

The top half of the slide features a background of concentric wood grain patterns in shades of brown and tan. A dark blue horizontal bar is overlaid on the right side of this section.

Second Investor Conference

March, 2002, Seville

The Telefonica logo is written in a yellow, cursive script font and is underlined with a thin yellow line. It is positioned on the right side of the slide, overlapping the dark blue bar.

*Telefonica*

The bottom half of the slide features a background of blue water ripples. A dark blue horizontal bar is overlaid on the left side of this section.

Julio Linares

Executive Chairman of Telefónica de España

## ***Safe harbour***

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# **Telefónica de España: Focus On Earnings And Profitable Broadband Growth**

# Contents

- **2001 results: fulfilling Rio de Janeiro commitments and reversing the downward trend**
- Traditional and wholesale businesses: extracting the maximum value
- Broadband: capturing the opportunity
- Forecasts and commitments: continuing our profitable growth

# We have fulfilled the commitments announced in Rio for 2001 ...

	Target 2001	Actual 2001	
<b>Operational Targets</b>	ADSL lines in service in 2001	250,000 with 90% coverage (84% effective)	375,800 with 88% coverage (82% effective) ✓
	Installation rate (ADSL/day)	1,000	3,000 ✓
	Voice mail boxes	10 million	10.1 million ✓
	Lines with caller ID	2 million	3.5 million ✓
	Semi Flat rate packages	5 million	3 million ✓
<b>Financial Targets</b>	Fixed revenues*	50% to 55%	47% ✓
	Operating expense growth	0% to -4%	-3.1% ✓
	Personnel costs	-4% to -5%	-5.8% ✓
	Capex over revenues*	<20%	18.9% ✓
	Capex in broadband*	30% to 35%	39.8% ✓
	Operating cash flow*	3 bn Euro	3.5 bn Euro (Free Cash Flow: 1.6 bn Euro) ✓

\* Parent company

*... and have advanced toward our objectives for 2004*

		Objective 00-04 Percent	Actual 2001	
<b>Operational objectives*</b>	• Lines per employee	+15 to 20%	+2.5%	✓
	• Network cost per minute	-40 to -50%	-35%	✓
	• I+M+C cost per line	-15% to -20%	-5%	✓
	• Sales cost per unit	-15%	-6%	✓
		CAGR 00-04	Actual 2001	
<b>Financial objectives</b>	• Operating revenues	-1 to +3%	0.4%	✓
	• EBITDA margin	42 to 45%	44%	✓

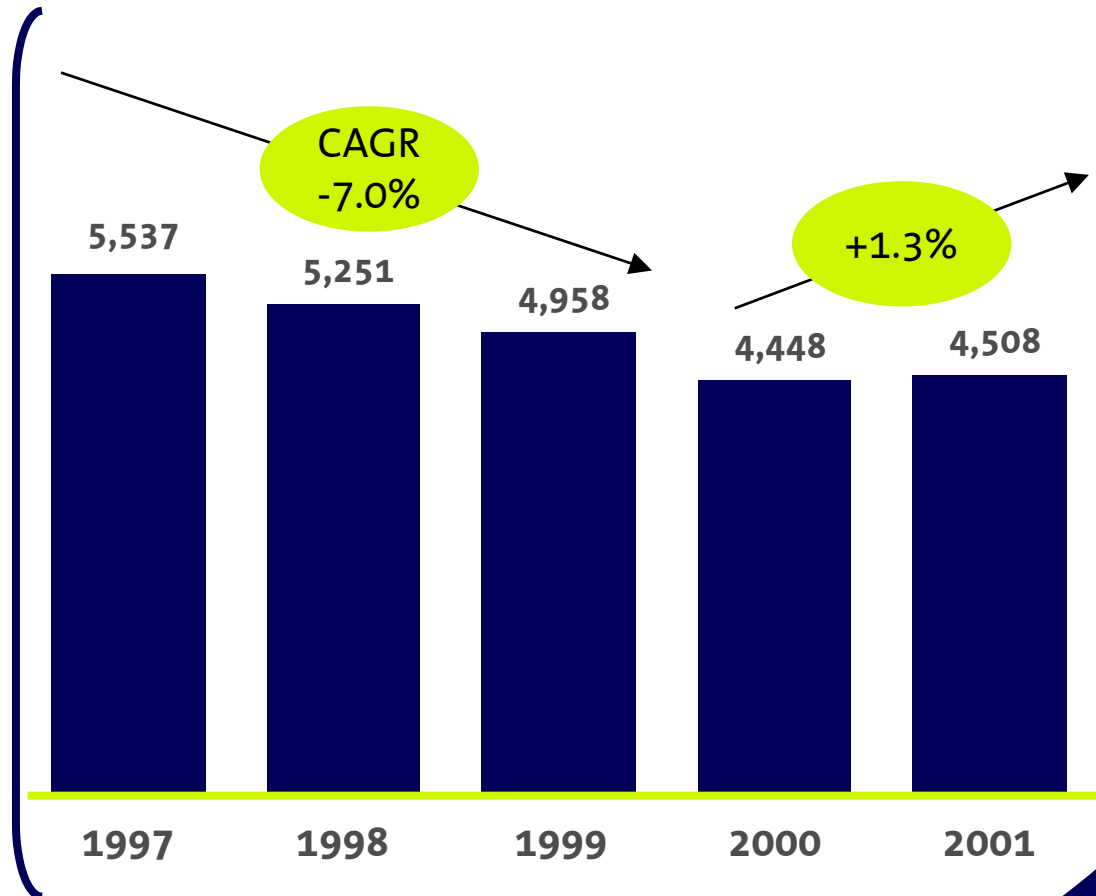
\* Parent Company

# In 2001 we continued to deepen our transformation process and are starting to capture its results

**EBITDA**  
Million Euro

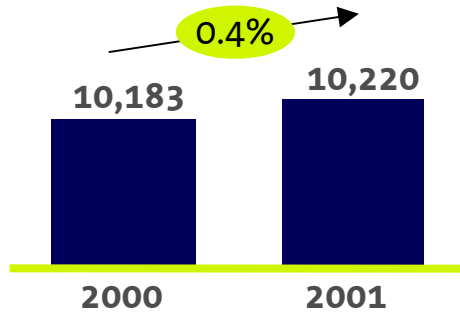
**Reversing a 3 year downward trend achieving EBITDA growth by:**

- Commercial strategy:
  - Traffic growth through packages
  - Price and discount management
- Efficiency improvement:
  - Reduction of operating expenses
- Regulatory context:
  - Tariff rebalancing through monthly fee increases

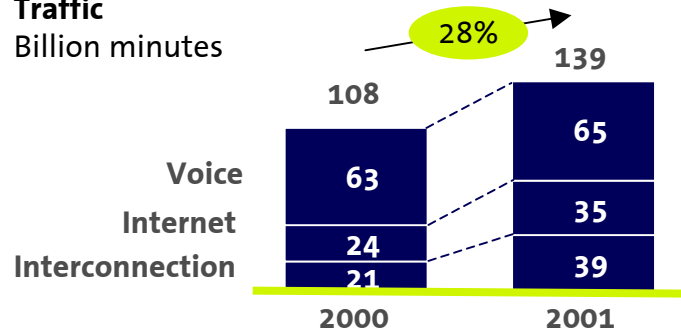


# We defended our business in a mature environment achieving revenue increase...

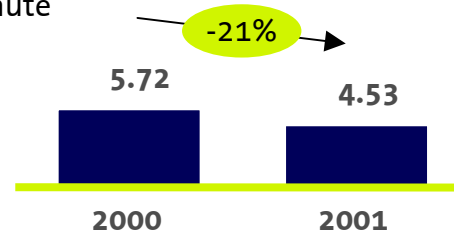
**Operating revenues**  
Million Euro



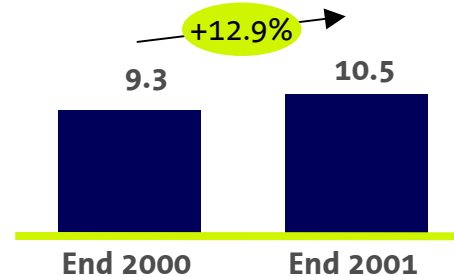
**Traffic**  
Billion minutes



**Effective prices**  
Euro Cents/minute



**Monthly fee**  
Euro/Month



- Selective commercialization of semi-flat voice packages
- ISDN high growth
- Interconnection traffic contribution

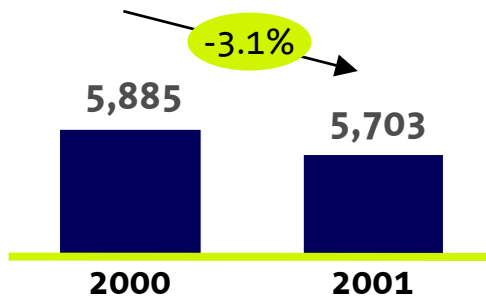
- Management of price-cap and competitive pressure

- Reduction of current access deficit



## ... and strictly controlling costs

**Operating Expenses**  
Million Euro



**Personnel costs**  
-5.8%

- Average headcount reduction of 9.9% partially offset by salary increases

**Interconnection costs**  
+0.5%

- Slowdown of interconnection costs growth due to tariff reduction

**External supplies, outsourcing and other costs**  
-3.2%

- Decrease of external supplies
- Significant effort in commercial costs
- Increased outsourced activities to offset:
  - headcount reduction
  - needs generated by ADSL

# As a result of this effort, we outperformed our peers and maintained operational leadership

## Profitability and growth

### EBITDA growth

2000-01



### EBITDA margin

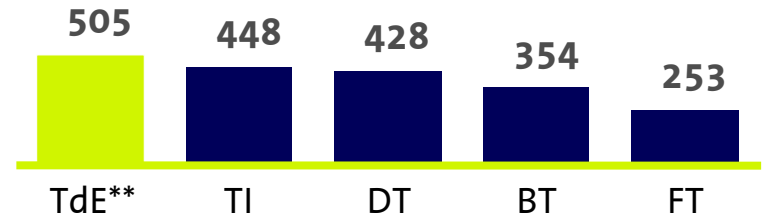
2000-01



## Operational efficiency

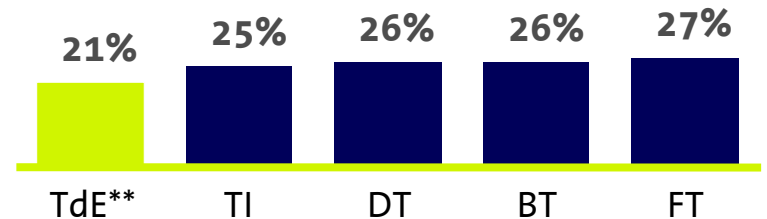
### Lines per employee

2001



### Personnel expenses/revenues

2001



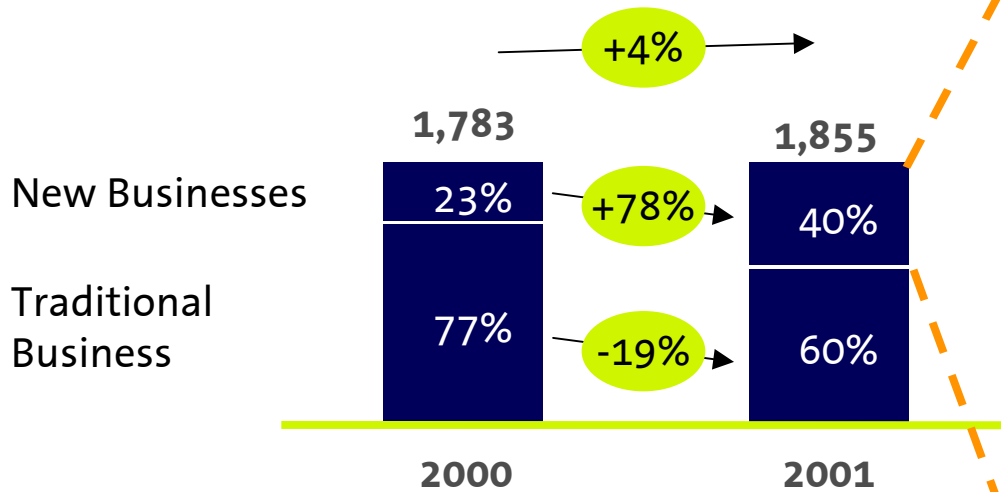
\* DT, BT, FT, TI

\*\* Parent company

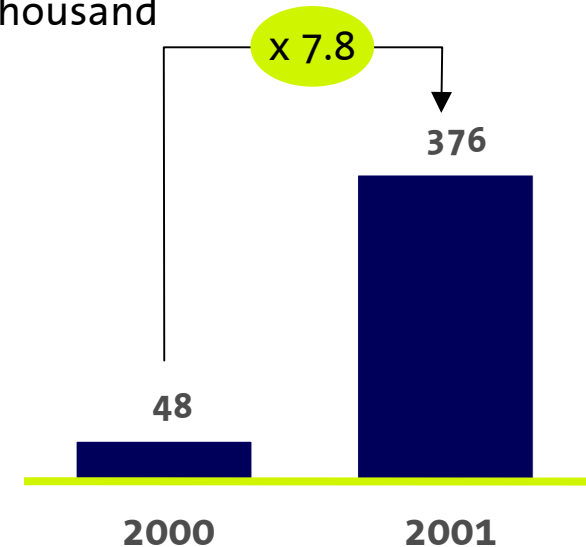
Source: Morgan Stanley, Operators' September results

# We controlled CAPEX in our traditional business to address broadband requirements

**CAPEX\***  
Million Euro



**TdE ADSL connections**  
Thousand



<b>CAPEX/Revenues</b>	18.6%	18.9%
<b>ROCE</b>	8.5%	9.9%
<b>Asset turnover</b>	74.6%	78.7%

**We have built a state-of-the-art IP network in 8 months**

\* Parent company

## *These results were accomplished within a highly demanding regulatory environment*

### Most significant facts

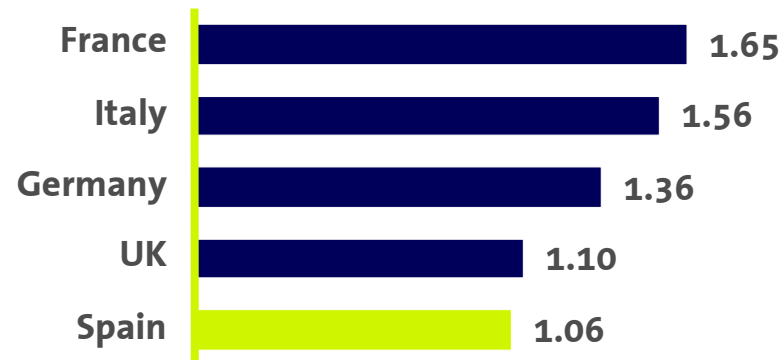
- Tacit extension to local traffic of carrier pre-selection since 1Q2001
- Number portability with strict delivery periods
- All possible alternatives for ULL offered (74 central offices available and 2.6 million accessible loops)
- Capacity-based voice interconnection since 4Q2001
- Regulated retail and wholesale flat-rate Internet access
- Regulated retail and wholesale ADSL prices (“retail minus” scheme)

### Retail Price Cap evolution

	2001	2002	2003
<b>Nominal price</b>	-7%	-6%	-2%
<b>Monthly fee</b> Euro	10.47	11.67	12.62

### Wholesale: lowest effective\* interconnection price

Euro



***Based on our current results we believe we are on the right track and we confirm our strategy to transform the Company***

**Continue transformation process with a dual effort**



**Extract maximum value from the traditional business**  
***“managing for cash flow optimization”***



**Capture the broadband opportunity**  
***“ensuring profitable growth”***

**Going forward we will:**

- **Leverage our 2001 results**
- **Take an additional step to higher aspirations**

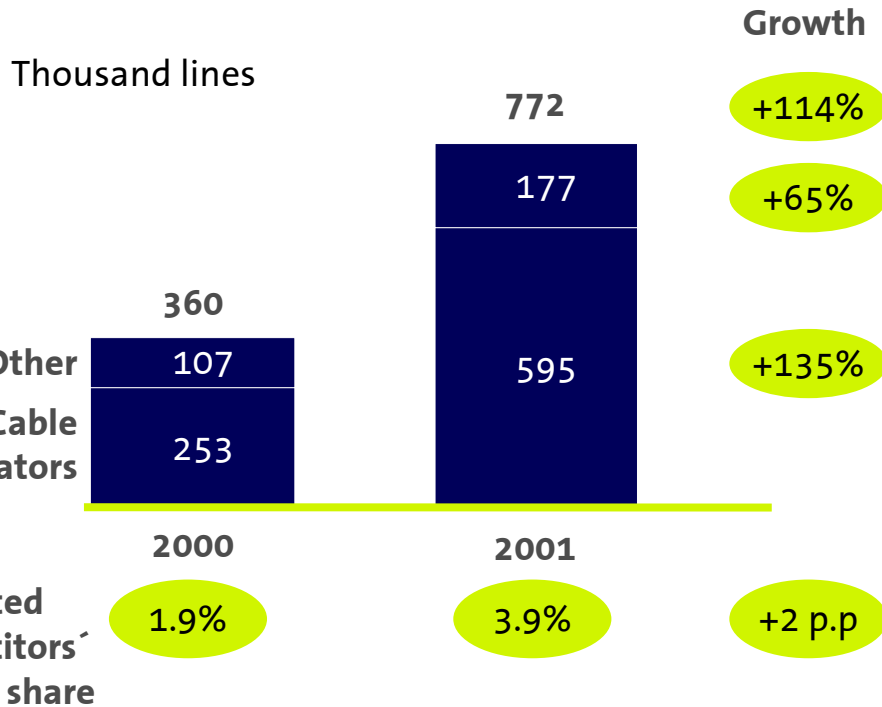
# Contents

- 2001 results: fulfilling Rio de Janeiro commitments and reversing the downward trend
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# Our traditional business is facing an increasingly competitive environment

## ACCESS

- Direct access competitors:



- **Mobile access:**

- More than 1 million homes use only mobile phones

## TRAFFIC

- Direct access competitors:

- Grew their traffic by 158%

- Indirect access competitors:

- More than 1.3 million customers with carrier preselection

- 83% traffic growth in 2001

- **Mobile:**

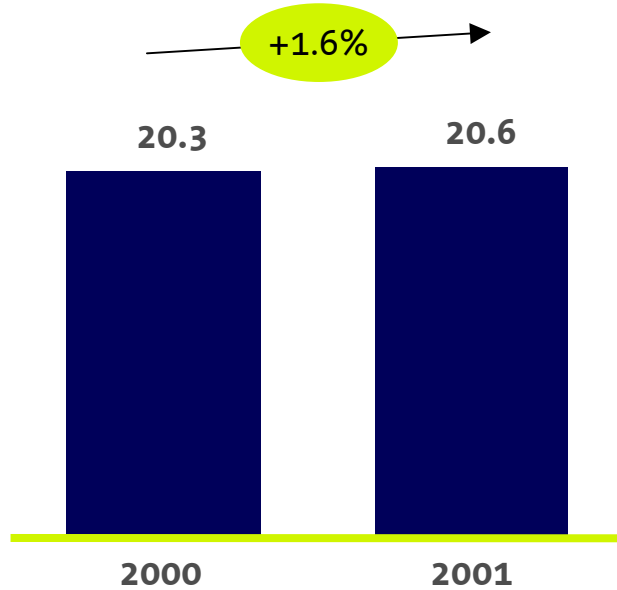
- ~22% originated voice traffic

- Estimated 20% voice market cannibalization

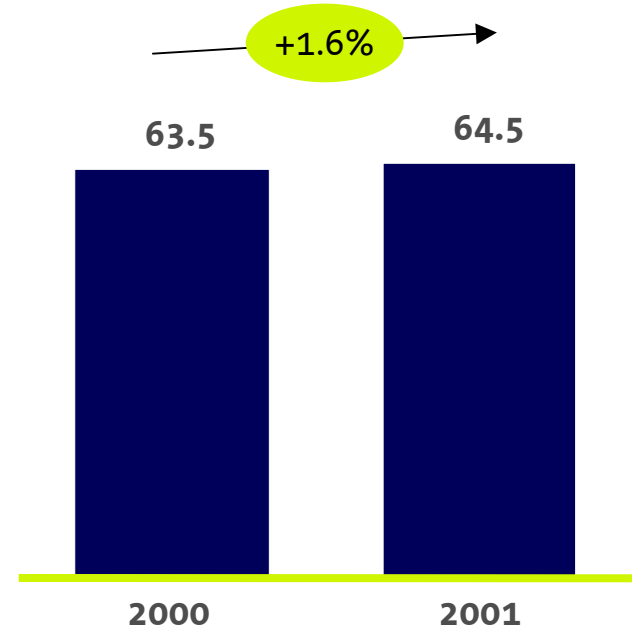
- Impact on public telephone business

# We have, however, managed to grow access lines and voice traffic

**ACCESS LINES**  
Million lines



**VOICE TRAFFIC**  
Billion minutes



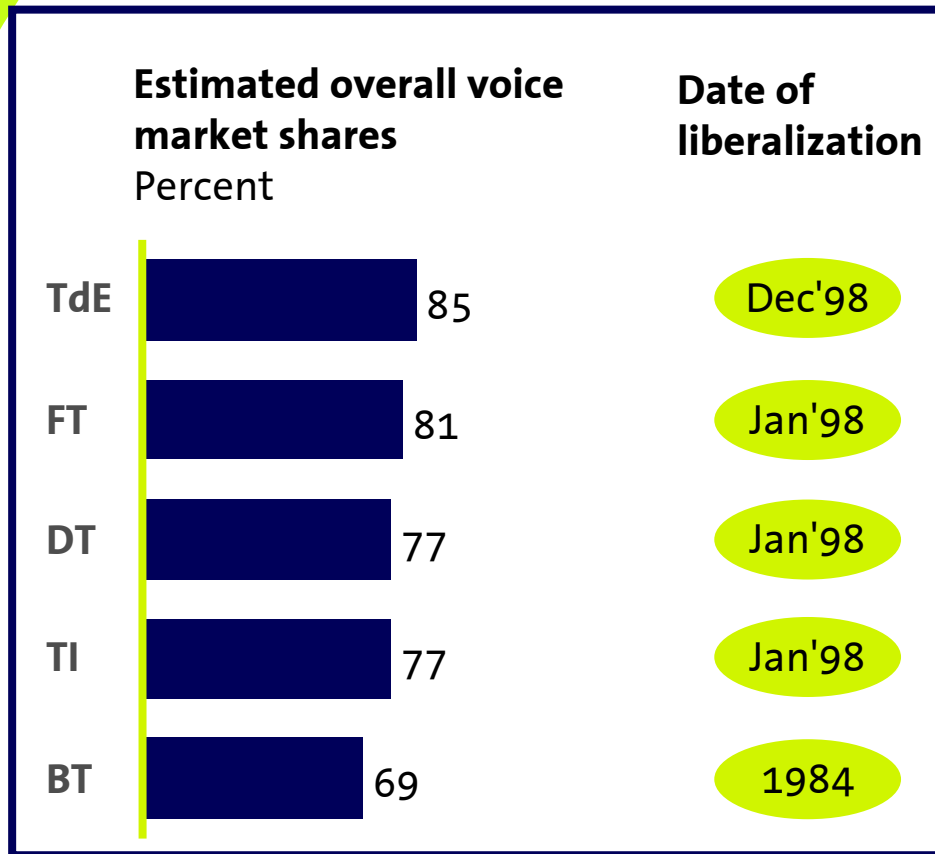
Total market growth

+2.7%

+5.7%



*In particular, we have defended our overall market share, strategically managing our market share loss*



**Won back 3 p.p. in DLD for SMEs**

**Lost 8 p.p. in local traffic**

**Estimated market share in ILD down to 70%**

Note: Year end figures for TdE

Source: Country Regulators at Jun 01 and Dec 01; Analysis; Dataquest

# We have obtained these results through a proactive commercial effort that we will continue in 2002

## Commercial Strategy for 2002

### Retain clients

- Voice + Internet + TV packages (in collaboration with Admira)
- IBERCOM-type solutions (VPN) for SMEs
- IP-based VAS over IBERCOM for corporations

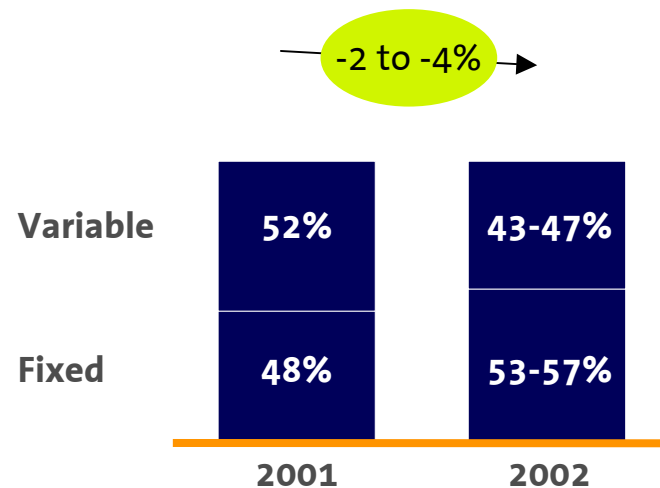
### Maintain ARPU

- Achieve traffic growth
  - New traffic generating products (SMS, 098 IS)
  - Higher VAS penetration (caller ID, voice mail)
- Defend traffic market share
  - New semi-flat voice packages for residential
  - New prepaid plans for SMEs

### Pursue targeted commercial effort




- Selective commercialization through CRM
  - Win-back effort
  - Focused campaigns for micro-segments
  - Specific actions leveraging on-line channel

## Operating Revenues in Traditional Business



**Defend revenue level despite decrease in price-cap (6%) and increasing competition**

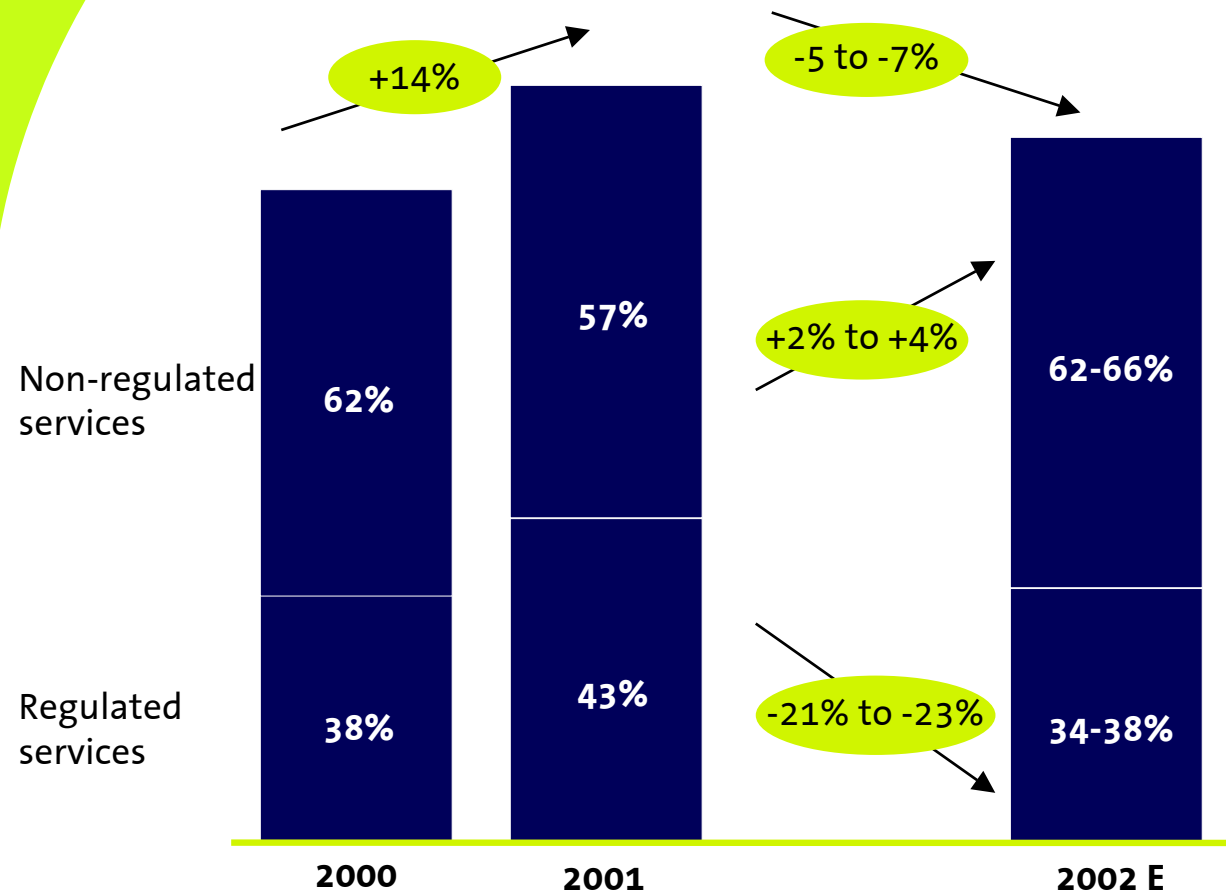
***In 2002, we will significantly increase our efforts to improve efficiency, and the results will fully materialize In the mid term***

Main levers	Estimated 2002 results in traditional business	Key Activities
<b>Control Expenses</b>	 <p><b>-2 to 0% in operating costs</b></p>	<ul style="list-style-type: none"> <li>• Transform major processes</li> <li>• Focus on core activities</li> <li>• Optimize support functions</li> <li>• Apply 6σ methodology</li> <li>• Extend usage of e-business applications</li> <li>• Reduce inventory levels</li> </ul>
<b>Increase controls to reduce bad debts</b>	 <p><b>-40 to -35%</b></p>	<ul style="list-style-type: none"> <li>• Improve monitoring of higher risk customers</li> <li>• Implement a strict credit check system</li> </ul>
<b>Reduce Capex</b>	 <p><b>-15 to -10%</b></p>	<ul style="list-style-type: none"> <li>• Prioritize investments along segment, geography and profitability</li> <li>• Optimize idle network capacity</li> <li>• Increase asset rationalization</li> </ul>

# *In wholesale we have grown our business and in 2002 we will implement a differentiated strategy*

Operating Revenues in Wholesale

2002 Strategy



**Segmented approach:**

- Turnkey solutions for niche operators
- Actively negotiate to capture incoming international traffic (Telefónica Wholesale)
- Capture growth from mobile and data operators

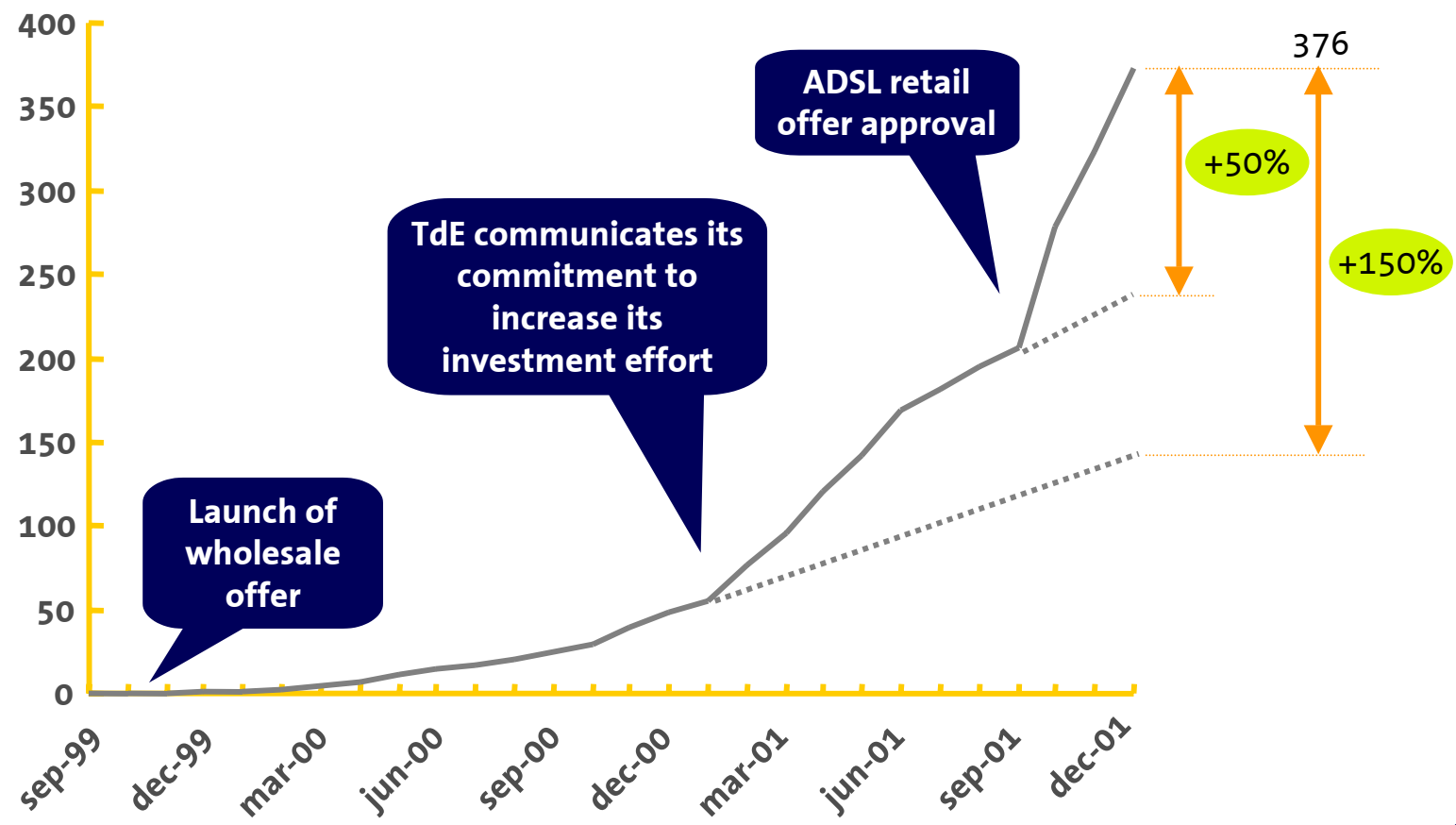
**Focus on efficiency to minimize regulatory impact of capacity-based interconnection**

# Contents

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# Telefónica's effort has fostered the broadband market in Spain

ADSL Connections. Total market  
Thousand



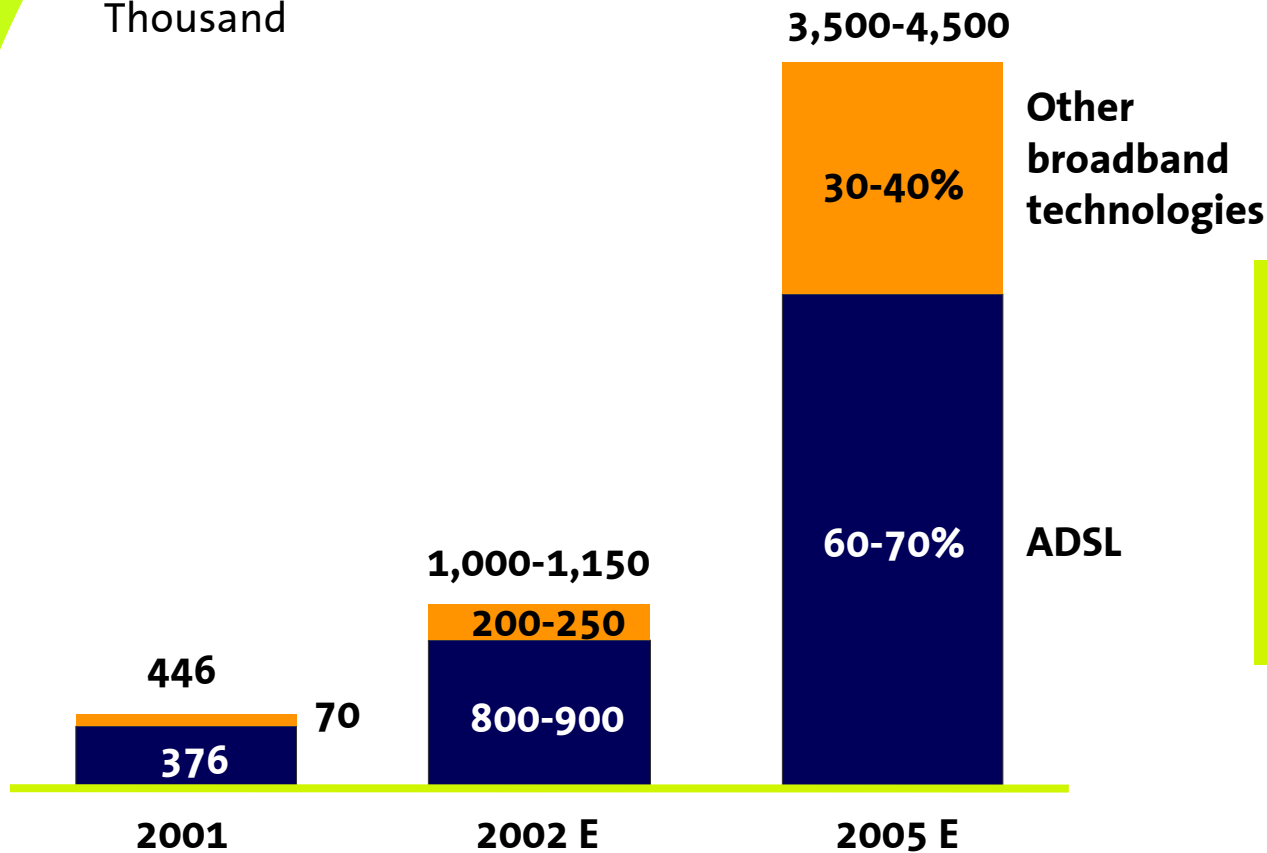
## ... And we are now in the leading European ADSL group

	Broadband households	DSL penetration over total lines
• Deutsche Telekom	6%	4.3%
• <b>TdE</b>	<b>2%</b>	<b>2.2%</b>
• Telecom Italia	1%	1.5%
• France Telecom	2%	1.2%
• BT	1%	0.5%

Source: ECTA 2001, OVUM 2001; Company data for TdE

# Looking forward, our goal is to contribute to enlarge the broadband market

**Broadband connections in Spain**  
Thousand

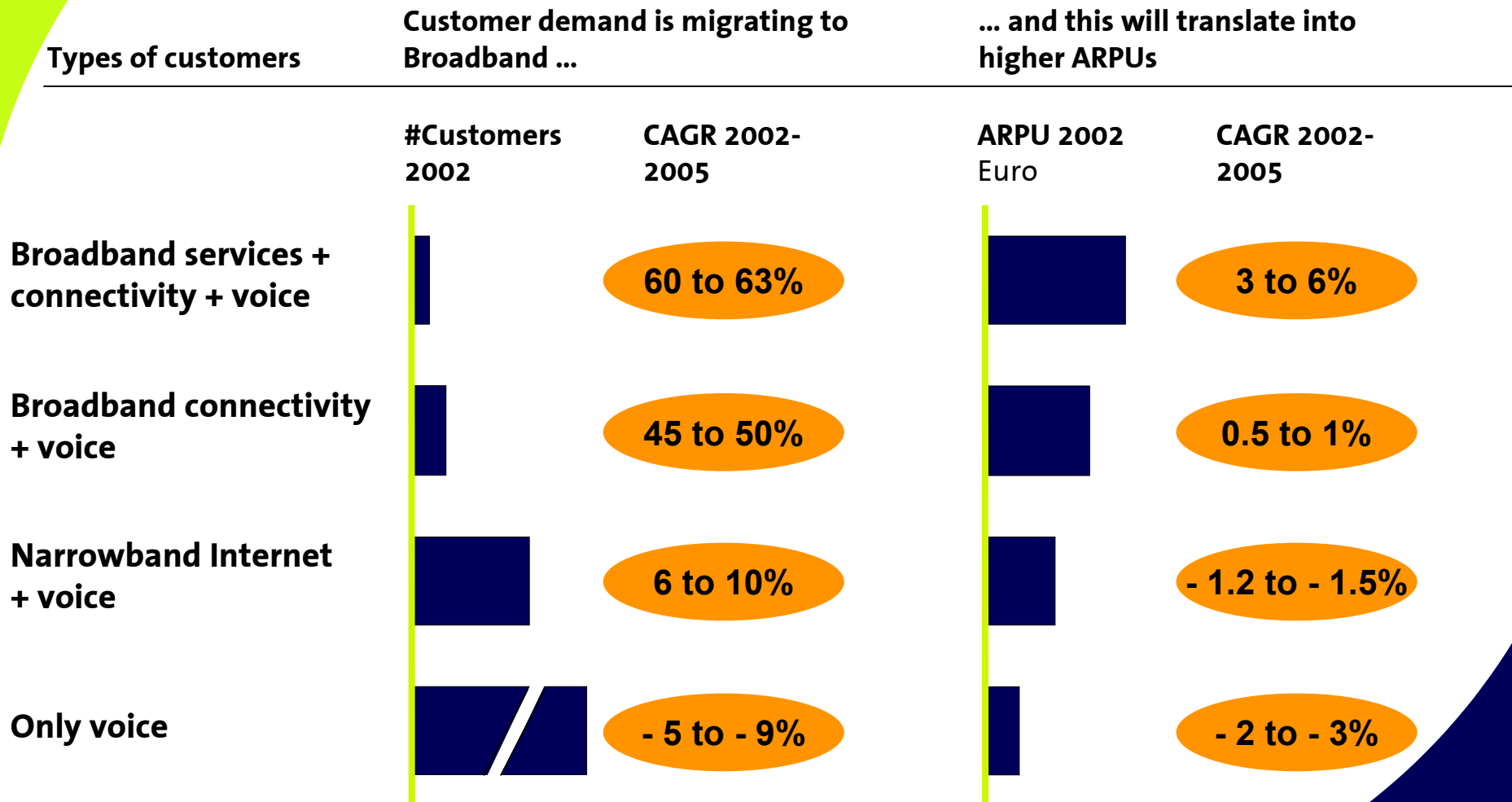


**Potential broadband penetration in 2005:**

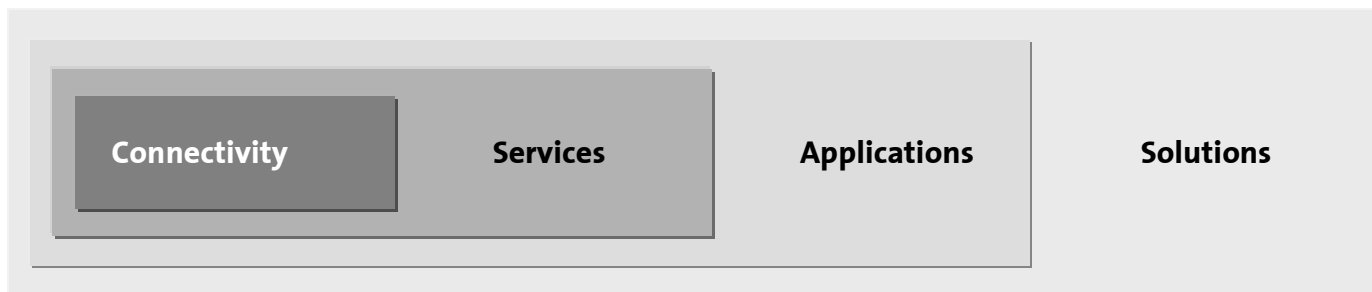
- 15 to 25% (residential)
- 50 to 70% (business)



# We will actively address the demand for new services to meet different customer needs



# In order to serve this demand we are developing a compelling offer for the digital market



## Digital Offer

For households

- 256 Kbps
- 512 Kbps
- 2 Mbps

- Bandwidth on demand

- On-line gaming
- Video conferencing
- Domotic
- Video Streaming

### Key projects

- Imagenio:**
- Broadband Internet
  - Digital TV
  - Video over DSL
  - Other (games, music, etc)

### Group partners

Terra, Admira, T-Cable

For businesses

- Access devices (Homegateways and networking)
- Wireless access (802.11)

- VPN

- Videoconferencing
- Remote applications

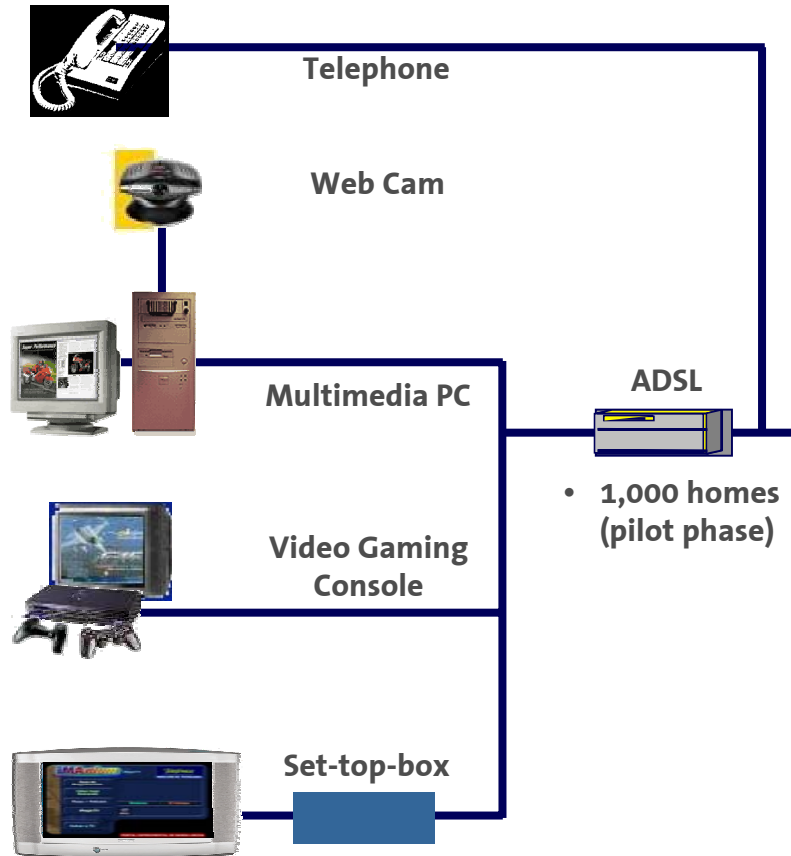
- eBA:**
- Large accounts
  - e-Government
  - Packages for SMEs

T-Data Terra

# For households we are already working on a full service offer through ADSL with Imagenio

**Imagenio** »

- Telephony
- Videoconferencing
- High speed Internet access
- Multimedia messaging
- 4 TV channels for PC
- Multi-player games
- Games on demand
- Digital TV (22 channels)
- Stereo digital audio (15 ch.)
- Video and music on demand
- Internet access on TV

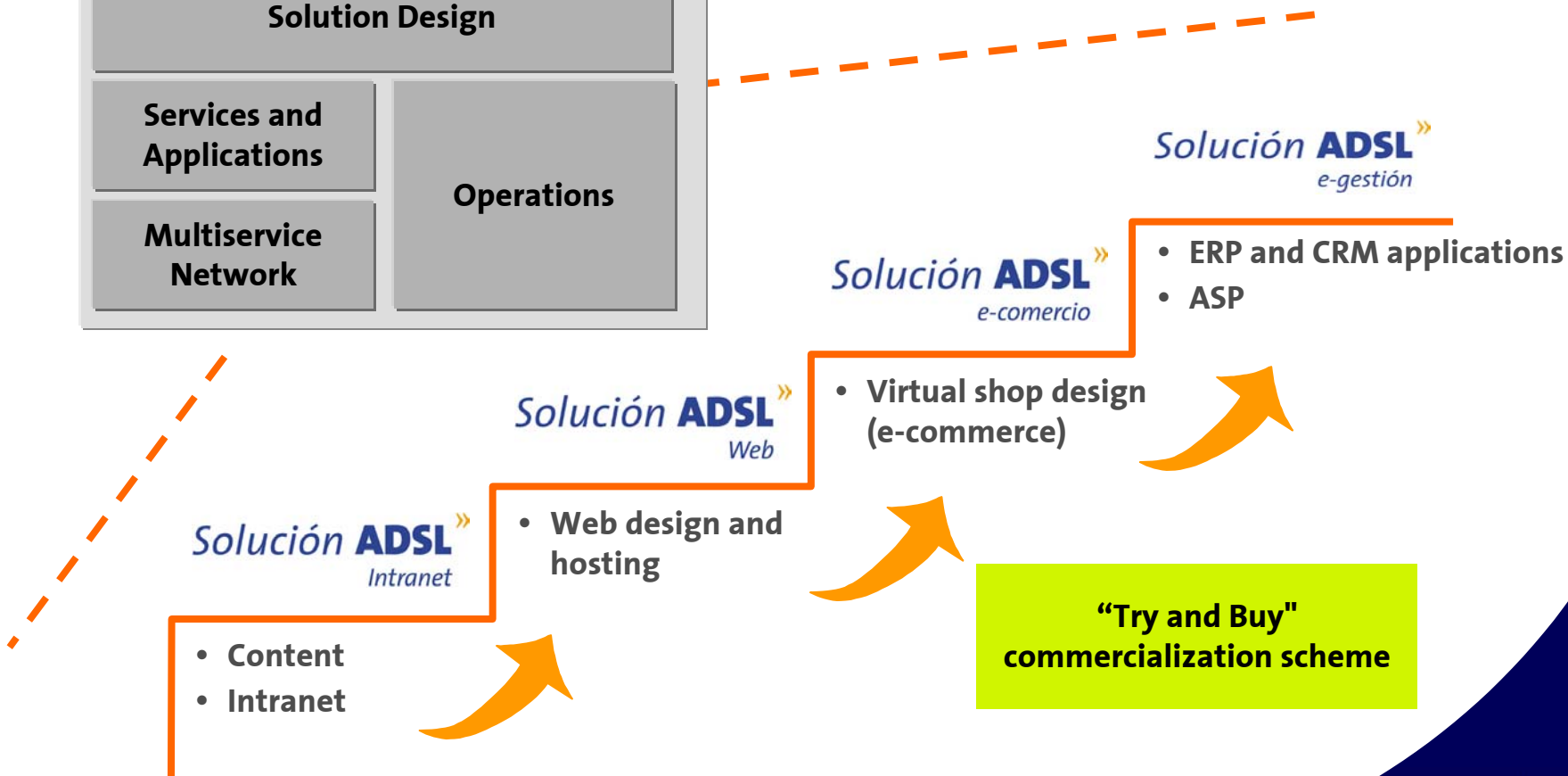
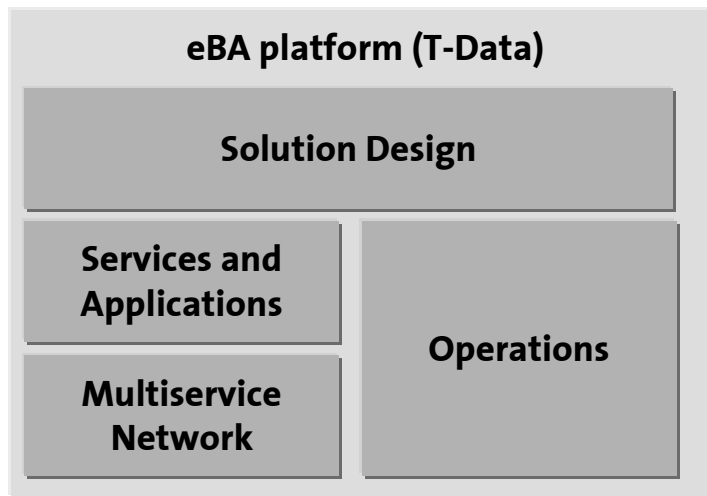


... and we have achieved these results by leveraging group capabilities

- TdE: project management
- Terra: PC content/ services
- Admira: audio visual contents for PC/TV
- Telefónica Cable: TV/Radio channel aggregator

# For businesses, we are launching an offer for SMEs within eBA

**eBA** | e-Soluciones de Banda Ancha



# *In order to support this wide offer we are already transforming our business model*

## Internal transformation

### Enhance Products & Services Factory:

Redesigning processes to increase quality, reduce TTM, integrate third parties and reposition brand

### Upgrade Infrastructure and IT:

Deploying state-of-the-art IP network and upgrading IT for Broadband

### Innovate Sales Force and Distribution:

Evolving from "sales people" to "consultants", and fostering usage of online channel

## New Business Model

- Focused on the "Digital Customer"
- Leveraging 3<sup>rd</sup> party capabilities, particularly Group companies, with a new relationship model

## External transformation

### New Service Development Model: "Partners Farm"

Joint ventures, Shared projects, Joint solutions, ADSL Forum

### New I+M+C Model:

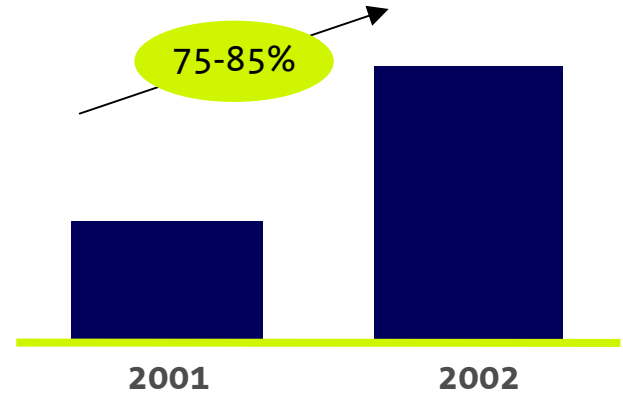
Certifying and aligning objectives with contractors

### New Distribution Model:

Expanding independent distributors role and opening new distribution channels

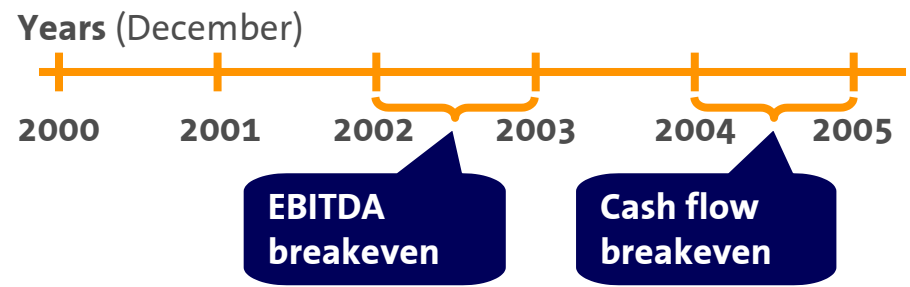
***Based on this strategy we believe it will be possible to achieve growth and reasonable levels of profitability***

**IP/Broadband revenues**



**Profitable business after reaching and maintaining 1 million ADSL lines**

**Economics of Telefónica ADSL Business Plan\***



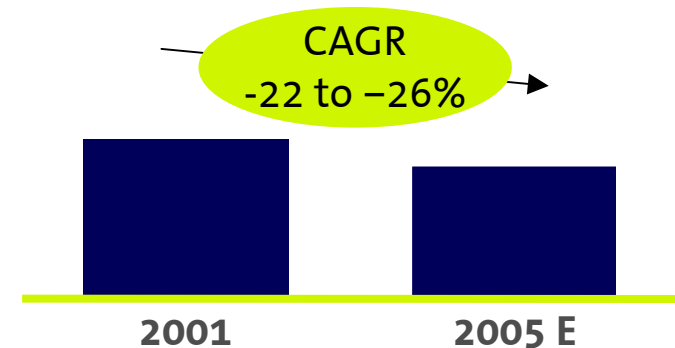
\* Incremental over other businesses

# We are working on improving key variables to assure profitability

## Opex/line

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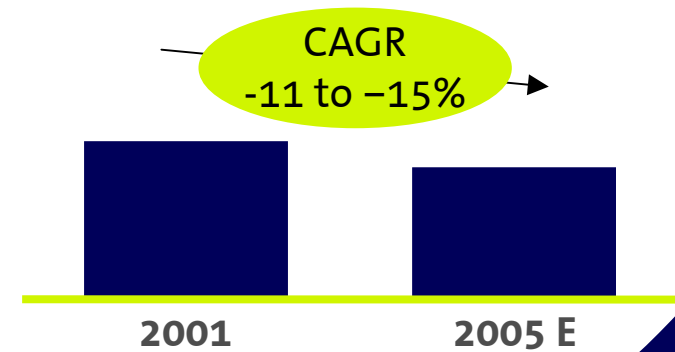
- Increase plug-and-play up to 85% of new lines
- Reduce IP international termination fees
- Improve customer care and network O+M processes
- Capture economies of scale



## Capex/new line

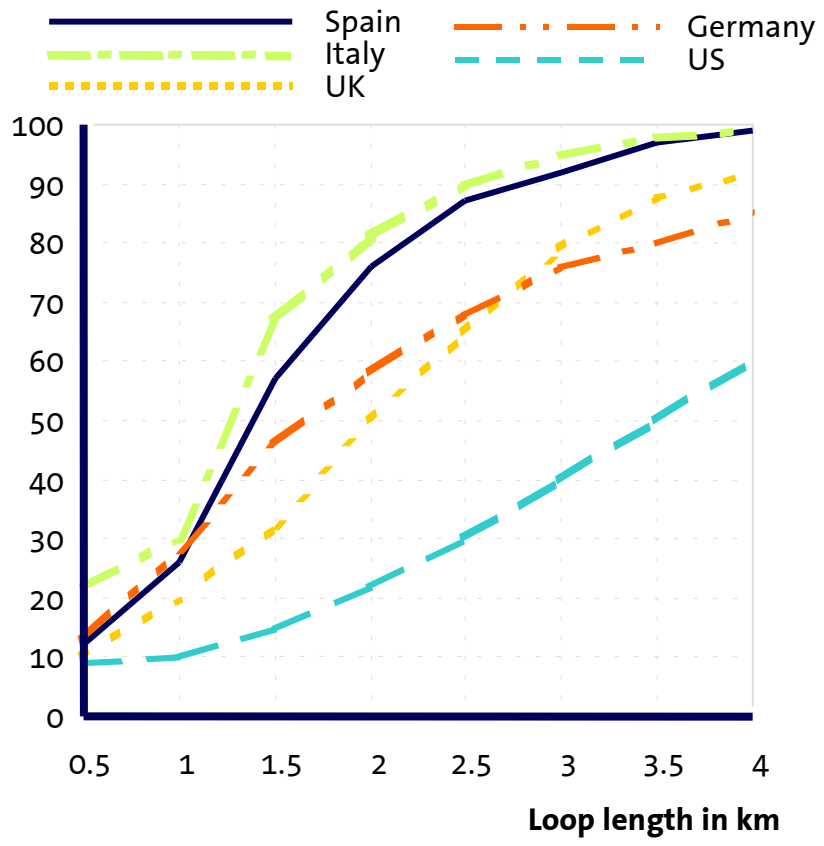
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- Capture economies of scale
- Take advantage of technology improvements
- Reduce IP network investments
- Leveraging our local loop quality

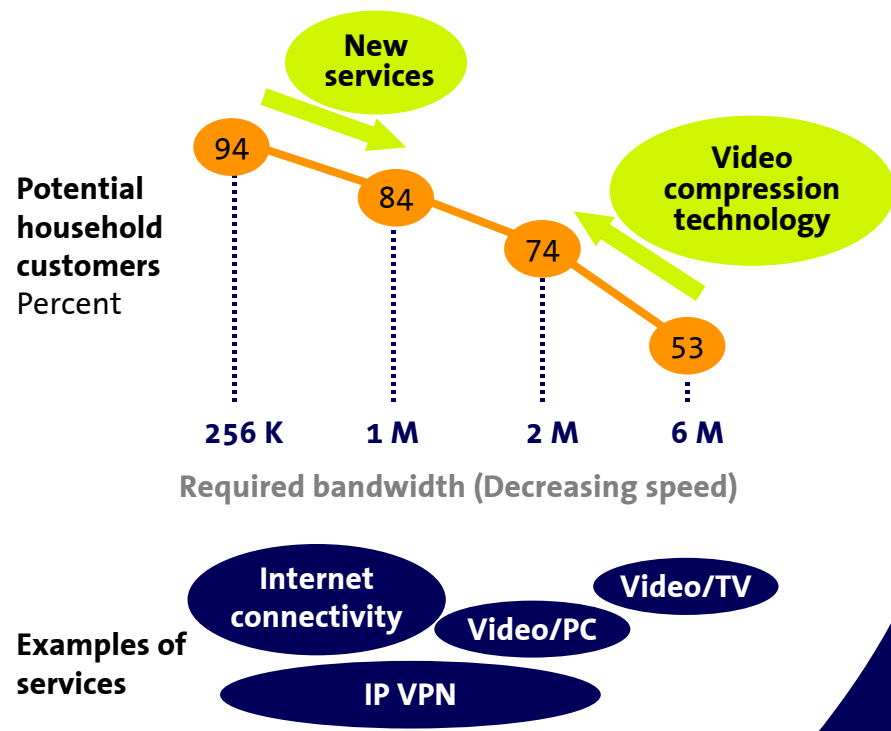


# Our local loop quality and technology evolution will facilitate CAPEX reduction

Percentage of customers reached



Bandwidth supported by TdE's access (local loop)



Source: IEEE; Telefónica



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**Today our highest priority is to lead the whole organization to go deeper in the transformation process to achieve profitable growth**

**+Growth**

- **Traditional Business**
  - Retain clients
  - Increase usage
- **IP/Broadband**
  - Foster penetration
  - Increase ARPU
- **Wholesale**
  - Grow in non regulated services

**+Competitiveness**

- **Control OPEX**
  - Rationalize processes
  - Focus on core activities
  - Extend 6σ driven quality
  - Intensify e-business use
  - Increase self-install ADSL
  - Reduce inventories
- **Reduce bad debt**
- **Control CAPEX**
  - Reduce CAPEX in traditional business
  - Reduce CAPEX/line in broadband



**+Commitment**

- **To transform our business model**
  - Renew internal skills
  - Open to third parties cooperation

# As a result, we will grow operating revenues reducing volatility and maintaining our EBITDA margins

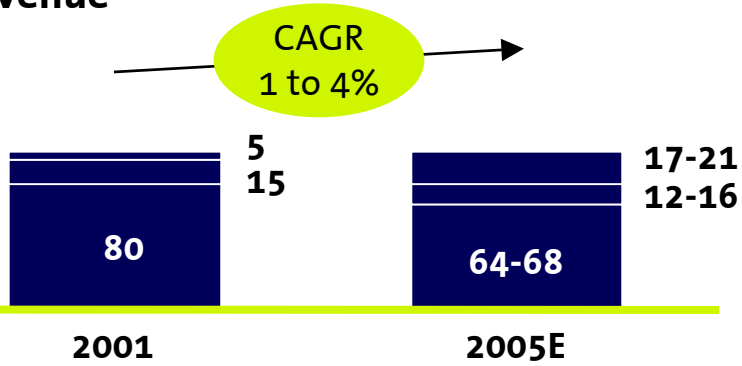
## Operating revenue\*

Percent

IP/ Broadband

Wholesale

Traditional

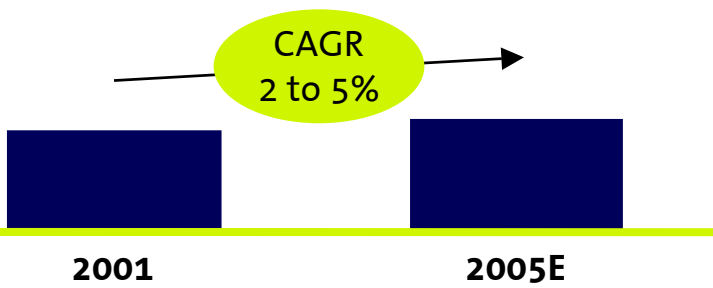


Fixed revenues over total



- Achieving revenue growth
- Shifting revenue mix towards IP/broadband
- Transforming variable revenues into fixed revenues

## EBITDA



EBITDA margin

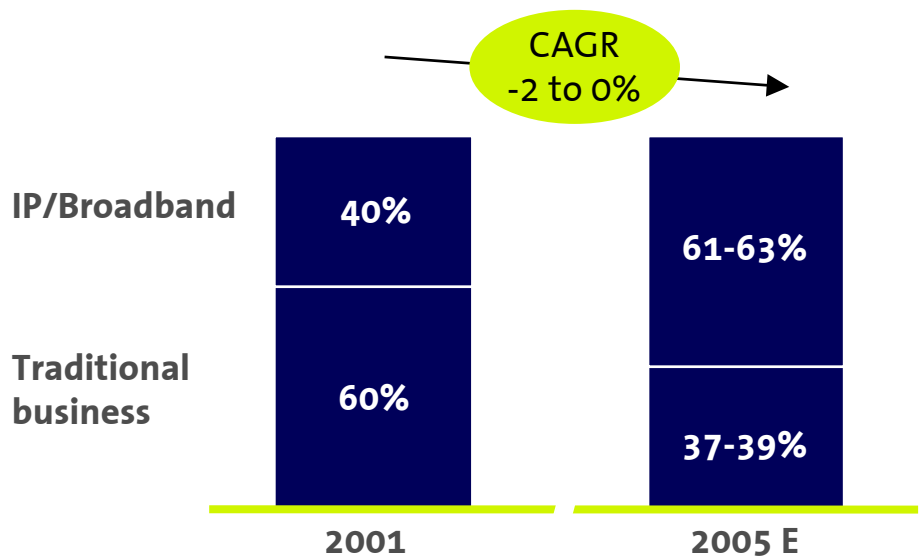


- Accelerating efficiency effort
- Growing EBITDA
- Maintaining EBITDA margins in current levels despite increased competitive pressure

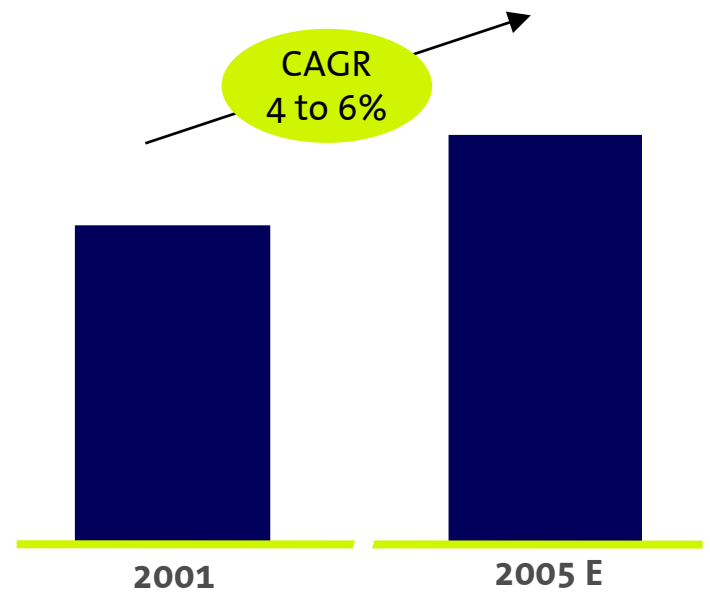
\* Parent company

**At the same time, we will control CAPEX  
and will ensure free cash flow growth**

**CAPEX  
Parent Company**



**Free Cash Flow\***



**CAPEX /  
Revenues**



\* Free Cash Flow = EBITDA - CAPEX - Net Financial Expenses - Taxes

## *In summary*

- We achieved good performance on Rio commitments and **managed to reverse a downward trend in results.**
- Based on these results, we **confirm our strategy for business transformation** with a dual effort; increasing our aspirations for the future.
- In the **traditional business**, during 2001, we reduced Opex and Capex. Going forward, we will continue to manage the business to **maximize cash flow**, increasing our efforts to **improve efficiency** and maintaining our leadership among European operators
- In **broadband**, during 2001, we built a significant client base and improved our knowledge of this new business. Going forward, we will focus on **capturing this opportunity for profitable growth** by further expanding our customer base, broadening our offer of services (leveraging Group capabilities) and advancing in the transformation of our business model.
- Our strategy will assure profitable growth to maintain TdE as a **solid contributor to Telefónica Group.**

*Telefónica*

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