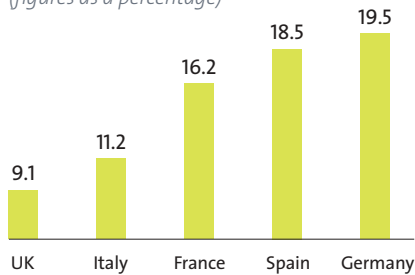


new trends

Telefónica is at the forefront of the sector with innovative offerings using ADSL technology, which will stimulate the growth of the Broadband business

Broadband penetration in homes with Internet access in Europe, 2002

(figures as a percentage)



With more than one million ADSL lines installed, Spain is the European country with the second-highest Broadband penetration in private homes



Telefónica has been characterised in recent years by constantly being one step ahead with strategies that later become common in the sector. The company will maintain this trend in the future, by continuing to advance in the design of viable business models, and by giving priority to the most relevant markets; all based on the pursuit of excellence in business management.

Commitment to Broadband

In the area of services, Telefónica is confident of the potential for growth in the Broadband market in fixed and mobile communications. ADSL technology is the focal point of its strategy for innovation in large-capacity fixed communications. Although at present the value of Broadband business lies almost exclusively in connectivity, there is great potential for growth if innovative business models are developed with multiple services' and contents' providers which different providers of services and content that give added value to connectivity.

In mobile communications, Broadband will contribute to a significant increase in data traffic and revenue per user in the coming years, which will create a positive balance in the development of total income.

In this respect, Telefónica is playing an important role in the expansion of Broadband throughout Europe. With more than one million ADSL lines installed, Spain is the second country in Europe with regard to Broadband coverage in private homes (7.3% of lines), only narrowly behind Germany (7.6%).

The deployment of Broadband is being carried out according to a business model which allows for investment profitability. In the first few years an important investment effort will be made, although there will then be a much longer period in which to recover these investments. In this model, the development of services and content is considered as an essential element to encourage an increase in users, as well as to create additional revenues for the sector, as this implies opening a new market segment.

The potential growth of fixed communications thanks to Broadband will enable the stabilisation of revenue from the traditional voice market, in any case, it will continue to be the service which generates the greatest Free Cash Flow in fixed communications.

Focusing on the Generation of Cash Flow and the Increase in Profitability

Despite acute instability in the sector and a profound crisis in Latin America, Telefónica has, once again, anticipated trends throughout 2002, focusing its efforts on cash generation and increasing profits. In more specific terms, the rate of growth of free minimum cash reserves has increased by 62.6% compared to the previous year, reaching a total of 7.935 billion Euros (EBITDA minus CAPEX).

Within this context, Telefónica has adopted a series of decisions and strategic agreements which have substantially improved its balance sheet, and have laid the foundations for the sustained growth of cash flow, net profits and return on employed capital in the coming years. The main agreements finalised were:



Telefónica once again anticipated trends in 2002, by focusing on the generation of cash flow and greater profitability



- **To re-establish the policy of compensating shareholders by paying dividends.** At its meeting held in December 2002, the Board of Directors approved the proposal to the General Shareholders' Meeting of the payment of a dividend of 0.25 Euros gross per share, drawn from freely available reserves.
- **The restructure and writedown of investments in third-generation mobile telephony in Europe.**
- **The repurchase of up to 2% of its own shares** and the proposal by the Board of Directors to the General Shareholders' Meeting that they be cancelled.
- **Divestiture or decreased activity in non-strategic business areas,** firmly focused on reducing cash outlay. An agreement was signed with Sogecable to merge both groups' pay-per-view satellite TV platforms, with Vía Digital's assets being incorporated into the newly-formed platform. Our data group has sold operators in Austria and Uruguay and in the media business, the Argentine channel Azul TV has been sold.
- **The formation of Brasilcel,** a Joint Venture between Telefónica Móviles and Portugal Telecom, with 100%



Telefónica develops joint actions to promote a framework for the Information Society giving priority to investment and innovation

of both companies' shareholdings in mobile telephony companies in Brazil. Furthermore, the purchase of the mobile operator Tele Centro Oeste (TCO) which, together with the Joint Venture, has given Telefónica 16.8 million customers and access to 80% of the Brazilian mobile market.

- **The acquisition and integration of the existing operations of the Mexican operator Pegaso**, making the Telefónica Group the second mobile telephone company in Mexico and the only alternative to the incumbent operator on a national level, with 2.2 million customers.

Constructing a new Framework for the Information Society

Telefónica actively participates in discussions regarding the new regulatory framework in Europe and has developed joint actions together with industry and operators to promote a framework for the Information Society which gives priority to investment and innovation.

In line with the most advanced trends, the Company is promoting a new model based on competition between different open technological

platforms based on upgraded traditional networks for cable, cellular mobile, radio access and satellite and other future networks capable of distributing all types of content. This model should be governed by general competition laws applicable to any sector of the economy.

In an era of increased regulatory norms, which could hinder investment and innovation, Telefónica defends the need to have less market interventionism and to establish regulatory frameworks which would allow all operators, including those who possess significant market positions, to have ample freedom of action and for setting prices in end services; with price structures, in those areas that remain regulated, that would allow recovery of investments.

Telefónica also promotes both technological neutrality in the regulation of the Broadband market, and a treatment of the latter consistent with its emerging-market condition, in which investments carry greater technological and commercial risks.