

*consolidated group*



## Telefónica S.A. Consolidated Results

(figures in millions of euros)

	january-december		
	2002	2001	% Change
Operating revenues	28,411.3	31,052.6	(8.5)
Work on fixed assets <sup>1</sup>	527.8	736.0	(28.3)
Operating expenses	(16,773.3)	(18,146.0)	(7.6)
Supplies	(7,002.8)	(7,221.4)	(3.0)
Personnel expenses	(4,793.8)	(5,390.3)	(11.1)
External services	(4,564.6)	(4,945.5)	(7.7)
Fees	(412.1)	(588.8)	(30.0)
Other net revenues (expenses)	(441.7)	(838.4)	(47.3)
<b>EBITDA</b>	<b>11,724.2</b>	<b>12,804.3</b>	<b>(8.4)</b>
Amortization/Depreciation	(6,692.4)	(7,374.0)	(9.2)
<b>Operating income</b>	<b>5,031.8</b>	<b>5,430.3</b>	<b>(7.3)</b>
Income associated companies	(527.9)	(376.5)	40.2
Financial income	(2,221.6)	(2,391.1)	(7.1)
Amortization Goodwill	(665.4)	(841.6)	(20.9)
Extraordinary income	(16,217.9)	212.8	c.s.
<b>Income before taxes</b>	<b>(14,601.1)</b>	<b>2,033.9</b>	<b>c.s.</b>
Tax provision	3,228.7	(198.1)	c.s.
<b>Income before minority shareholders</b>	<b>(11,372.4)</b>	<b>1,835.8</b>	<b>c.s.</b>
Income from minority shareholders	5,795.6	271.0	n.s.
<b>Net profit</b>	<b>(5,576.8)</b>	<b>2,106.8</b>	<b>c.s.</b>
<b>Average number of shares (millions)<sup>2</sup></b>	<b>4,957.9</b>	<b>4,893.1</b>	<b>1.3</b>
<b>Net result per share</b>	<b>(1.12)</b>	<b>0.43</b>	<b>c.s.</b>

(1) Including projects under way

(2) Average number of shares in the period considering the effect of the free capital increases charged to reserves which do not change the standing of ownership from the 1st of January of each year. Including shares corresponding to the capital increase charged to freely distributable reserves, registered in the Mercantile Register on 18 February 2003. The total number of shares at the end of the period was therefore 4,957,874,511

The new strategic approach, based on increasing cash flow and profitability, is threefold: focusing on key business areas and natural markets; restructuring underperforming businesses; and maintaining strict financial discipline.

There was continued expansion of the client base in 2002, which showed considerable growth in the Broadband sector, thus reinforcing the company's role as Latin America's leading telecommunications provider and improving its position in the mobile sector.

At the end of 2002, the Grupo Telefónica client base totalled more than 89 million customers (84.7 managed), including all the subsidiaries in the joint venture with Portugal Telecom in Brazil, up 15.1% from December 2001, and 9.7% more than in September 2002. The number of clients at the end of the year was 90 million compared to 78.7 million on the same date in 2001 and 82.4 million in September 2002.

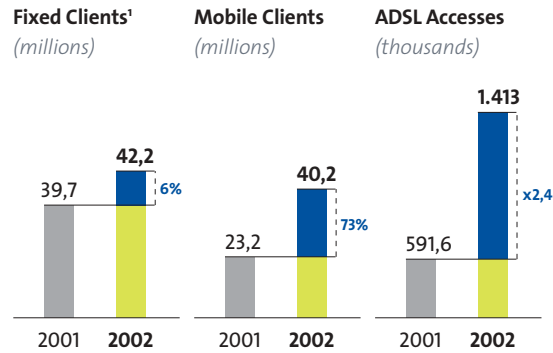
The client base managed by Brasilcel in December 2002 totalled 13.7 million clients, of which 47.3% pertained to operators in which Telefónica Móviles has a shareholding. With this incorporation, the managed client base for mobiles reached 41.4 million at the end of the financial year, representing almost half the total number of customers managed by the Group. Moreover, this meant, that for the first time, Latin America is the geographical area making the greatest contribution to the total number of managed clients (50.9%), ahead of Spain (47.2%).

At the end of 2002, the Grupo Telefónica ADSL connections totalled 1.4 million, an increase of almost 800,000 clients over the previous year and a clear sign of Telefónica's commitment to broadband.

With regard to the restructuring of underperforming businesses, 2002 saw the write-down of assets and restructuring costs relating to the UMTS business in Germany, Austria, Italy and Switzerland, val-

*There was continued expansion of the client base in 2002, with considerable growth in Broadband*

## Expansion of the client base is being maintained



(1) Not including CANTV. As of financial year 2003 there has been a change to the calculation for the Equivalent Lines in service for fixed telephony within the Grupo Telefónica. This new criterion introduces a different treatment of the ISDN Primary Accesses and of the 2/6 accesses for exchanges and Ibercom.

*In 2002 a writedown of assets and restructuring costs was taken in the UMTS business in Germany, Austria, Italy and Switzerland*

ued at 12,341.3 million euros. Telefónica Móviles also wrote off 154.5 million euros attributable to the cancellation of the goodwill of Terra Mobile subsidiary I.O.Box, as a result of the restructuring of that company's operations outside of Spain.

There was also a writedown valued at 1,303.2 million euros corresponding to the investment of Terra Lycos which, in accordance with conservative evaluation criteria, has been determined by continuously reviewing the recovery of goodwill.

A further provision of 305.5 million euros was made as a result of the analysis carried out at the end of the year regarding the recovery of existing goodwill from investments by Telefónica Contenidos, particularly in the case of Pearson, for a total amount of 173.4 million euros.

These operations have also led to other extraordinary results, including a provision of 288.1 million euros for valuation of the company's own holdings at market prices, the greater negative extraordinary results, caused by the restructuring of personnel in 2002 carried out by Telefónica Latinoamérica's operators (Telefónica Móviles, Terra Lycos, Admira Media, etc).

These and other writedowns have reinforced the Telefónica Group's balance sheet, with the percentage of intangible assets compared to total assets decreasing from 31.9% in December 2001 to 22.5% in December 2002.

### Country Risk Management

2002 was a year marked by change and uncertainty in Latin America, both in the financial markets

(with strong devaluations of the Argentine peso, Brazilian peso and Venezuelan bolivar) and on the political scene (changes in the presidency in Argentina; instability in Venezuela). To a lesser extent, there was also devaluation of the Mexican peso and the Chilean peso, and elections in Brazil led to a change in the political scene with a new President (in an environment of absolute normality). This caused some worry for international investors. One indicator frequently used to measure the financial risk of countries is the difference in profitability between bonds issued by nations in dollars, and US treasury bonds. This is known as 'country risk'. The higher the risk of non-payment as perceived by investors, the higher the difference in the profitability they demand in order to invest in Latin American bonds.

Argentina is a case in point. Due to the situation of suspension of payments by the Republic (whose debt was given a «default» rating by the credit agencies), its bond prices are so low that very high profitability would be obtained if the coupons and principal were paid on their respective dates.

The loss in value suffered by Latin American currencies relative to the dollar has been considerable. The devaluation of the Argentine peso and the Brazilian real has had a very negative effect on investment values in euros in these countries.

Telefónica, as one of Latin America's largest companies, has had to manage the risks involved in operating in the region. In order to do so, different tools have been used, with the implementation of policies to control operations and the way in which they are financed.



In the management of operations, special emphasis was placed on cash generation, paying particular attention to cost control and delinquent payments. At the same time, the pace of investment was brought in line with expected growth in demand under reasonable conditions of profitability. The early fulfilment in 2001 of the network deployment goals in the Brazilian state of São Paulo, doubling the number of lines in only three years, was followed in 2002 by a reduction in the pace of the investment in the network deployment plans for the rest of the country. In Argentina, weakened demand obviated the need for investments other than those required for network maintenance.

Another element of protection in the face of country risk is the financing of operations through debt acquired by the Latin American companies. Practically all of this debt (except in the case of Argentina) is protected against fluctuations in exchange rates (either because it is originally in the local currency, or because it has been covered through financial instruments derived from the exchange rate). The use of external financing in Latin America allowed the parent company to avoid making a greater commitment of funds. Similarly, borrowing in Latin American currencies has made it possible for the current debt to be reduced with the devaluation of those currencies, thereby counteracting the negative effect on operating results measured in euros. The value in euros of debts in other currencies was reduced by a total of 3,044 million euros in 2002, thanks to the devaluation of other currencies against the euro, resulting in considerable savings for the Group.

## Horizontal Corporate Initiatives

Horizontal corporate policies have been applied throughout the financial year, making it possible to make better use of synergies within the Group.

### Purchasing Policy

In 2002, a purchasing volume exceeding 10 billion euros has been controlled using Telefónica's purchasing model (SAC). Purchasing management throughout the year has been based on three strategic points: an increase in the use of e-Business technologies, particularly electronic commerce, extension of the use of the Purchasing Model to new companies within the Group and purchasing collaboration with other companies and suppliers.

In line with Telefónica's goal to keep abreast of the latest advances in technology, the year saw a continuous development of different e-Business projects for organising purchasing and working relationships with suppliers, particularly in the use of B2B e-commerce. Advances were made in the project which began in 2001 to develop an electronic market for the on-line management and negotiation of offers. Already installed in Spain, launches are currently underway in Brazil, Argentina, Peru and Chile. By the end of 2002 there were more than 1,100 suppliers incorporated within this electronic market, moving a total of more than 250 million euros.

During 2002, Adquira started the process of setting up its Electronic Business Platform jointly with the Grupo Telefónica companies. With everything included, Adquira has already channelled the pur-



*During 2002 Telefónica's purchasing model was extended to new units within the Group and there was collaboration with other companies and suppliers*

chase of goods and services for a value of almost 300 million euros.

By using existing installations in Spain, Brazil and Argentina, there has been continuous project development to install a global e-procurement platform for the entire Telefónica Group, making it possible to order from suppliers over the Internet in different areas, using catalogues with prices previously negotiated by the Purchasing Department.

As part of the strategic measures adopted to reduce costs and improve efficiency, there has been emphasis on the use of advanced methods for regulating purchasing, such as the analysis of total costs and collaboration with user areas has been intensified.

Furthermore, six new companies have been incorporated into the Advanced Purchasing System, with a total of 109 companies using it to organise purchasing by the end of the year.

Given the relevance and impact caused by these purchasing operations, it is important to note the incorporation of the Mexican mobile telephone operator Pegasus, as well as the implementation of a Purchasing Board in Mexico, used to organise important purchases not only for companies in this country, but also in Guatemala, Puerto Rico, El Salvador and the United States.

Similarly, the creation of a Joint Venture in Brazil with Portugal Telecom (Brasilcel) led to a Management Model for Purchasing being installed for these operators which, by being fully integrated with those of Portugal Telecom and Telefónica,

makes it possible to take full advantage of the capacities and synergies of both Groups, both in terms of scaled economies, as well as Information Systems and know-how applicable to carrying out operations.

Advances were also made throughout the year to create a framework for collaboration on purchasing, with Telefónica's other partners, including BBVA, Repsol-YPF and Iberia, for specific products and services.

This collaboration agreement complements the previously-existing agreement to develop the electronic market created by Adquira, which will make it possible to manage joint purchasing by taking advantage of the main synergies between companies and sharing their purchasing powers.

The «Suppliers Club» was another initiative developed in 2002, where Telefónica helps its official suppliers to obtain advantageous conditions for buying specific products. At present, this Club is operating in Spain and Brazil and will be extended to Argentina, Chile and Peru in the coming months.

#### **Real Estate**

Approval was given in 2002 to the Master Plan for Real Estate Efficiency, which is expected to obtain a positive net balance of approximately one billion euros in Spain from the sale of released properties.

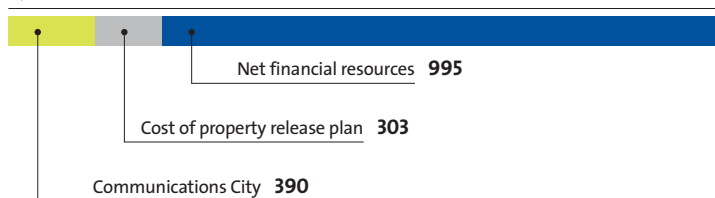
The main objectives of this plan are to improve the office-space occupation ratio, free up space in telephone exchanges, build the «Communications City», terminate leases, and sell non-strategic surplus properties.

## Results of the Real Estate Efficiency Plan

(figures in millions of euros)

Sale of real estate properties in management, commercial, industrial and mixed uses, and savings in rentals and maintenance

**1,688**



A total of 204 projects of this type were carried out in 2002, making available a total of 130,000m<sup>2</sup>, together with another 314 projects currently under way which will make a further 150,000m<sup>2</sup> available in 2003.

The «Communications City» project, which will be built by Inmobiliaria Telefónica at PAU de las Las Tablas, north of Madrid, to house the Telefónica Group's Decision Centres, is undergoing intensive development. In 2002, the Master Plan was finalized, under an international team of experts who will be responsible for executing the project, the design concept was completed, planning for the construction stages was carried out, and the site preparation work was started.

The Communications City will follow an open, *business-park* model, comprising 13 buildings of between 7,000 and 20,000 m<sup>2</sup>, grouped among four zones in an open, landscaped environment. It will have a total of 171,000 m<sup>2</sup> of office space, with a capacity for 14,000 people, 20,000 m<sup>2</sup> of services (including a visitors' reception centre, restaurants, pharmacy, banks, shops, nursery, gym, etc.), and 5,800 covered parking spaces, offering a market solution to the Group's requirements.

Work on Phase 1 will start in July 2003, with the first buildings expected to be occupied by the end of 2004. This operation will continue uninterrupted until the end of 2006, when construction work on Phase IV will be completed.

The sale of 380 properties is already under way, with real estate auctions starting in 2003. This

operation is radically different from sales of assets carried out by other telecommunications companies as only unnecessary properties are being sold, and the selling method is a first in operations of this kind, with bidding by telephone and via Internet.

### Logistics

Throughout 2002, Telefónica has continued to optimise the organisation of logistical activities within the group.

During the year, the company's capacities and needs were focused on a subsidiary company, Zeleris. At present, Zeleris contains and co-ordinates all of the Group's logistical capacities in Spain and manages practically all of the logistical services required by companies within the Group. Its integration has also meant that it is possible to provide services to companies outside the group, with the subsequent increase in efficiency and reduction of unit costs which this produces. As a result of the integrated management of the Group's capacities and requirements, and its possibilities for working with external markets, Zeleris obtained positive financial results for the year.

Throughout 2003, Zeleris will consolidate its position as a provider of integrated logistics services, whose element of differentiation with respect to the market is the technology on which its operations are based.

One of the most important aspects involved in optimising the control of logistics has been the results obtained from the Plans for Reducing Basic Logistical Costs, affecting logistical assets and

*In 2002 Telefónica approved the Master Plan for Real Estate Efficiency which aims primarily to free-up space, improve the occupation ratio, sell real estate, and build Communications City*



*In 2003, Zeleris will consolidate its position as a provider of integrated logistics services*



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inventories. It is expected that, as a whole, this will represent a saving of 200 million euros for the Group. Finally, it is important to note that Corporate Logistics are working on a series of global projects that will take shape in 2003 and contribute to making full use of the synergies currently existing in the Group's logistics. These include developing a Standardisation Plan for Logistical Processes for Logistical Operation Centres in South America, integrated into the Latin American shared services centres

#### **Information Systems**

The advances foreseen in the main lines of activity for existing Information System strategies continued throughout 2002.

Aimed at creating common operational processes supported by shared systems leading to a high level of synergy, the ATIS Project has continued its advance in Fixed Telephony in Latin America and in Telefónica Data, with work starting on implementing the systems in Chile and Peru.

In line with the Broadband network solutions offered by Telefónica to its own clients, work is underway to incorporate Broadband into the company's Corporate Network, improving capacities and level of use and making it possible to incorporate new services and multimedia applications.

Telefónica Data has also been involved in developing hosting services for servers, services and data storage in its Internet Data Centres (TIC). These centres are equipped with the very latest infrastructures and communication technologies, guaranteeing an efficient and secure service. The appli-

cation of TIC's in the Corporate Network has favoured connectivity and accessibility for all of the companies within the Group.

In the case of Data Processing Centres, the optimisation process has continued by outsourcing operational areas with less added value, as well as by consolidating tasks.

Information Systems' common architecture has become firmly established as the management model that makes it possible to create applications using the same technological principles. This makes it possible to greatly increase efficiency in efforts for the development and reutilization of solutions within the Group.

The use of software agencies in the Group has proved to be the most efficient solution for both maintaining and developing applications. The Group has agencies in companies in Spain, Chile, Argentina and Brazil.

The e-Business transformation process has become a reference point throughout this period in all activities connected with Information Systems. There has also been a continuous evaluation of operational methods and technologies currently on the market, reflected in the increased traffic and use of the e-Business portal.

#### **Management of human Capital**

Throughout the year, the 157,504 persons employed in our companies have put all their abilities, experience and professionalism at the service of the millions of Telefónica Group clients around the world.



*The use of software agencies in the Group has proved to be the most efficient solution for maintaining and developing Information Systems applications*

The most important challenges that faced us during the year were taking advantage of synergies to strengthen our business, preparing the Group to offer more opportunities for development and rotation to our own employees and managing resources more efficiently. These actions are important in order to be perceived as a thoroughly consolidated company by clients and the market and to present Telefónica to the public at large as an organisation striving for excellence.

The Human Resources Department has worked on designing a series of policies and programmes which contribute not only to improved management through professional and cultural development, but also planning, through the following actions:

- The creation of a common reference framework for the main Human Resource policies to be implemented by all companies within the group.
- To foster communication and implement the Corporate Values of the Group in all the countries and Lines of Activity in which it is involved. In order to do so, a thorough revision has been carried out of generic responsibilities and their adaptation to corporate values, gradually introducing the models used by the Group for Human Resource management, performance evaluation, recruitment, training, etc.

A complementary factor to the aforementioned is the creation of a common profile for Management responsibilities, aimed at implementing our management style in the Group as a whole. Around 300 managers from all our differ-

ent business areas have been involved in this project:

- To identify the Group's Management Talent with new systems and more efficient policies to guarantee maintaining and developing managerial potential.
- To configure the Framework for Managerial Development in two main areas:
  - a) Programmes designed to reinforce strategic and cultural adjustment, both in the acquiring of new knowledge and the development of generic competencies.
  - b) Programmes for professional development, to guarantee effective coverage of structural posts with suitable personnel and to help their progress within the organisation.

Two new projects under the Harvard-IESE Management Programme were carried out in 2002, with 125 managers from different divisions taking part, contributing to the integration and cohesion of management teams.

- To support Lines of Activity in achieving improved control of personnel costs, by implementing and perfecting the Human Resources Management Indicators System as well as through convergence in administration processes and systems.

In line with the strategy to create e-Business processes within the group, the e-Learning model has been implemented in all of the Group's Lines of Activity and companies, improving technical tools-platforms, servers, software, bandwidth,



*The main challenges for HR in 2002 were to use synergies to strengthen our businesses, and preparing the Group to offer more opportunities for development and rotation of our employees*



etc. -together with accessibility, with particular efforts being made in content acquisition. Some companies have already reached a ratio of 40% in training offered in this way.

#### **Control of Shared Services**

Telefónica Shared Services Management, operating under the commercial name of t-gestiona, is the group of specialised companies within the Telefónica Group offering business management services to companies based on the model of Shared Service Centres.

t-gestiona is configured as a basic tool for its clients' businesses, controlling non-strategic and common support activities between different companies. It offers a complete catalogue of services that can provide clients with an integrated support system for economic activities, human resources, logistics, real estate, etc.

The Shared Services Centres were launched as a corporate initiative in April 2001 in several countries. In January 2002 the European Shared Service Centre started operations, offering services to all of the Group's companies in Europe, except for those in Spain. In July of the same year, operations started at the Shared Service Centre for Mexico and Central America, offering services to companies in Mexico, Guatemala and El Salvador. With this new centre and following the integration of operations in Europe and Spain into one single centre, Telefónica now has 6 SSCs in Argentina, Brazil, Chile, Spain, Mexico and Peru. They now have more than 250 companies on their client list, including 50 outside the Telefónica Group, who have started

to receive services which take advantage of the economies of scale involved in their operations.

The rapid consolidation of this initiative within the Telefónica Group, and the profits already obtained, have been acknowledged by the shared services sector and have even attracted the attention of several multinational companies who have requested assessment for the creation and start of their own SSCs. Detailed below is a summary of the resulting qualitative and quantitative benefits for client companies and the Group as a whole:

- Savings valued at more than 110 million euros, accumulated in 2001 and 2002;
- The standardisation of directives and corporate initiatives in operational working processes.
- Transparency in the cost of support activities and their rationalisation due to pricing pressure and consumption optimisation.
- The standardisation of processes by extending the use of the best internal and external practices, leading to a progressive improvement in efficiency.
- Support for creating new companies and for concentrating managers' efforts in the running of their business, minimising their structural needs.

By following-up results gained from the Customer Satisfaction Survey, advances were made in 2002 towards the goal of offering a more professional service. This was also the case with plans to



*The t-gestiona offices  
in Monterrey, México*

regionalise and globalise certain activities to offer increasingly standardised and integrated services, processes and systems.

The current incorporation level of companies within the Group in t-gestiona will be concluded in 2003 with Móviles in Spain, Mexico and Brazil and Telefónica de España, among other companies.

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