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*Telefonica*

## ***Safe harbour***

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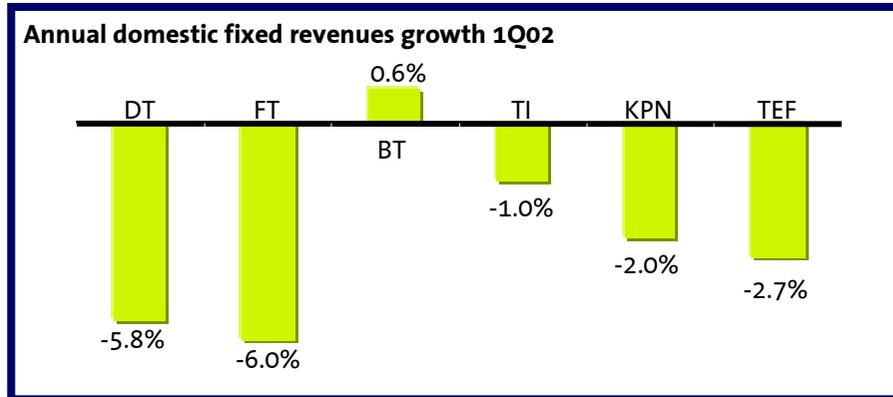
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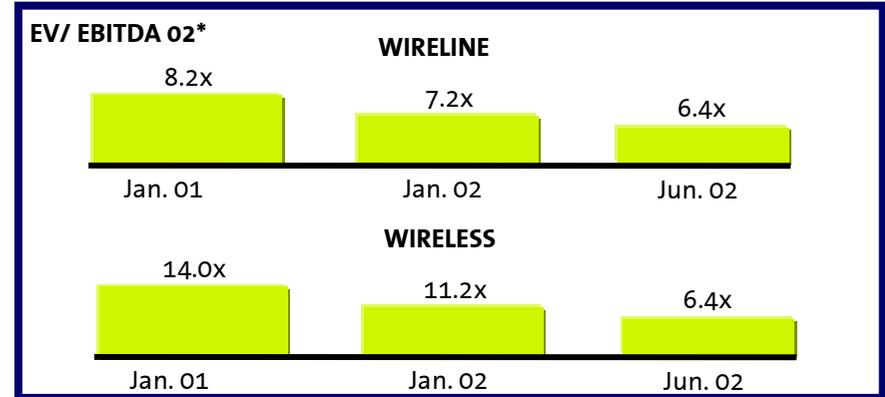
- **WE HAVE DELIVERED IN 1Q02 AMID A CHALLENGING ENVIRONMENT**
- OUR STRATEGY IS FOCUSED ON FCF GENERATION TO ADDRESS SEVERAL CHALLENGES...
  - SECTOR CHALLENGES
  - TELEFONICA'S SPECIFIC CHALLENGES
- ...COMBINED WITH FINANCIAL MANAGEMENT AND DISCIPLINE
- CONCLUSIONS

# Telecom sector is facing a tough momentum ...

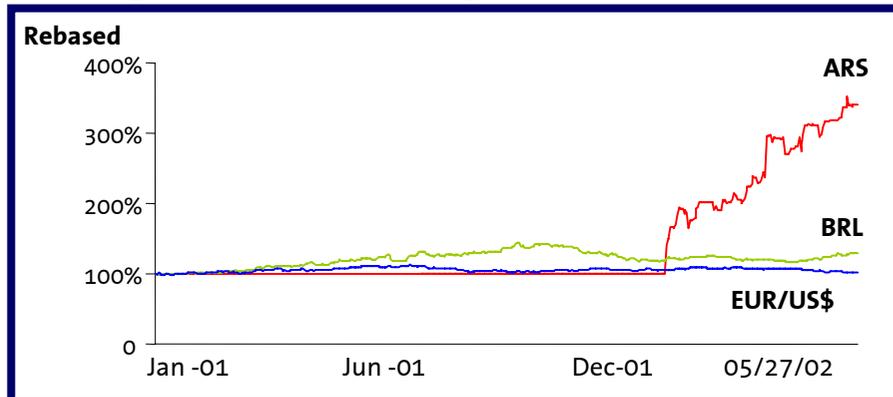
## Pressure on wireline incumbents



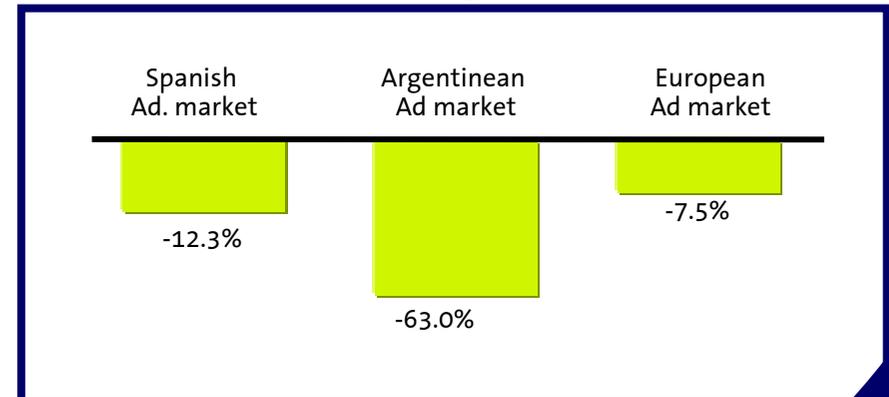
## Change in expectations for telecom sector



## Exchange rate evolution: Argentine crisis



## Downturn of the advertising market \*\*



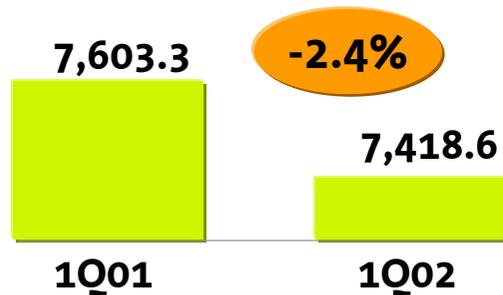
\* Average EV/EBITDA 2002 ratios of DT, TI, FT, KPN, PT and BT for wireline; TIM, Vodafone, Orange and mm02 for wireless

\*\* 1Q02 vs 1Q01, except European average (2001 vs 2000). Europe is the average of France (Sécodip), Germany (Nielsen S+P), Italy (ACNielsen) and UK (Media Week)

Source: Datastream, Multex Estimates

## ...Telefónica was not immune in 1Q02...

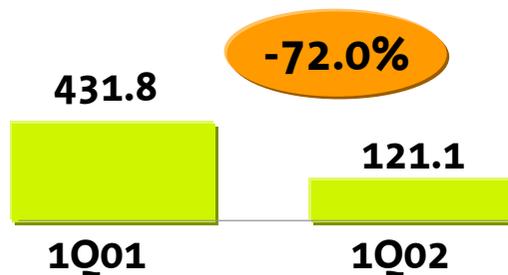
### REVENUES (€ in Millions)



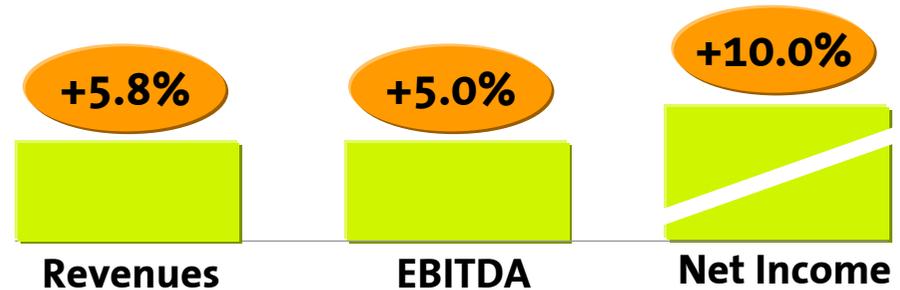
### EBITDA (€ in Millions)



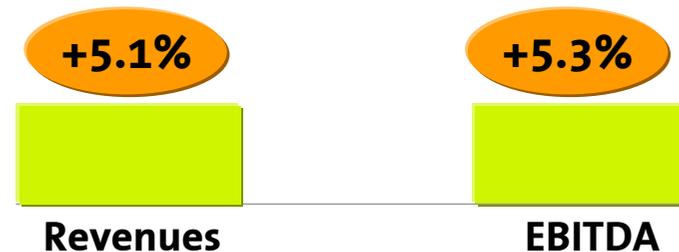
### NET INCOME (€ in Millions)



### GROWTH RATES EXCLUDING ARGENTINA



### GROWTH RATES EXCLUDING Fx



#### ✓ ARGENTINA

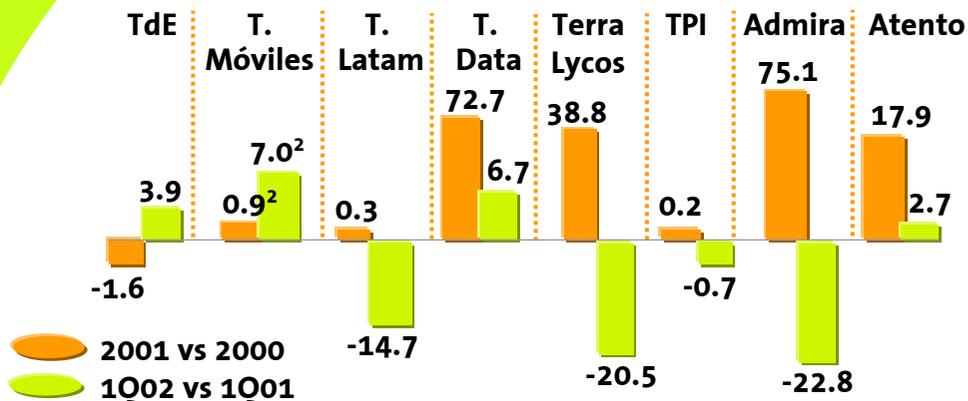
TASA: -7.5% in revenues and -7.0% in EBITDA, ex-Fx.

#### ✓ LATAM EXCHANGE RATES

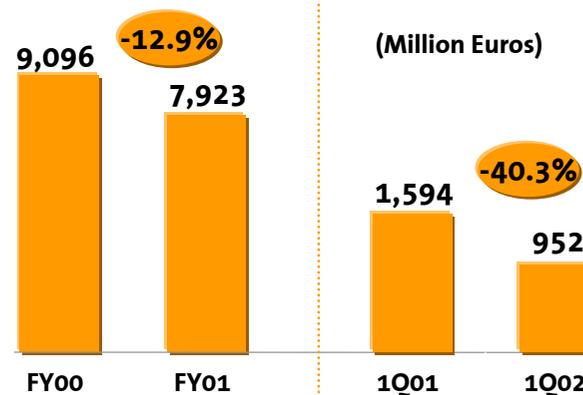
Close to -8 p.p. to both revenues and EBITDA growth.

# ...but efficiency and tight control of capital enables to deliver on cash flow generation...

## COST RATIONALIZATION (%)<sup>1</sup>



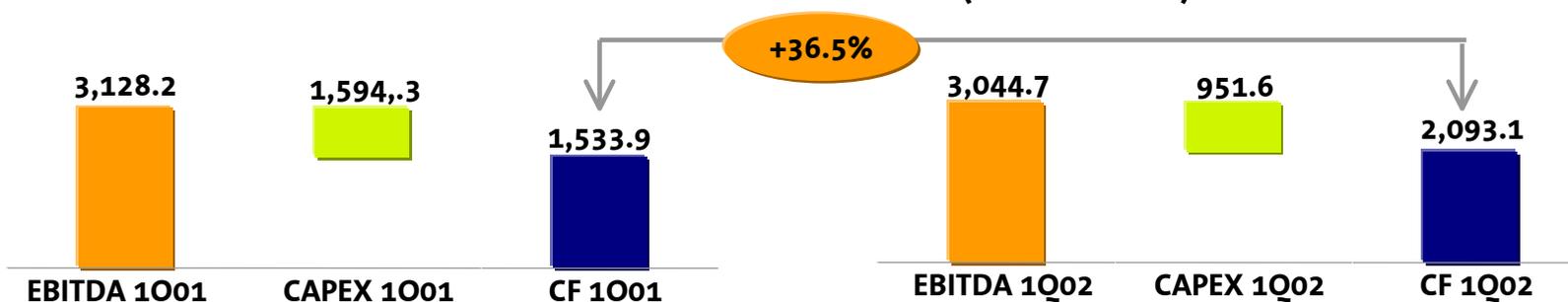
## CUMULATIVE CAPEX



- ✓ All subsidiaries are managing costs successfully
- ✓ Effort in bad debt control: stable at 2.5% of rev. for the Group
- ✓ Keeping Group EBITDA margin in the 41% level

- ✓ Adapting Capex to Latam environment:
  - ⇨ Argentinean crisis & Compliance of Metas in Brazil
- ✓ Focus on broadband

## CASH FLOW GENERATION (Million Euros)



<sup>1</sup> Operating expenses, including bad debt provisions.

<sup>2</sup> Excluding Handset Costs

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## ***Our business strategy is focused on FCF generation ...***

### **Accelerating performance of core business**

- Enhance Commercial focus
  - Improve efficiency
  - Optimize capital base
- } To maximize cash-flow

### **Capture our natural growth potential**

- ADSL and Wireless data
- Brazil and Mexico

### **Turning around non-performing businesses**

- UMTS: manage options & limit financial exposure
- Refocus media assets to maximize value

### **Strengthen our “one company” model**

- Share best practices and align priorities
- Optimize critical resources
- Capture synergies

## *... to address sector challenges*

### Challenging economic environment

- Financing restrictions
- Impact on demand
- Slow recovery expected

### Challenging telecom sector environment

- Pressure on traditional fixed telephony revenues, obliging to additional efficiency
- Concerns over xDSL economics: ROIC and increasing ARPU beyond connectivity
- Stagnation of mobile net adds & ARPU recovery
- Assure FCF generation (difficulties to implement debt reduction plans)
- Concerns on balance sheet's quality



### TEF specific challenges

- Exposure to Argentinean crisis
- Repatriating funds from Brazil
- Cash-out from non-performing businesses (UMTS greenfield operations, Media assets, ...)

The market will oversee short term sector performance and its ability to address these challenges

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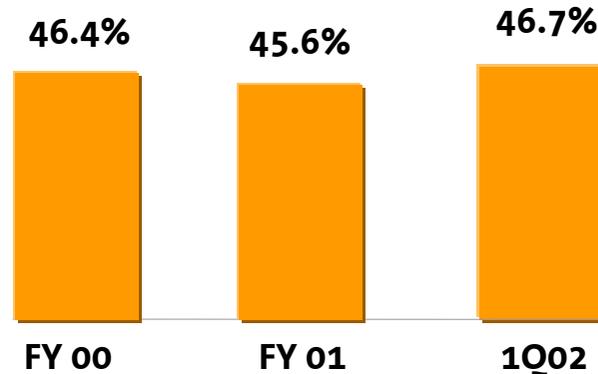
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# Sector's challenges: Wireline - Efficiency & DSL economics

## Telefónica de España

### Efficiency

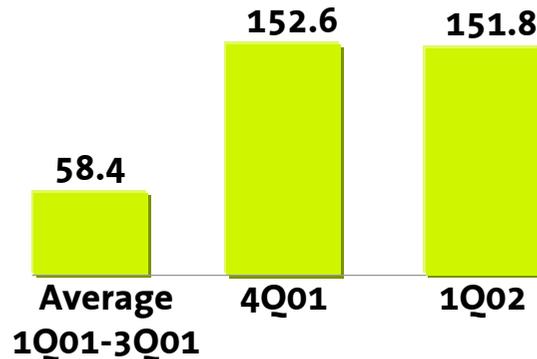
CUMULATIVE EBITDA MARGIN



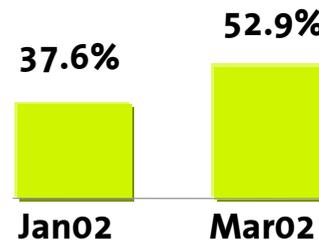
- 3,4% traffic growth in 1Q02
- Highly demanding regulatory framework

### ADSL economics

WHOLESALE ADSL NET Adds ('000)



CUMULATIVE PLUG&PLAY RETAIL ADDITIONS

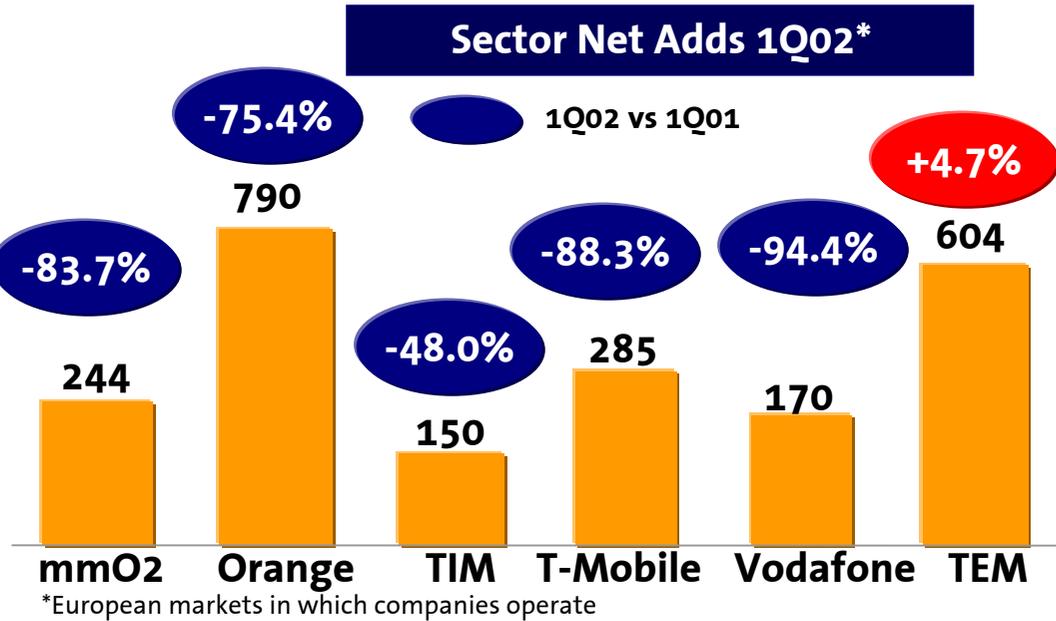


- Over 640,000 ADSL connections
- Broadband: 47% of 1Q02 CAPEX

- Improving economics by capturing additional value from business customers : *e-BA launched jointly with Terra Lycos for SMEs*

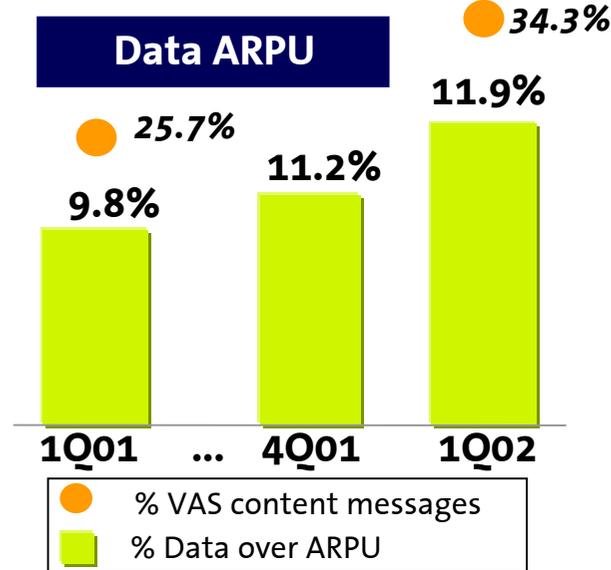
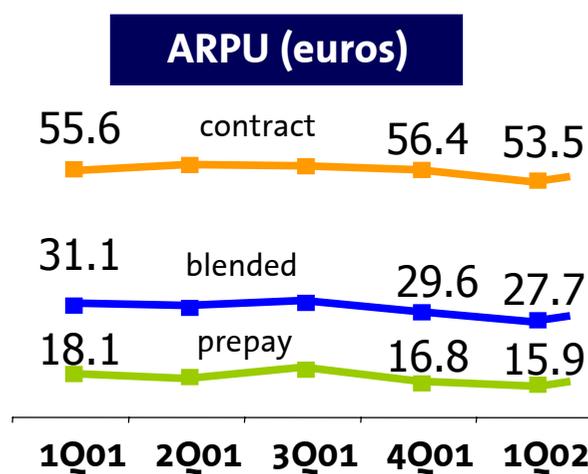
# Sector's challenges: Wireless - Net adds & ARPU recovery

Net adds



- Controlled Churn rate under 1.5% in Spain
- TEM presents room for additional customer growth

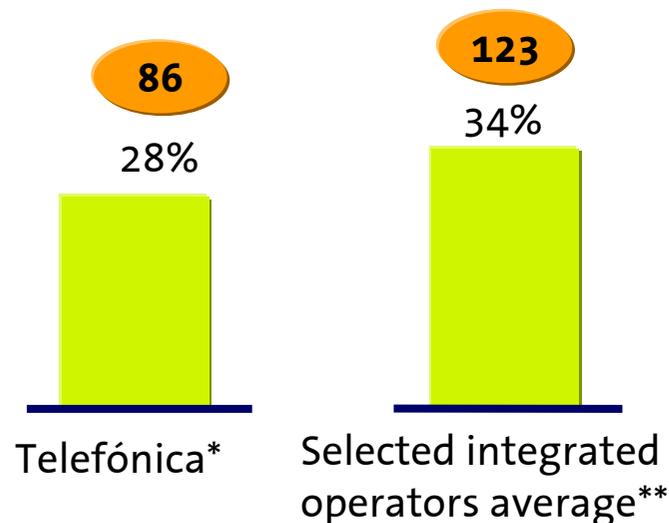
ARPU



- Monthly blended ARPU has already reached its minimum point in February 2002

# Sector's challenges: Balance sheet quality

## Lower proportion of intangible assets on balance sheet (as of 2001)



## Restated asset base to fair value since 1998

- Restatement to fair value of several tangible assets both in Spain and abroad
- Write off goodwill arose within several acquisitions
- Accounting hedging of acquisitions financed with equity

## Impact (Euro billion)

2.2  
1.5  
16.5  
**20.2**

 Total assets (Euro billion)

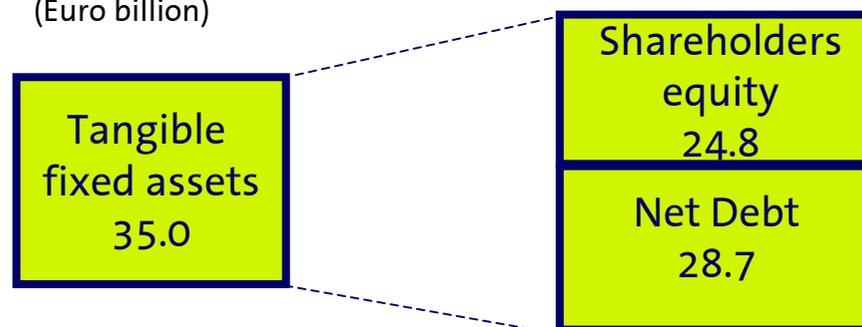
\* Under proportional consolidation method

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

Source: ABN AMRO

## Sound financial structure (as of 1Q02)

(Euro billion)



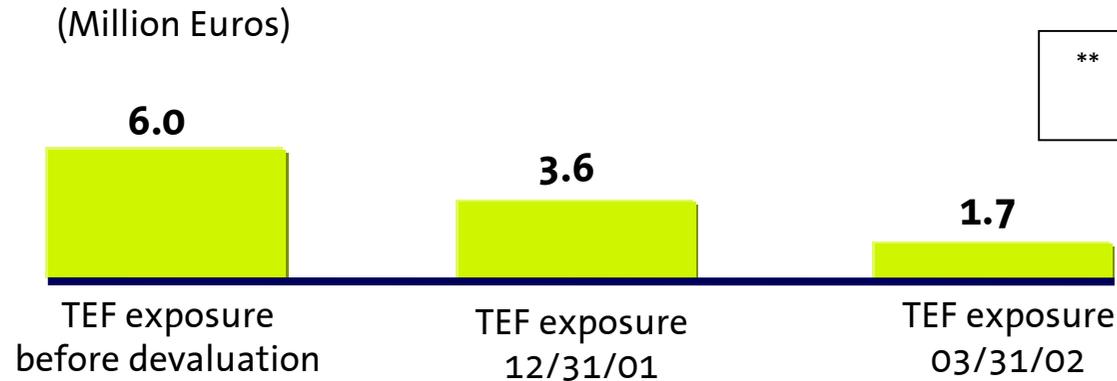
**Tangible fixed exceeds net debt**

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# Telefónica's specific challenges: Exposure to Argentinean crisis

**Total  
Telefónica  
exposure\*\***



**TASA:  
Protecting  
Liquidity**

**CAPEX  
Reduction**

- Supplier contracts renegotiation
- Strict fixing of opex priorities
- Over 40% reduction during 1st quarter 2002

**Cash Control**

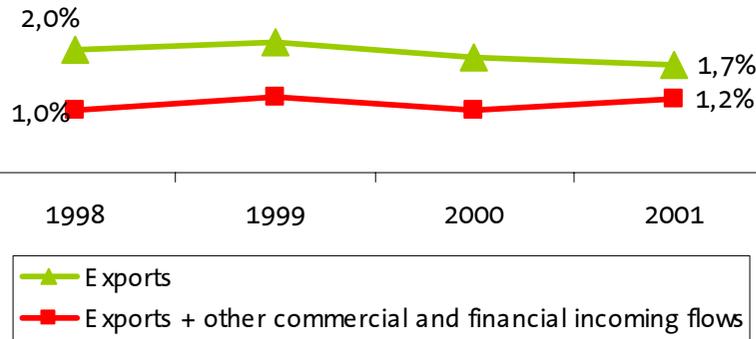
- “Zero investment model”
- Keeping projects linked to sales

**Cost  
Optimization**

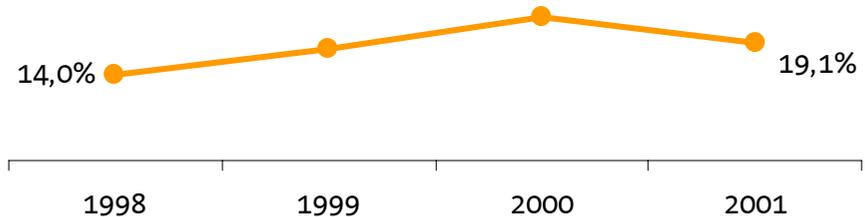
- Manage payments vs collections
- Bad debt control

# Telefónica's specific challenges: Repatriating funds from Brazil

## US\$ 1 bn. Incoming flows

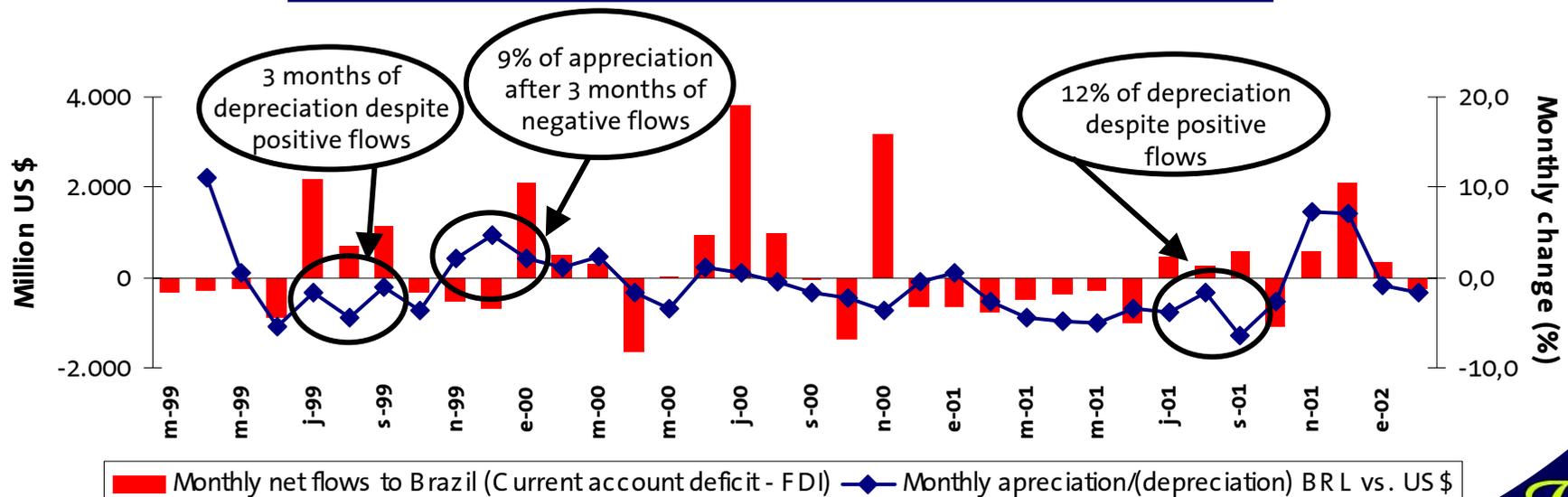


## US\$ 1 bn. as % of Profits and dividends outflows



- In 1998-2001 profits and dividends remittances represented on average 20% of FDI.

## Correlation exchange rate vs. Net flows to Brazil



# *Telefónica's specific challenges: Cash out from UMTS greenfield operations*

## **CONSERVATIVE ROLL-OUT OF GSM/GPRS**

Soft commercial launch as a MVNO

## **BUILD UP + SHARE UMTS NETWORK**

Owner of 50% of 1 of the 3 strongest UMTS networks to be built in Germany

## **NON RECOURSE VENDOR FINANCING**

500-600 Million € already signed

*Managing our options while limiting our financial exposure*

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

**QUAM in 1Q02**

**91,000 clients**

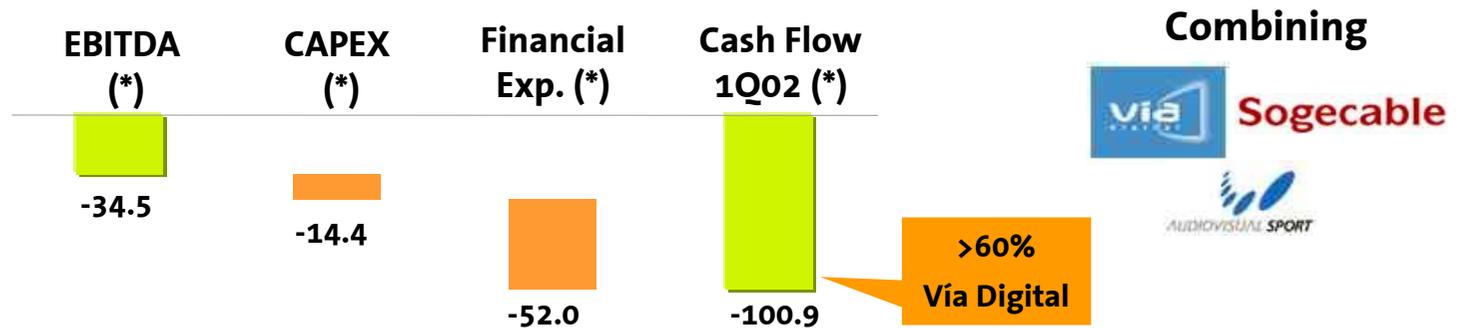
**58 MM€ EBITDA losses**

**38 MM€ in CAPEX**

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

# Telefónica's specific challenges: Cash out from Media assets

**Minimize  
Cash-out**



**Restructure  
the portfolio  
of assets**

**Admira**



**Traditional Media, advertising-based, oriented to the Spanish speaking market**

**Telefónica Contenidos**



**Lead the convergence of content & applications, to drive broadband development**

**Consider  
selective  
divestitures**

- Assess potential divestitures
- when Telefónica is not the natural owner
  - Non-core businesses
  - Regulatory obligations



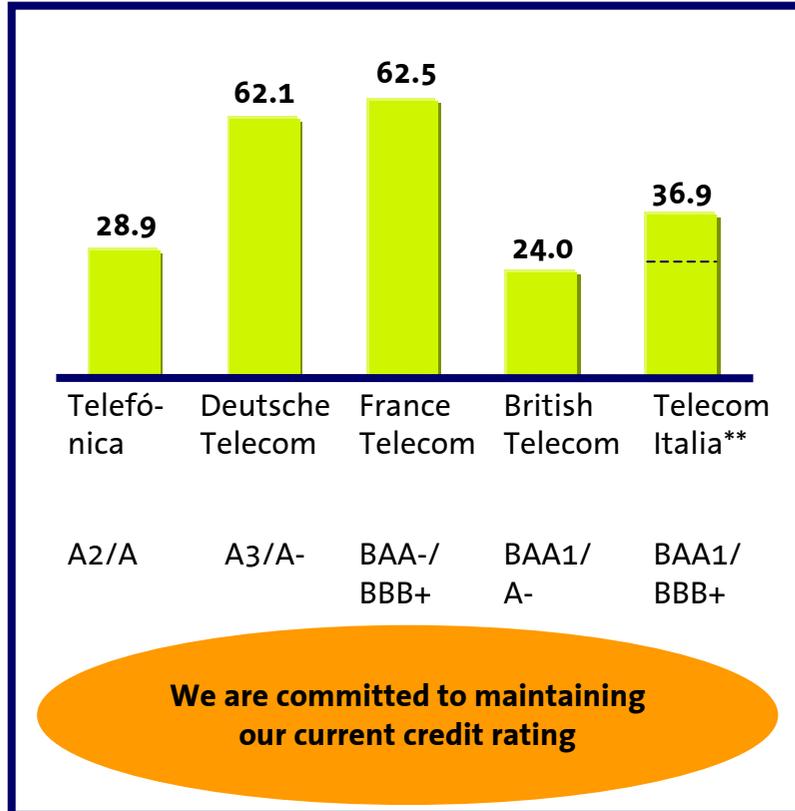
(\*) Fully consolidated subsidiaries and A3, Vía Digital and Onda Cero.

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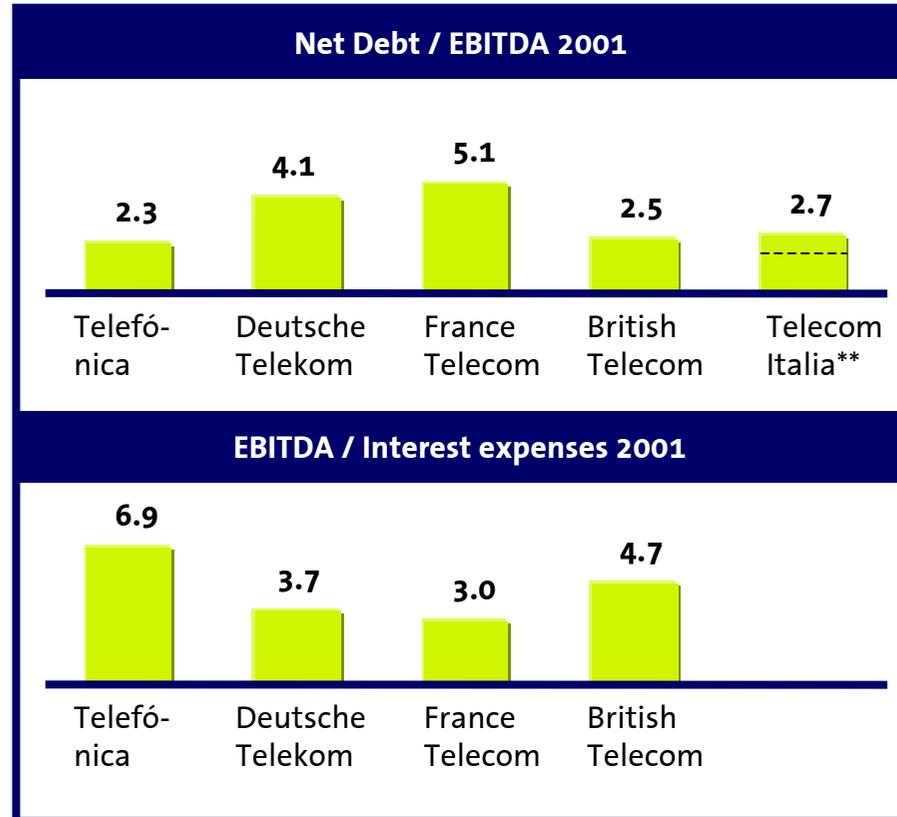
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# Telefónica enjoys the best financial position among the large integrated European operators

Net debt position and rating\* (Euro billion)



Debt capacity position



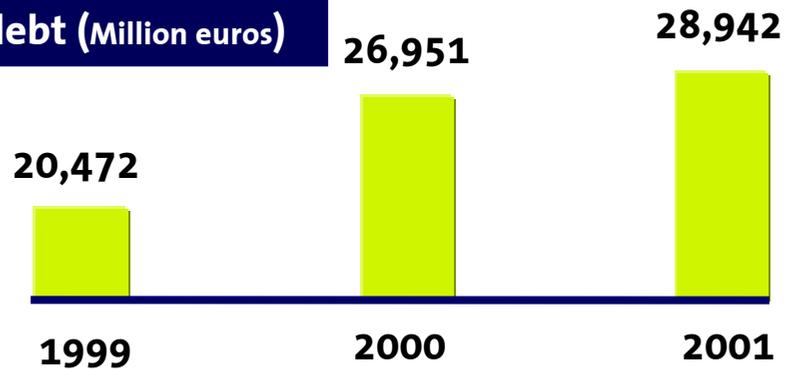
\* Moody's/Standard and Poors

\*\* Including Olivetti net debt

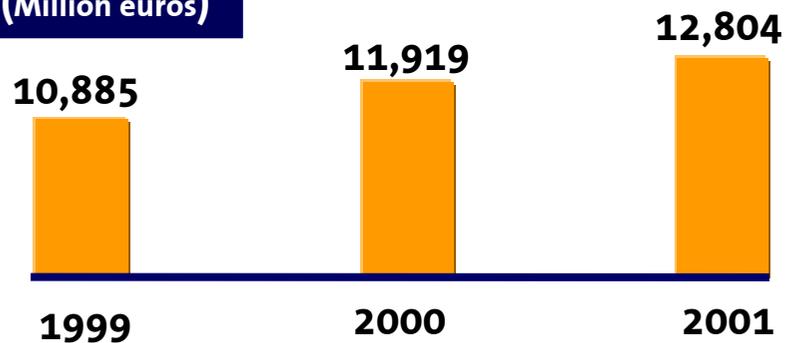
Source: Annual Reports, SSSB, ABN Amro

## Debt Ratios evolution

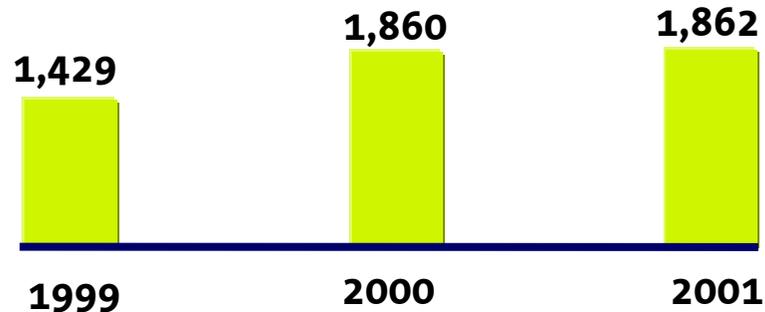
### Net debt (Million euros)



### EBITDA (Million euros)



### Financial Expenses (Million euros)



### $\frac{\text{Net Debt}}{\text{EBITDA}}$

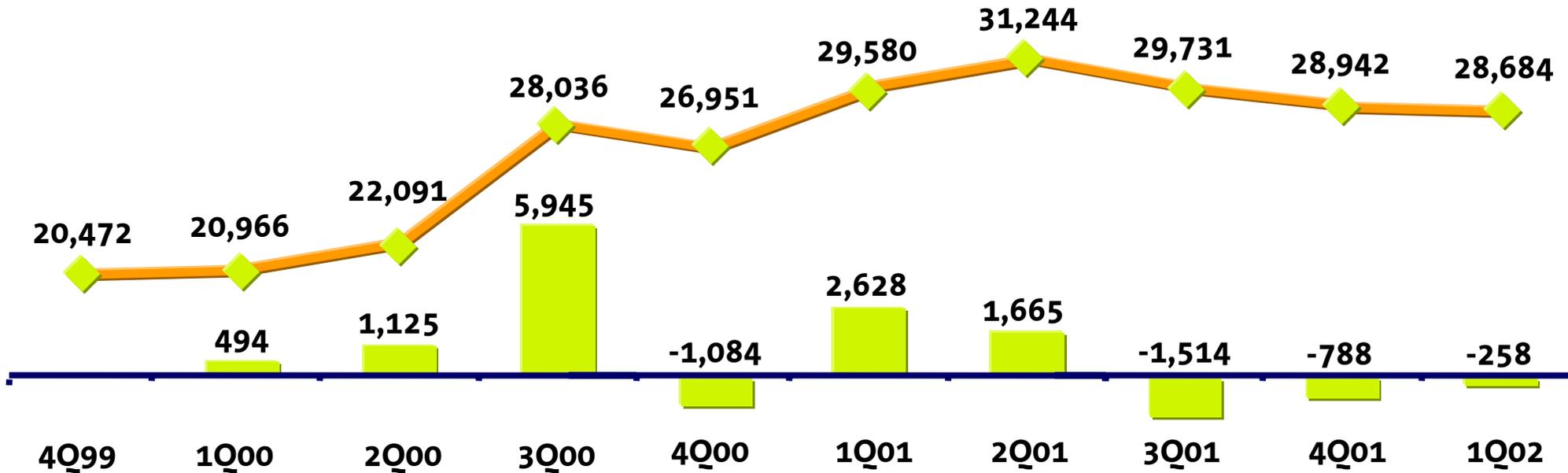
	1999	2000	2001
$\frac{\text{Net Debt}}{\text{EBITDA}}$	1.88	2.26	2.26

### $\frac{\text{EBITDA}}{\text{Financial Expenses}}$

	1999	2000	2001
$\frac{\text{EBITDA}}{\text{Financial Expenses}}$	7.62	6.41	6.88

# Quarterly net debt evolution

Net debt evolution (Million euros)



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## **CONCLUSIONS**

- ✓ **We are actively addressing sector & company challenges**
- ✓ **Efficiency continues to be a key pillar in our strategy**
- ✓ **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**

***Telefónica is committed to strong FCF generation***

*Telefónica*

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