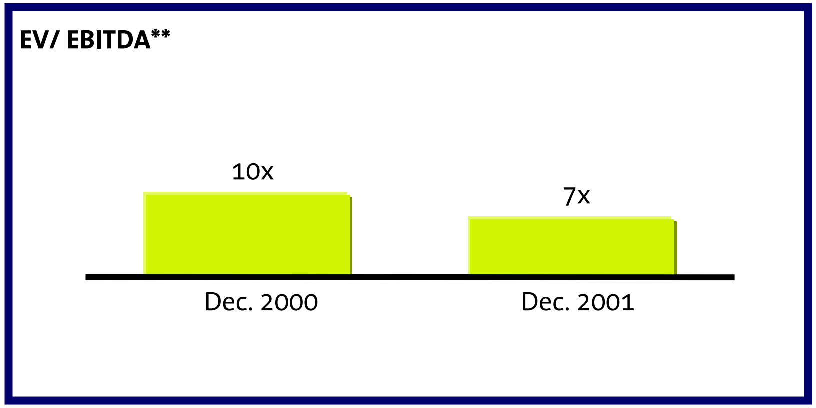
Telecom sector is facing a tough economic environment

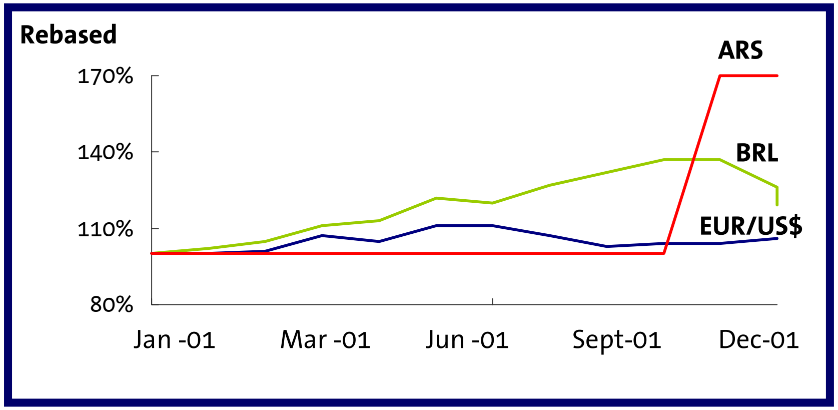
General economic slow down



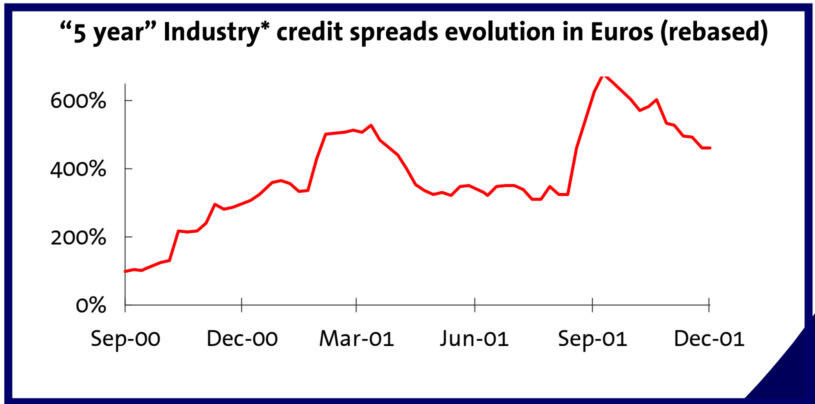
Change in expectations for telecom sector



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

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... Telefónica has overcome this situation based on ...

4 drivers of operational performance

- Diversified revenue streams
- Optimize efficiency and Strong EBITDA margins
- Capital allocation and Capex discipline
- Develop new growth platforms

+

4 principles for financial excellence

- Manage risk proactively
- Solid balance sheet
- Optimize cost of capital (funding strategy)
- Efficient support processes

... and has delivered strong fundamentals

Euro Billion

	2001	2000	% Change
Operating revenues	**31,053**	**28,486**	**9.0**
EBITDA	**12,804**	**11,919**	**7.4**
EBITDA margin	*41.2%*	*41.8%*	*-0.6 p.p.*
Operating profit	**5,430**	**4,958**	**9.5**
Net interest expense	(1,862)	(1,860)	0.1
Argentinean peso devaluation to 1.7 ARS per USD	(529)	-	n.a.
Amortization of goodwill	(842)	(501)	68.1
Other income (expense)	(163)	271	n.a.
Income before taxes	**2,034**	**2,868**	**(29.1)**
Net income	**2,107**	**2,505**	**(15.9)**

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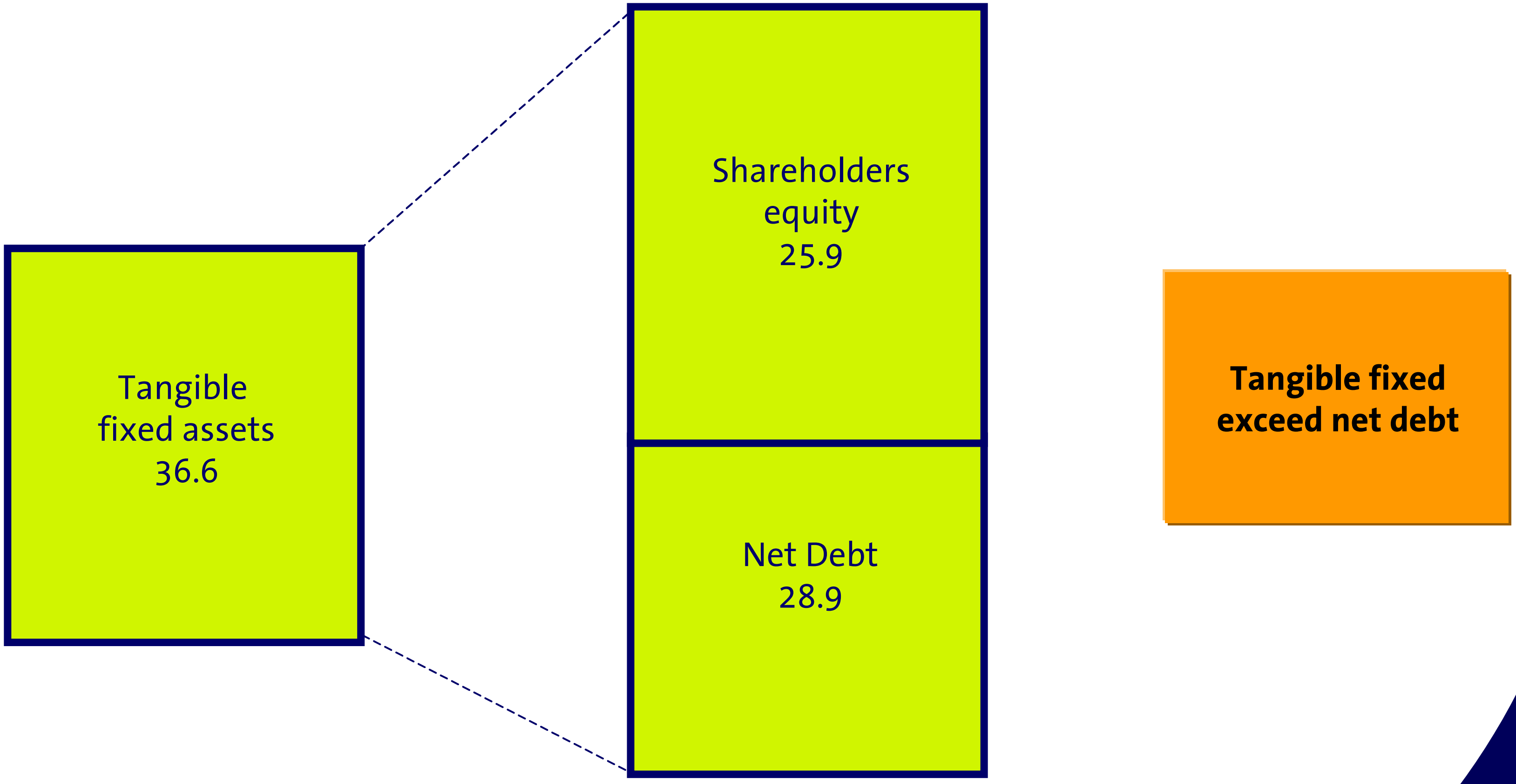
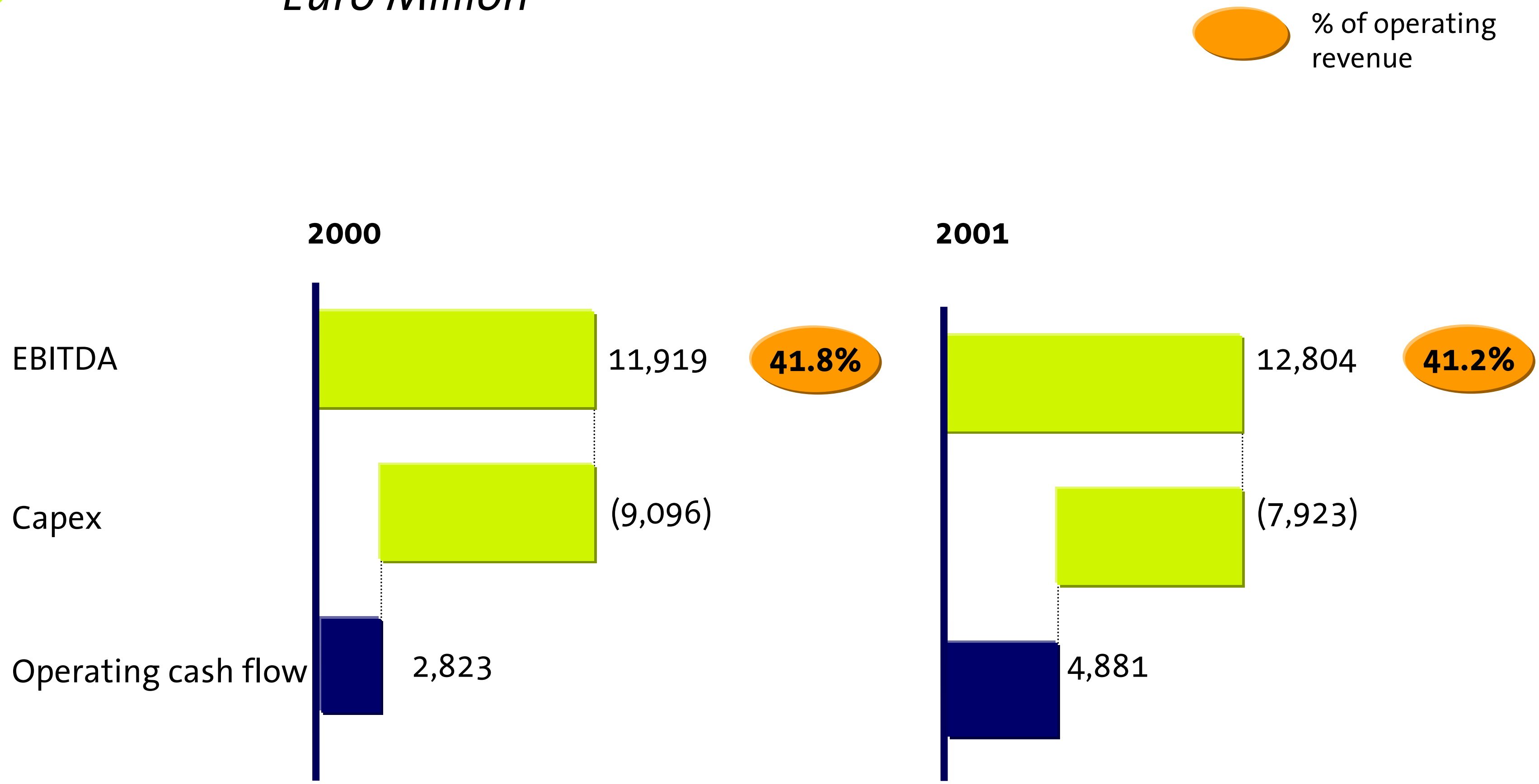
Telefónica enjoys a sound financial structure

Euro Billion



Telefónica has achieved a positive strong operating cash flow

Euro Million



Key messages

- **Strong financial performance in 2001**
- **Sound financial management and flexibility**
- **Commitments to build value**

Telefónica consistently pursues excellence within its financial management

Manage risk proactively	• Continuous evaluation of macroeconomic situation • Expertise in risk management • Address different hedging needs with different tools

Telefónica

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

Telefónica has a diversified portfolio

- Geographic diversification limits overall portfolio volatility
- Equity financed acquisitions share FX risk with seller

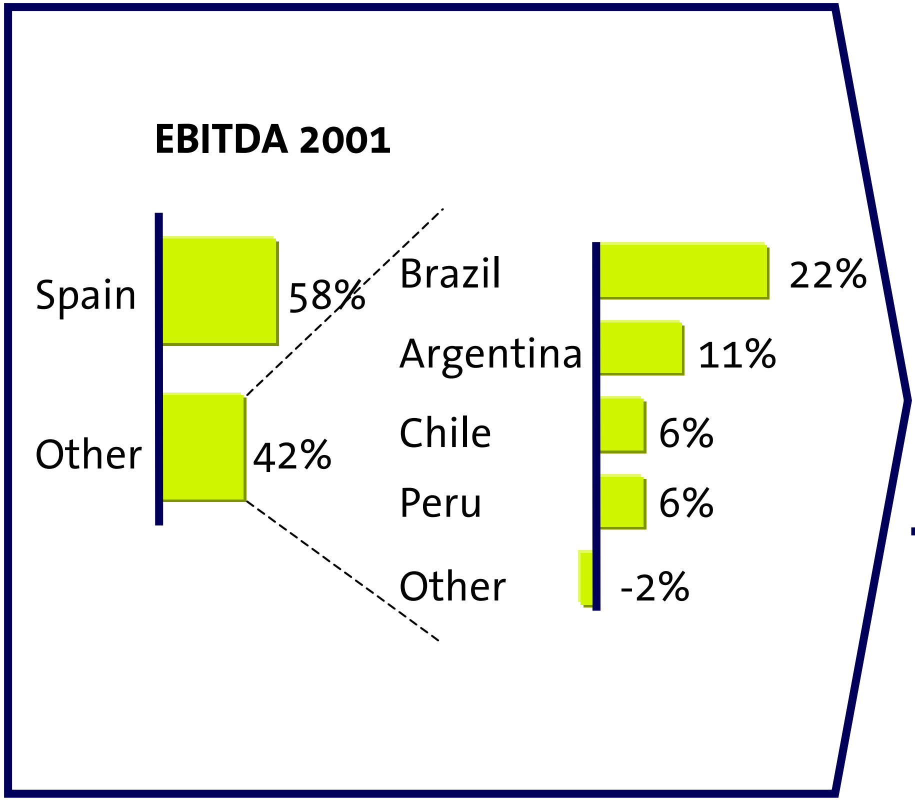
Continuous evaluation of macroeconomic situation

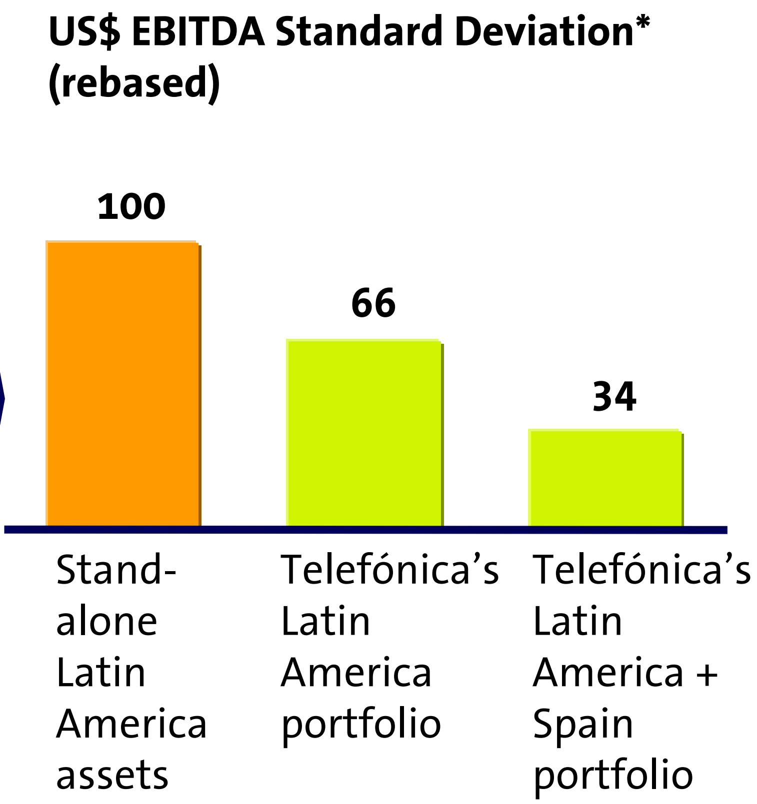
- Evaluate macroeconomic trends through a global team of macroeconomists supported by local experts
- Use Telefónica's deep network in Latin America to gain insight on economic situation and future developments
- Periodic top management and board reviews of situation in key geographies
- Launch "deep reviews" when needed (i.e. early 2001) to modify local business plans and prepare hedging plans

Top class hedging capabilities

- Use accounting hedges to reduce FX balance sheet exposure
- Match FX cash flow exposures with cash hedges

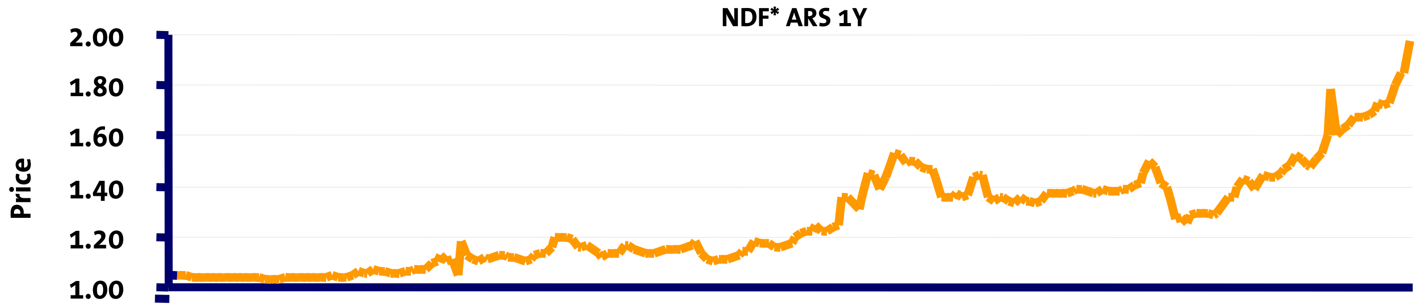
… based on our geographic diversification …

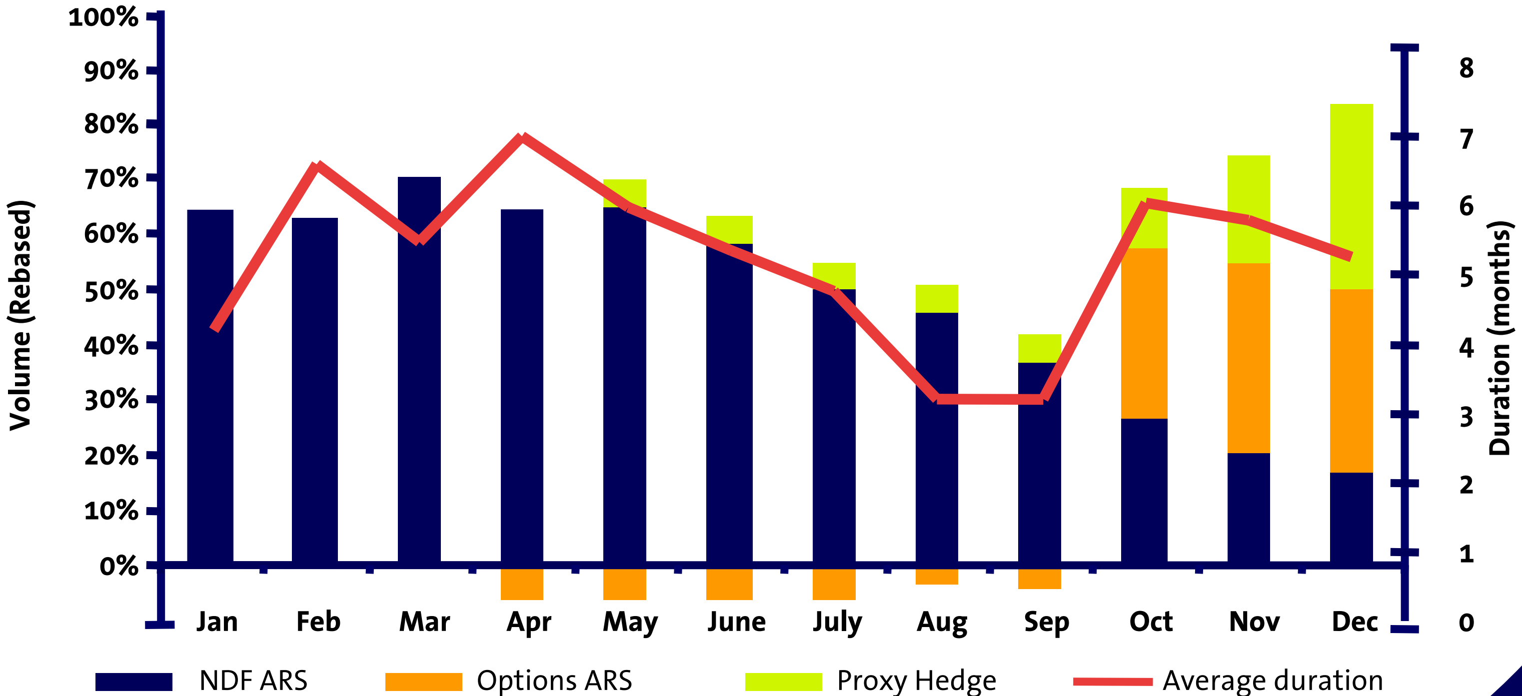




*1990-2001

... and timely accessing imperfect hedging markets ...



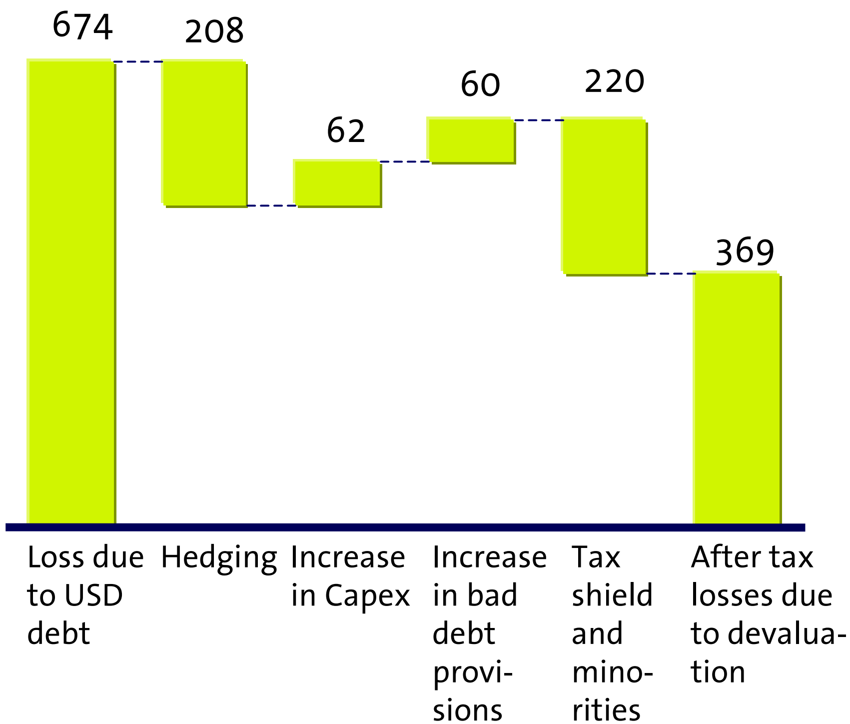


* Non delivery forwards

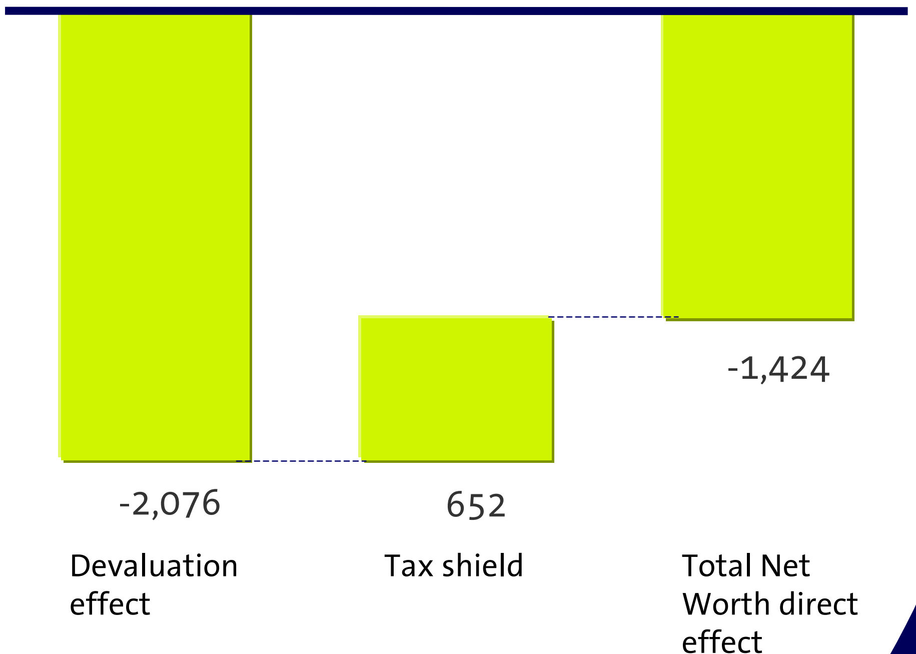
... we managed to mitigate the effects of the crisis in Argentina in 2001 ...

Euro Million

Income statement effect*



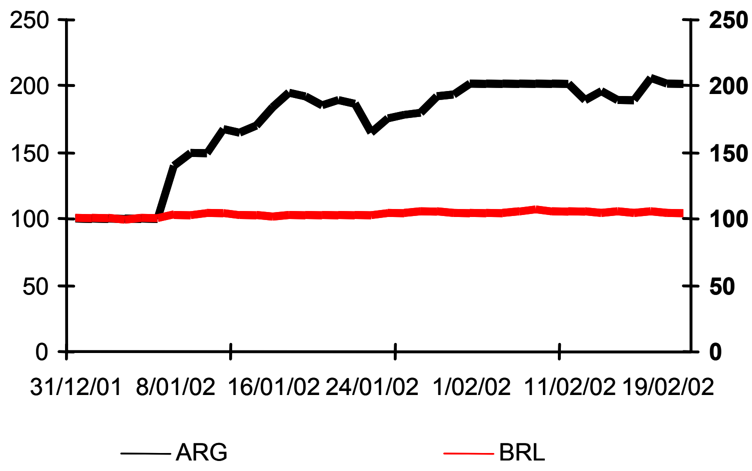
Net Worth effect*



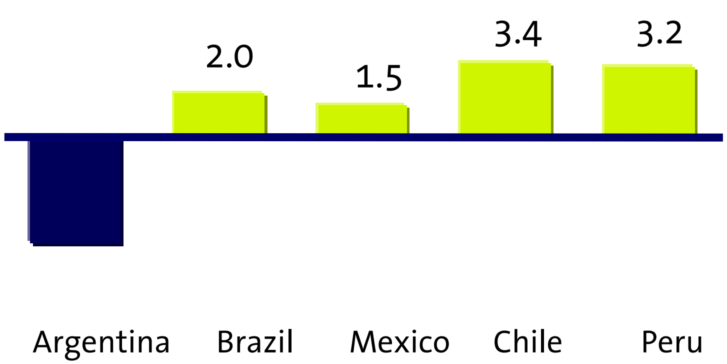
* ARS/USD = 1.7

...and we have protected our exposure in the rest of the region although markets do believe in decoupling

Exchange rates indexed



2002 GDP Growth



Brazilian Real is not correlated with Argentinean Peso

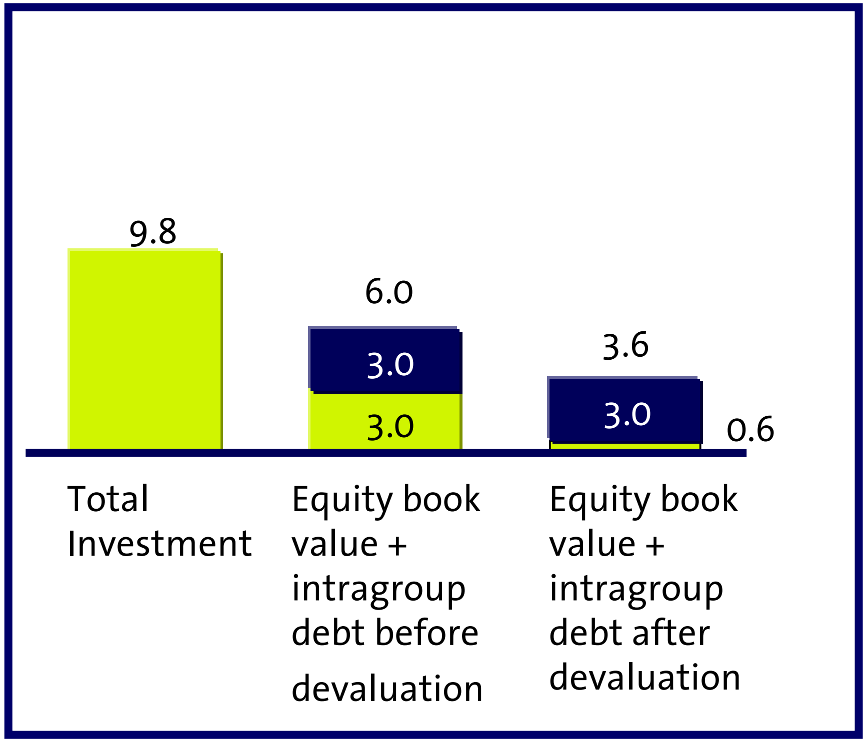
Economic crisis in Argentina is not expected to affect the rest of the region

Source: Bloomberg and Market consensus

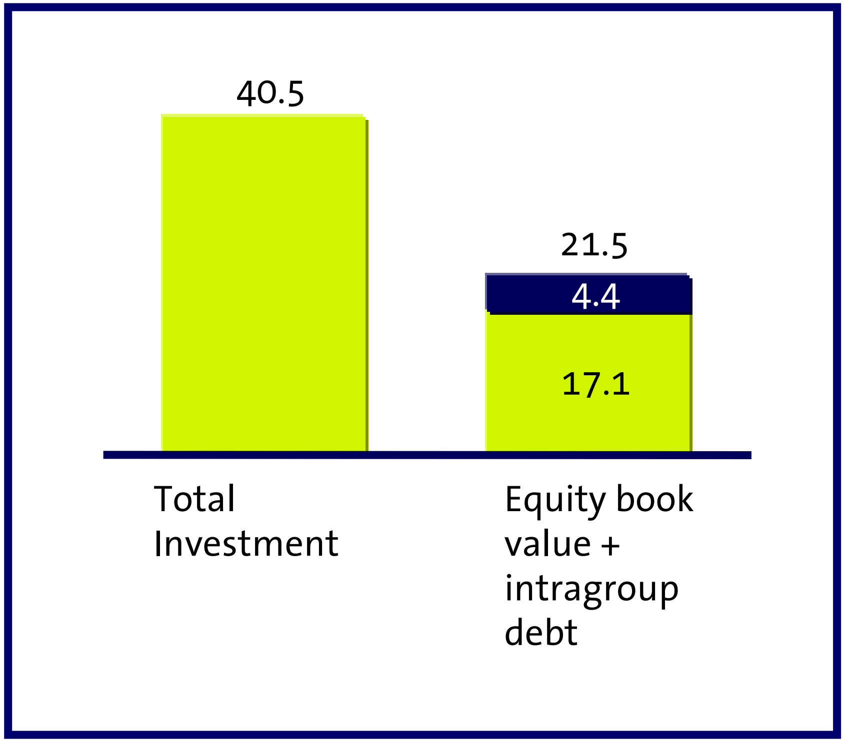
We have used different hedging tools to cover both accounting and cash risks

Euro Billion

Argentina



Latin-America



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...and we benefit from sound investments made in recent years (case study: Telesp)

US dollar Billion

Transaction	Telefónica investment	Stake acquired	Implicit EV/EBITDA* Multiple
Telebras privatization	3.1	8.3%	18.5 x
Debt payment	0.3	0.8%	18.5 x
Shares buy-back	0.4	5.1%	13.4 x
Telesp Restructuring		5.1%	10.0 x
Telesp Tenders	8.9	62.6%	7.8 x
Other acquisitions	0.1	0.7%	14.0 x
Total**	12.8	82.6%	8.3 x

Equity book value
$ 7.8 Billion

* 2001 EBITDA
** 87.4% after equity swap with Portugal Telecom

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

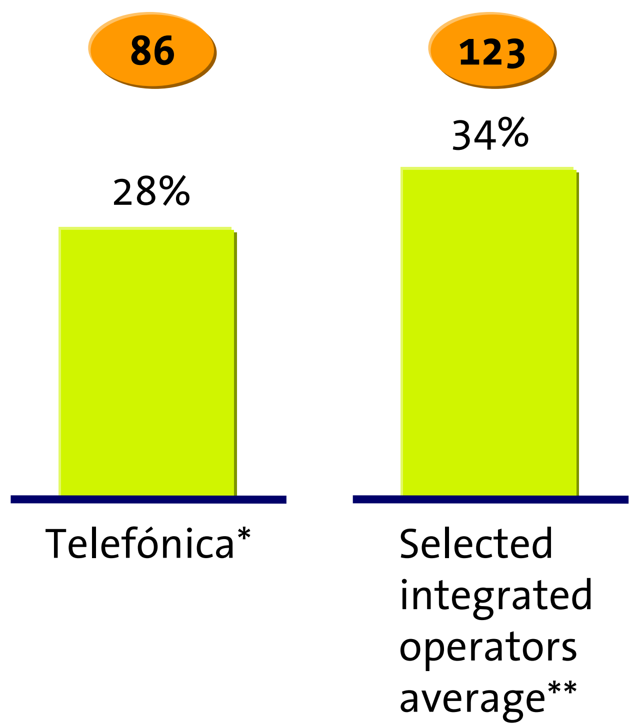
Manage accounting quality

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

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

Total assets (Euro billion)

Lower proportion of intangible assets on balance sheet



Restated asset base to fair value since 1998

Restated asset base to fair value since 1998	Impact (Euro billion)
▪ Restatement to fair value of several tangible assets both in Spain and abroad	2.2
▪ Write off goodwill arose within several acquisitions	1.5
▪ Accounting hedging of acquisitions financed with equity	16.5
	20.2

* Under proportional consolidation method

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

Source:ABN AMRO

… and we follow prudent accounting practices and total transparency

Conservative accounting principles (Spain GAAP)

- Spain GAAP is based on the principle of prudence: account for all eventual losses and all foreseeable risks when known
  - We record provisions to reflect a decrease in the fair value of assets; but account for profits only when materialized
- We do not record the increases in the fair value of assets

Transparent accounting and reporting

- All subsidiaries are consolidated in the Group accounts, including all SPV's
- In accounting for IRU's (Indefeasible Right of Use of Capacity Agreements), we recognize the income over the period of the contracts in an accrual basis

Telefonica

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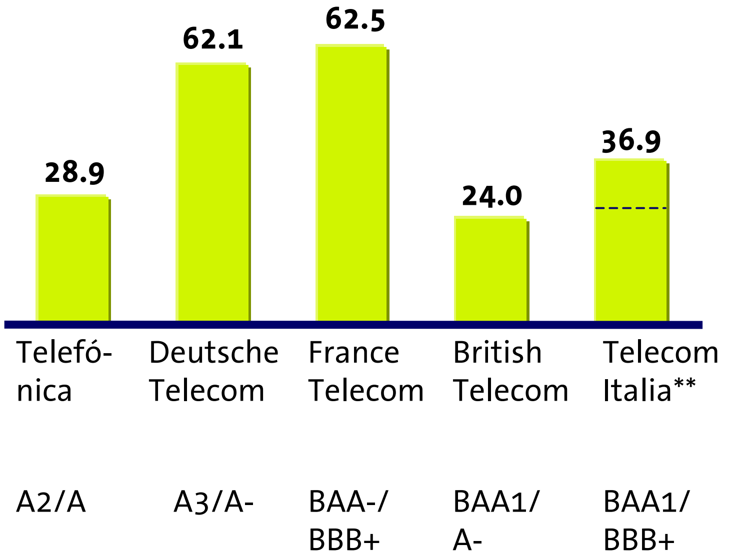
- Transparency

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"

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

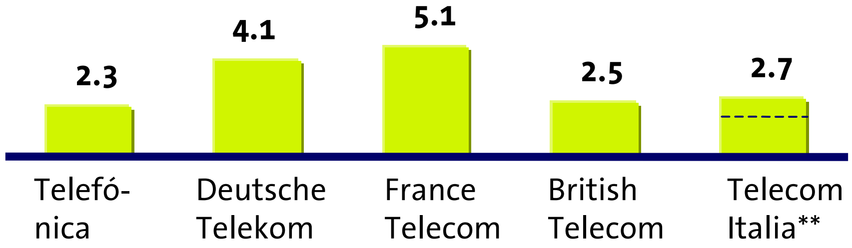
Net debt position and rating* (Euro billion)



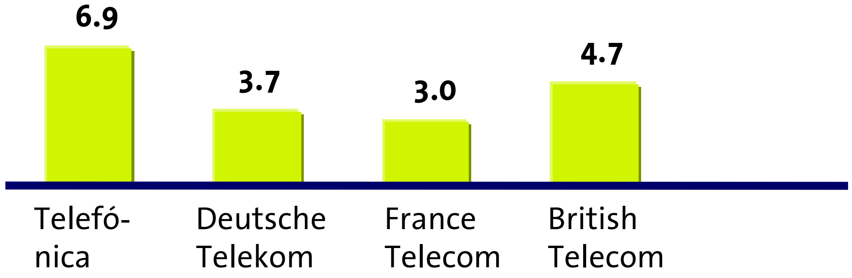
We are committed to maintaining our current credit rating

Debt capacity position

Net Debt / EBITDA 2001



EBITDA / Interest expenses 2001

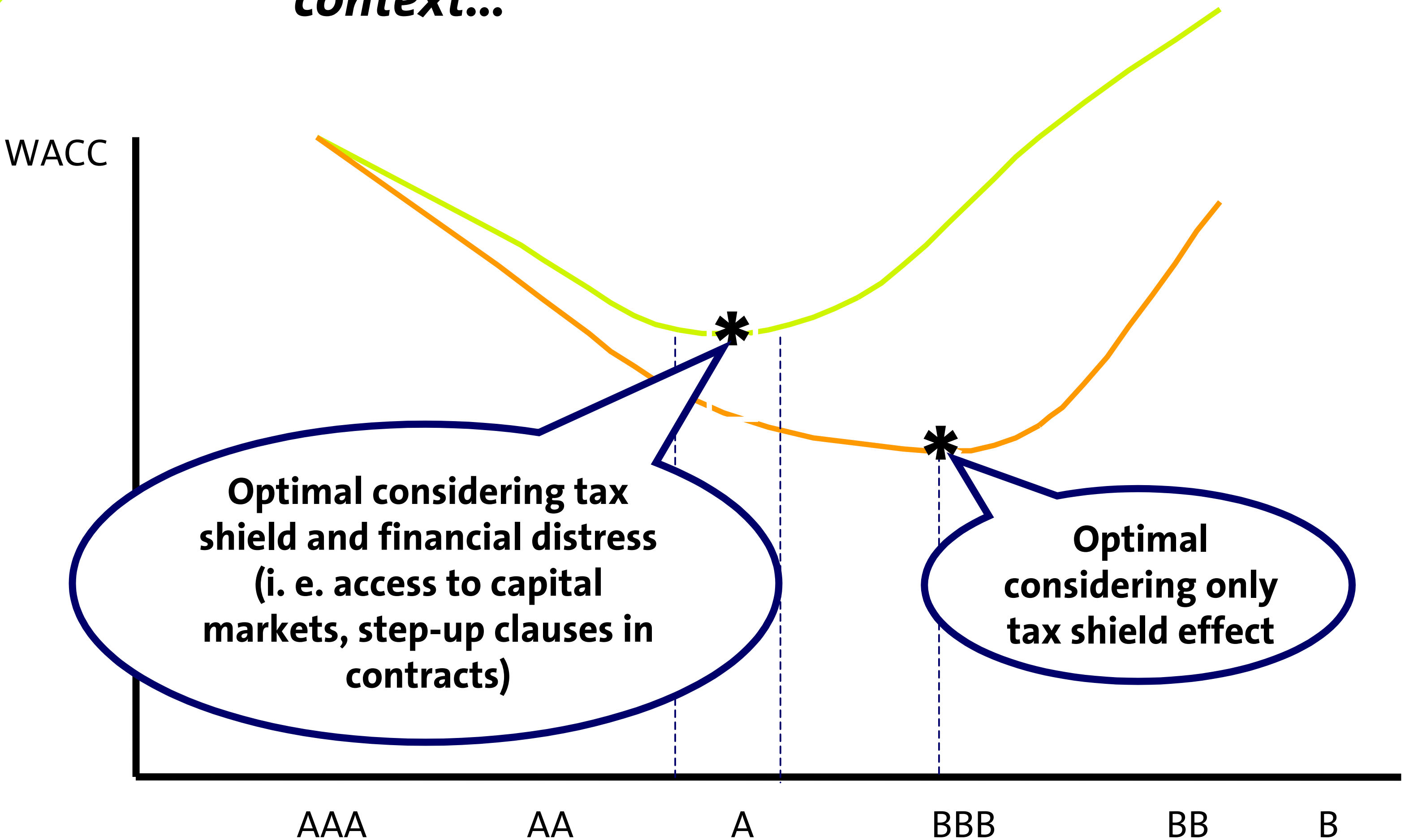


* Moody's/Standard and Poors

** Including Olivetti net debt

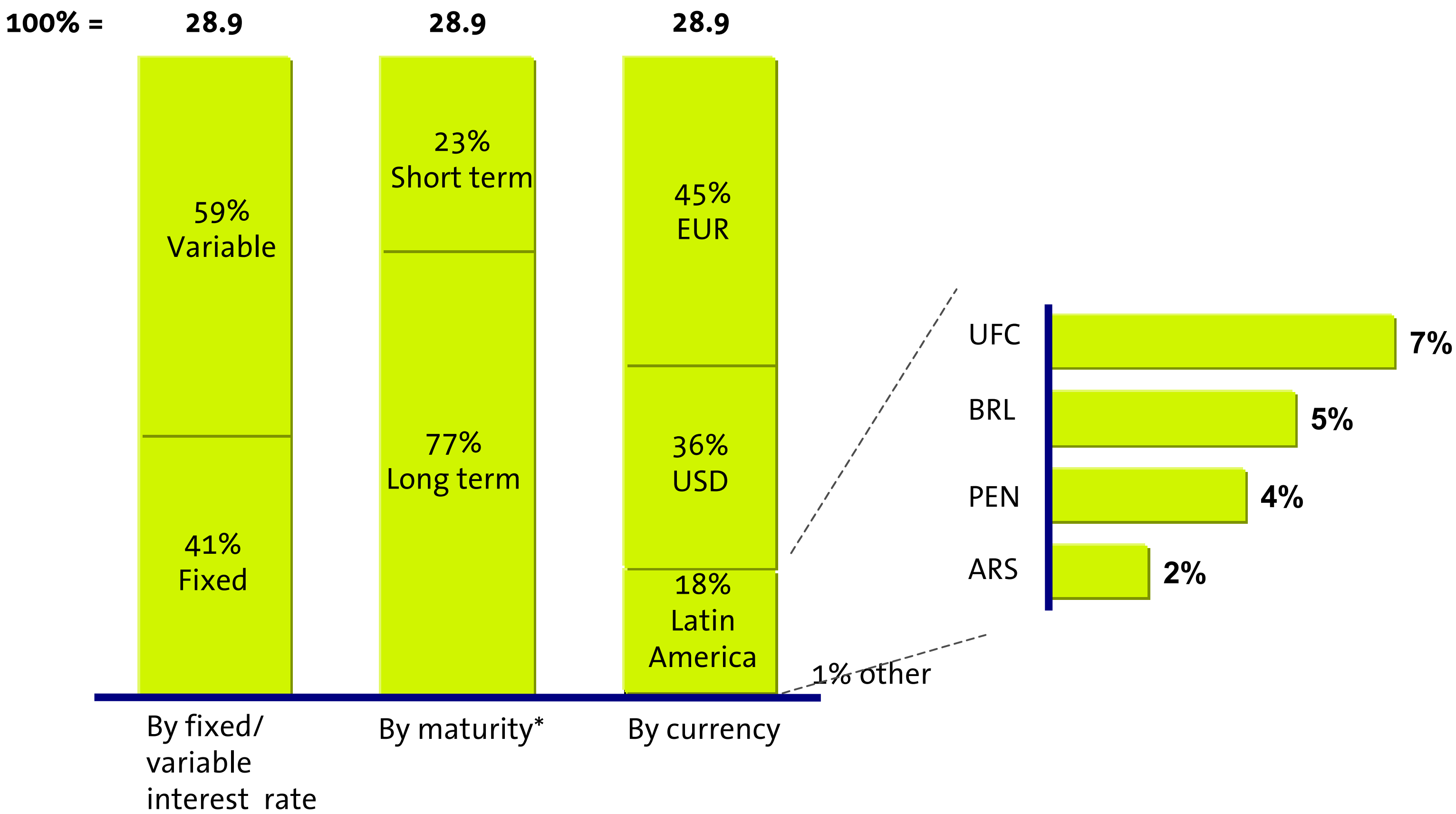
Source: Annual Reports, SSSB, ABN Amro

... with a single "A" rating that we consider optimal within the current economic context...



... and a balanced debt structure ...

Total debt. Euro Billion. Percentage



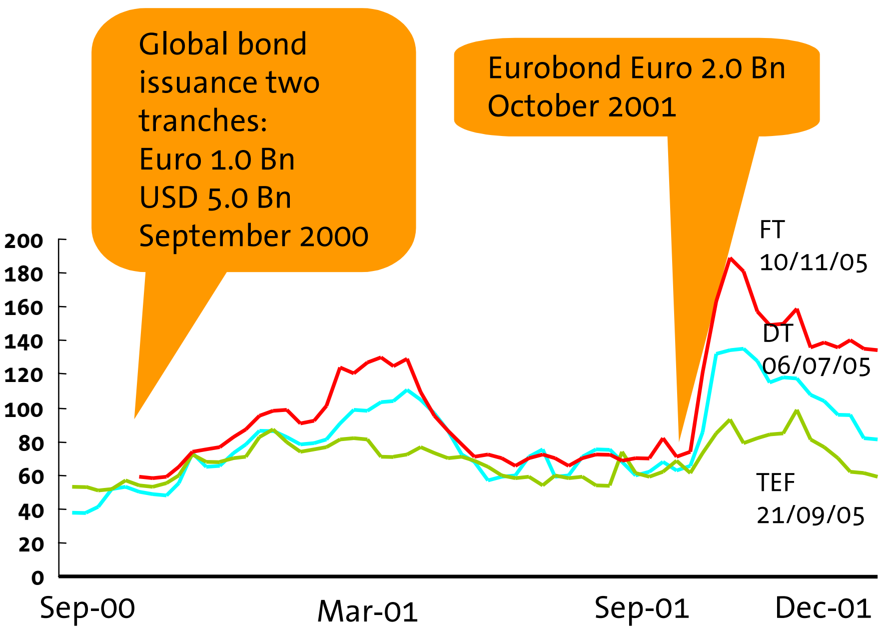
* Average maturity of 5.5 years

... that we manage to refinance even within current difficult market conditions

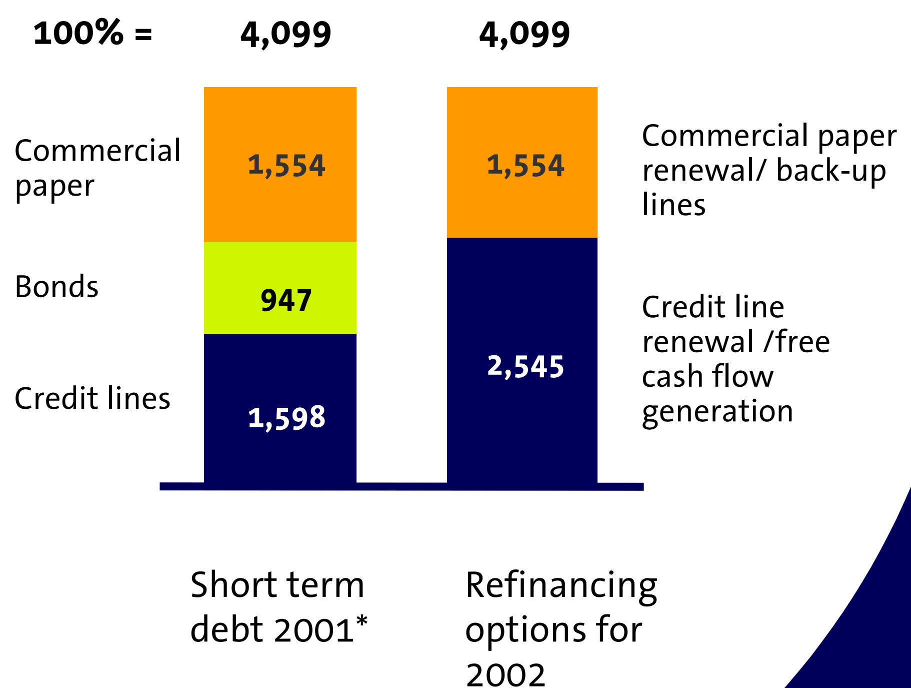
Euro Million

"5 year" credit spreads evolution in Euros

Spread over IRS in B.P.



Telefónica's short term debt refinancing



*Net maturity until 31/12/2002

Source: Bloomberg

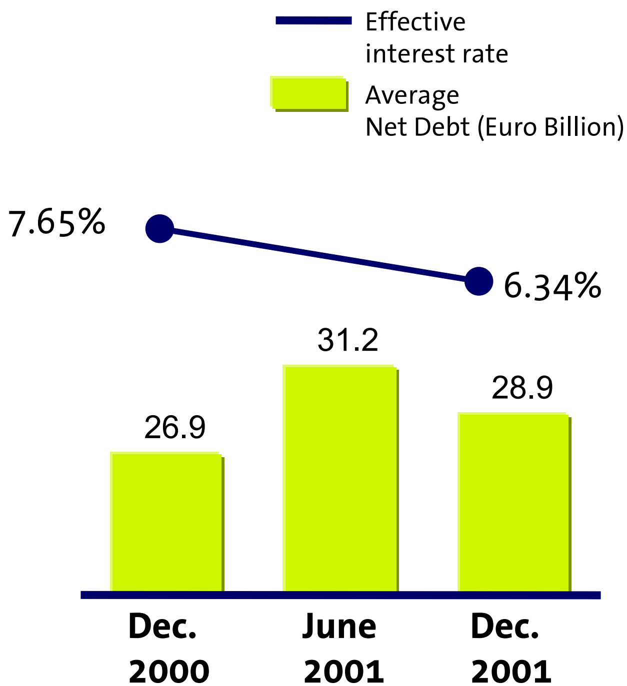
Telefónica consistently pursues excellence within its financial management

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

Telefónica

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

Telefónica

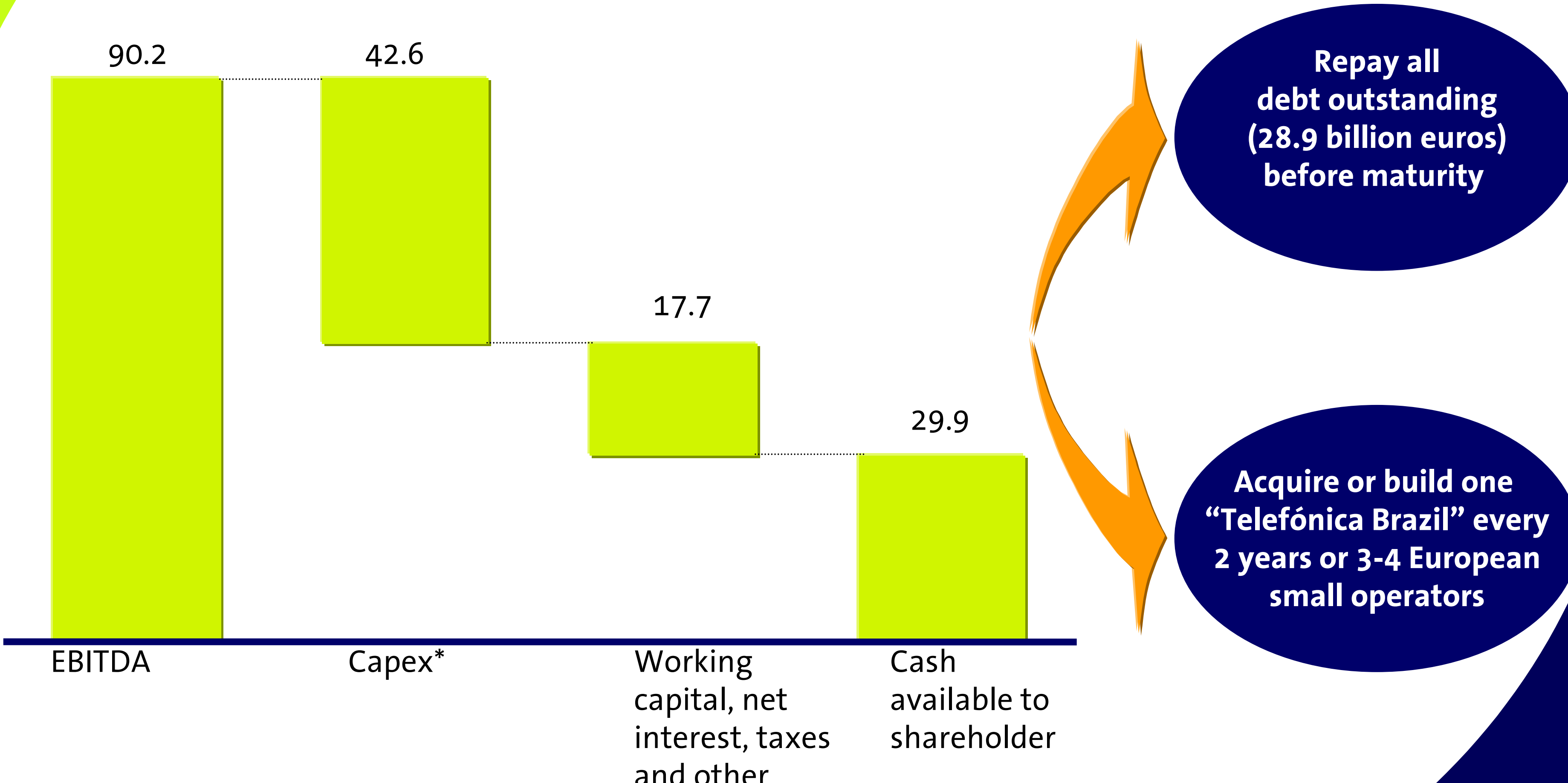
We have obtained remarkable efficiency improvements in support processes in the finance area through several initiatives

	Description	Savings
Shared services	• Reduced costs and investments through concentration of support activities • For the units swap a fixed cost to variable • Free up management time and provide common tools	• NPV USD 850 million
Treasury manage-ment	• Cash pooling for all business units in Spain • Corporate treasury: finance short term needs of the Group and manage working capital for non-Spanish operators	• Implicit savings of Euro 21 million in 2001 • Implicit savings of Euro 65 million in 2001
Insurance	• Manage centrally corporate insurance	• Quality coverage and savings
Investor relations	• Provides transparency (2nd in Europe as per Reuters Institutional Investor Survey 2002)	

Telefónica

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

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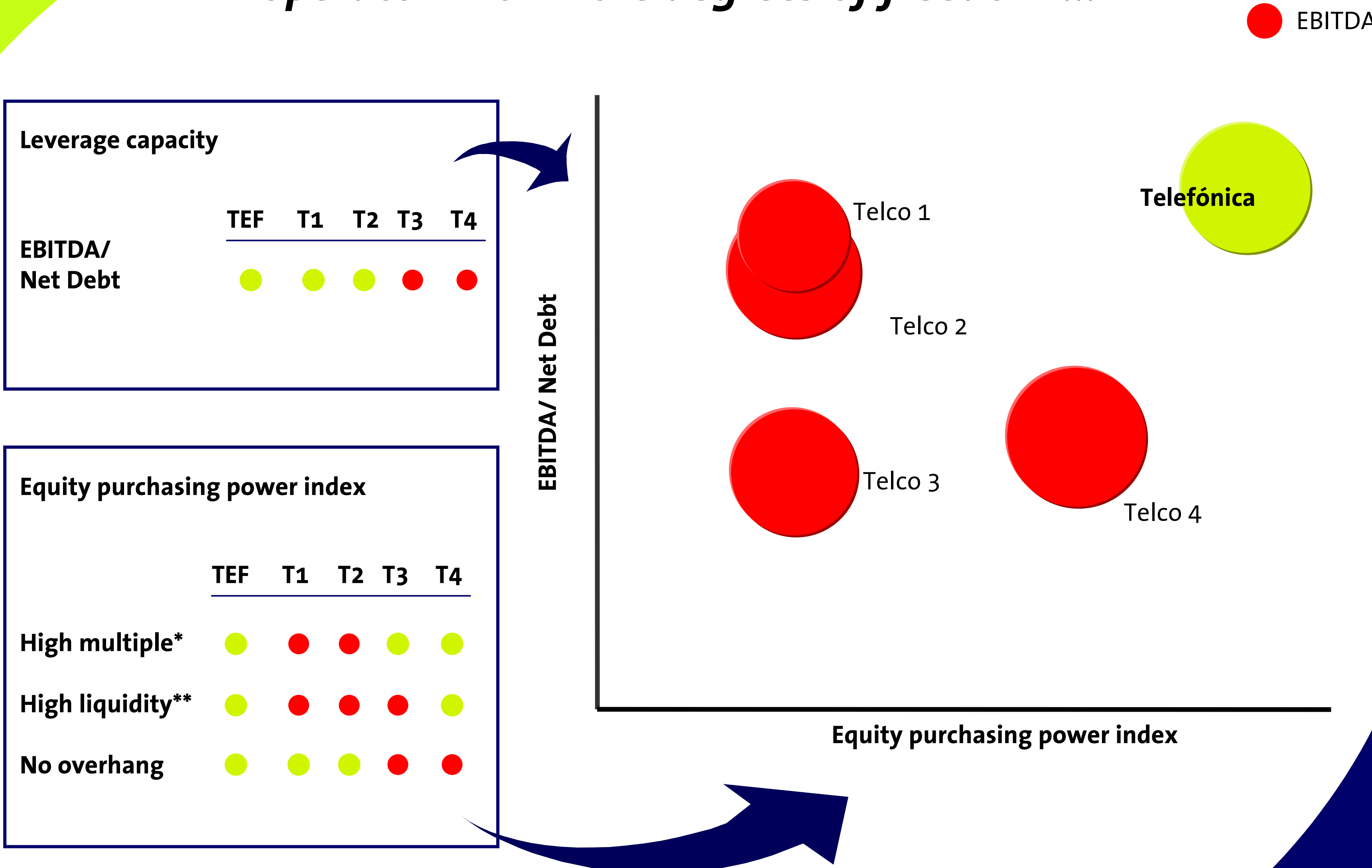
... and makes Telefónica the European large operator with more degrees of freedom ...



* 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

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 additional aspects and processes

- Optimize cost of capital
- Efficient support processes

Key messages

- **Strong financial performance in 2001**
- **Sound financial management and flexibility**
- **Commitments to build value**

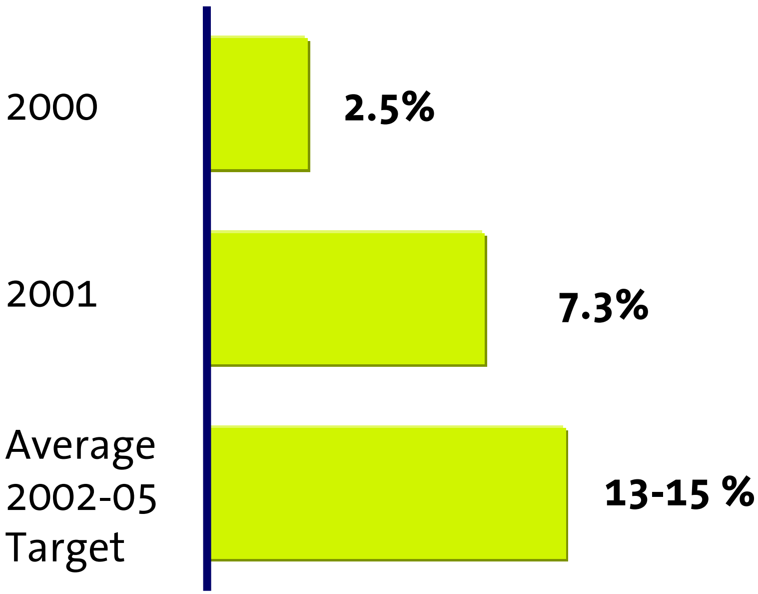
Telefónica

We have made good progress against the commitments shared in Rio

- Solid and well diversified revenue growth ✓
- Well balanced growing EBITDA margin ✓
- Reinforcing capital discipline: Capex/Revenue ✓
- **Enhancing free cash flow margins** ✓
- **Improving asset turnover: revenue/capital employed** ✓

Concrete actions have been taken to reach cash flow margin targets

Cash flow* margins



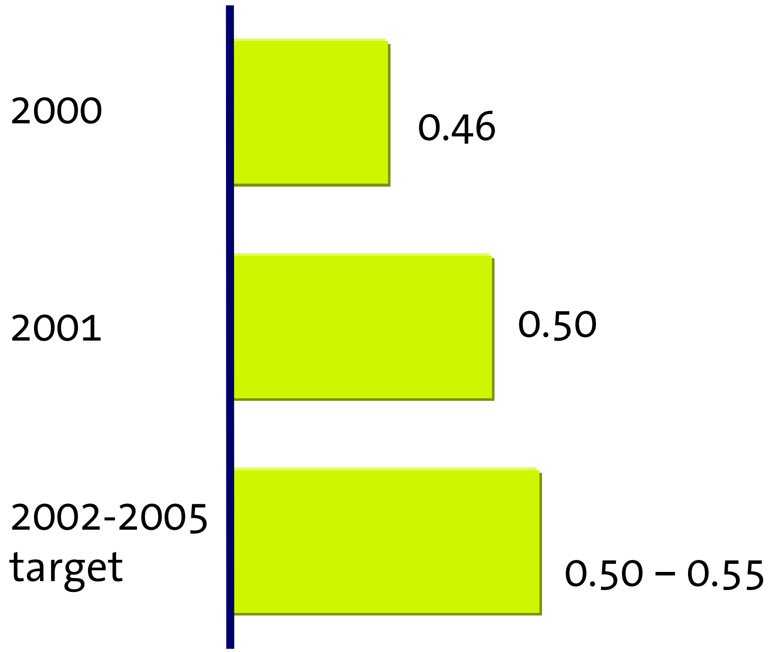
Key actions to improve CF

- Improving operational efficiencies
- Monitoring interest expense
- Generating more value in centralized functions
- Optimizing tax planning
- Reducing minority losses

* Operating cash flow – financial expenses - taxes

... and to continue optimizing asset turnover

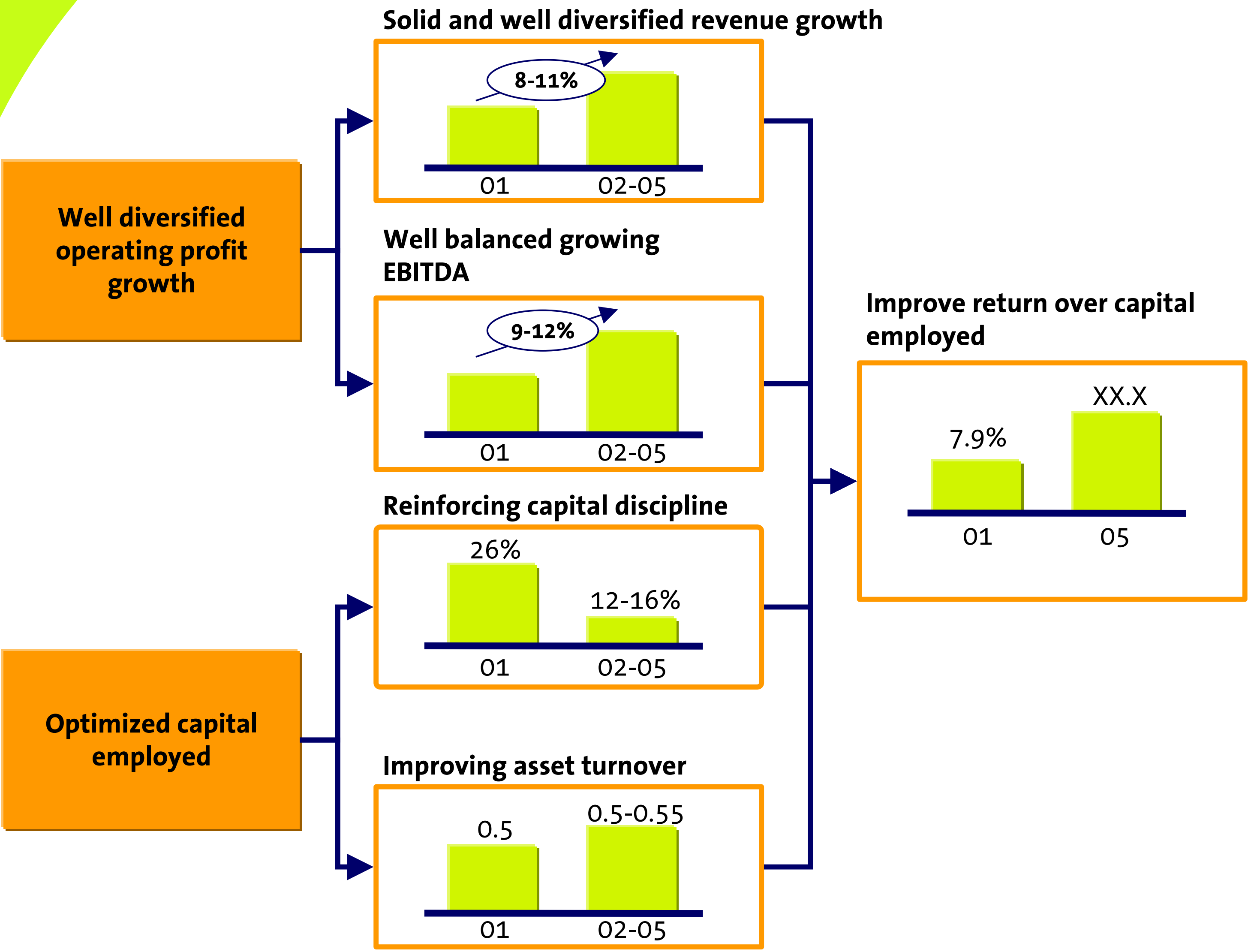
Asset turnover*



- **Telefónica has launched a number of actions to reduce capital employed while creating value**
  - **Real estate divestitures to reduce capital employed by one billion euros in three years**
  - **Factoring**
  - **Divestiture of financial stakes**

* Revenues/capital employed

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



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

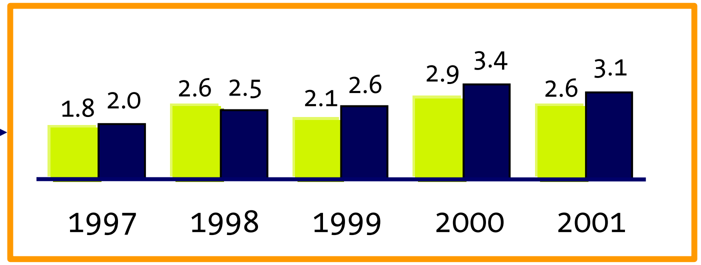
... while continuing to enhance our cost of capital

Percentage

Telefónica
Selected Peers' average*

Efficient cost of equity

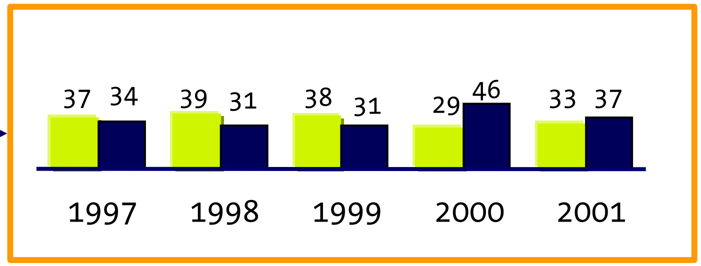
Limit operational and financial risk
Share price standard deviation



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

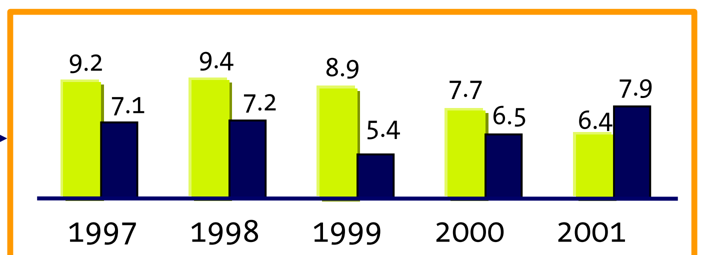
Optimised cost of debt

Optimize capital structure at efficient frontier
Net debt/total assets



- **Optimal position at efficient frontier for debt**

Improve cost of debt
Effective interest rate



- **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

Telefónica

Finally, we are committed to continue offering a unique investment proposition with a clear focus on value creation

We have a strong position . . .

- Strong operational performance in 2001
- Solid and transparent balance sheet
- Flexibility to capture organic and non organic growth opportunities
- Better financials than the peer group

. . . that we commit to improve further . . .

- Five clear commitments from "Rio"
- Maximize ROCE
- Optimize Cost of Capital
- Use cash generated in value creating opportunities

. . . counting on the competitive advantage that represents our financial expertise

- Efficient shared services (horizontal initiatives)
- Intra group "debt market"
- Top class risk management integrated with the businesses
- Financial innovation
- Commitment to value creation

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