BUILDING VALUE:
Driving business and financial performance for continued earnings growth

José María Alvarez-Pallete
CFO of Telefónica Group
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• STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT

• STRATEGY: OPERATIONAL KEY DRIVERS ...  
  - Accelerating performance of core businesses  
  - Capturing our natural growth potential  
  - Focusing to turn around non-performing businesses  
  - Strengthening our “one company” model

• ... COMBINED WITH FINANCIAL MANAGEMENT AND DISCIPLINE

• THESE DRIVERS TRANSLATE INTO A SET OF MANAGEMENT COMMITMENTS

• CONCLUSIONS
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


** Average EV/EBITDA ratios of Deutsche Telekom, Telecom Italia, France Telecom and British Telecom

Source: Datastream, Multex Estimates
Strong fundamentals and solid growth platforms will become key differentiators

Challenging economic environment
- Financing restrictions
- Impact on demand
- Slow recovery expected
- Increasing saturation in developed markets
- Slowdown in demand growth
- Unfinished regulatory framework
- Efficiency improvements increasingly difficult

Environment remains uncertain and highly demanding for telecom companies

Key differentiating factors among integrated telcos:
- Strong fundamentals
- Solid growth platform
Telefónica has delivered strong results...

## Euro Million

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2000</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenues</td>
<td>31,053</td>
<td>28,486</td>
<td>9.0</td>
</tr>
<tr>
<td>EBITDA</td>
<td>12,804</td>
<td>11,919</td>
<td>7.4</td>
</tr>
<tr>
<td>Operating profit</td>
<td>5,430</td>
<td>4,958</td>
<td>9.5</td>
</tr>
<tr>
<td>Argentinean peso devaluation to 1.7</td>
<td>(529)</td>
<td>-</td>
<td>n.a.</td>
</tr>
<tr>
<td>Amortization of goodwill</td>
<td>(842)</td>
<td>(501)</td>
<td>68.1</td>
</tr>
<tr>
<td>Income before taxes</td>
<td>2,034</td>
<td>2,868</td>
<td>(29.1)</td>
</tr>
<tr>
<td>Net income</td>
<td>2,107</td>
<td>2,505</td>
<td>(15.9)</td>
</tr>
</tbody>
</table>

### Euro Million

- **Capex**: (9,096) (2000), (7,923) (2001), **41.2%** (2001 vs. 2000)
...Capitalizing in its unique position

- We have delivered on earnings
- We have optimized efficiency, showing strong EBITDA margins
- We have achieved capital allocation and Capex discipline
- We have a solid and diversified client base and revenue streams
- We have developed new growth platforms
- We are well positioned to capture profitable growth ahead

Important achievements to date ...

... rather than restating our achievements, we would like to review how Telefónica will deliver earnings growth
• STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT

• STRATEGY: OPERATIONAL KEY DRIVERS ...
  – Accelerating performance of core businesses
  – Capturing our natural growth potential
  – Focusing to turn around non-performing businesses
  – Strengthening our “one company” model

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• THESE DRIVERS TRANSLATE INTO A SET OF MANAGEMENT COMMITMENTS

• CONCLUSIONS
Four drivers to support our future performance

- **Accelerating performance of core business**
  - Enhance Commercial focus
  - Improve efficiency
  - Optimize capital base
  - Work towards a fair regulatory framework

- **Capture our natural growth potential**

- **Turning around non-performing businesses**

- **Strengthen our “one company” model**
Accelerating performance of core businesses
Enhance commercial focus

Actively managing our customer base

Developing new products and services (innovation)

Adapting our distribution model

**Nº of total customers (millions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Pay-TV</th>
<th>Wireless</th>
<th>Wireline</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>68.2</td>
<td>24.9</td>
<td>42.3</td>
</tr>
<tr>
<td>2001</td>
<td>78.4</td>
<td>32.3</td>
<td>45.0</td>
</tr>
<tr>
<td>2004</td>
<td>100</td>
<td>1.1</td>
<td></td>
</tr>
</tbody>
</table>

Spain + Latam
Thousands of DSL lines

- 2000: 90
- 2001: 620
- 2005: >4,500

Actively managing our customer base
Developing new products and services (innovation)
Adapting our distribution model
**Accelerating performance of core businesses**

**Improve efficiency**

Manageable Cost Efficiency = \( \frac{\text{Discretionary costs}^*}{\text{Net Revenues}^{**}} \)

- **2000**: 49.1%
- **2001**: 46.5%
- **2002**: \( \approx -2/-3\text{pp} \)

Continuous effort in manageable costs efficiency in 2001 with ambitious objectives for 2002

* Includes personnel and external services
** Revenues less cost of sales (purchases, interconnection expenses, provisions and tributes)
**Accelerating performance of core businesses**

Selective CAPEX to optimize capital base

• Significant effort to control CAPEX compatible with organic business growth...
  – 19% CAPEX reduction in TdE’s traditional business
  – 7.9% CAPEX reduction in Telefónica Latam
  – Significant CAPEX rationalization in Telefónica Móviles, especially in Spain
• ...and aggressive investments to develop growth businesses
  – ADSL expansion in Spain
  – Achievement of “metas” in Brazil
• In line with a multi-year effort to improve EBIT

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* Excluding UMTS licences and capitalized costs
Four drivers to support our future performance

Accelerating performance of core business

Capture our natural growth potential
- Extracting the full potential of our existing customer base
  – Broadband and Wireless Data
- Expanding our customer base
  – Brazil and Mexico

Turning around non-performing businesses

Strengthen our “one company” model
Extracting the full potential of our existing customer base
Translating the Broadband opportunity into revenues and earnings

1. Closing the penetration gap in Broadband access infrastructure
   – Ambitious but realistic objectives for 2005: more than 4.5 million DSL connections in Spain & Latam

2. Developing a full and compelling service offering for the residential segment
   – “Imagenio” in its pilot phase, adding Multimedia Interactive Services (VoD) to traditional telephony

3. Evolving towards end-to-end solutions for our business customers, to capture additional value
   – “eBA” for the development of a complete and customized “end-to-end” industry specific solutions for corporations

4. Refocusing our media assets to address the content opportunity and capture the value for Telefónica
   – New Multiplatform Unit, to centralize content acquisition and development, and identify opportunities for intragroup synergies
Expanding our customer base
Brazil: we have the best platform for growth

* Proforma (including Teleleste)
### Expanding our customer base

**Brazil: TEM-PT JV to lead the market**

<table>
<thead>
<tr>
<th></th>
<th>2000A</th>
<th>2001A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregated figures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer base (MM)</td>
<td>9,395</td>
<td>11,601</td>
</tr>
<tr>
<td>Market share in area of operations</td>
<td>60%</td>
<td>60.8%</td>
</tr>
<tr>
<td>Revenues (MM Reais)</td>
<td>5,634</td>
<td>6,291</td>
</tr>
<tr>
<td>EBITDA (MM Reais)</td>
<td>1,747</td>
<td>1,931</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>31%</td>
<td>30.7%</td>
</tr>
<tr>
<td>Connections/employee</td>
<td>1,243</td>
<td>1,752</td>
</tr>
</tbody>
</table>

1 Includes Telesp Celular, Global Telecom, TeleSudeste Celular, Celular CRT & TeleLeste Celular

#### #1 wireless operator in Brazil (01E)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>JV</td>
<td>11.6</td>
<td>41%</td>
</tr>
<tr>
<td>TIM</td>
<td>4.5</td>
<td>16%</td>
</tr>
<tr>
<td>Bell South</td>
<td>2.7</td>
<td>9%</td>
</tr>
</tbody>
</table>

#### Outperforming competitors (01E)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>JV</td>
<td>2.2</td>
<td>66%</td>
</tr>
<tr>
<td>TIM</td>
<td>0.6</td>
<td>36%</td>
</tr>
<tr>
<td>Bell South</td>
<td>0.3</td>
<td>25%</td>
</tr>
</tbody>
</table>

#### Brazilian average

- ~ 900

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1 Includes Telesp Celular, Global Telecom, TeleSudeste Celular, Celular CRT & TeleLeste Celular
Expanding our customer base
Mexico: becoming the second largest wireless operator

- **1Q 01**: 2,309 net adds
- **2Q 01**: 28,126 net adds
- **3Q 01**: 43,155 net adds
- **4Q 01**: 108,853 net adds

**CURRENT OPERATIONS**
- Customer base expansion
- Consolidate brand positioning
- Enhanced commercial offer
- New IT systems
- Improved operating efficiency & productivity

**PEGASO**
- Network in the high growth areas
- Immediate access to Mexico D.F. (20MM POPs)
- Nationwide PCS licenses with optimal spectrum allocation
- Solid distribution network: >3,500 POS
- Seamless nationwide roaming agreement with the US & Mexico

**BECOMING THE UNIQUE REAL ALTERNATIVE TO THE INCUMBENT OPERATOR**
Four drivers to support our future performance

- Accelerating performance of core business
- Capture our natural growth potential
- Turning around non-performing businesses
  - UMTS: manage options & limit financial exposure
  - Monitor T.Data in countries where we are incumbent
  - Refocus media assets to maximize value
- Strengthen our “one company” model
**UMTS strategy: Germany**
*Managing our options while limiting our financial exposure*

**CONSERVATIVE ROLL-OUT OF GSM/GPRS**
- Soft commercial launch as a MVNO targeted at specific segments
- Transparent, flexible, simple & competitive pricing offer
- Multichannel distribution strategy

**BUILD UP + SHARE UMTS NETWORK**
- G3G will own 50% of 1 of the 3 strongest UMTS networks to be built in Germany

**NON RECURSIVE VENDOR FINANCING**
- 500-600 Million € already signed
- Potential additional external financing

**FINANCIAL CAP 2002-2003 (*) : 800-900 MM€**

(*) EBITDA losses + Capex - Non recourse vendor financing
**Terra Lycos**

*A key profitable long term player in the industry*

- Consistently delivering growth (+22 YoY) and improving profitability (+24pp YoY)
- New diversified revenue streams (IMS, OBP, Geographical diversification)
- Cost management efficiency (€103 M cost out in 2001)
- Solid financial position: €2.2 bn (Dec 01)
- Strong organization: management team and processes
- Telefónica: a unique strategic partner
Admira
Refocusing Admira to capture the value of our media assets

- Consolidate a coherent traditional media, advertising-based group

- Assess potential asset restructuring, or divestitures when Telefónica is not the natural owner

- Develop Admira’s content business to support and benefit from broadband development in Telefónica
Four drivers to support our future performance

- Accelerating performance of core business
- Capture our natural growth potential
- Turning around non-performing businesses
- Strengthen our “one company” model
  - Consolidate our “one company model”
Strengthening our “one company” model

**Multibusiness working sessions**
- Group and country Committees
- Focused task forces
- Competence Centers

**Structured horizontal processes**
- Finance and treasury
- Planning/Control
- Procurement
- Brand management
- IT architecture

**Centralization of non-core areas and growth initiatives**
- Efficiency improvement in non-core areas
- Multi-business growth initiatives

**VALUES THAT STRENGTHEN OUR COMMON CULTURE**
- Share best practices and align priorities
- Optimize critical resources
- Capture synergies
INDEX

• STRONG FUNDAMENTALS IN A CHALLENGING ENVIRONMENT

• STRATEGY: OPERATIONAL KEY DRIVERS …
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• … COMBINED WITH FINANCIAL MANAGEMENT AND DISCIPLINE

• THESE DRIVERS TRANSLATE INTO A SET OF MANAGEMENT COMMITMENTS

• CONCLUSIONS
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
Manage risk proactively
Risk management has been a key element to weather the current Latin American environment ...

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

- 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

- Use accounting hedges to reduce FX balance sheet exposure
- Match FX cash flow exposures with cash hedges
Manage risk proactively
... based on our geographic diversification, together with an active hedging policy ...

**EBITDA 2001**

- Spain: 58%
- Brazil: 22%
- Argentina: 11%
- Chile: 6%
- Peru: 6%
- Other: 42%
- Other: -2%

**US$ EBITDA Standard Deviation** (rebased)

- Stand-alone Latin America assets: 100
- Telefónica’s Latin America portfolio: 66
- Telefónica’s Latin America + Spain portfolio: 34

*1990-2001
Manage risk proactively

... help us to mitigate the effects of the crisis in Arg. in 2001 ...

Euro Million

<table>
<thead>
<tr>
<th>Income statement effect*</th>
<th>Net Worth effect*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loss due to USD debt</strong></td>
<td><strong>-2,076</strong></td>
</tr>
<tr>
<td><strong>Hedging increase in Capex</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Increase in bad debt provisions</strong></td>
<td><strong>62</strong></td>
</tr>
<tr>
<td><strong>Tax shield and minorities</strong></td>
<td><strong>60</strong></td>
</tr>
<tr>
<td><strong>After tax losses due to devaluation</strong></td>
<td><strong>220</strong></td>
</tr>
<tr>
<td><strong>Total Net Worth direct effect</strong></td>
<td></td>
</tr>
<tr>
<td><strong>-1,424</strong></td>
<td></td>
</tr>
</tbody>
</table>

* ARS/USD = 1.7
**Manage risk proactively**

*We have protected our exposure in the rest of the region, although markets do believe in decoupling...*

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**Exchange rates indexed**

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**2002 GDP Growth**

- Argentina: 2.0
- Brazil: 1.5
- Mexico: 3.4
- Chile: 3.2
- Peru: (value not shown)

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**Brazilian Real is not correlated with Argentinean Peso**

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

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*Source: Bloomberg and Market consensus*
Manage risk proactively
...using different hedging tools to cover both accounting and cash risks (Euro Billion)

**Argentina**

- Total Investment: 9.8
- Equity book value + intragroup debt before devaluation: 6.0
- Equity book value + intragroup debt after devaluation: 3.0, 3.0

**Latin-America**

- Total Investment: 40.5
- Equity book value + intragroup debt before devaluation: 21.5
- Equity book value + intragroup debt after devaluation: 17.1

Net Worth
Intra-group debt
**Manage accounting quality**

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

<table>
<thead>
<tr>
<th>Lower proportion of intangible assets on balance sheet</th>
<th>Restated asset base to fair value since 1998</th>
<th>Impact (Euro billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telefónica*</td>
<td>Restatement to fair value of several tangible assets both in Spain and abroad</td>
<td>2.2</td>
</tr>
<tr>
<td>Selected integrated operators average**</td>
<td>Write off goodwill arose within several acquisitions</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>Accounting hedging of acquisitions financed with equity</td>
<td>16.5</td>
</tr>
</tbody>
</table>

**AND WE FOLLOW PRUDENT ACCOUNTING PRACTICES AND TOTAL TRANSPARENCY**

* Under proportional consolidation method
** Telecom Italia (incl. Olivetti), France Telecom, British Telecom (incl. MM02), Deutsche Telekom

Source: ABN AMRO
Manage the balance sheet efficiently
Telefónica enjoys the best financial position among the large integrated European operators

Net debt position and rating* (Euro billion)

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Debt (Euro billion)</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telefónica</td>
<td>28.9</td>
<td>A2/A</td>
</tr>
<tr>
<td>Deutsche Telekom</td>
<td>62.1</td>
<td>BBB+/A-</td>
</tr>
<tr>
<td>France Telecom</td>
<td>62.5</td>
<td>BAA-/BBB+</td>
</tr>
<tr>
<td>British Telecom</td>
<td>24.0</td>
<td>BAA1/-A-</td>
</tr>
<tr>
<td>Telecom Italia**</td>
<td>36.9</td>
<td>BAA1/BBB+</td>
</tr>
</tbody>
</table>

Debt capacity position

Net Debt / EBITDA 2001

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Debt / EBITDA 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telefónica</td>
<td>2.3</td>
</tr>
<tr>
<td>Deutsche Telekom</td>
<td>4.1</td>
</tr>
<tr>
<td>France Telecom</td>
<td>5.1</td>
</tr>
<tr>
<td>British Telecom</td>
<td>2.5</td>
</tr>
<tr>
<td>Telecom Italia**</td>
<td>2.7</td>
</tr>
</tbody>
</table>

EBITDA / Interest expenses 2001

<table>
<thead>
<tr>
<th>Company</th>
<th>EBITDA / Interest expenses 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telefónica</td>
<td>6.9</td>
</tr>
<tr>
<td>Deutsche Telekom</td>
<td>3.7</td>
</tr>
<tr>
<td>France Telecom</td>
<td>3.0</td>
</tr>
<tr>
<td>British Telecom</td>
<td>4.7</td>
</tr>
</tbody>
</table>

We are committed to maintaining our current credit rating

- Single A, optimal within the current economic context
- Balanced debt structure by currency, maturity and interest rate
- Only European telco with 2002 needs fully refinanced

* Moody’s/Standard and Poors
** Including Olivetti net debt
Source: Annual Reports, SSSB, ABN Amro
Manage the balance sheet efficiently

Sound debt levels that we manage to refinance even within difficult market conditions

Euro Million

“5 year” credit spreads evolution in Euros
Spread over IRS in B.P.

Global bond issuance two tranches:
Euro 1.0 Bn
USD 5.0 Bn
September 2000

Eurobond Euro 2.0 Bn
October 2001

Telefónica’s short term debt refinancing

100% = 4,099 4,099

Commercial paper 1,554 1,554
Commercial paper renewal/ back-up lines

Bonds 947 947
Credit line renewal /free cash flow generation

Credit lines 1,598 2,545

Short term debt 2001*
Refinancing options for 2002

*Net maturity until 31/12/2002
Source: Bloomberg
Manage costs
Telefónica has achieved significant savings in financial expenses

Interest rate management

- Effective interest rate
- Average Net Debt (Euro Billion)

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>7.65%</td>
<td>26.9</td>
<td>31.2</td>
<td>28.9</td>
</tr>
</tbody>
</table>

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

- Well diversified operating profit growth
- Solid and well diversified revenue growth
  - 8-11%
  - Well balanced growing EBITDA
    - 9-12%
- Reinforcing capital discipline Capex over revenues
  - 26% - 12-16%
- Improving asset turnover
  - 0.5 - 0.5-0.55

- Improve return over capital employed
  - 7.9% - XX.X

- 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

- Efficient cost of equity
- Optimize capital structure at efficient frontier
- Improve cost of debt

Limit operational and financial risk
Share price standard deviation

Optimised cost of debt

Net debt/total assets

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

Optimal position at efficient frontier for debt

- 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
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• CONCLUSIONS
In summary, our strong operating performance and financial management provides unique flexibility when considering opportunities ...


<table>
<thead>
<tr>
<th>EBITDA</th>
<th>Capex*</th>
<th>Working capital, net interest, taxes and other</th>
<th>Cash available to shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>90.2</td>
<td>42.6</td>
<td>17.7</td>
<td>29.9</td>
</tr>
</tbody>
</table>

Capex excluding UMTS licenses
Source: Analysts estimates

Rpay all debt outstanding (28.9 billion euros) before maturity

Acquire or build one “Telefónica Brazil” every 2 years or 3-4 European small operators
... 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
We continued to show strong underlying operating performance in 2001

We are building on our strong fundamentals and solid growth platforms

We are committed to financial management and discipline

We have strengthened our one company model

Our commitments will deliver tangible results in terms of return over capital employed and cash flow generation

Our solid operating & financial position enhance our strategic flexibility to capture profitable growth

Building Value: Driving business and financial performance for continued earnings growth