



# Telefónica: real earnings, real options

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**COMMUNACOPIA**  
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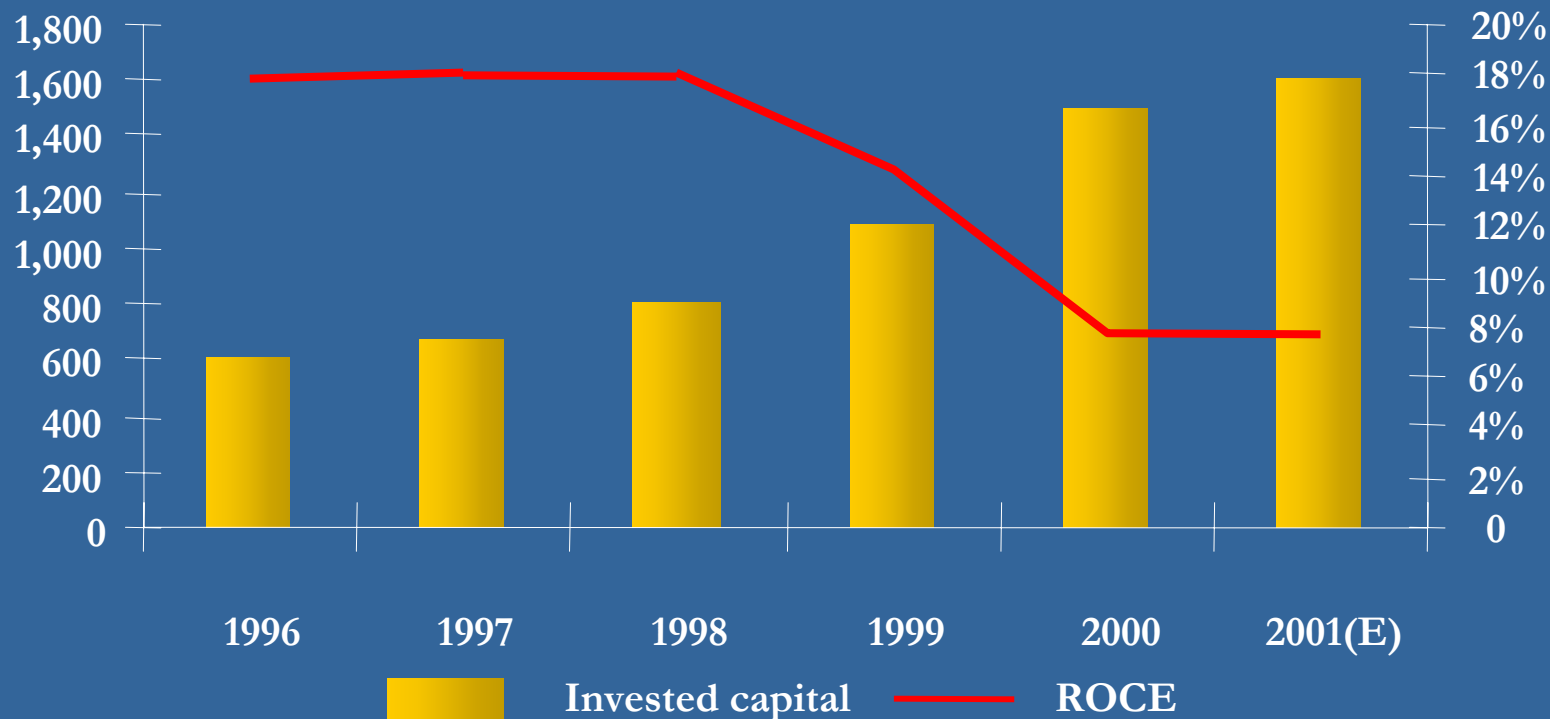
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# THEMES FOR TODAY

- **The world has changed and our sector has soured**
- Telefónica is structurally strong
- We will come out stronger of these uncertain times, delivering sustained earnings growth and keeping optionality

# INVESTED CAPITAL vs RETURNS IN TELECOMS

Bn. USD



- ✓ Increasing concern on returns over invested capital
- ✓ Increasing cost of capital (lower cost of debt vs higher equity risk premium)
- ✓ Different investment cases across the sector

Source: WDR

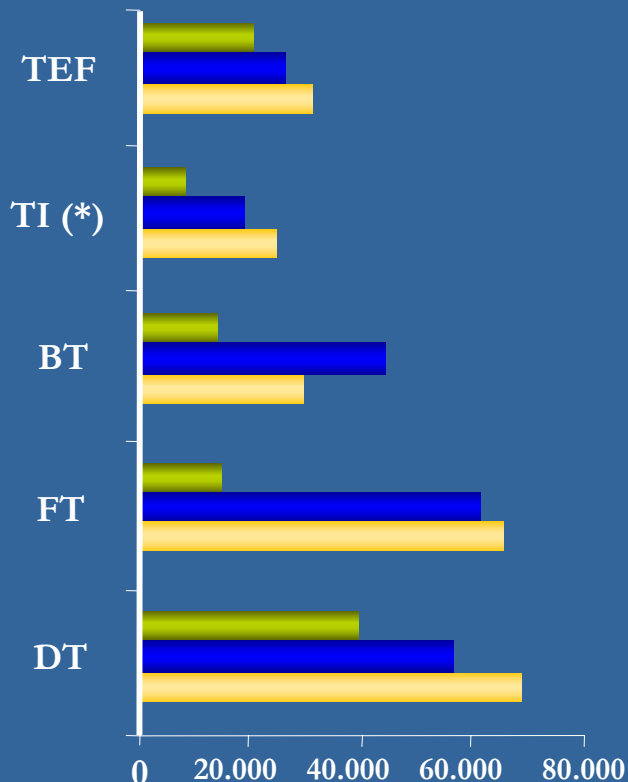
## 1. A NEW CONTEXT

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# INCREASE IN DEBT LEVELS WEAKEN BALANCE SHEET AND ERODE MARKET CAP

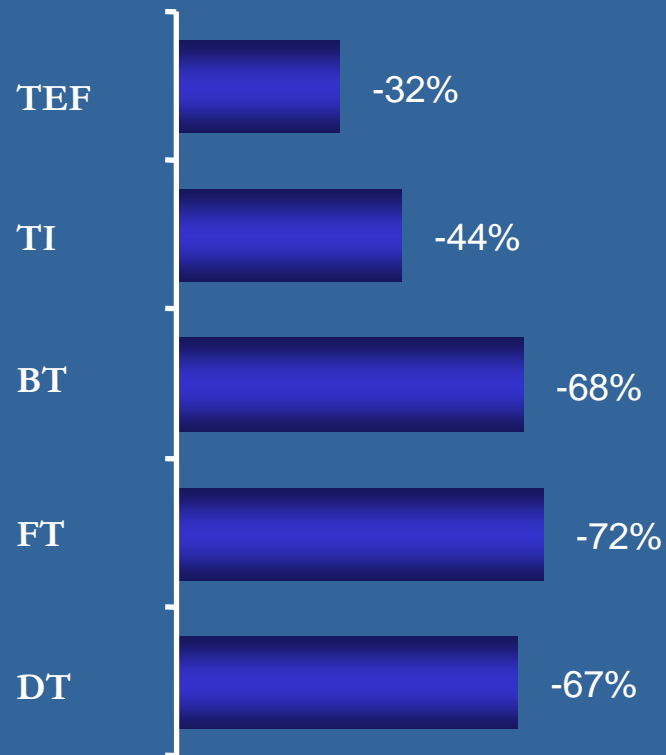
## Net Debt

MM □



## Change in Market Cap

(Percentage, Dec 99 vs 26 Sep 01)



Dec. 99  
Dec. 00  
Jun 01

(\*) Excluding Olivetti's debt

1. A NEW CONTEXT

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# A NEW CONTEXT

- Downward revision in expectations for growth businesses. Financial markets focus shifting from long term growth to cash and short term returns
- Increased cost of equity. Outflow of funds from the sector. Difficulty to raise new capital
- Overcapacity and decreasing returns on invested capital
- Increased debt levels weaken balance sheets and erode market cap
- Slowdown in the global economy

Solid companies that adapt better and retain more options will come out stronger

# THEMES FOR TODAY

- The world has changed and our sector has soured
- **Telefónica is structurally strong**
- We will come out stronger of these uncertain times, delivering sustained earnings growth and keeping optionality

# TELEFONICA'S SOLID POSITION

## Sound financials

- Strong financial performance
- Lower debt levels and strong cash flow generation
- High credit quality

## Solid fundamentals

- Large and growing customer base
- Strong operational performance and skills

## Strong strategic position

- Balanced business portfolio
- Solid positions along the value chain
- Best placed for success in all scenarios



# TELEFONICA: A DIVERSIFIED GLOBAL PLAYER

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# 10 Telco worldwide by market cap (# 15 in Dec 99)

# 2 among European incumbents (up from # 5 in Dec 99)

*Telefónica*  
Wireline in Spain

*Telefónica*  
Wireline in Latam

*Telefónica*  
Móviles

*Telefónica*  
Data

terra  
lycos

*Telefónica*  
Media

**TPI**

Others

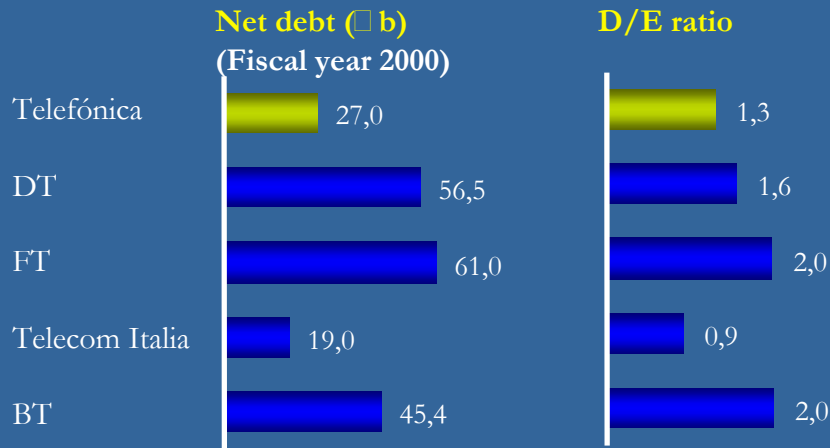
Million	2000	% Change	1H01	% Change
Revenues	28,485.5	24.1	15,302	15.2
EBITDA	11,918.8	9.5	6,356.6	9.2
Reported Net inc.	2,504.8	38.8	1,148.6	16.1
Net inc. - goodwill	3,005.4	50.3	1,631.8	41.6

**2. STRUCTURALLY STRONG**

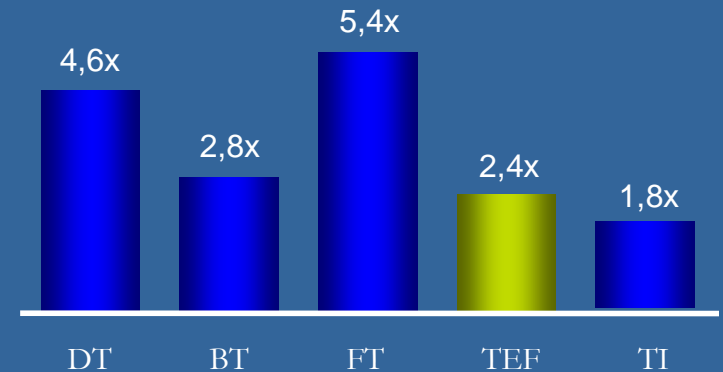
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# LOWER DEBT LEVELS AND STRONG CASH FLOW GENERATION

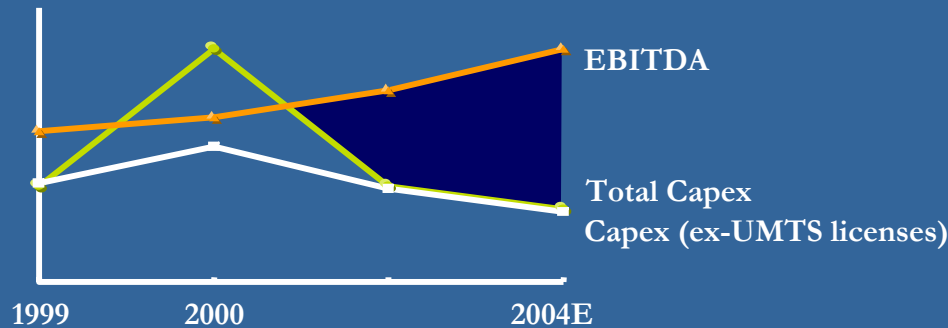
## Low debt levels relative to major competitors



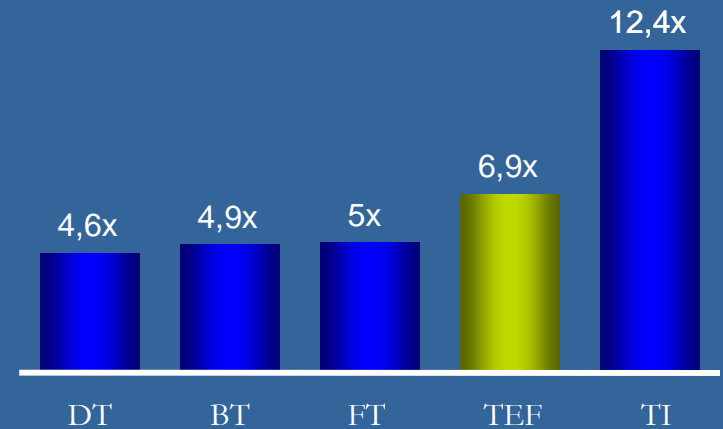
## Superior debt cover ratios Net Debt/EBITDA 01E



## EBITDA generation in excess of CAPEX required for organic growth



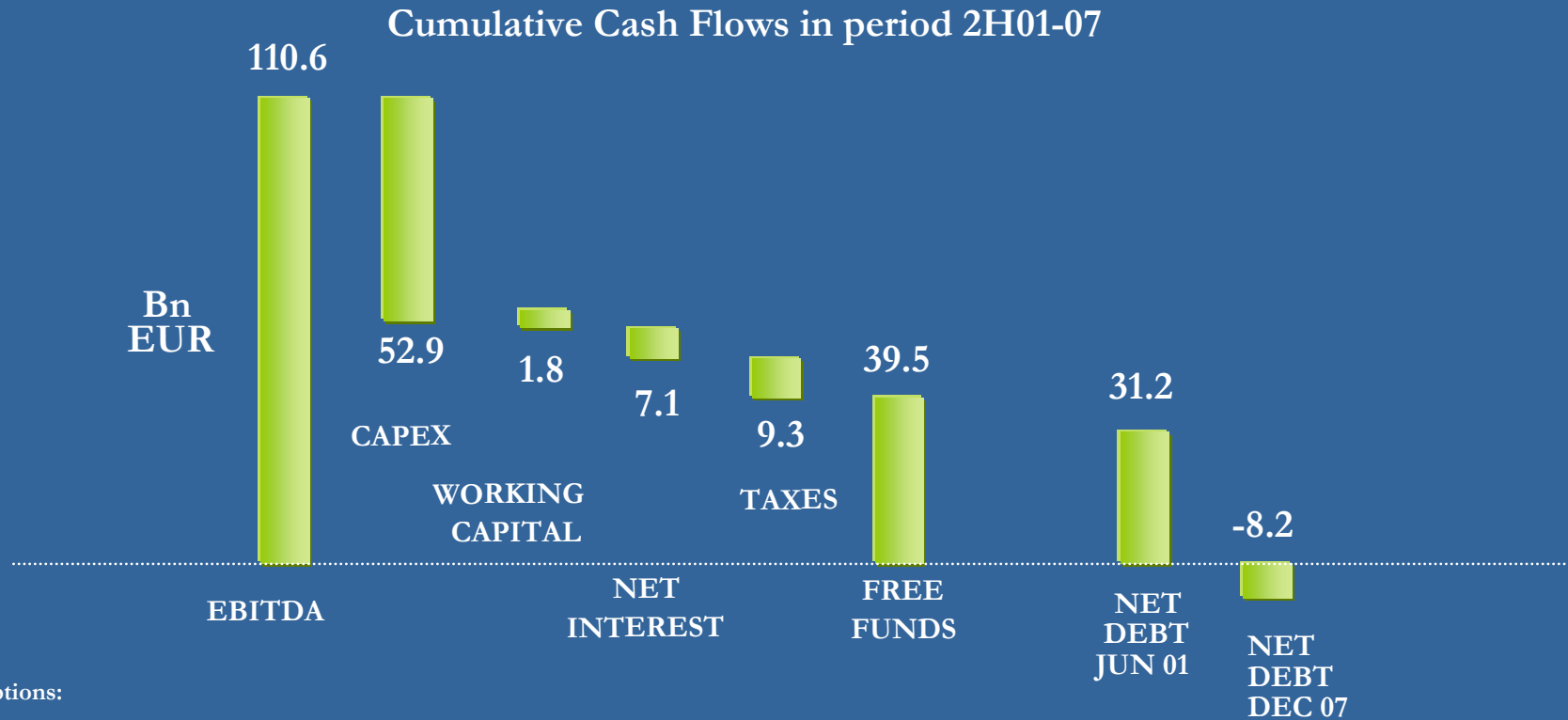
## EBITDA 01E /Net Interest Expense 01E



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# CASH FLOW GENERATION CAPACITY: FULL DEBT REPAYMENT POSSIBLE BEFORE CURRENT AVERAGE MATURITY (5.9 YEARS)



## Assumptions:

- EBITDA: 9% annual growth
- Capex: Average of analysts forecasts (recent reports by Lehman Brothers, Merrill Lynch, Credit Suisse and BSCH)
- Working capital requirements: 20% of EBITDA increase, effective tax rate of 30%, and average debt cost estimated from current market interest and FX rates
- Net debt as of Dec 07 would be around 0.9 bn EUR higher if assumption about average debt cost increases by 100 bp.

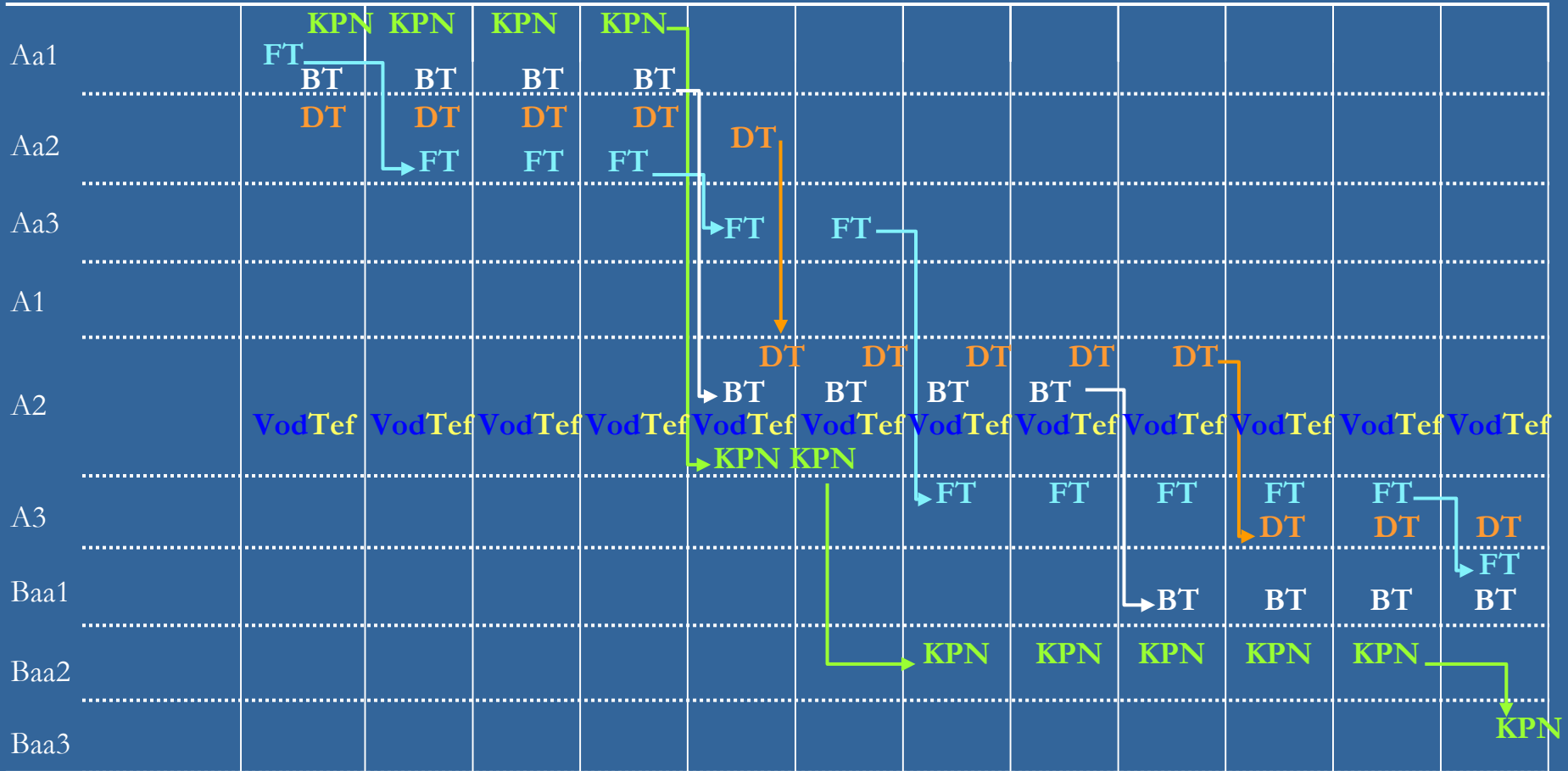
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# HIGH CREDIT QUALITY

## Evolution of ratings (Moody's)

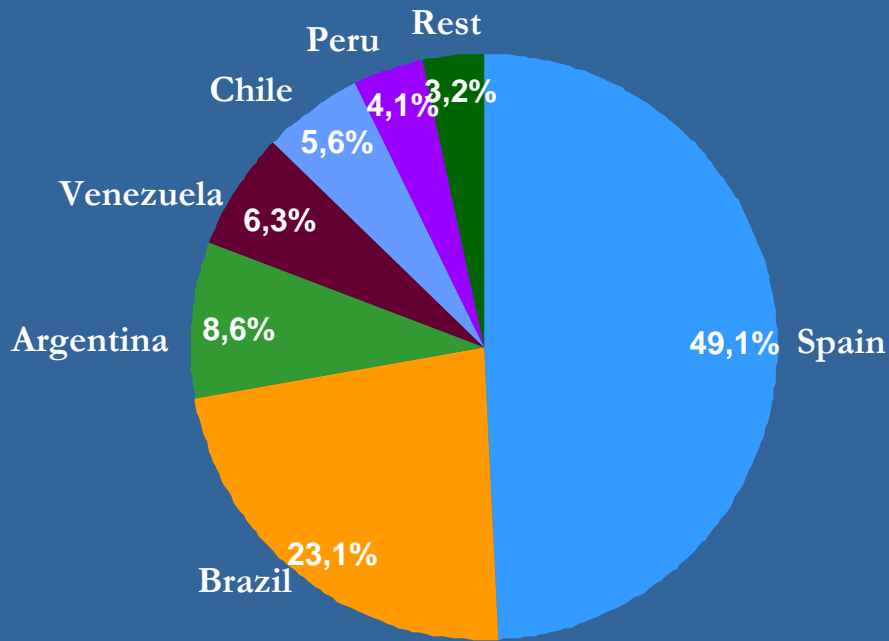
09/99 12/99 03/00 06/00 09/00 12/00 01/01 04/01 05/01 06/01 07/01 08/01 09/01



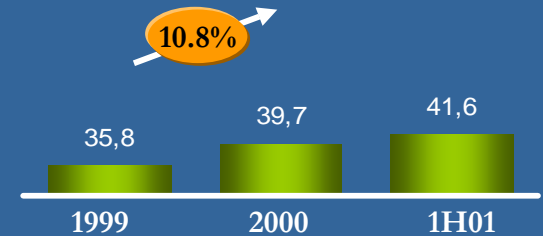
2. STRUCTURALLY STRONG



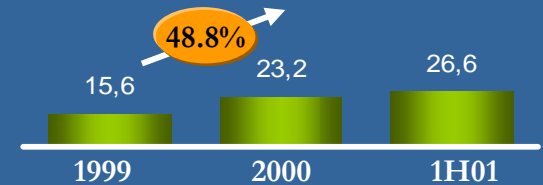
# LARGE AND GROWING CUSTOMER BASE



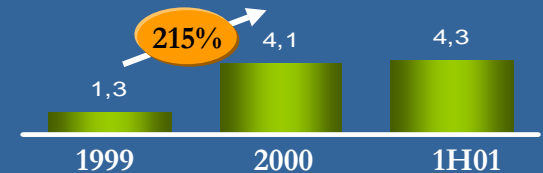
Managed wireline clients (millions)



Managed cellular clients (millions)



Internet access clients (millions)



- A market with more than 500 million potential customers
- More than 70 million customers currently being served
- Homogeneous markets with strong cultural and economic links
- Positive growth outlook despite economic slowdown

## 2. STRUCTURALLY STRONG

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# STRONG OPERATIONAL PERFORMANCE

## Wireline strategy delivering results in Spain

### 1.- Lead the direct access front through ADSL

- Number of ADSL subscribers up by 315%
- TdE's market share in ADSL users: 95%

### 2.- Lead the Internet Growth

- Number of flat-fee subscribers up by 210%
- Dialup access market share of 65%

### 3.- Defend voice traffic market share

- Managing Price Policies
- New services to promote traffic
- Marketing win-back campaigns

### 4.-Stabilize regulatory framework

- Increase in monthly fee
- Price cap: CPI - 4%
- Commercial flexibility

	1H01	% vs. 1H00
Total traffic (mill. min)	68,940	+38.2%
LIS ('000)	20,600	+4.1%
Lines per employee	502.8	+15.9%
Operating expenses before Interconnection (mill. Eur)	1,903.8	-7.6%
EBITDA (mill. Eur)	2,440	+4.2%

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# STRONG OPERATIONAL PERFORMANCE

## Latam wireline: proven expertise and performance on track

**TeleSP (acquisition in Aug' 98)  
3 year management**

	As of take over	As of 06/30/01	% Change
• LIS ('000)	6,407	12,006	87%
• Lines per employee	338	979	190%
• Avg. Waiting time (months)	105	2	-98%
• EBITDA (\$US MM)	2,046	2,213 (1)	8%
• EBITDA margin (2)	58%	64%	6 p.p.

**TASA (acquisition in Nov' 90)  
11 year management**

• LIS ('000)	1,696	4,450	162%
• Lines per employee	78	504	546%
• Avg. Waiting time (months)	49	0.3	n.m.
• EBITDA (\$US MM)	637	1,864 (1)	160%
• EBITDA margin	38%	53%	15 p.p.

(1) Latest FY

(2) Net of interconnection

**SKILLED TEAMS WITH UNIQUE TRACK RECORD ON TURN OVERS**

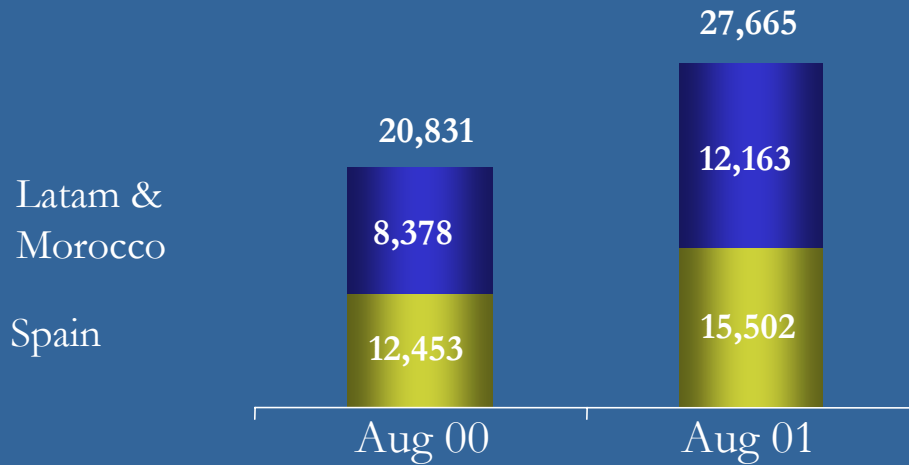
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# STRONG OPERATIONAL PERFORMANCE

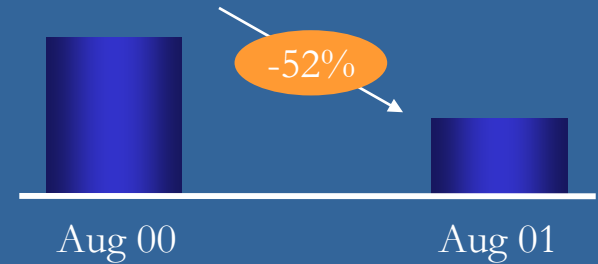
**Wireless: significant size, ongoing growth and increasing margin**

Managed customers ('000)



	1H01	%(1H01/1H00)
Operating Revenues	3,933.9	14.2%
EBITDA	1,551.6	32.4%
EBITDA Margin	39.4%	+ 5.4 p.p.

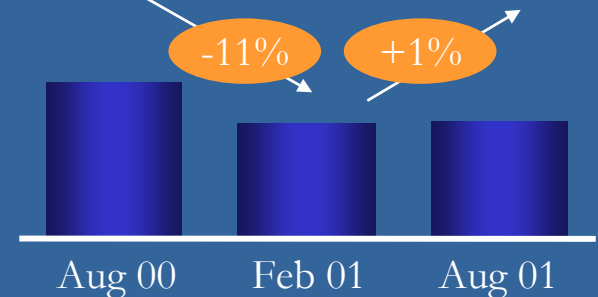
TME Monthly churn



TME SAC (□)



TME ARPU (□)



**2. STRUCTURALLY STRONG**





# BALANCED BUSINESS PORTFOLIO



*Telefonica*  
Wireline in Spain

*Telefonica*  
Wireline in Latam

*Telefonica*  
Data

*Telefonica*  
Wireline in Spain

*Telefonica*  
Wireline in Latam

*Telefonica*  
Data

**emergia**

terra lycos

*Telefonica*  
Media

**TPI**

- 20.6 million lines in Spain
- 20.9 million lines in Latam
- 3 million Km. of optical fibre in Spain and Latam
- 90% market share of corporate customers where we are incumbents

- Emergia's 25,000 Km optical fibre network with 40 Gbps capacity scalable to 1.92 Tbps
- Spanish IP network with 170,000 switched ports and 7 Gbps transport capacity
- 67% of Spanish homes with fibre to the curb
- 10 Internet Data Centers

- Over 4.3 million Internet clients
- 460 Mill. Terra-Lycos average daily page views in June 01
- More than 600,000 directory business SME unique customer
- Endemol as the first TV producer worldwide with more than 400 formats

## 2. STRUCTURALLY STRONG



# OUR STRENGTH: SOLID POSITION AND OPTIONALLITY

- **Sound financials**
- **Solid fundamentals**
- **Strong strategic position**

- Telco with all options open
- Our future returns are not jeopardized by short term debt repayment
- Strong EBITDA diversification
- Strategic flexibility: currencies, horizontal organization, diversification

# THEMES FOR TODAY

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# TELEFONICA'S PROJECT IN THE NEW INDUSTRY CONTEXT

- Strengthen our relative position in the short term: focus on earnings



- Evolve and reposition business platforms: building our future



- Leverage our strong position in the sector restructuring

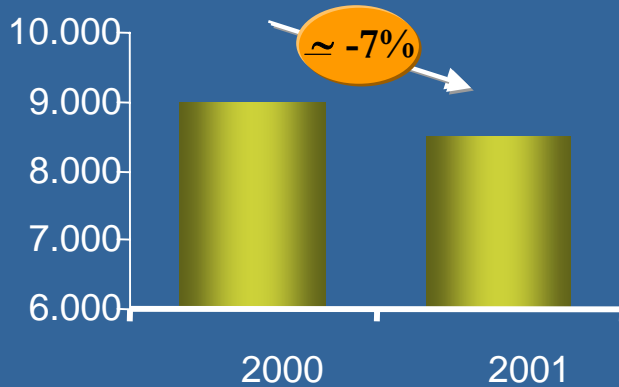
- Operational efficiency
- Capital efficiency
- Transformation towards client
- Organizational alignment/horizontal integration for synergies

- Natural strategic development of core businesses
- Strategic reposition of start-up businesses for the new context

- Consolidation in Lines of Business where scale is critical
- Accretive acquisitions with strategic fit

# PROACTIVE MANAGEMENT OF INVESTED CAPITAL

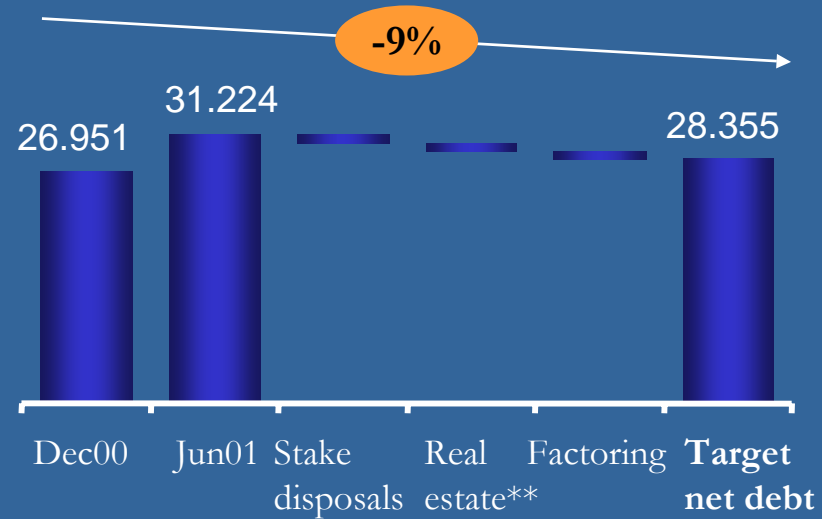
## Capex reduction



- TESA: below 20% over revenues despite broadband roll-out effort
- T.Móviles: Lower than expected due to network sharing agreements
- T.Latam: Decreasing significantly to levels close to 12% of revenues in 2005

## Deleverage our balance sheet

Net debt expected evolution

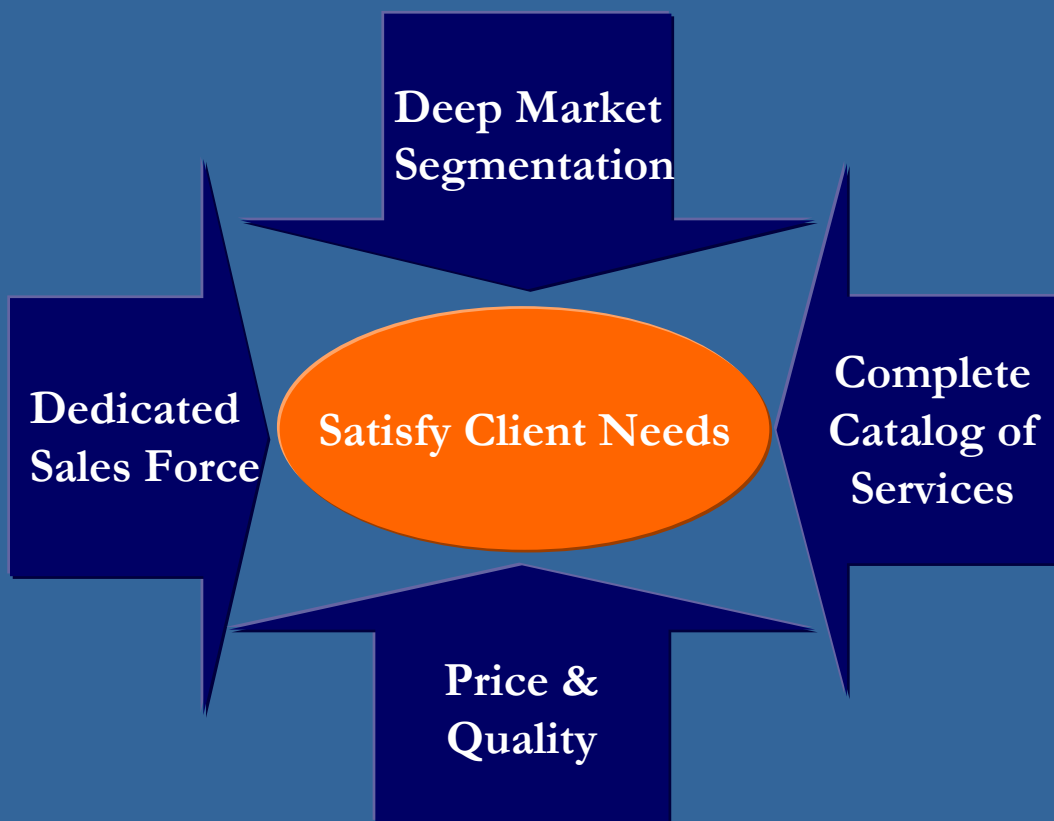


- Target net debt/EBITDA 2.18 from today's 2.40
- Options to use operating FCF >2bn  
□ in 2000\*

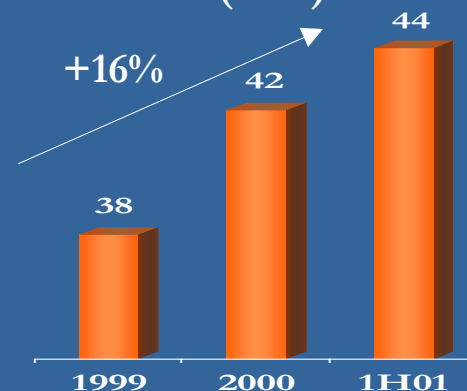
\* Excluding intangible assets and LT financial investments

\*\* Funds raised – PV of future rents

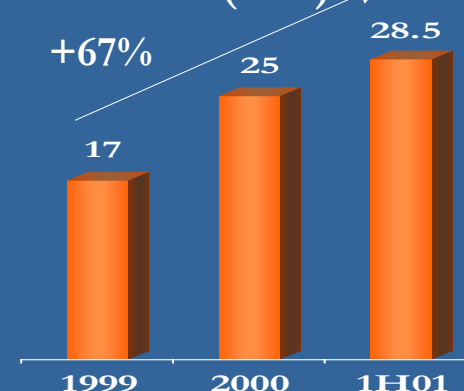
# TRANSFORMATION TOWARDS THE CLIENT



Lines in service (MM)



Cellular clients (MM)



- ✓ Leverage our position in our natural markets (Latam)
- ✓ Take advantage of new interactive communication channels (broadband)

100 MM clients in 2004

3. REAL EARNINGS, REAL OPTIONS

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# **BENEFITING FROM AN INTEGRATED STRUCTURE**

- Achieve functional articulation and horizontal synergies
  - Purchasing
  - IT
  - Efficiency on shared services centers: expected NPV of  $\square$  960 million
  - Talent
- Cash management and internal financial circuit to reduce finance costs and to lower impact of potential currency devaluations
- Improve “real time” capital allocation by business lines and by country
- Assist to and demand strong performance manage across business, and shape the development of the group

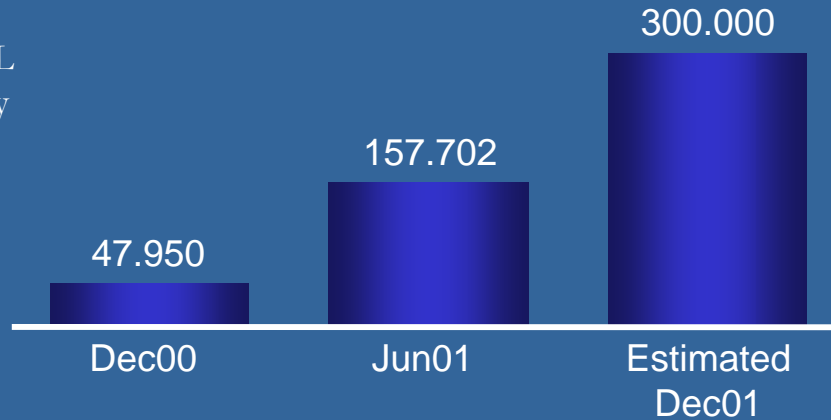
# NATURAL STRATEGIC DEVELOPMENT OF CORE BUSINESSES

## Access: fast deployment of our ADSL commitments

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Wireline in Spain

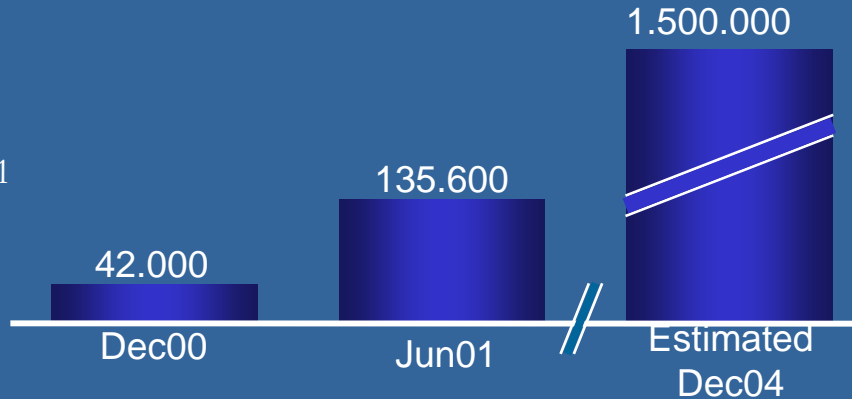
- Up to 1.800 ADSL lines installed daily



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Wireline in Latam

- 21% increase on ADSL lines Jul01 over Jun 01 in Telesp



- Leveraging our strong position in access
- Evolving our wireline network to broadband
- Positioned to capture future revenues from new services

- 70% of ADSL coverage reached for 40 million lines in Telefónica Group

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# NATURAL STRATEGIC DEVELOPMENT OF CORE BUSINESSES

**Brazil 2002**

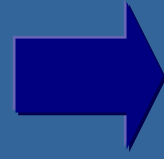
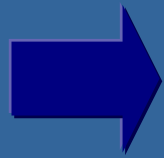
## BUSINESS OPPORTUNITIES

Creation of a leading Long Distance Carrier

Developing data & VAS businesses to corporations

Complete Brazilian broadband network

- ✓ Tap a 10 Bn. Euros market
- ✓ Leverage Group position



## COMPETITIVE POSITION

12 Million LIS

Sao Paulo: 40% of DLD+ILD

Telesp: >80% Intra-State mkt. share

Sao Paulo: 80% of top 250 corporations

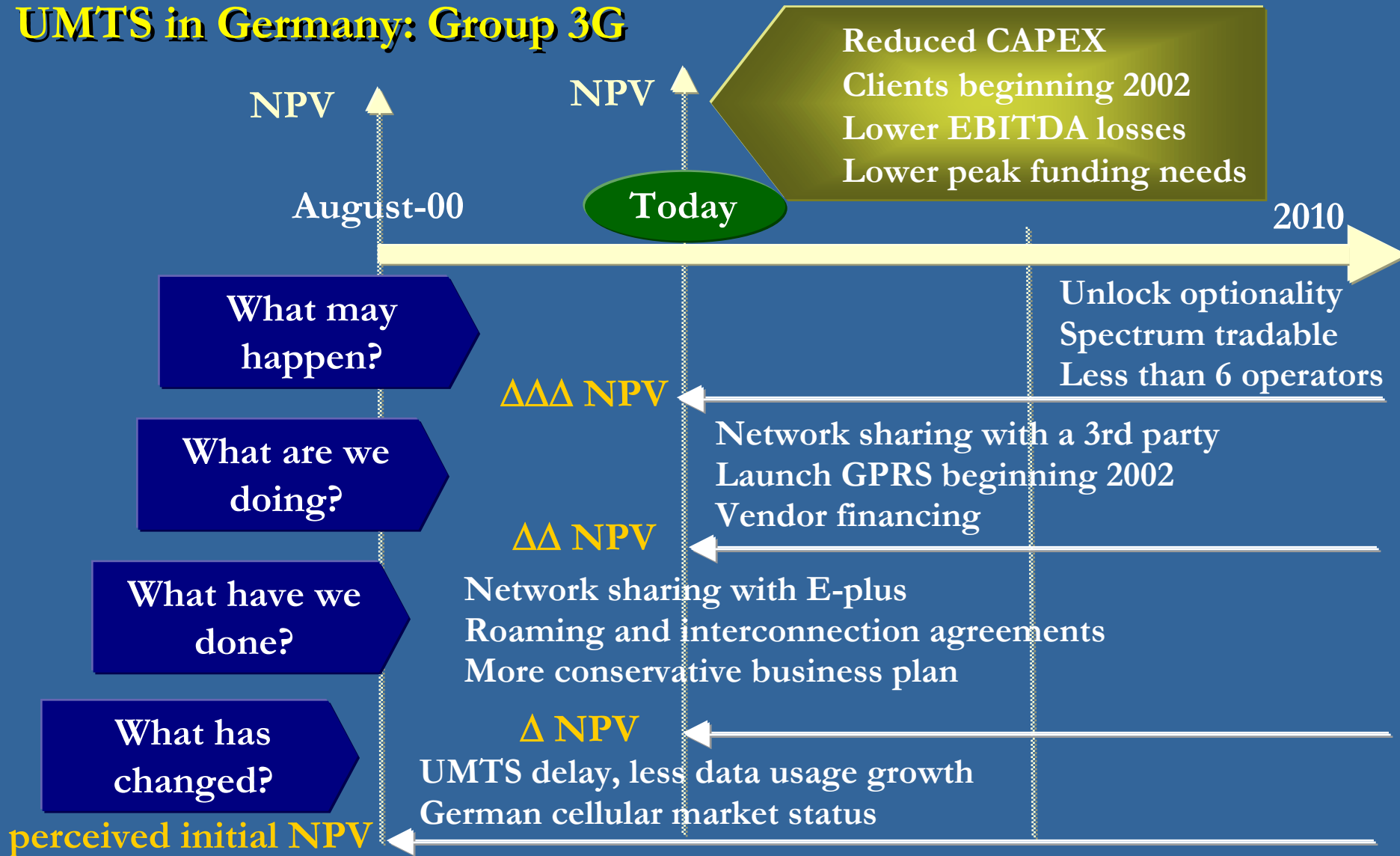
90% of those serviced by Telesp

Capacity swaps through Emergia  
Group bandwidth needs

- ✓ Marginal CAPEX
- ✓ EBITDA > 0 from year one

# STRATEGIC REPOSITIONING OF START-UP BUSINESSES

## UMTS in Germany: Group 3G



# STRATEGIC REPOSITIONING OF START-UP BUSINESSES

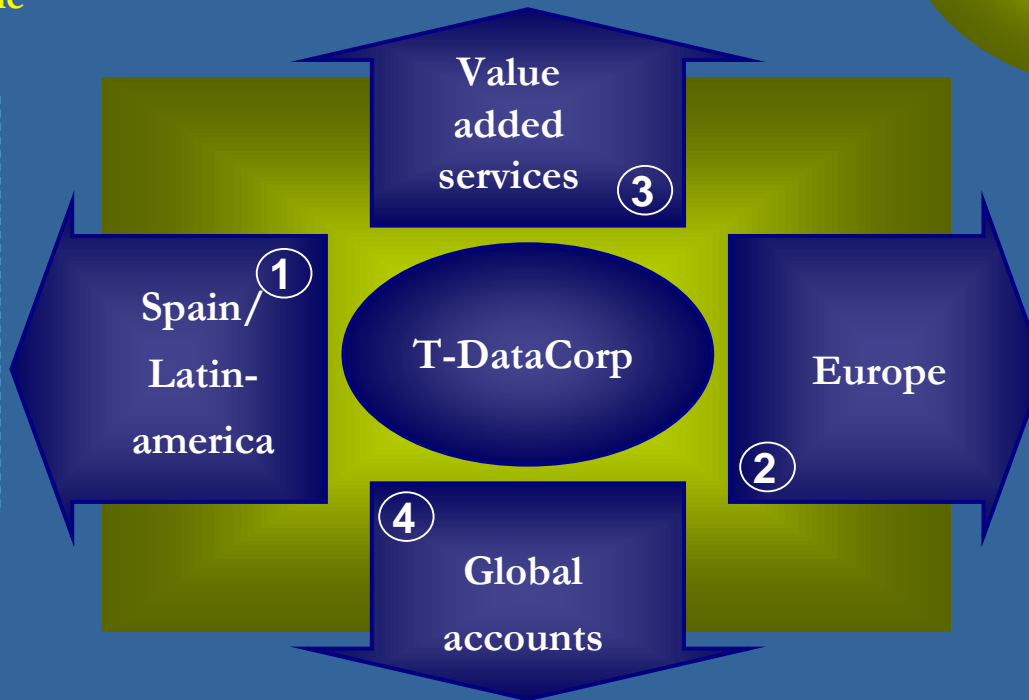
## Telefónica Data-Corp

Centralized management of international backbone capacity

- Hosting
- ASP
- e-consulting

Joint effort with fixed line operators

- Consolidation of leadership position in Spain
- Evolution of product and service portfolio in Latam
- Expansion to new markets in Latam
- Regional offer in Latam



- Development of high potential businesses in new markets (Germany, Italy)

- Global offer to strategic key accounts

# STRATEGIC REPOSITIONING OF START-UP BUSINESSES

## Broadband content factory: beyond connectivity

Broadband portal based on our content factory...



...easily scalable to natural markets.... ...with other content and formats



3. REAL EARNINGS, REAL OPTIONS



# MANAGEMENT PRIORITIES GOING FORWARD

## Enhance business performance

- Pursue multiple initiatives in different areas to meet ambitious targets for 2002 and 2003 in all the Lines of Business

## Start-up business repositioning

- Review the business model and strategy for those businesses which have been more significantly affected by the changes in the environment

## Optimization of invested capital

- Monitor additions to invested capital (Capex control)
- Reduction of capital base (de-assetization)

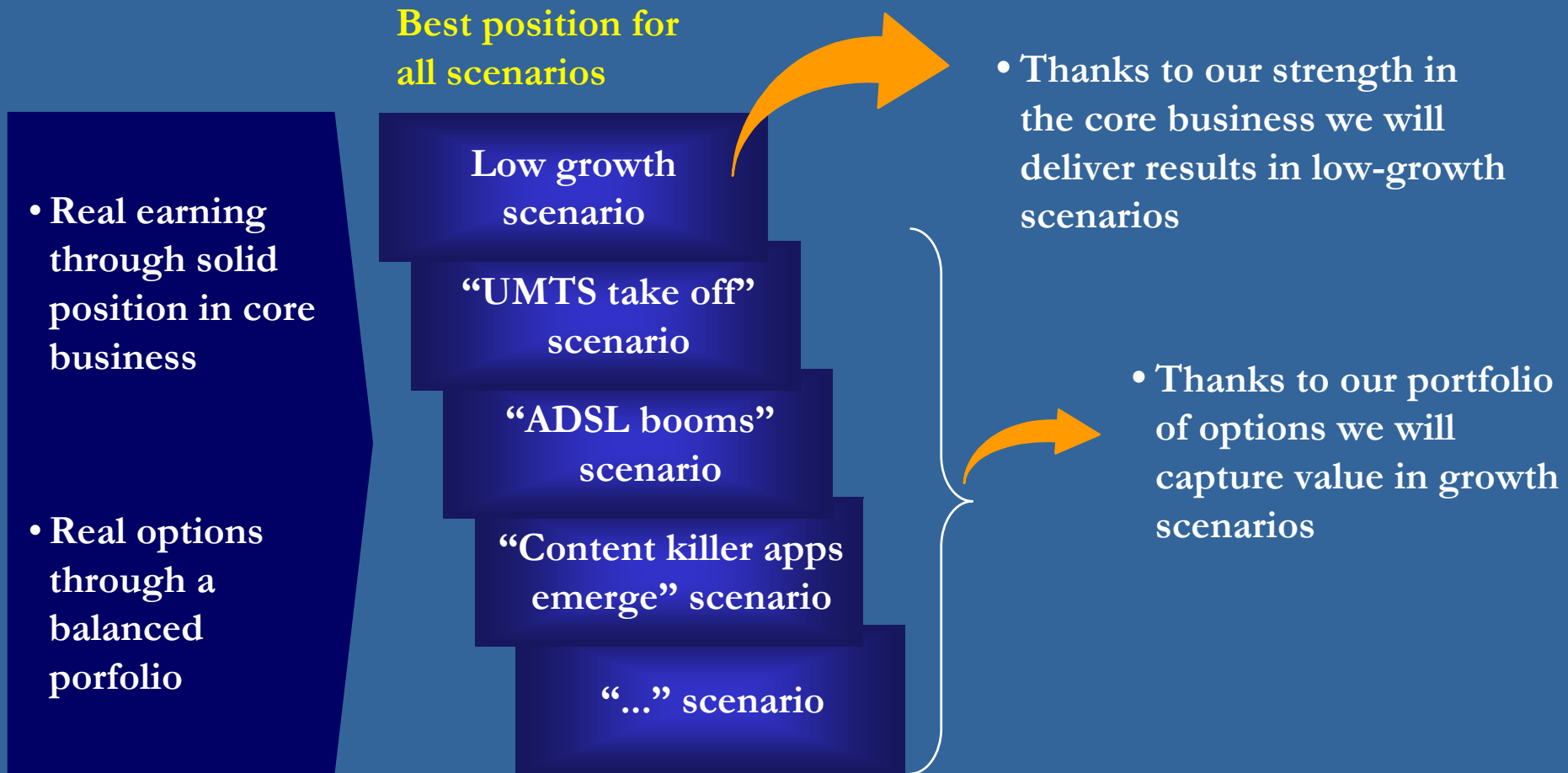
## Organization

- Adapt the organizational model to ensure the achievement of key management priorities in the new industry context

## Consolidation

- Consider accretive opportunities with good strategic fit arising from industry restructuring

# BEST PLACED FOR SUCCESS IN ALL SCENARIOS



# IN SUMMARY

- Need to adapt to the new industry context
- Strong starting position
- Recognition of open issues
- High ambition and strong commitment to deliver
- Rich portfolio of options

## A clear project going forward

- Strengthen our relative position in the short term: focus on earnings
- Evolve and reposition business platforms: building our future
- Leverage our strong position in the sector restructuring

- Our management priorities going forward are clear
- We are making progress in many fronts and are working hard to advance on the rest
- We are committed to come out stronger from the changed industry context

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