

Santiago Fernández Valbuena

CFO

Telefónica Group

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Telefónica



Safe harbor

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Content

- **A SUCCESSFUL MANAGEMENT OF OPERATIONS IN A TOUGH ENVIRONMENT FOR A SOLID STARTING POINT**
- **CLEAR STRATEGIC PRIORITIES AND LINES OF ACTION FOR PROFITABLE GROWTH IN THE COMING YEARS**
- **STRONG FREE CASH FLOW GENERATION WITH A CLEAR RATIONALE FOR ITS USE**

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We are anticipating sector trends and taken the steps required ahead of our peers

The Telco sector's To-Do List

	Telefónica	EU telco peers
Extend growth potential in wireless	✓ ✓	?
Firm decisions taken to transform traditional wireline	✓ ✓	?
Leveraging on mass-market DSL opportunity	✓ ✓	?
Divesting non-core assets	✓ ✓ ✓	?
Solid delivery of FCF growth	✓ ✓	?
Optimising capital structure	✓ ✓ ✓	?
Establishing long-term dividend policy	✓ ✓ ✓	?

Since early 2002, we have successfully managed the company through a tough environment...

I Strengthened position in our core markets to capture customer growth

- In Spanish wireline, we are managing top-line pressure and over-performing on cash generation
- Our Spanish wireless operation is performing outstandingly

II Proactively managed the challenging LatAm environment

- Tight control of OpEx and CapEx across all operations
- Effective management of bad debt
- Proactive financial management

III Continued to strengthen commercial and operational focus, and tight cost and CapEx discipline

- Ambitious efforts to improve OpEx efficiency and flexibility across business lines
- Sustained CapEx rationalisation to decrease asset intensity

IV Decisively restructured under-performing operations to focus on core businesses

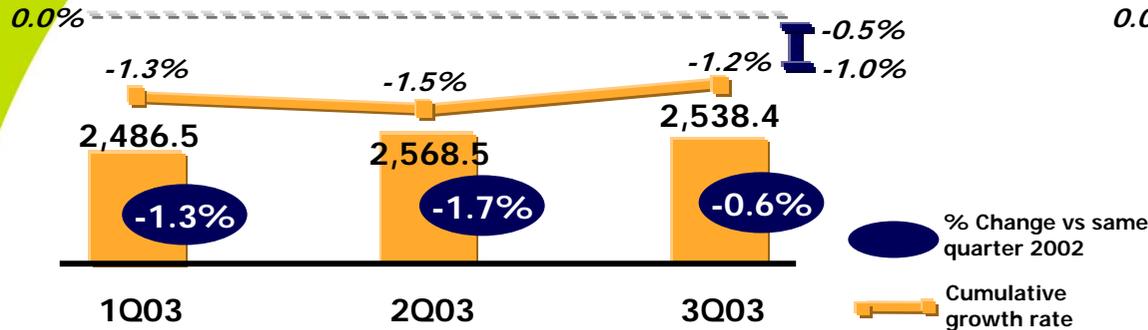
- European UMTS operations, Media divestitures, Via Digital merger agreement ...
- Terra-Lycos buy-out
- Corporate data and solutions businesses

**Beating 2003 targets
&
Driving strong free
cash flow generation
&
Keeping a solid
Balance Sheet**

Telefónica de España Group: Managing top line pressure and outperforming on cash generation...

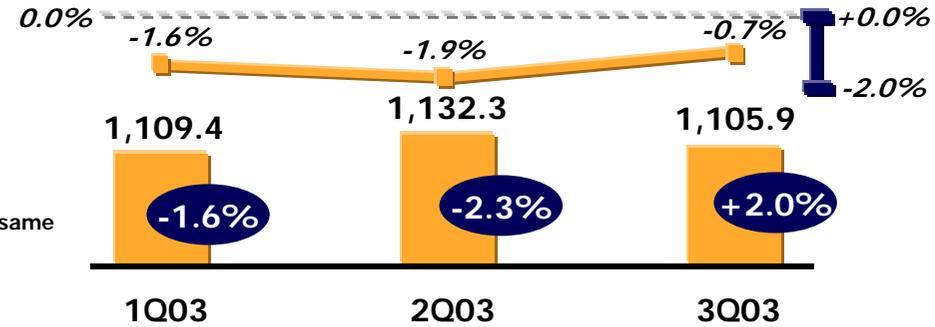
OPERATING REVENUES (€ in Million)

2003 target range

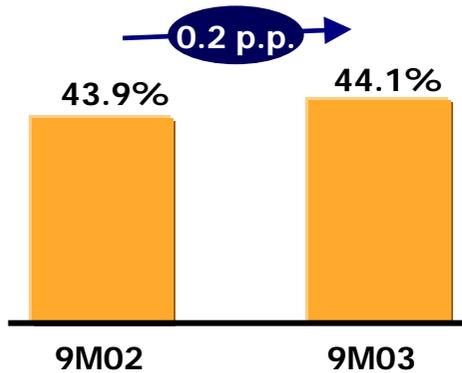


EBITDA (€ in Million)

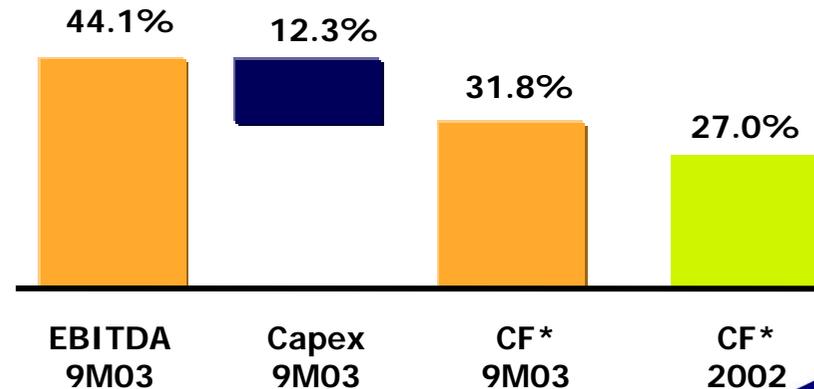
2003 target range



EBITDA MARGIN



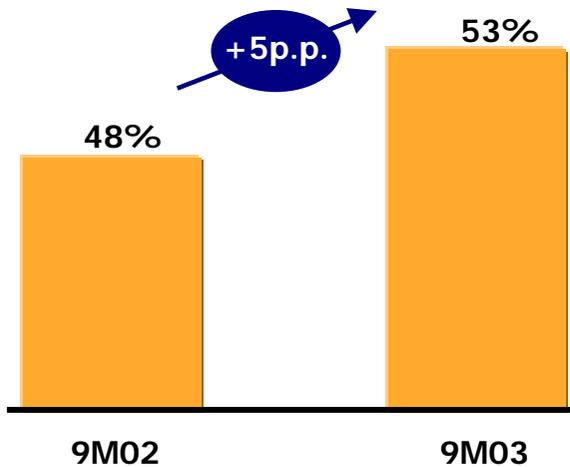
CASH FLOW (as a % of revenues)



(*) EBITDA-Capex

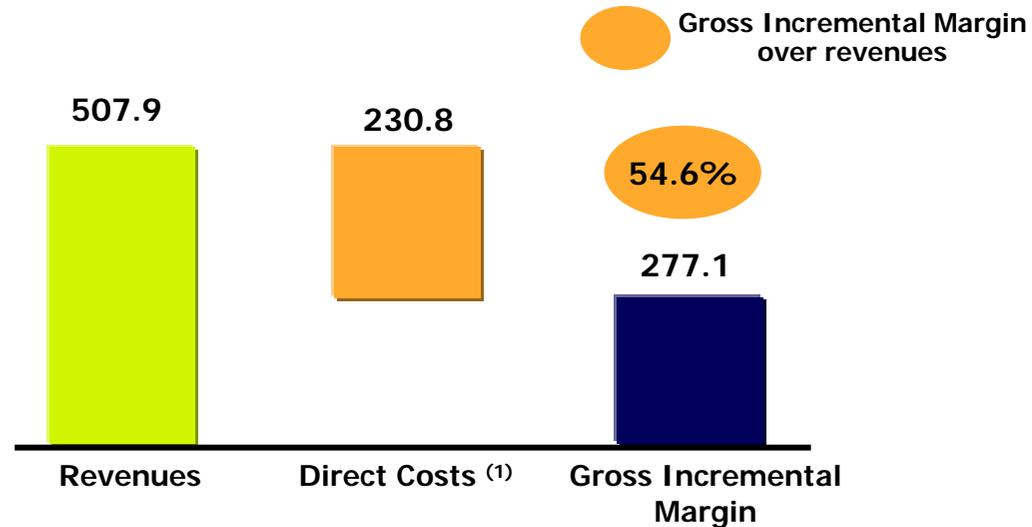
...By shifting towards fixed revenues and Broadband

FIXED REVENUES T. DE ESPAÑA PARENT (% over total revenues)



- +3.4% y-o-y growth in client access revenues (1/3 of total revenues)
- Broadband development (7% of 9M03 revenues)

9M03 BROADBAND ECONOMICS (€ in Millions)

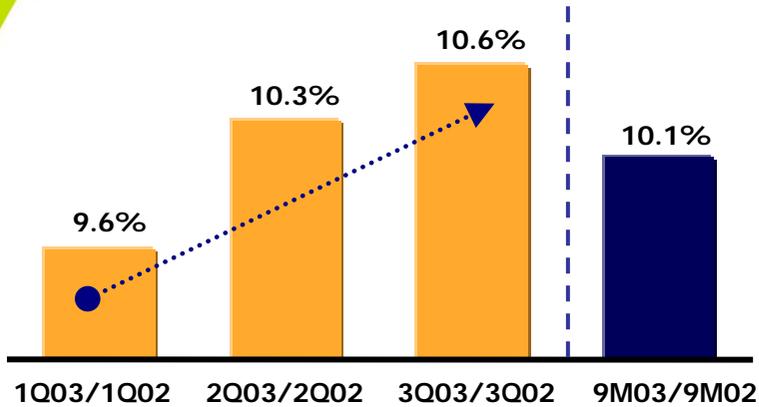


- 1.5 Million ADSL connections by October
- +6.1% ARPU growth since 2002

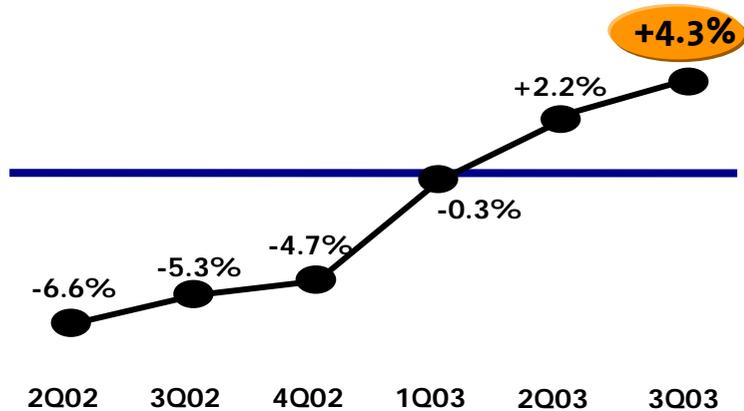
(1) Direct costs include CAT/Help Desk, Internet connection, IP network maintenance, Operations maintenance, Marketing, Installation, Modems, Commissions and Others

Telefónica Móviles España: high operating standards are providing for growth and profitability

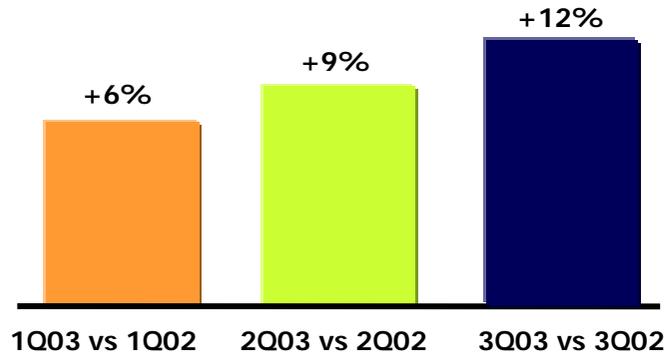
CONSISTENT MOU GROWTH



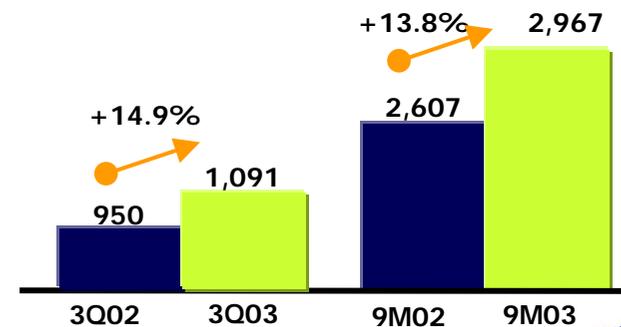
REVERSING ARPU TREND



ACCELERATING SERVICE REVENUES GROWTH RATE



A SOLID EBITDA PERFORMANCE (€ in Millions)



Telefónica Latinoamérica: organic growth and cash flow generation...

REVENUE GROWTH (Ex-Fx)

2003 target range

9%
7%

2003



2002



1Q 1H 9M FY

EBITDA GROWTH (Ex-Fx)

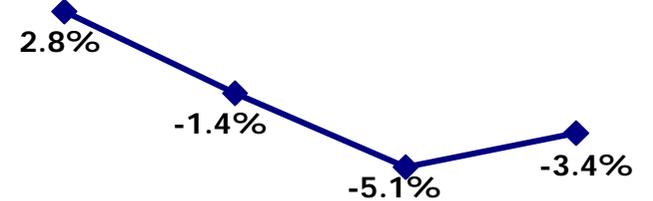
2003 target range

8%
6%

2003



2002



1Q 1H 9M FY

GROUP EBITDA MARGIN

48.1%

48.0%

2002

9M03

CASH FLOW BREAKDOWN * (€ in Millions)

961.1

339.0

252.1

312.0

1,864.2

Telesp

TASA

CTC

TdP

Total

(*) EBITDA-Capex

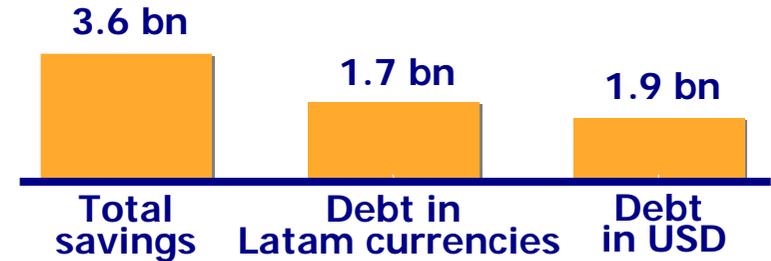
We are actively addressing Latin American risk

Managing debt exposure

A balanced mix of currencies (€, \$US, Latam)



DEBT REDUCTION DUE TO FX SINCE 2001

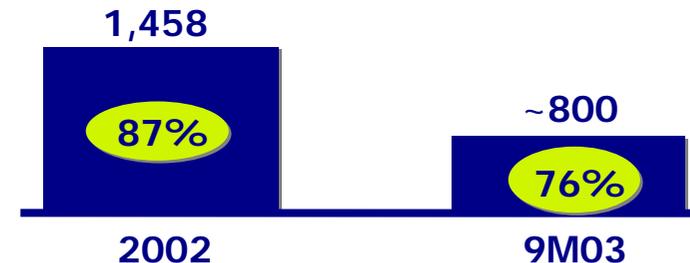


Accessing Cash Flow

Flexible instruments (M.fees, Intra-Group loans, dividends)



TOTAL REPATRIATED FUNDS (M USD)



Percentage repatriated funds/latam free funds

Leveraging at the subsidiaries level

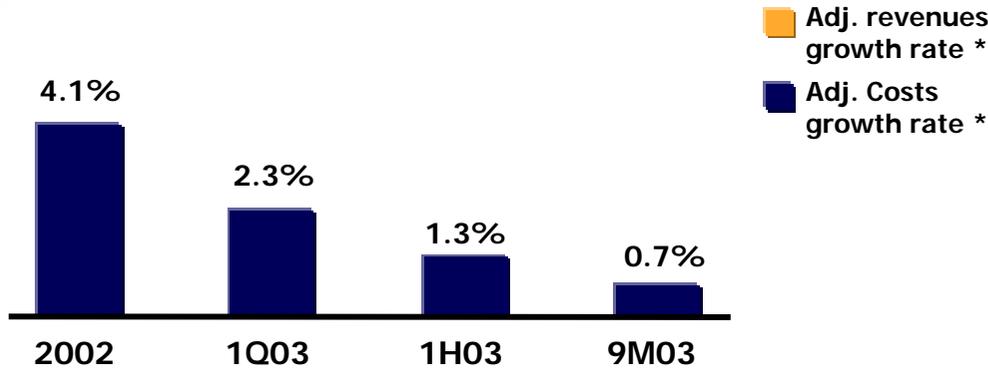
Tapping the local markets & hedging foreign currency financing



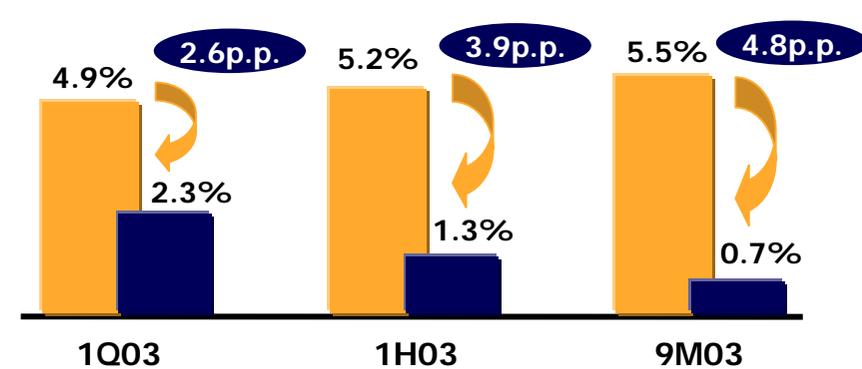
- Latam debt (23% of total) non recourse to Parent
- Excluding Argentina, Latam debt is fully hedged

Ambitious efforts to improve Opex efficiency and flexibility across business lines

A LEANER COST STRUCTURE
(cumulative % change)

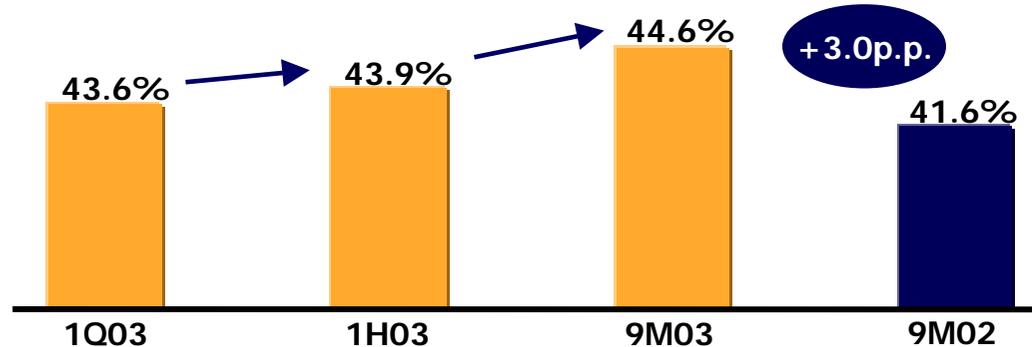


COSTS VS REVENUES GROWTH RATES



OPENING THE GAP BETWEEN REVENUES AND COST GROWTH RATES FOR THE BENEFIT OF MARGINS

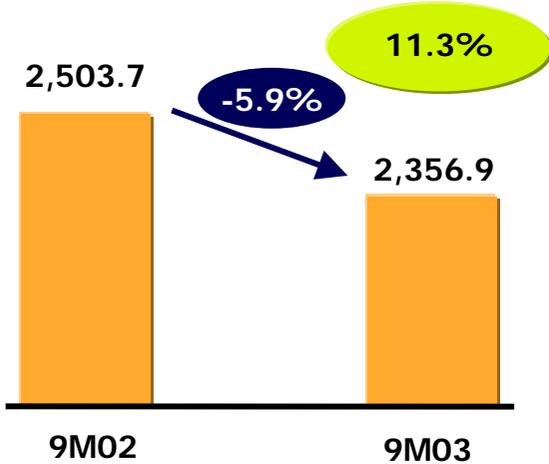
CUMULATIVE EBITDA MARGIN



(*) Excluding forex and changes in the consolidated accounts

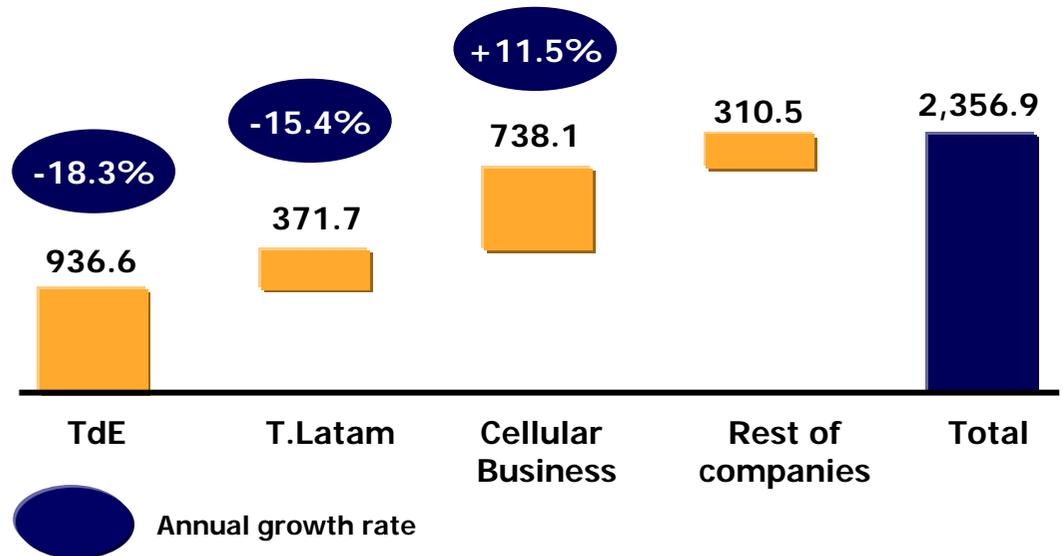
Sustained Capex rationalization to decrease asset intensity

CAPEX EVOLUTION
(€ in Million)



Capex over Revenues

9M03 CAPEX BREAKDOWN
(€ in Million)



Annual growth rate

- Increasing pace of **Telefónica de España** Capex cuts following efficiency gains in ADSL deployment.
- 9M03 wireline Capex in **Latin America** decreased by 20% in local currency terms, mainly driven by Telesp
- The launch of GSM services in Mexico and Chile are the factors behind **Group's wireless** Capex trend

We have decisively restructured under-performing operations to concentrate on core businesses

European UMTS operations

Closing of UMTS operations outside Spain

Media

Divestiture of broadcast TV assets (Antena 3, Azul TV)

Via Digital

Merger agreement with Sogecable

Terra Lycos

Buy-out of Terra completed and NSA fully developed

Corporate data and solutions businesses

Divestitures of unprofitable operations, and operational integration with our wireline operators

For a stronger Balance Sheet...

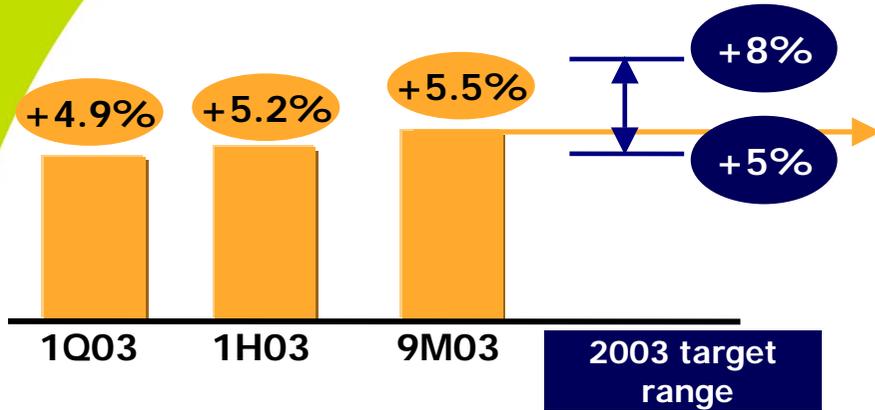
Intangibles over total assets have come down by 10 p.p. to 24% in the last twelve months

...and Net Income

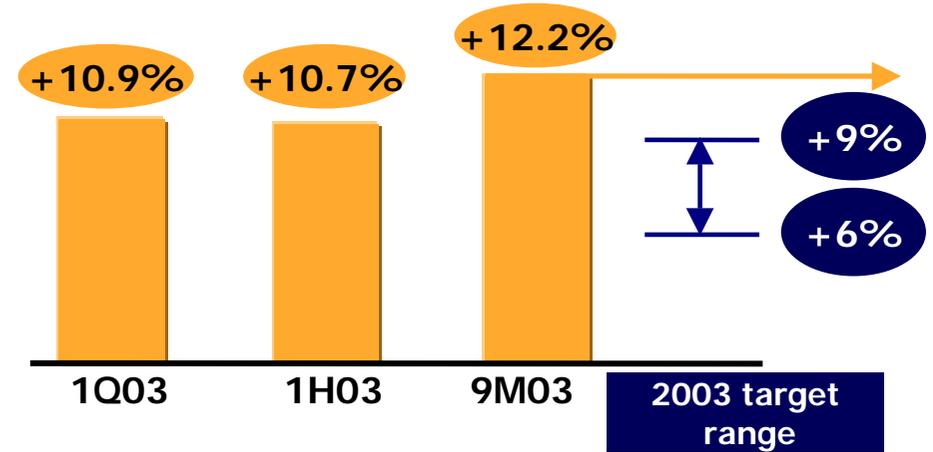
> 2 Billion € in 9M03 versus a 5 Billion € loss in 9M02, with non-operating results contributing positively

This active management of operations is leading to beat 2003 guidance...

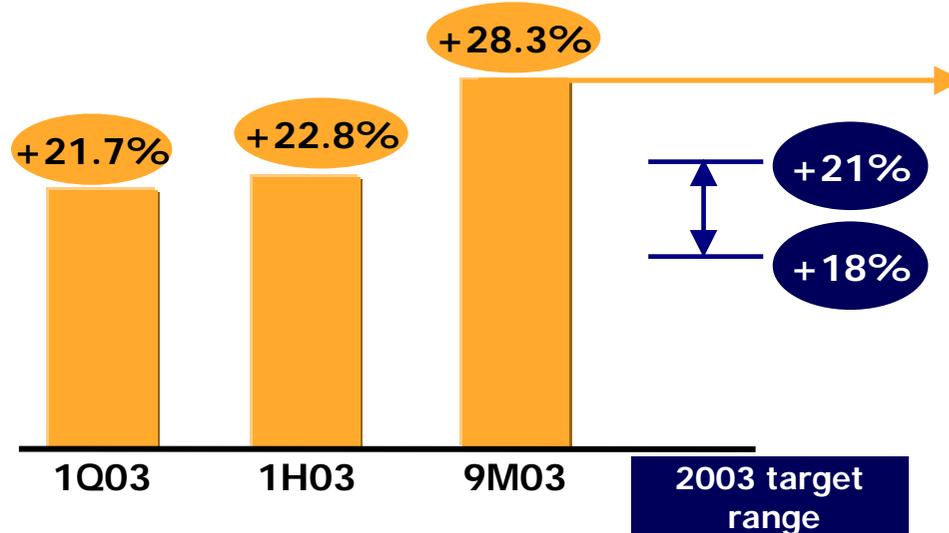
REVENUES*



EBITDA*



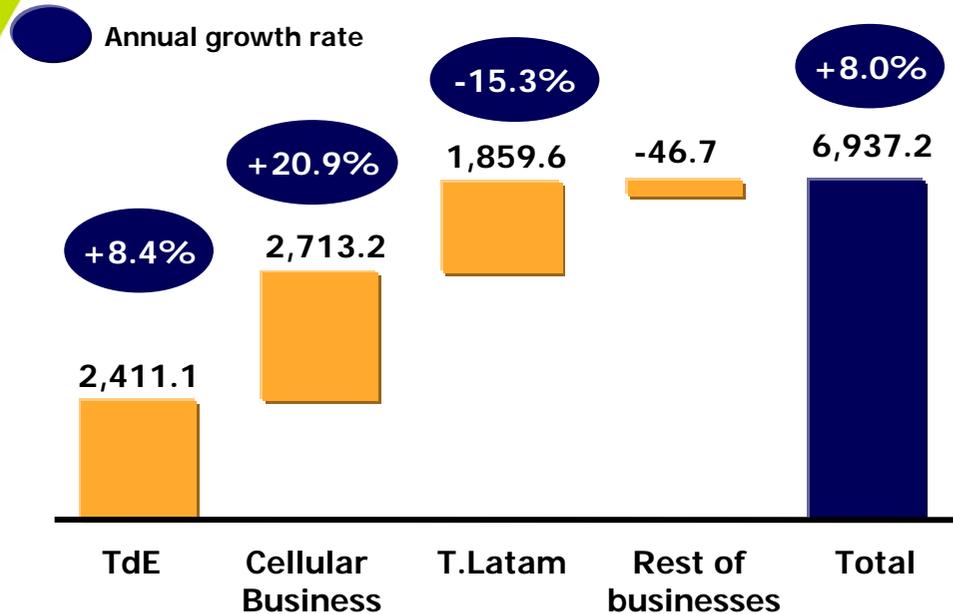
EBIT*



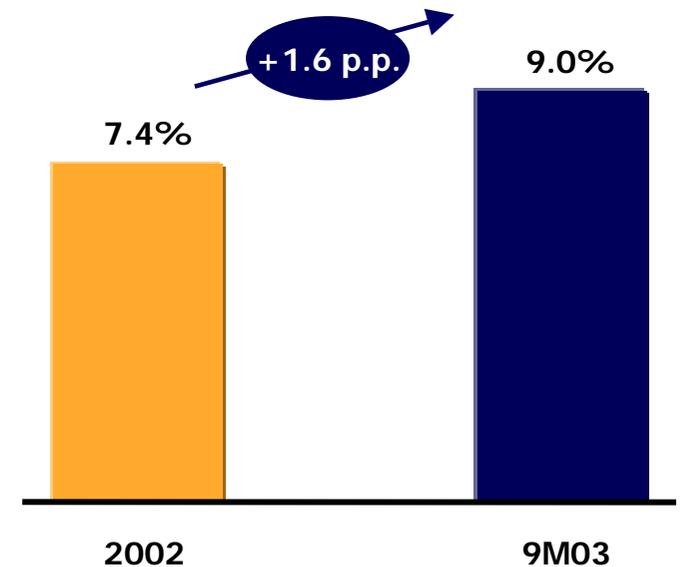
(*) Excluding Fx and changes in consolidation

... generate strong cash flow and improved returns...

9M03 CASH FLOW BREAKDOWN * (€ in Million)



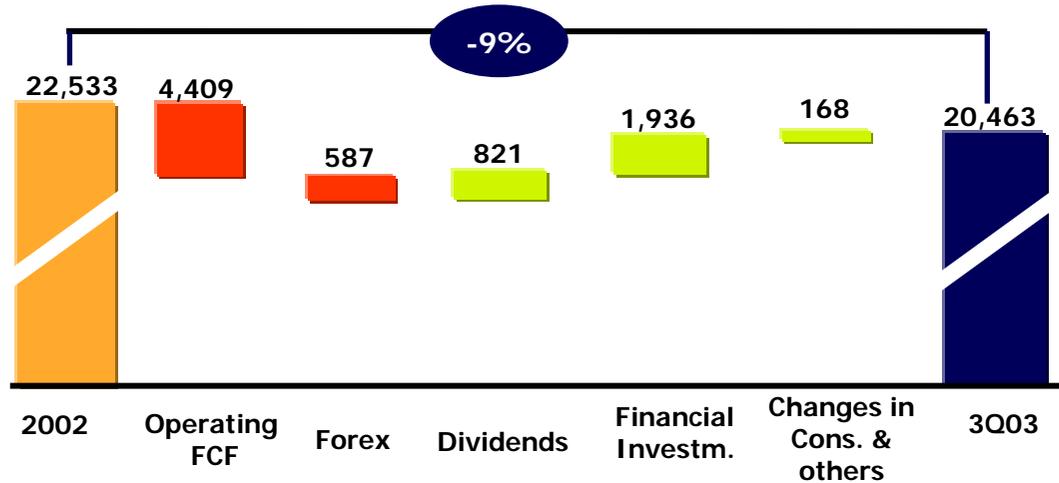
ROCE EVOLUTION



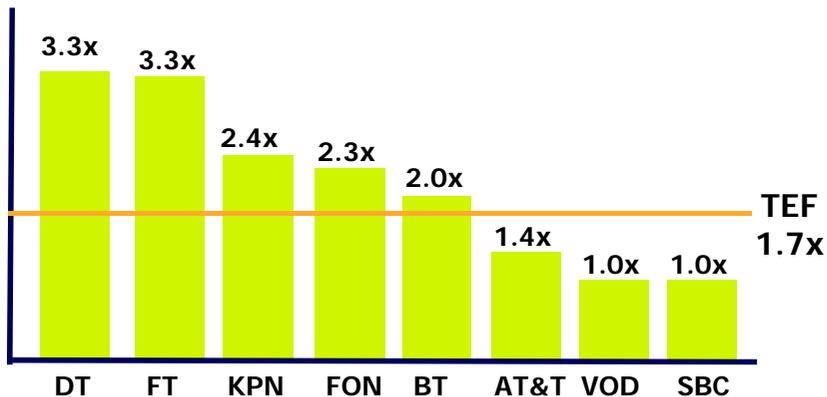
- Quarterly Cash Flow remains consistently over the 2 Billion € mark
- CF over revenues above 33%, compared to 28% in 2002
- Excluding Terra Lycos, the rest of businesses are contributing positively to Group CF

...and strengthen our Balance Sheet ahead of our peers

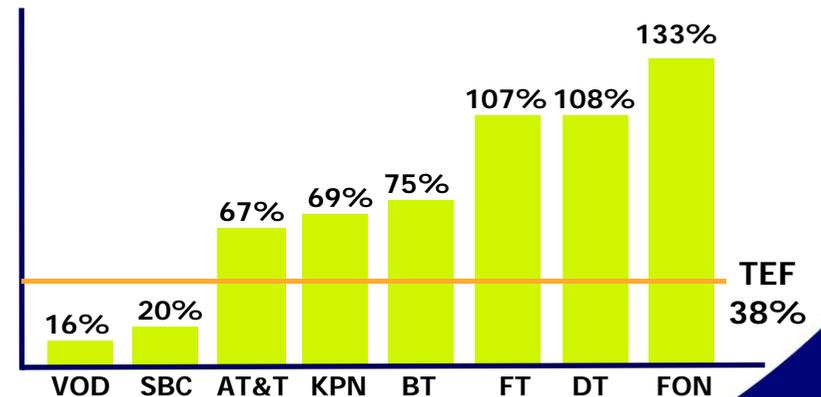
9M03 DEBT REDUCTION BREAKDOWN (€ in Million)



NET DEBT / EBITDA (2003E)



NET DEBT / MARKET CAP. (2003E)



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Looking ahead, we have a clear strategy to grow cash flows and improve returns

Objectives

Sustainable cash flow growth

Improved returns on capital



Lines of action

Customer orientation

Growth

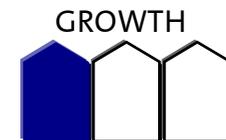


Transformation



- I Over 6 Mill. Telefónica Group DSL connections by 2006
- II Short and Medium term growth driven by Voice Upside and Data Services, respectively
- III Retain and grow customer base while stimulating usage and ARPU
- IV Build-up of excellent marketing and sales capabilities to ensure growth
- V Less capital intensity through CapEx optimization towards growth activities

Innovating to make broadband a truly "mass-market" service



Households
and
Individuals

Broadband as a truly
"mass-market"
product

SMEs
and
Corporations

Broadband as a
"must-have" for
businesses



Stimulate Penetration and VAS up-take

Push our own
initiatives

- New products: eBA, Soluciones ADSL, Mundo ADSL, Imagenio...
- New segments
- New devices: WiFi, consoles...
- Pricing innovation

+

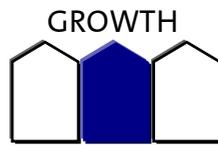
Cooperate
with service
providers to
stimulate
market
growth

- Sony
- Philips
- Securitas Direct
- ...

2006
ASPIRATIONS

- Over 6 million Telefónica Group DSL connections
- SME's Broadband penetration of 65% and 100% in Corporations in Spain

In wireless, we stand to capture substantial further growth, both in Spain...



Short term growth: VOICE UPSIDE

- Increased penetration:
 - Intra-company and residential niches
- Tariff and service innovation
- Prepaid-to-contract migrations
- Loyalty schemes

Medium term growth: DATA SERVICES

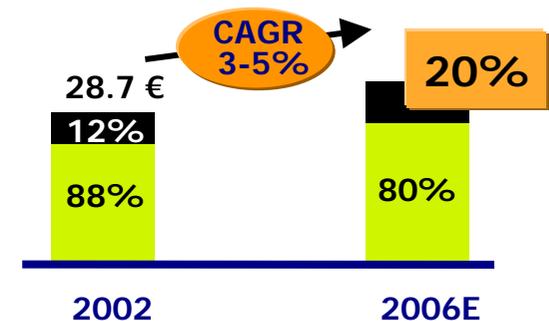
- Offer customized data services oriented to all customers by segment
- Enhance customer experience with new content & applications
- Guarantee access to affordable and enhanced handsets

MoU

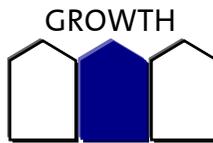


UMTS deployment will simultaneously support voice growth and guarantee the future contribution of data services

Total ARPU and Data contribution



...and in LatAm, given the huge market potential



+52 Million subs in 2003-06 in total current TEM 's LatAm markets
with

the expected market penetration in Brazil and Mexico moving from low 20's today to 35%-40% by 2006

OUR STRATEGY TO GROW

Brazil

- Leverage on largest mobile community to lead market growth and customer usage
- Growing focus on customer loyalty (30% drop in monthly churn by 2006)
- Drive profitability through integration of operations

Mexico

- Accelerate GSM network deployment (> 80 cities by end 2003)
- Build up a strong commercial channel across the country (> 5,000 POS by end 2003)
- Launch a comprehensive GSM service offering leveraging on TME

TO REACH OUR 2006 OBJECTIVES

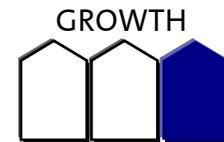
Consolidate our leadership while increasing profitability

- 12%-16% EBITDA CAGR 02-06
- 40%-45% EBITDA margin

Become the 2nd profitable player in the market

- > 20% market share
- 22%-26% EBITDA margin

Also, our LatAm wireline business will keep growing organically



Retain and grow customer base while stimulating usage and ARPU

Retain and grow customer base

- Maximize penetration by income level
- Accelerate internet mass penetration
- Retain customers through bundling and segmentation
- Anticipate and minimize churn from high-value, high risk customers

Stimulate usage and ARPU

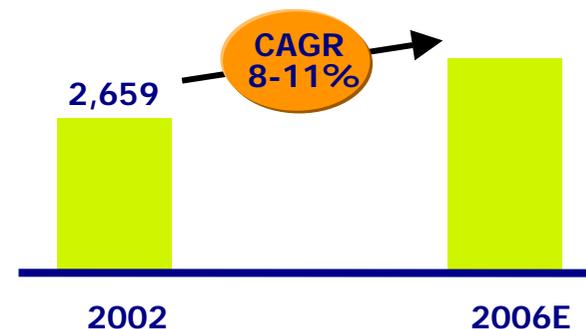
- Traffic bundling and flat rates,
- Introduce new VAS
- Develop new businesses

Continue current efficiency effort

- Capex regional management
- Improve network operation and maintenance
- Leverage on existing network capacity

Continuous organic growth

Operating Free Cash Flow *
€ in Millions



(*) EBITDA-Capex.
Constant exchange rate as of 2002

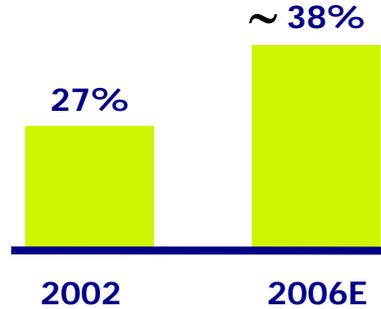
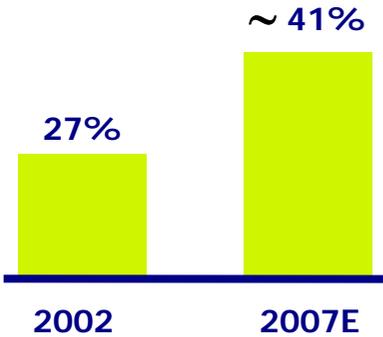
A transformation centered around the customer and focused on becoming a commercially oriented company...

Deep workforce transformation in our wireline operations

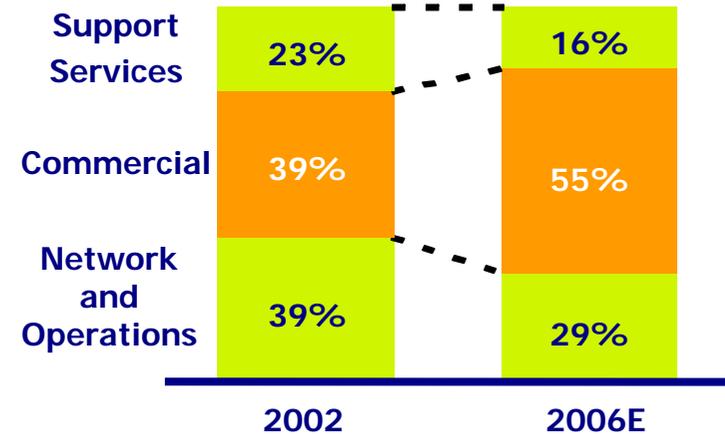
Increased expenditure directed to commercial efforts

T. de España
 (% commercial Staff)

Telefónica Latam
 (% commercial Staff)

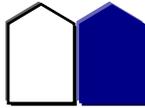


Telefónica Wireline business *



Moving from a product focus to a customer oriented company

(*) Aggregated figures for TdE and Telefónica Latinoamérica



...and evolving the Group's economic model towards a leaner one

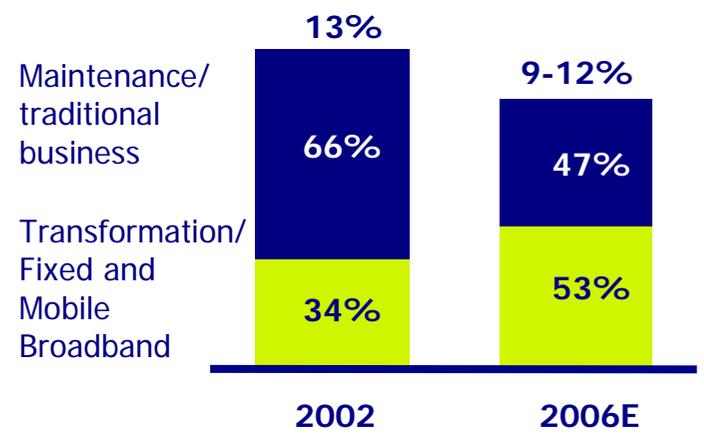
More efficient operations

Lower capital intensity

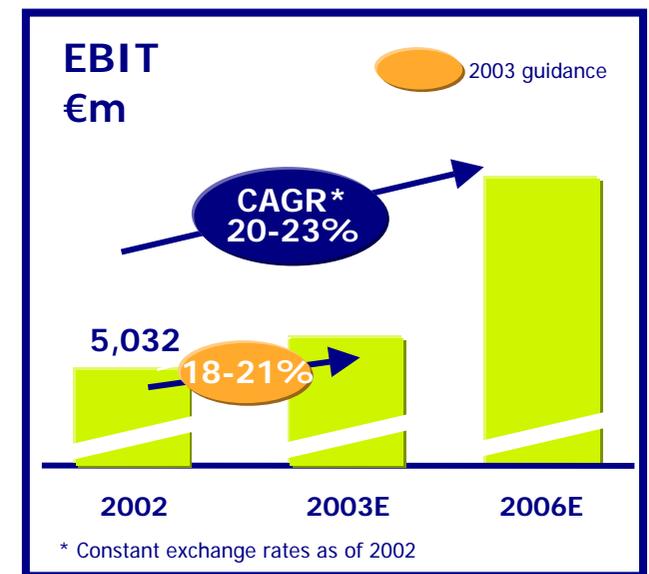
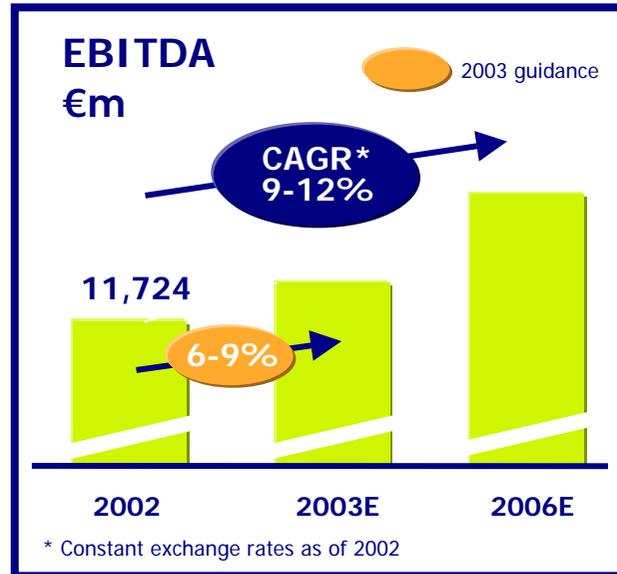
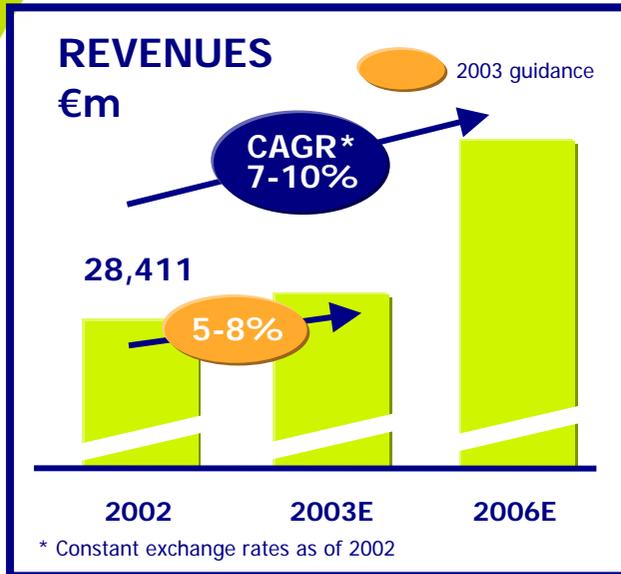
T. de España
(Headcount reduction)

Telefónica Latam
(Headcount reduction)

CapEx as % of revenues
Telefónica Group



We have fixed ambitious but achievable financial projections



Double-Digit Return on capital employed (ROCE **) by 2005

* Return on Capital Employed: $EBIT \times (1 - \text{effective tax rate}) / \text{average capital employed}$

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...and strong Cash Flow generation for the period

OPERATING FREE CASH FLOW*

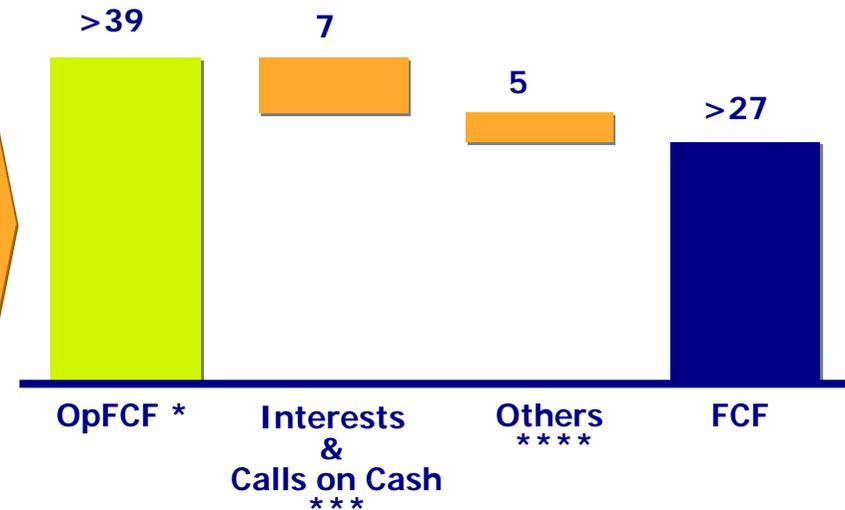
- Client focus & commercial excellence to drive top line growth
- Build-up of a cost efficient model
- Optimizing Capex for lower capital intensity

NON-OPERATING OUTFLOWS

- Financial expenses
- Cash Taxes
- Minorities
- Working capital
- Calls on cash flow

FREE CASH FLOW GENERATION 2003-2006 **

(€ Bn., 2002 constant exchange rates)



* EBITDA-CAPEX

** Before Financial Investments. Excluding forex and changes in consolidation

*** Assuming limited debt reduction

**** Cash Taxes, Minorities and Working Capital

Our Rationale For 2003-2006 Cash-flows Distribution

TWO BASIC PRINCIPLES... ...TO ACHIEVE OUR FOUR PRIORITIES

TO FULLY
DELIVER ON OUR
FIRM
COMMITMENTS

TO KEEP STRATEGIC
FLEXIBILITY TO
GROW OUR
BUSINESSES

1. SHAREHOLDER REMUNERATION

2. SOLVENCY PROTECTION FOR A
"SINGLE A" RATING

3. BUSINESS LONG TERM EXPANSION

4. FINANCIAL FLEXIBILITY

ON-GOING
RECIRCULATION

Cash Flow generation is:

- ➔ **Contingent upon fulfilment of Strategic Plan, sensitive to:**
 - Business risks and opportunities: Demand, costs, competition, capex needs.
 - Financial markets developments: cost of capital.
 - Major technological changes and business opportunities.
- ➔ **Sensitive to changes in Exchanges Rates.**

FIRM COMMITMENTS AND
SIZE ALLOCATIONS FOR
THE USE OF CASH-FLOW
MUST BE BALANCED
AGAINST THESE ITEMS.

Our Approach To The Destination Of 03-06 Cash-flows (I)

WE HAVE FIRM COMMITMENTS IN EXCESS OF € 19 Bn

**SHAREHOLDER
REMUNERATION**

≅ 11.4 Bn.€

- Cash dividends.
- Share buy-backs.



- 1.2 Bn.€ to be paid in 2003.
- 2 Bn.€ a year from 2004 to 2006.
- 200 Million € executed in 1H03.

• 4 Bn.€ share buy-back for period 2003-2006 conditioned to the generation of free cash flow over our firm commitments

**SOLVENCY
PROTECTION FOR
SINGLE A RATING ***

≅ 7.9 Bn.€

- We have cash commitments for 7.9 Billion€:
 - ✓ Gross NPV 98 Redundancy Program of 3.5 Bn.€
 - ✓ Guarantees of 0.8 Bn.€
 - ✓ Gross NPV of Expected 03 Redundancy Program of 3.6 Bn.€

... Fully funding NPV of cash commitments would leave (net debt + cash commitments)/ EBITDA in the 1.4x-1.7x region in 2006

* subject to prospective risks and Rating Agencies opinion

Our Approach To The Destination Of 03-06 Cash-flows (II)

***KEEPING STRATEGIC FLEXIBILITY ABOVE 7.5 Bn.€
TO ACCOMMODATE***

**SELECTIVE BUSINESS
EXPANSION** **BASED ON**

AND

FINANCIAL FLEXIBILITY **COULD
PROVIDE ROOM FOR** eg:



- Complementarity to core businesses.
- Target selection based on cash flow generation capabilities.



- A 50% value loss of Latam currencies
- plus**
- A 10% drop of average 04-06 Non-Latam EBITDA below its 2003 level.

In summary, execution of Growth and Transformation to offer a unique combination in the Telco industry...

**Sustainable
FREE cash flow
generation**

**> cumulative 27
bn€ 2003-06**

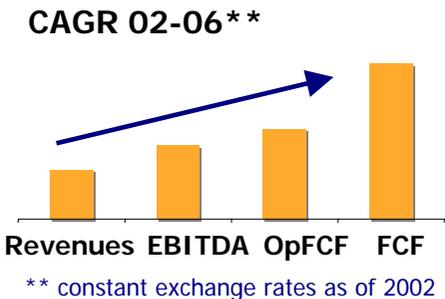
**Improved
returns on
capital**

**Double digit in
2005**

STRONG AND LONG-TERM SHAREHOLDER REMUNERATION

**> 11.4 bn Euros 03-06, more than 21% current market cap
yield dividend of 3.7% + 7.4% share buy back at current prices***

POWERFUL CONVERSION RATE OF CASH FLOW INTO EQUITY METRICS



SOLID GROWTH POTENTIAL

CAGR 02-06 revenues of 7%-10% **

LEANER ECONOMICS IN A TWOFOLD WAY

**Less asset intensity
Less equity**

* share price as of closing 13th November 2003

Telefónica
