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**SECURITIES AND EXCHANGE COMMISSION**  
**FORM 20-F**

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2001

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 1-9531

**TELEFÓNICA, S.A.**

(Exact name of registrant as specified in its charter)

**KINGDOM OF SPAIN**

(Jurisdiction of incorporation of organization)

**Gran Vía, 28, 28013 Madrid, Spain**

(Address of principal executive offices)

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

Shares, nominal value one euro each, listed on the New York Stock Exchange not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the New York Stock Exchange.

American Depositary Shares, each representing the right to receive three shares, listed on the New York Stock Exchange.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

None

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

None

The number of issued shares of each class of stock of Telefónica, S.A. at December 31, 2001 was:

Shares, nominal value one euro each: 4,671,915,885

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this Annual Report and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of the introduction of competition in the Spanish telecommunications market
- trends affecting our financial condition or results of operations
- acquisitions or investments which we may make in the future
- our capital expenditures plan
- supervision and regulation of the Spanish telecommunications sector
- our strategic partnerships
- the potential for growth and competition in current and anticipated areas of our business

Such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our businesses that could affect the matters referred to in such forward-looking statements include but are not limited to:

- changes in general economic, business, or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services
- changes in currency exchange rates and interest rates
- the impact of current, pending or future legislation and regulation in Spain and other countries where we operate
- the actions of existing and potential competitors in each of our markets
- the outcome of pending litigation
- the potential effects of technological changes

Some of these and other important factors that could cause such differences are discussed in more detail under “Item 3—Key Information—Risk Factors”, “Item 4—Information on the Company”, “Item 5—Operating and Financial Review and Prospects” and “Item 11—Quantitative and Qualitative Disclosures about Market Risk”.

Readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date of this Annual Report including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

## CERTAIN TERMS AND CONVENTIONS

Our ordinary shares, nominal value one euro each, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges under the symbol “TEF”. They are also listed on various foreign exchanges such as the London, Frankfurt, Paris, Buenos Aires and Tokyo stock exchanges and are quoted through the Automated Quotation System of the Spanish stock exchanges and through the SEAQ International System of the London Stock Exchange. American Depositary Shares (“ADSs”), each representing the right to receive three ordinary shares, are

listed on the New York Stock Exchange under the symbol “TEF” and on the Lima Stock Exchange. ADSs are evidenced by American Depositary Receipts (“ADRs”) issued under a Deposit Agreement with Citibank, N.A., as Depositary. Brazilian Depositary Shares (“BDSs”), each representing the right to receive one ordinary share, are listed on the São Paulo Stock Exchange. BDSs are evidenced by Brazilian Depositary Receipts (“BDRs”) issued under a Deposit Agreement with Banco Bradesco, S.A., as Depositary.

As used herein:

- “Telefónica” and terms such as “we,” “us” and “our” mean Telefónica, S.A. and its consolidated subsidiaries unless the context otherwise requires
- “Telefónica de España” means Telefónica de España, S.A., our subsidiary that conducts our fixed-line telecommunications services business in Spain, and its consolidated subsidiaries
- “Telefónica Móviles” means Telefónica Móviles, S.A., our subsidiary that conducts our worldwide wireless communications services business, and its consolidated subsidiaries
- “Admira Media” means Grupo Admira Media, S.A. (formerly known as “Telefónica Media, S.A.”), our subsidiary that conducts our worldwide audiovisual content and media business, and its consolidated subsidiaries
- “Telefónica Internacional” means Telefónica Internacional, S.A., our subsidiary that conducts our fixed-line telecommunications business in Latin America, and its consolidated subsidiaries
- “Telefónica Data” means Telefónica DataCorp, S.A., our subsidiary that conducts our worldwide data transmission business, and its consolidated subsidiaries
- “Terra Networks” means Terra Networks, S.A., our subsidiary that conducts our worldwide Internet-related business, and its consolidated subsidiaries

## **PRESENTATION OF CERTAIN FINANCIAL INFORMATION**

In this Annual Report, references to “dollars” or “\$” are to United States dollars and references to “euro” or “€” are to the single currency of the participating member states in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time. We historically published our financial statements in Spanish pesetas (“pesetas” or “Ptas”). Beginning January 1, 1999, we began publishing our financial statements in both Spanish pesetas and euro. We have translated financial information presented in this Annual Report for periods prior to January 1, 1999 from Spanish pesetas into euro using the official irrevocably-fixed conversion rate of  $\text{Ptas } 166.386 = \text{€}1.00$ . Financial information for periods prior to January 1, 1999 reported in euro depicts the same trends that would have been presented had we continued to present such financial information in Spanish pesetas. However, financial information for periods prior to January 1, 1999 is not comparable with that of other companies reporting in euro that restated these amounts from a currency other than the Spanish peseta.

For the convenience of the reader, some of the financial information in this Annual Report has been translated from euro into United States dollars at an assumed rate of  $\text{€}1.00 = \text{\$}0.8901$ , the Noon Buying Rate in New York City for cable transfers in euro as certified for customs purposes by the Federal Reserve Bank of New York (the “Noon Buying Rate”) on December 31, 2001. These convenience translations should not be construed as representations that the euro amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated. The assumed rate also differs from the rates used in the preparation of our consolidated financial statements. Further information about recent rates of exchange between the euro and dollar appears in “Item 3—Key Information”.

## PART I

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

#### A. DIRECTORS AND SENIOR MANAGEMENT

Not applicable.

#### B. ADVISERS

Not applicable.

#### C. AUDITORS

On April 1, 2002, Arthur Andersen y Cia entered into an agreement with the French and Spanish national practices of Deloitte Touche Tohmatsu ("DTT") that provides for the association of Arthur Andersen y Cia with those national practices (and therefore with DTT), subject to regulatory approval which is currently under consideration. Until such time as this approval is granted and this relationship becomes final, Deloitte & Touche has agreed to perform the quality control procedures required for foreign associated firms that are embodied in the requirements of the SEC Practice Section of the American Institute of Certified Public Accountants. Deloitte & Touche has performed such quality control procedures with respect to Arthur Andersen y Cia's audit of the financial statements for the year ended December 31, 2001 included in this Annual Report.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. SELECTED FINANCIAL DATA

The information in this section should be read in conjunction with our consolidated financial statements, and the notes thereto, included elsewhere in this Annual Report. Our consolidated financial statements have been prepared in accordance with Spanish GAAP, which differ in certain respects from U.S. GAAP. Please refer to note 25 to our consolidated financial statements for a discussion of these differences.

The basis of presentation and principles of consolidation are described in detail in note 2 to our consolidated financial statements.

	At and for the Year ended December 31,					2001  (millions of dollars, except per share and per ADS data)(2)
	1997(1)	1998(1)	1999	2000	2001	
	(millions of euro, except per share and per ADS data)					
<b>INCOME STATEMENT DATA</b>						
<b>Spanish GAAP:</b>						
Revenue from operations .....	14,202.5	17,465.5	22,957.0	28,485.5	31,052.6	27,639.9
Other operating revenue.....	248.2	116.5	199.2	266.7	254.7	226.7
Internal expenditures						
capitalized.....	708.8	747.1	835.0	899.1	730.4	650.1
Increase (decrease) in						
inventories, net.....	18.2	50.8	74.5	112.3	(103.9)	(92.5)
Goods purchased.....	(2,007.8)	(2,203.8)	(4,093.1)	(6,045.2)	(7,111.9)	(6,330.3)
External services and local						
taxes .....	(1,800.2)	(2,225.5)	(3,975.6)	(5,786.1)	(5,534.3)	(4,926.1)
Personnel costs.....	(3,431.2)	(3,907.6)	(4,411.5)	(5,111.7)	(5,390.3)	(4,797.9)
Provision for depreciation and						
amortization .....	(3,622.0)	(4,360.0)	(6,108.8)	(6,960.8)	(7,374.0)	(6,563.6)
Trade provisions .....	(214.9)	(637.7)	(565.8)	(761.1)	(1,023.8)	(911.3)

	At and for the Year ended December 31,					
	1997(1)	1998(1)	1999	2000	2001	2001
	(millions of euro, except per share and per ADS data)					(millions of dollars, except per share and per ADS data)(2)
Other operating expenses .....	(132.2)	(145.5)	(134.3)	(140.7)	(69.3)	(61.7)
Total operating costs before financial expenses and goodwill amortization .....	(11,208.3)	(13,480.0)	(19,289.0)	(24,805.6)	(26,503.5)	(23,590.8)
Operating profit.....	3,969.4	4,899.9	4,776.6	4,958.0	5,430.3	4,833.5
Financial income (expense) .....	(1,050.6)	(1,339.6)	(1,490.4)	(1,611.8)	(1,608.4)	(1,431.7)
Exchange gains (losses), net .....	(77.7)	(40.6)	434.3	(248.5)	(782.7)	(696.7)
Income (loss) from associated companies .....	59.9	73.3	(3.9)	(161.4)	(376.5)	(335.1)
Amortization of goodwill on consolidation.....	(200.2)	(127.0)	(194.3)	(500.6)	(841.6)	(749.1)
Profit from ordinary activities.....	2,700.8	3,466.1	3,522.3	2,435.7	1,821.1	1,620.9
Extraordinary income .....	310.5	329.2	2,029.4	4,302.3	1,167.1	1,038.8
Losses on sale of fixed assets.....	(165.4)	(157.9)	(235.6)	(239.9)	(233.0)	(207.4)
Extraordinary expenses .....	(816.6)	(1,221.3)	(5,348.7)	(3,630.5)	(721.3)	(642.0)
Income before tax and minority interest.....	2,029.3	2,416.1	(32.7)	2,867.6	2,033.9	1,810.4
Corporate income tax .....	(442.0)	(552.2)	758.0	(242.2)	(198.1)	(176.3)
Minority interest .....	(445.0)	(556.2)	(655.7)	(120.6)	271.0	241.2
Net income .....	1,142.3	1,307.7	69.6	2,504.8	2,106.8	1,875.3
Net income per share(3).....	0.35	0.37	0.02	0.63	0.45	0.40
Dividends per share .....	0.18	—	—	—	—	—
Weighted average number of shares (thousands).....	3,276,060	3,532,281	3,532,282	3,980,218	4,674,378	4,674,378
Net income per ADS(3)(4).....	1.05	1.11	0.06	1.89	1.35	1.20
Dividends per ADS(4) .....	0.53	—	—	—	—	—
Weighted average number of ADSs (thousands) .....	1,092,020	1,177,427	1,177,427	1,326,739	1,558,126	1,558,126
<b>U.S. GAAP</b>						
Total revenues.....	13,226.4	15,866.4	21,190.4	27,326.1	31,577.2	28,106.9
Total costs and expenses.....	(10,669.7)	(13,189.6)	(16,813.1)	(23,977.8)	(37,492.9)	(33,372.4)
Profit from ordinary activities.....	2,556.8	3,006.4	4,377.3	3,348.3	(5,915.7)	(5,265.6)
Income (loss) before tax.....	1,359.4	1,636.4	(367.2)	1,765.5	(6,707.0)	(5,969.9)
Corporate income tax .....	170.0	340.7	921.4	294.1	(475.3)	(423.0)
Net income .....	1,189.4	1,288.9	554.2	1,856.0	(7,182.3)	(6,392.9)
Net income per share(3)(5) .....	0.36	0.36	0.16	0.47	(1.54)	(1.37)
Net income per ADS(3)(4)(5).....	1.09	1.09	0.47	1.40	(4.61)	(4.10)

## BALANCE SHEET DATA

### Spanish GAAP:

Cash .....	62.7	143.0	186.1	765.6	621.9	553.5
Property plant and equipment .....	24,930.7	27,821.6	35,754.9	38,721.9	36,606.1	32,583.1
Total assets.....	37,411.6	48,593.6	64,114.0	92,377.3	86,422.6	76,924.7
Total long-term debt .....	11,519.2	13,695.4	17,788.3	24,692.9	27,692.4	24,649.0
Total shareholders' equity.....	11,968.4	15,295.1	14,544.7	25,930.5	25,861.6	23,019.4

### U.S. GAAP:

Cash .....	42.4	131.4	239.2	678.7	619.6	551.5
Property, plant and equipment .....	19,706.3	23,474.1	30,079.1	38,277.9	36,231.6	32,249.7
Total assets.....	30,705.3	43,113.8	59,306.5	108,017.1	91,041.1	81,035.7
Total long-term debt .....	9,150.8	13,695.4	15,385.0	20,618.5	27,771.2	24,719.1
Total shareholders' equity.....	11,607.5	14,937.3	16,926.5	44,357.8	31,769.8	28,278.3

	At and for the Year ended December 31,					
	1997(1)	1998(1)	1999	2000	2001	2001
	(millions of euro, except per share and per ADS data)					(millions of dollars, except per share and per ADS data)(2)
<b>CASH FLOW DATA</b>						
<b>Spanish GAAP:</b>						
EBITDA(6) .....	7,591.5	9,259.9	10,885.4	11,918.8	12,804.3	11,397.1
Net cash provided by operating activities.....	6,111.5	6,735.7	7,758.9	8,996.9	8,828.8	7,858.5
Net cash used in (provided by) investing activities(7) ....	6,620.7	11,765.8	(9,600.9)	(17,719.5)	(9,895.4)	(8,807.9)
Net cash used in (received from) financing activities.....	1,027.4	4,630.2	2,332.0	14,320.9	(1,321.1)	(1,175.9)
<b>U.S. GAAP:</b>						
EBITDA(6) .....	5,443.5	7,986.9	9,447.7	10,825.6	13,169.7	11,722.4
Net cash provided by operating activities.....	5,293.2	5,556.0	6,661.7	16,370.1	8,995.8	8,007.1
Net cash used in (provided by) investing activities(7) ....	5,642.6	12,228.7	7,633.3	(25,572.6)	(9,528.5)	(8,481.3)
Net cash used in (received from) financing activities.....	(1,023.6)	(3,902.2)	(1,839.9)	14,689.4	(1,347.0)	(1,199.0)

- (1) The consolidated financial statements at December 31, 1997 and 1998 and for the years then ended were prepared in Spanish pesetas and have been translated into euro at the irrevocably-fixed rate of exchange of Ptas 166.386 = €1.00.
- (2) Translated into U.S. dollars from euro at the Noon Buying Rate of \$0.8901 = €1.00 on December 31, 2001.
- (3) The per-share and per-ADS computations for all periods presented have been adjusted to reflect the stock split and stock dividends which occurred during the periods presented and after the close of the 2001 period but before issuance of the financial statements.
- (4) Each ADS represents the right to receive three ordinary shares. Figures do not include any charges of the Depositary.
- (5) U.S. GAAP earnings per share and per ADS have been computed using the weighted average number of shares outstanding for each period.
- (6) Earnings before interest, taxation, depreciation and amortization. EBITDA has been included to provide additional information relating to our ability to generate cash from operations. EBITDA is not a measure of financial performance under Spanish or U.S. GAAP and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles. Management believes EBITDA is useful to an investor in evaluating our company because it is widely used in the telecommunications industry as a measure to evaluate a company's operating performance before debt expense and its cash flow. EBITDA is not calculated identically by all companies and the presentation here may not be comparable to other similarly titled measures of other companies. Management's discretionary use of funds depicted by EBITDA may be limited by working capital, debt service and capital expenditure requirements and by restrictions related to legal requirements, commitments and uncertainties.
- (7) Includes net cash outflow for capital expenditures and for investments in affiliates.

### Exchange Rate Information

The following table sets forth certain information concerning the Noon Buying Rate for dollars expressed in pesetas per \$1.00.



Year ended December 31,	Noon Buying Rate			
	Period End	Average(1)	High	Low
1997 .....	152.40	147.14	158.80	129.80
1998 .....	142.15	149.42	157.41	136.80

Source: Federal Reserve Bank of New York.

(1) The average of the Noon Buying Rates on the last day of each full month during the relevant period.

Effective January 1, 1999, the following 11 European Union member states adopted the euro as a common currency: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. They also established fixed conversion rates between their respective sovereign currencies and the euro. On January 1, 2001, Greece joined the European Economic and Monetary Union. The exchange rate at which the Spanish peseta has been irrevocably fixed against the euro is Ptas 166.386 = €1.00. On January 1, 2002, the participating member states began issuing new euro-denominated bills and coins for use in cash transactions. As of March 1, 2002, the participating member states have withdrawn the bills and coins denominated in their respective currencies from circulation, and they are no longer legal tender for any transactions.

The Noon Buying Rate for the euro on June 27, 2002 was \$0.9885 = €1.00. The following tables describe, for the periods and dates indicated, information concerning the Noon Buying Rate for the euro. Amounts are expressed in U.S. dollars per €1.00.

Year ended December 31,	Noon Buying Rate			
	Period End	Average(1)	High	Low
1999 .....	1.0070	1.0588	1.1812	1.0016
2000 .....	0.9388	0.9207	1.0335	0.8270
2001 .....	0.8901	0.8909	0.9535	0.8370

Source: Federal Reserve Bank of New York.

(1) The average of the Noon Buying Rates for the euro on the last day of each month during the relevant period.

Month ended	Noon Buying Rate	
	High	Low
December 31, 2001 .....	0.9044	0.8773
January 31, 2002 .....	0.9031	0.8594
February 28, 2002 .....	0.8778	0.8613
March 31, 2002 .....	0.8836	0.8652
April 30, 2002 .....	0.9028	0.8750
May 31, 2002 .....	0.9373	0.9022
June 30, 2002 (through June 27, 2002) .....	0.9885	0.9692

Source: Federal Reserve Bank of New York.

Monetary policy within the member states of the euro zone is set by the European Central Bank. The European Central Bank has set itself the objective of containing inflation and will adjust interest rates in line with this policy without taking account of other economic variables such as the rate of unemployment. It has further declared that it will not set an exchange rate target for the euro.

Our ordinary shares are quoted on the Spanish stock exchanges in euro. Currency fluctuations may affect the dollar equivalent of the euro price of our shares listed on the Spanish stock exchanges and, as a result, the market price of our ADSs, which are listed on the New York Stock Exchange. Currency fluctuations may also affect the dollar amounts received by holders of ADRs on conversion by the Depositary of any cash dividends paid in euro on the underlying shares.

Our consolidated results are affected by fluctuations between the euro and the currencies in which the revenues and expenses of some of our consolidated subsidiaries are denominated (principally the Brazilian real, the Argentine peso, the Chilean peso, the Peruvian nuevo sol and the U.S. dollar). See "Item 11—Quantitative and Qualitative Disclosures about Market Risk".

## **B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

## **C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

## **D. RISK FACTORS**

*A material portion of our foreign operations and investments is located in Latin America, and we are therefore exposed to risks inherent in operating and investing in Latin America.*

At December 31, 2001, approximately 50% of our assets were located in Latin America. In addition, approximately 43% of our EBITDA for 2001 was derived from our Latin American operations. Our foreign operations and investments in Latin America are subject to various risks, including risks related to the following:

- government regulations and administrative policies may change quickly
- currencies may be devalued or currency restrictions and other restraints on transfer of funds may be imposed
- the government may expropriate assets
- the government may impose burdensome taxes or tariffs
- political changes may lead to changes in the business environment in which we operate
- our operations are dependent on concessions and other agreements with the government
- economic downturns, political instability and civil disturbances may negatively affect our operations

In addition, revenues from operations of our Latin American subsidiaries, their market value and the dividends and management fees received from them are exposed to material country risk as a result of adverse economic conditions in the region that may adversely affect demand, consumption and exchange rates. For example, in January 1999, as a result of adverse economic conditions in Brazil, Telefónica Internacional wrote down the book value of its investments in Brazil in the amount of €717.5 million.

*The recent devaluation of the Argentina peso and the adverse macroeconomic conditions currently prevailing in Argentina and recent emergency measures adopted by the Argentine government have had, and may continue to have, a material adverse effect on our results of operations and financial condition.*

As a result of the devaluation of the Argentine peso in January 2002, in accordance with Spanish accounting regulations we created various provisions and allowances against our net income for 2001 and adjusted the “translation differences in consolidation” account in our consolidated balance sheet at December 31, 2001. Accordingly, the devaluation of the Argentine peso resulted in a decrease in net income of €369.0 million in 2001 and a reduction in shareholders’ equity of €1,793.1 million at December 31, 2001 (including the decrease in net income). These provisions and allowances were made applying the rate of exchange of €1.00 = 1.5149 Argentine pesos, which is equivalent to the rate of U.S.\$1.00 = 1.7 Argentine pesos at January 11, 2002, which is the date the Argentine currency markets first opened following the decision by the Argentine Central Bank to close such markets on December 21, 2001. At March 31, 2002, the rate of exchange had fallen to €1.00 = 2.4862 Argentine pesos, resulting in a decrease in net income of €25.4 million during the first quarter of 2002 and a reduction in shareholders’ equity of €1,093.0 million at March 31, 2002. On June 25, 2002, the rate of exchange was €1.00 = 3.78 Argentine pesos. Our financial condition and results of operations may be adversely affected by this subsequent decline and any further declines in the value of the Argentine peso or declines in the values of the currencies of other Latin American countries (including the Brazilian real, which has experienced some recent depreciation) where we operate.

In addition, the deepening recession and mounting unemployment has led to a reduction of wages in real terms and a reduction in disposable income across all class sectors of the Argentine population. This has resulted in and may continue to result in lower use of our services in Argentina and a deterioration in the collection of accounts receivable, as a result of which our revenues from operations and cash flows in Argentina may decrease further. Further, as part of the measures adopted by the Argentine government in response to the economic crisis, the government annulled the semi-annual adjustments in accordance with the U.S. Consumer Price Index applied to the rates we charge in Argentina for measured services and authorized the government to renegotiate these rate agreements. If future rates evolve at a pace below increases in general price levels as a result of inflation, this would adversely affect our future financial condition and results of operations as well as the recoverability of the value of our fixed assets in Argentina through cash flows.

Furthermore, in light of recent macroeconomic developments in Argentina, sources of third-party financing may no longer be available to our Argentine fixed-line operator in amounts sufficient for it to meet its debt obligations. Should no third-party financing be available to it, or if we do not provide additional financing to it, or if it does not succeed in refinancing its indebtedness, our Argentine fixed-line operator may be unable to meet its current obligations with local and foreign creditors and may be unable to continue as a going concern.

Additionally, the Central Bank of Argentina has imposed a prohibition on transfers of funds outside Argentina by private sector parties, without its prior authorization, when such transfers relate to debt principal repayments and distributions of income or dividends, except for certain debts, including those involving multilateral lending entities and official or officially-recognized credit agencies. This prohibition remains in effect as of the date of this Annual Report. If the restrictions on funds transfers remain in effect and the Central Bank does not authorize the remittance of funds abroad by our Argentine fixed-line operator, its debt obligations may become immediately due and payable, unless new financing is funded outside Argentina and is available for it to pay its foreign creditors or it is able to refinance the indebtedness that is subject to the restrictions. If our Argentine fixed-line operator fails to secure such financing, or it does not succeed in refinancing such indebtedness, it may not be able to continue as a going concern.

***We face intense competition in most of our markets, which could result in decreases in current and potential customers, revenues and profitability.***

We face significant competition in all of the markets in which we operate. Governmental authorities in many of the countries in which we operate continue to grant new licenses and concessions to new market entrants, which will result in increased competition in those countries and markets. In addition, technological developments are increasing cross-competition in certain markets, such as between wireless providers and fixed-line telephony operators.

Although we continue to have a significant market share in most segments of the fixed-line telecommunications market in Spain, telecommunications regulators are promoting competition in fixed-line telecommunications services through policies that favor other fixed-line telecommunications operators. We may lose market share as a result of these policies, which could adversely affect our results of operations and the profitability of our Spanish fixed-line telecommunications operator.

These competitors could:

- offer lower prices, more attractive discount plans or better services and features
- develop and deploy more rapidly new or improved technologies, services and products
- bundle offerings of one type of service with others
- in the case of the wireless industry, subsidize handset procurement
- expand and enhance more rapidly their networks

Some of our competitors in certain markets have, and some potential competitors may enjoy, competitive advantages, including the following:

- greater name recognition

- greater financial, technical, marketing and other resources
- larger customer bases
- well-established relationships with current and potential customers

To compete effectively with our competitors, we will need to market our services effectively and anticipate and respond to various competitive factors affecting the relevant market, including the introduction of new products and services by our competitors, pricing strategies adopted by our competitors, changes in consumer preferences and general economic, political and social conditions. If we are unable to compete effectively with our competitors, it could lead to price reductions, lower revenue, under-utilization of our services, reduced operating margins and loss of market share

***The industry in which we conduct our business is subject to rapid technological changes and such changes could have a material adverse effect on our ability to provide competitive services.***

The telecommunications industry is in a period of rapid technological change. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will further develop. These new products and technologies may reduce the prices for our services or they may be superior to, and render obsolete, the products and services we offer and the technologies we use, and may consequently reduce the revenues generated by our products and services and require investment in new technology. As a result, our most significant competitors in the future may be new entrants to our markets which would not be burdened by an installed base of older equipment. It may be very expensive for us to upgrade our products and technology in order to continue to compete effectively.

***Our business depends substantially on the upgrading of our existing networks.***

We must continue to upgrade our existing wireless and fixed-line networks in a timely and satisfactory basis in order to retain and expand our customer base in each of our markets, to enhance our financial performance and to satisfy regulatory requirements. Among other things, we must:

- upgrade the functionality of our networks to permit increased customization of services
- fill in coverage gaps and increase coverage in buildings in some of our markets
- expand and maintain customer care, network management and administrative systems
- upgrade older systems as new technologies become available.

Many of these tasks are not entirely under our control. If we fail to successfully execute them, our services and products may be less attractive to new customers and we may lose existing customers to our competitors, which would adversely affect our results of operations.

***Our future revenue growth and profitability depends in part upon the development of UMTS technology and upon demand for UMTS services and products, which are unproven.***

Telefónica Móviles, our subsidiary that conducts our worldwide wireless communications services business, has made substantial investments to acquire UMTS licenses in Spain, Germany, Italy, Austria and Switzerland. Substantial additional investments will be required over the next several years if it is to establish a customer base, gain market share and develop new services and products in each of Germany, Italy, Austria and Switzerland. Telefónica Móviles may elect in the future to make substantial investments in order to build its UMTS networks and develop related services and products.

Telefónica Moviles' future revenue growth and profitability is dependent, in large measure, upon the capabilities and widespread market acceptance of UMTS technology. UMTS technology, however, is unproven. It has developed more slowly than initially anticipated, and has not been commercially rolled-out in its markets in a timely manner and, if developed, it may not provide the expected advantages over existing technologies. In addition, demand is unproven for UMTS-based services and products, and may not develop and be rolled out as we anticipate. If UMTS technology is not developed and rolled out on a timely basis, or if it does not deliver the

anticipated advantages or gain widespread acceptance, we would be materially and adversely affected because revenues of UMTS-related services would fail to offset related financial costs and operating expenses.

In addition, Telefónica Móviles depends upon a small number of major suppliers for essential products and services, such as handsets and network infrastructure. Although Telefónica Móviles has not been materially affected by supply problems in the past, these suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. If these suppliers fail to deliver products and services on a timely basis, or fail to develop and deliver to Telefónica Móviles handsets that are comparable with or better than handsets otherwise available in its markets, Telefónica Móviles could be negatively affected. Similarly, interruptions in the supply of telecommunications equipment for Telefónica Móviles' networks could impede network development and expansion. Although these equipment supply risks are no longer significant in relation to Telefónica Móviles' existing networks, they could be substantial in relation to the build-out of UMTS networks as multiple operators seek to construct networks in multiple countries at the same time.

***Telefónica Móviles may be required to adjust the value of its investments in UMTS licenses.***

Telefónica Móviles has acquired UMTS licenses in Spain, Germany, Italy and Switzerland. Although this technology is not yet commercially available, there are specific plans in each of these countries to develop the related businesses. These plans are based on certain assumptions Telefónica Móviles has made, and its actual results may vary. Accordingly, management of the companies plans to periodically update its business plans and make, where appropriate, any necessary adjustments to the carrying value of such licenses.

Due to the variety of concerns relating to the development of the UMTS network and services, Telefónica Móviles regularly performs a review of the value of its investments in UMTS licenses. There can be no assurance that a change of strategy or business plans of these companies or changes in the telecommunications industry will not require Telefónica Móviles to write-down the value of these investments in the future, which could adversely affect our business, financial condition or results of operations.

***We operate in a highly regulated industry and could become subject to more burdensome regulation, which could adversely affect our businesses.***

As a multinational telecommunications company, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. Furthermore, the licensing, construction, operation and interconnection arrangements of our communications systems are regulated to varying degrees by national, state, regional or local, and supra-national authorities, such as the European Union. These authorities could adopt regulations or take other actions that could adversely affect us and our companies, including revocation of any of our licenses or concessions to offer services in a particular market, failure to renew a license or concession, modification of the terms of a license or concession or the granting of new licenses or concessions to competitors.

Most of our operating companies require licenses or concessions from the governmental authorities of the countries in which they operate. These licenses and concessions specify the types of services permitted to be offered by our operating companies. The continued existence and terms of our licenses and concessions are subject to review by regulatory authorities in each country and to interpretation, modification or termination by these authorities. Many of these licenses and concessions are revocable for public interest reasons. The rules of some of the government regulatory authorities having jurisdiction over our operating companies require us to meet specified network build-out requirements and schedules. In particular, our wireless licenses and concessions typically require that we satisfy certain obligations, including minimum specified quality, service and coverage conditions and capital investment. Failure to comply with these obligations in a given license area could result in the imposition of fines, or revocation or forfeiture of the license for that area. In addition, the need to meet scheduled deadlines may cause our company to expend more resources than otherwise budgeted for a particular network build-out. We cannot assure you that our operating companies will be able to comply fully with the terms and conditions of their licenses and concessions.

Increased or significant changes in the regulation of the activities of our operating companies, including the regulation of rates that may be charged to customers for services, could have a material adverse effect on our company. New regulations could also increase the costs of regulatory compliance.

***We are subject to evolving regulatory policies which favor increased competition and which could expose us to additional competition in our markets.***

Regulatory policies of many of the countries in which we operate generally favor increasing competition in most of the segments of the market in which we operate, especially in the fixed-line and wireless services industry, including by granting new licenses in existing licensed territories in order to permit the entry of new competitors. These regulatory policies are likely to have the effect, over time, of reducing our market shares in the service territories in which we currently operate. For example, Spanish telecommunications regulators have attempted to promote competition in fixed-line telecommunications services through policies that favor other fixed-line telecommunications operators. Regulations introduced in recent years in Spain have allowed other operators to locate their equipment in or adjacent to our exchanges (i.e., local loop unbundling) and made it easier for our customers to route some or all of their calls over our competitors' networks (i.e., carrier pre-selection).

We may lose market share as a result of these policies, which could adversely affect our revenues from operations and our profitability. Additional regulatory changes resulting in increased competition could have a further adverse effect on our business, results of operations, financial condition and prospects.

In addition to this, because we hold leading market shares in many of the countries in which we have operations, we could face regulatory actions by national or, in the case of Europe, European Union antitrust or competition authorities if it is determined that we have prevented, restricted or distorted competition. These authorities could prohibit us from making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on us, which if significant, could harm our financial performance and future growth.

***We must successfully implement our business plans as planned, but factors beyond our control may prevent us from doing so, which could have a material adverse effect on our business.***

Our ability to increase our revenues and maintain our position as a leading European and Latin American provider of advanced telecommunications and Internet services will depend in large part on the successful, timely and cost-effective implementation of our business plan, including our plan to operate our various businesses along global business lines.

Factors beyond our control that could affect the implementation and completion of our business plan include:

- difficulties in developing and introducing new technologies
- declining prices for some of our services
- our ability to manage costs
- the effect of adverse economic trends on our principal markets
- the effect of foreign exchange fluctuations on our results of operations
- our ability to obtain applicable government, shareholder and other approvals
- our ability to enter into necessary contracts with third parties
- the growth of free Internet access in many core markets that may increase competition
- the need to establish and maintain strategic relationships
- difficulties in integrating our acquired businesses
- the effect of future acquisitions on our financial condition and results of operations
- our ability to secure the timely performance of independent contractors hired to engineer, design and construct portions of our network
- the potential lack of attractive investment targets

- our ability to attract and retain highly-skilled and qualified personnel
- the effect of unanticipated network interruptions

***The development of our business could be hindered if we fail to maintain satisfactory working relationships with partners.***

Some of our operations are conducted through joint ventures in which our company owns a significant, but often less than controlling, ownership interest. In these operations, our company does not have absolute control over the operations of the venture. In addition, in some cases where we own a majority of the venture, we may be subject to provisions in shareholders' agreements restricting our control over the venture. The particular corporate governance provisions affecting our company vary from venture to venture, and often depend upon the size of our investment relative to that of other investors, our experience as a telecommunications operator compared to that of the other investors and the preferences or requirements of foreign governments that local owners hold an interest in licensed telecommunications operators. As a result, we must generally obtain the cooperation of our partners in order to implement and expand upon our business strategies and finance and manage our operations.

Telefónica Móviles has acquired UMTS licenses in some Western European countries through consortia involving partners with established local and international market presences. The success of these consortia will depend, in part, upon the cooperation of the partners and will be subject to risks comparable to those affecting its other joint ventures.

***Our financial condition and results of operations may be adversely affected if we do not effectively manage our exposure to interest rate and foreign currency exchange rate risk.***

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes and foreign currency exchange rate fluctuations. We employ risk management strategies to manage this exposure, in part through the use of financial derivatives such as interest rate swap agreements, foreign currency forwards and currency swap agreements. Our risk management strategies may not be successful, however, in limiting our exposure to changes in interest rates and foreign currency exchange rates, which could adversely affect our financial condition and results of operations.

In order to limit our exposure to Latin American currency exchange rate fluctuations, we use financial derivatives and other instruments. If the financial derivatives market is not sufficiently liquid for our risk management purposes or if we cannot enter into arrangements of the type and for the amounts necessary to limit our exposure to Latin American currency exchange rate fluctuations, such failure could adversely affect our financial condition and results of operations.

***The costs and difficulties of acquiring and integrating businesses could impede our future growth and adversely affect our competitiveness.***

We intend to evaluate, and may enter into, acquisition transactions in order to, among other things, provide services in countries in which we do not currently have operations or enhance our product portfolio. Any such acquisitions may expose us to the following risks:

- the difficulty of identifying appropriate acquisition candidates in the countries in which we do business or intend to do business
- the difficulty of assimilating the operations and personnel of the acquired entities
- the potential disruption to our ongoing business caused by senior management's focus on the acquisition transactions
- our failure to incorporate successfully licensed or acquired technology into our network and product offerings
- the failure to maintain uniform standards, controls, procedures and policies

- the impairment of relationships with employees as a result of changes in management and ownership

We cannot assure you that we would be successful in overcoming these risks, and our failure to overcome these risks could have a negative effect on our financial condition.

***We have recorded an impairment charge to goodwill and may be required to make additional write offs in the future.***

Goodwill represents the purchase price of an acquisition in excess of the fair value of the assets acquired less liabilities assumed. We have generated substantial amounts of goodwill from some of our acquisitions. At December 31, 2001, under Spanish GAAP we had goodwill of €9,128.9 million, equal to 10.6% of our total assets and 35.3% of our shareholders' equity at that date, and at December 31, 2000, we had goodwill of €7,714.8 million, equal to 8.4% of our total assets and 29.8% of our shareholders' equity at that date. At December 31, 2001, under U.S. GAAP we had goodwill of €14,100.6 million, equal to 15.5% of our total assets and 44.4% of our shareholders' equity at that date, and at December 31, 2000, we had goodwill of €21,500.2, equal to 19.9% of our total assets and 48.5% of our shareholders' equity at that date.

In December 2001, we performed an analysis of projected discounted cash flows from Lycos, Inc., Endemol Entertainment Holding, N.V., Tele Sudeste Celular Participações and Telefónica del Perú as a result of which we determined that such projected cash flows were not adequate to support the value of goodwill related to these companies under U.S. GAAP. Accordingly, we determined under U.S. GAAP that goodwill related to these companies was impaired, and we recorded a goodwill impairment charge in an aggregate amount of approximately €8,452.0 million in 2001.

We cannot be certain that we will be able to recover all of the goodwill that we now carry as an asset or that we will not have to write off additional goodwill in the future under U.S. GAAP or Spanish GAAP. We could be forced to write off goodwill because of rapid technological change, intense competition, significant declines in sales, earnings or cash flows and other factors that in the future indicate that the fair value of our acquisitions is not worth their carrying value.

***Loss of key personnel could weaken our business expertise and delay the completion of our network and other business plans.***

Our operations throughout the world are managed by a small number of key executive officers. The loss of our key executive officers in the future could significantly impede our financial plans, product development, network completion, marketing and other objectives. We believe that the growth and future success of our business will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel. Competition for qualified personnel in the telecommunications industry is intense. We cannot assure you that we will be able to hire or retain necessary personnel.

***We may be adversely affected by unanticipated network interruptions.***

Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including network, hardware or software failures, that cause an interruption in our service could result in reduced revenues and costly repairs and could bring harm to our reputation. Although we carry business interruption insurance, this policy may not be in amounts sufficient to compensate us for any losses we incur.

***Forward-looking statements may not be realized.***

All statements in this Annual Report that are not clearly historical in nature are forward-looking. Examples of forward-looking statements include:

- statements concerning our operations and prospects
- the size of European and Latin American telecommunications markets
- estimated demand forecasts



- our ability to secure and maintain telecommunications infrastructure licenses, rights of way and other regulatory approvals
- our strategic initiatives and plans for business growth
- plans for entering into strategic relationships and joint ventures
- possible bids for additional licenses or concessions
- industry conditions
- funding needs and financing sources
- network completion and product development schedules
- strategy, plans and timing for the introduction or enhancement of our services and products
- expected characteristics of competing networks, products and services
- our Argentine fixed-line operator's ability to meet its debts as they come due and to continue as a going concern
- other statements of our expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts

These forward-looking statements are uncertain, and we cannot assure you that any such statements will prove to be correct. Actual results and developments may be materially different from those expressed or implied by such statements. Readers should carefully review the other risk factors set forth in this section and the information under "Item 4—Information on the Company", "Item 5—Operating and Financial Review and Prospects" and "Item 11—Quantitative and Qualitative Disclosures about Market Risk" for a discussion of factors which could result in any of these forward-looking statements proving to be inaccurate.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

###### **Overview**

We are a limited liability company duly organized and existing under the laws of the Kingdom of Spain. We are:

- a diversified telecommunications and multimedia group which currently provides a comprehensive range of services in Spain and Latin America through one of the world's largest and most modern telecommunications networks
- the leading provider of fixed-line public voice telephone services, wireless communications services, Internet access services and data transmission services in Spain
- one of the largest telecommunications operators in Latin America, with operations principally in Brazil, Argentina, Chile, Peru, Mexico, El Salvador, Guatemala and Puerto Rico
- a leading Spanish multinational corporation

We have also expanded our presence in Europe through the acquisition, alone or as part of consortia, of UMTS licenses in Germany, Italy, Switzerland and Austria.

At December 31, 2001, we managed companies that had approximately 42.3 million access lines in service, 29.8 million wireless subscribers and 1.1 million pay television subscribers, including approximately 342,000 cable subscribers and 806,000 direct-to-home satellite television subscribers.

The following table reflects the development of our customer base since 1999.

	At December 31,		
	1999	2000	2001
		(thousands)	
Access lines in service in Spain(1) .....	19,226.2	20,317.8	20,646.9
Access lines in service in other countries(2).....	18,194.1	19,374.7	21,649.7
Total access lines in service .....	37,420.3	39,692.5	42,296.6
Wireless subscribers in Spain .....	9,052.3	13,669.1	16,793.4
Wireless subscribers in other countries(3) .....	6,455.7	9,545.1	13,001.4
Total wireless subscribers .....	15,508.0	23,214.2	29,794.8
Pay television subscribers in Spain.....	440.1	633.1	806.4
Pay television subscribers in other countries(4).....	597.0	349.4	341.7
Total pay television subscribers.....	1,037.1	982.5	1,148.1

- (1) Includes third-party private automatic branch exchange services that use Telefónica de España's network access services.
- (2) Includes 100% of the access lines of our subsidiaries in Argentina, Brazil (including Companhia Riograndense de Telecomunicações in 1999), Chile, El Salvador, Guatemala and Perú.
- (3) Includes 100% of the wireless subscribers of our subsidiaries in Argentina, Brazil, Chile, El Salvador, Germany, Guatemala, Mexico and Perú. Also includes 100% of the wireless subscribers of the wireless operations in Puerto Rico and Morocco (in 2000 only) in which we have minority interests but which we solely or jointly manage.
- (4) Includes Telefónica del Perú's pay television subscribers. Also includes Compañía de Telecomunicaciones de Chile's pay television subscribers in 1999.

In January 2000, we announced a reorganization of our business along global business lines to enhance our strategic and competitive position globally and in each of these business lines. As part of this reorganization, our Board of Directors formed two new global business divisions, Telefónica Móviles and Telefónica Data. Some or parts of some of our then-existing lines of business were combined with other business lines in connection with the reorganization. As a result of this reorganization, our group is now organized according to six principal lines of business, each of which is headed by an operating subsidiary that is under our direct control. These six principal lines of business are:

- fixed-line telecommunications services in Spain conducted through Telefónica de España
- worldwide wireless communications services conducted through Telefónica Móviles
- fixed-line telecommunications services in Latin America conducted through Telefónica Internacional
- worldwide corporate data transmission conducted through Telefónica Data
- worldwide Internet-related services conducted through Terra Networks
- worldwide audiovisual content and media conducted through Admira Media

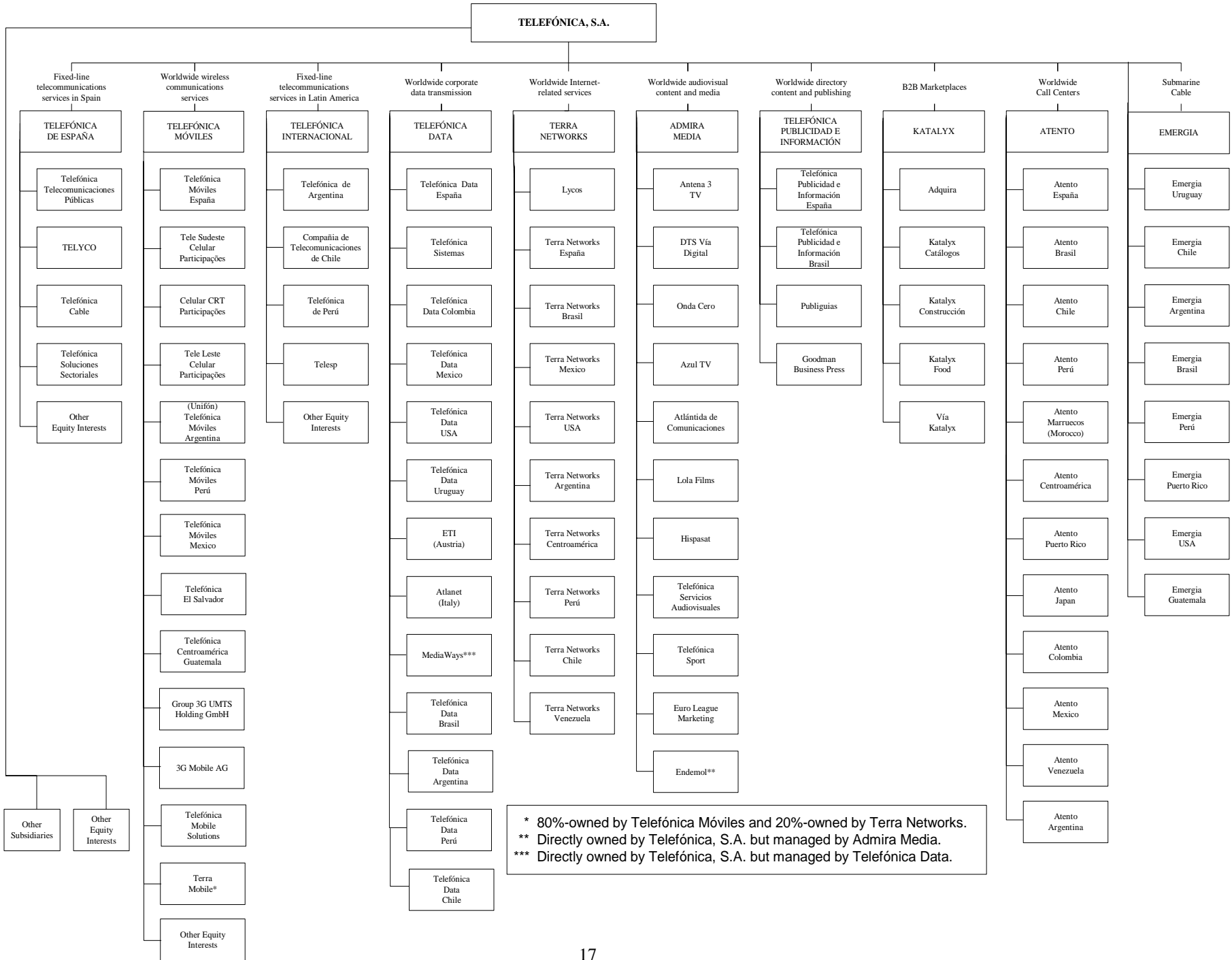
In addition, we have several other lines of business, including:

- publishing, development and sale of advertising in telephone directories conducted through Telefónica Publicidad e Información, S.A.
- operation of call centers in Europe (Spain), Latin America, Northern Africa (Morocco) and Asia (Japan) conducted through Atento Holding Telecomunicaciones, S.A.
- development of business-to-business (B2B) marketplaces conducted through Katalyx, S.A.

- provision of broadband communications through submarine fiber optic cable conducted through Emergia, S.A.

We may create new business lines in the future.

As part of the reorganization of our business along global business lines, during 2000 and 2001 we spun-off or transferred the wireless operations, data operations and directory publishing businesses of certain of our integrated Latin American operators to our respective companies which head those lines of business. The following chart shows the organizational structure of the principal companies of the Telefónica Group at December 31, 2001.



In addition, we operate a corporate center. Our corporate center's objectives are to:

- coordinate the group's activities
- allocate resources efficiently among the group
- provide managerial guidelines for the group
- manage the portfolio of businesses
- provide cohesion within the group
- foster synergies among the group's subsidiaries

Our principal executive offices are located at Gran Vía, 28, 28013 Madrid, Spain and our telephone number is (34) 91-584-0306. Our agent for service of process in the United States is Telefónica Internacional USA, Inc., 1001 Brickell Bay Drive, Miami, FL 33131.

## **B. BUSINESS OVERVIEW**

### **Fixed-Line Telecommunications Services in Spain – Telefónica de España**

Our fixed-line telecommunications services in Spain are managed by Telefónica de España. The principal services offered by Telefónica de España are:

- fixed-line telecommunications services, including access lines and local and long-distance calling
- integrated services digital network, which provides high speed transmission of voice, data and video through existing fixed-line infrastructure
- public telephone services from phone booths
- circuit leasing
- value-added services, including call waiting, call barring and conference calling
- private automatic branch exchange services for companies, under the trade name Ibercom, which, through a telephone switch located on a customer's premises, provides voice-grade circuits with advanced features for the local premises, including features such as least-cost routing and call-detail recording
- leasing and sale of terminal equipment and exchanges
- interconnection services
- intelligent network services, including services such as caller identification, phone-messaging and call-forwarding
- Internet access services, including asymmetrical digital subscriber ("ADSL") line services

Historically, fixed-line telecommunications services in Spain has been our leading business in terms of total revenues. However, its relative contribution to total revenues has decreased in recent years, principally due to the integration of our Brazilian operating subsidiaries in 1998, the adverse effects of competition, tariff reductions and discount plans in Spain and the rapid growth of our wireless operations in recent years.

Telefónica de España is developing a multi-dimensional strategy in order to continue to compete effectively in the Spanish telecommunications market. This strategy involves:

- developing a commercial strategy that:

- creates customer loyalty through incentive programs
- increases revenues by introducing new and attractive services
- offers global solutions through integrated approaches contributed by our affiliates
- maintains income levels
- improves the efficiency of the network by increasing the volume of traffic
- decreasing the unit cost of the network and achieving a higher level of asset turnover

### Operations

The following table shows the development of Telefónica de España's domestic telecommunications network and growth in usage of that network since 1999:

	At December 31,		
	1999	2000	2001
Spanish access lines in service(1) (thousands).....	18,315.7	19,003.0	20,646.9
Fixed telephone service, including payphones (thousands).....	16,480.4	16,373.0	17,487.6
Ibercom(2) (thousands).....	856.5	955.9	1,074.1
Integrated services digital network (thousands).....	978.8	1,674.1	2,094.2
Growth in fixed telephone lines in service, including payphones .....	1.2%	(0.7)%	6.8%
Fixed-lines in service, including payphones, Ibercom and integrated services digital networks, per 100 inhabitants(3) .....	49.0	52.5	53.4
Fixed telephone lines, payphones, Ibercom and integrated services digital network lines in service per employee .....	412.4	493.2	505.4
Degree of digitalization.....	86.5%	86.6%	86.8%
Average days between application and installation .....	7.2	8.8	7.7
Average line usage (minutes per day)(4) .....	13.4	16.8	21.1
Growth in average line usage(4) .....	11.9%	25.6%	25.6%
Internet access users (thousands) .....	1,579.0	2,504.0	3,109.0
Growth of outgoing international traffic .....	9.2%	30.7%	18.4%
Growth of incoming international traffic .....	16.0%	9.4%	24.4%
Fixed telephone lines installed and billed (thousands).....	16,998.7	17,101.7	17,238.1
Coaxial cable (km).....	5,059.0	4,787.0	4,756.0
Fiber optic cable (km).....	52,511.0	54,920.0	58,156.0
Copper cable in domestic long-distance lines (km) .....	57,430.0	57,259.0	57,095.0
Subscriber networks (thousand km-par)(5).....	66,713.0	67,554.0	68,563.0

- (1) Does not include third party private automatic branch exchange services that use Telefónica de España's network access services.
- (2) Ibercom is the tradename for Telefónica de España's private automatic branch exchange service. The number of Ibercom lines is presented on the basis of extensions.
- (3) Includes third-party private automatic branch exchange services that use Telefónica de España's network access services.
- (4) Includes interconnection with wireless networks.
- (5) The transmission cables in the subscriber networks contain a variable number of conducting filaments, which are insulated from each other and grouped in pairs. Each such pair is called a "par".

Line usage continued to increase in 2001. The number of minutes consumed increased 30.2% to 138,580 million from 106,400 million in 2000, which in turn represented a 28.9% increase from 1999. The increase in line usage in 2001 was mainly due to a 5.6% increase in the number of calls to 39,169 million and a 21.5% increase in

the average duration per call to 3.54 minutes. Increases in Internet access traffic, provincial and interprovincial calls and traffic with other fixed-line operators were the most significant factors contributing to these increases, more than offsetting the 5.0% decrease in metropolitan calls to 37,470 million minutes in 2001 from 39,440 million minutes in 2000. During 2001, calls for Internet access increased 47.8% to 35,499 million minutes in 2001 from 24,020 million minutes in 2000, provincial calls increased 26.5% to 7,640 million minutes in 2001 from 6,040 million minutes in 2000, interprovincial calls increased 0.4% to 7,996 million minutes in 2001 from 7,964 million minutes in 2000 and traffic with other fixed-line operators increased 134.8% to 29,995 million minutes in 2001 from 12,775 million minutes in 2000. The increase in line usage in 2000 was mainly due to a 7.9% increase in the number of calls to 36,248 million and a 19.4% increase in the average duration per call to 2.94 minutes. Calls to and from wireless telephones, Internet access traffic and traffic with other fixed-line operators were the most significant factors contributing to these increases. During 2000, calls to and from wireless telephones increased approximately 29.5% to 9,844 million minutes in 2000 from 7,600 million minutes in 1999, calls for Internet access increased 112.6% to 24,020 million minutes in 2000 from 11,300 million minutes in 1999 and traffic with other fixed-line operators increased 209.0% to 12,775 million minutes in 2000 from 4,134 million minutes in 1999.

Services such as voice mail are also an important factor in increasing line usage. At December 31, 2001, almost all of Telefónica de España's lines in service were capable of using network-based voice mail, and more than 10.1 million customers took advantage of this service during 2001 compared to 9.1 million customers in 2000.

Despite the growth in Telefónica de España's domestic telecommunications network in recent years, the level of penetration of fixed telephone service in Spain of approximately 53.4 access lines in service per 100 inhabitants at December 31, 2001, remains relatively low compared to other Western European countries.

#### *International Traffic*

Currently, 99.9% of all international traffic originating in Spain is dialed direct. Total revenues from international incoming and outgoing calls increased by 13.2% in 2001 and 8.1% in 2000. The increases in 2001 and 2000 were principally a result of a 21.6% increase in 2001 and an 18.2% increase in 2000 in the number of minutes of international traffic, offset in part by tariff reductions and discounts in each of those years.

Revenues from outgoing calls are usually derived from tariffs paid by customers in Spain, net of our payments to foreign carriers for the portion of the calls carried over such carriers' networks. Revenues from incoming calls are derived from payments made by foreign carriers. Payment rates and currencies are agreed upon bilaterally under the general auspices of the International Telecommunications Union. Due to Spain's geographic location between the United States and the Middle East and between Northern Europe and Africa, we also derive revenues from the use of our network to retransmit voice and data traffic and television signals between such regions.

#### *Digitalization*

At December 31, 2001, 86.8% of urban lines were digital. In addition, Telefónica de España has completed the upgrade of its telephone exchanges. As a result, Telefónica de España is able to provide basic digital services, such as itemized billing, to 100% of its customers. The high degree of digitalization of Telefónica de España's network also enables it to provide a broad range of digital services to satisfy customer demands. Telefónica de España's international switching exchanges and domestic and international transmission links are 100% digitalized.

#### *Cable Telecommunications*

Telefónica de España, through Telefónica Cable, currently provides cable telecommunications services on a pre-commercial basis in the Spanish regions of Extremadura, Castilla La Mancha, Cataluña, Castilla Leon and Cadiz. Telefónica de España has provided cable telecommunications services in Menorca through Telefónica Cable Menorca, S.A. (Tecamesa) since 1998. Under the pre-commercial service, subscribers are not required to pay for such services. Telefónica Cable may commence providing cable television services in all Spanish regions due to the fact that the applicable waiting period has expired, subject to certain conditions. See "—Regulation—Cable Telecommunications". Our strategy regarding the offer of cable telecommunications services will depend upon the competitive environment and the obligations we would be required to undertake in order to receive the necessary license for each particular region.

On January 31, 2002, the Secretary of State for Telecommunications and Information Society approved a resolution which transformed Telefónica Cable's concessions into a Type B1 license for the provision of fixed-line

telecommunications services, a Type C license for the transmission of data, a provisional authorization for the offering of video-on-demand services and a concession for the provision of broadcast services.

## ***Regulation***

### *Overview*

Below is a description of the current Spanish telecommunications regulatory framework. This description should be considered in light of certain developments currently underway in the regulatory and competitive environment that will have a material impact on Telefónica de España's business and operations in future years.

Prior to efforts that began in 1987 and culminated in full market liberalization in December 1998, we operated as the exclusive provider of telecommunications services in Spain pursuant to government concessions dating to 1946. At present, all telecommunications services provided by us are subject to competition. Retevisión and Lince were our first two competitors licensed to provide nationwide fixed-line public voice telephone services, consisting of local, domestic long-distance and international long-distance telephone services and the corresponding carrier services. Retevisión launched its services in January 1998, and Lince commenced operations under the trade name UNI2 in December 1998. Since January 1998, licensed cable telecommunications operators have been permitted to offer fixed-line public voice telephone services that originate and terminate within their regions, using their own networks. Also, since December 1998, the provision of fixed-line public voice telephone services has been open to competition from all sources, subject to basic regulatory licensing requirements.

The Spanish government undertook a process of revising the legislative and regulatory scheme applicable to participants in the telecommunications industry in preparation for the liberalization of the telecommunications market in December 1998. As the main step in this process, on April 24, 1998, the Spanish Parliament passed the new General Law on Telecommunications (Law 11/1998). This law was published in the Official Gazette on April 25, 1998 and took effect on April 26, 1998.

The General Law on Telecommunications repealed and replaced nearly all the existing laws and regulations on telecommunications (including laws regulating satellite and cable telecommunications). However, the General Law on Telecommunications does not govern television and radio broadcasting and cable television, and therefore, certain provisions of previous telecommunications statutes dealing with radio and television broadcasting and cable television remain in effect. In general terms, the General Law on Telecommunications adopted all European Union directives mandating the liberalization of telecommunications services, some of which had already been implemented in Spain. Among other things, the General Law on Telecommunications addresses the following matters relating to our business:

- conditions for granting licenses to provide telecommunications services
- the obligation of telecommunications providers to extend service to rural areas and the financing of associated capital expenditures

Since 1991, we have provided telecommunications services under a state contract entered into with the Spanish government in that year, in accordance with the Telecommunications Regulation Law of 1987. The state contract was approved by the Spanish government on November 21, 1991 and published in the Official Gazette on January 23, 1992. As of the date of this Annual Report, the state contract remains in effect solely with respect to fixed-line telecommunications services.

On August 27, 1998 we requested the Spanish government to transform our concession into a Type B1 license to provide fixed-line telecommunications services through the operation of a fixed telephone network. As of the date of this Annual Report, the Spanish government has not granted our request, and we continue to provide fixed-line telecommunications services under the state contract.

### *The State Contract*

Generally, the state contract specifies the terms and conditions under which we are authorized to provide telecommunications services in Spain. The contract may be amended or modified in accordance with the legal regime established by the Spanish General Law of Public Contracts and other regulations governing agreements



entered into by the government. The state contract may be superseded by European Union directives. Below is a summary of the material provisions of the state contract.

*Term.* We and the government entered into the current state contract in 1991 for an initial term of 30 years, subject to the standard termination provisions under Spain's General Law of Public Contracts (i.e., breach of contract, expiration of term, pre-emption of services by the Spanish government, cancellation of services for reasons of public interest, bankruptcy or suspension of payments and mutual agreement).

*Services.* The state contract provides that we may continue to render all services that we provided prior to market liberalization, as long as we fulfill the technological and service requirements set forth in the relevant regulations. This provision in effect grants us a non-exclusive concession to provide any service we have provided in the past, including fixed-line services, data transmission services, wireless communications services and other value-added services.

*Other Obligations.* The state contract requires us to:

- pay taxes as required by general tax regulations
- adopt whatever measures are necessary to guarantee privacy in communications
- prepare plans to establish technical conditions, investments and goals for improvement of services and network upgrades and to present such plans to the Ministry of Science and Technology
- present information to the Secretary of State for Telecommunications and Information Society regarding internal procedures, an annual audit by independent accountants and financial statements that segregate our industrial activities from our investments in other companies and segregate services provided on a monopoly basis from services open to competition
- pay certain royalties

#### *European Union Regulations*

Since 1995, the European Union has adopted a number of directives that regulate the provision of telecommunications services in European Union member states, including:

- regulations designed to ensure the full liberalization of the telecommunications sector
- regulations which impose standard conditions throughout member states for granting individual licenses and general authorizations
- regulations regarding access and interconnection between competing operators
- regulations dealing with the universal service obligation
- regulations requiring member states to allocate wireless radio based services according to the DCS-1800 standard and the UMTS standard
- regulations relating to telecommunications data protection and privacy regulations
- regulations for unbundled access to the local loop

The General Law on Telecommunications and other applicable Spanish law were designed to implement all applicable European Union directives with respect to the provision of telecommunications services. In 1999, the European Union began to revise the directives in force with respect to the provision of telecommunications services. We anticipate that the Spanish government will need to revise its regulatory framework in 2002 and 2003 to comply with the revised directives.

### *Regulatory Framework*

The provision of telecommunications services in Spain is regulated and overseen by the Spanish government through the Secretary of State for Telecommunications and Information Society, a unit of the Ministry of Science and Technology. The Ministry of Science and Technology has various powers, including in certain cases the authority to grant licenses or authorizations, if applicable, for telecommunications services and to impose sanctions for certain infringements of the General Law on Telecommunications. An additional independent oversight body, the Telecommunications Market Commission, was created in 1996. The Telecommunications Market Commission supervises the activities of telecommunications operators and has the authority to grant licenses for telecommunications services and to arbitrate any conflicts that may arise between operators, subject to the consent of the interested parties. The Telecommunications Market Commission is also responsible for safeguarding free competition in the telecommunications market, particularly with regard to a plurality of service offerings, access to networks and network interconnection. With regard to interconnection, the Telecommunications Market Commission may make a binding decision in respect of any conflict between operators and may fix tariffs (other than for regulated services), such as interconnection charges, in the event of disputes.

The Telecommunications Market Commission has advisory and arbitration responsibilities with respect to tariffs for end user services. It issues reports on all proposed tariffs and the regulation of prices for telecommunications services. It also issues reports on proposed tariffs for exclusive services or services for which a dominant operator exists.

### *The General Law on Telecommunications*

The General Law on Telecommunications culminates the liberalization process initiated in 1987 with the enactment of the Telecommunications Regulation Law and establishes a regulatory framework for telecommunications services in accordance with applicable European Union directives. The General Law on Telecommunications provides for free competition with respect to all telecommunications services and with respect to the construction and operation of telecommunications networks, subject to individual licensing or general authorization requirements. Individual licenses are required:

- to construct or operate public telecommunications networks
- to provide fixed-line telephony services to the general public
- to provide telecommunications services or construct or operate telecommunications networks using radio spectrum

The Spanish Government may determine pursuant to a Royal Decree other activities and services that require individual licenses. In all other cases where the type of service or network does not fall within the scope of the individual license regime, only a general authorization is required. A general authorization is automatically granted to any party who fulfills basic licensing requirements.

The Ministry of Science and Technology may, in order to guarantee the most efficient use of radioelectric spectrum, limit the number of individual licenses it will grant, in which case individual licenses will be granted to the winner of a bidding contest administered by the Ministry of Science and Technology.

In accordance with the General Law on Telecommunications, Telefónica de España has requested that the state contract be converted into individual licenses. Telefónica de España is currently negotiating the rights and obligations under the state contract which will exist under individual licenses that may be granted to Telefónica de España. These rights and obligations may not afford Telefónica de España any competitive advantage.

*Tariffs.* Under the general principles of the General Law on Telecommunications, operators are free to fix tariffs. Nevertheless, the Spanish government's Delegate Commission for Economic Affairs has the authority, subject to the issuance of a report by the Telecommunications Market Commission, to establish fixed, maximum or minimum tariffs, or to determine the criteria by which to establish tariffs and the mechanism for their control. In doing so, the government's Delegate Commission for Economic Affairs must take into account:

- the effective cost of the applicable service

- the degree of competition in the market for the applicable service

The General Law on Telecommunications recognized the existence of an imbalance in the tariffs charged for fixed-line telephone services as of the date of its enactment and the need to rebalance such tariffs. The General Law on Telecommunications further recognized the possibility of compensating the dominant operator (Telefónica de España) for the access deficit which may result from the existing rate imbalance. Because the access deficit problem had not been resolved, on December 1, 1998, the date the market was fully liberalized, we filed a complaint against the Spanish government with the European Commission alleging that the Spanish government failed to comply with European Union directives that require rates to be rebalanced prior to the liberalization of a telecommunications market. In November 1999, we also filed a complaint against the Spanish government seeking compensation for the imbalance in tariffs. The Spanish government has initiated the process of denying our claim.

On January 29, 2001, the European Commission issued an opinion addressed to the Kingdom of Spain in which it concludes that the Spanish government failed to comply with the relevant European Union directives because the Spanish government did not allow Telefónica de España to raise tariffs sufficiently to cover its costs. In June 2001, the Delegate Commission for Economic Affairs of the Spanish government approved rate rebalancing measures, which we believe will eliminate the access deficit by 2003. See “—The Tariff Structure and Pricing for Principal Services” below. The Spanish government has also informed the European Commission of these measures, which have been adopted in order to comply with the European Union directives related to the access deficit and with the above-mentioned opinion of the European Commission. Telefónica de España has also advised the European Commission that it believes these measures will eliminate the access deficit by 2003. Nonetheless, the European Commission has initiated a formal sanction proceeding against the Kingdom of Spain before the European Community Court of Justice based on the Kingdom of Spain’s failure to comply with its obligations under the relevant European Union directives.

*Interconnection.* The General Law on Telecommunications requires owners of public telecommunications networks to allow competitors to interconnect with their networks and services at non-discriminatory rates and under non-discriminatory conditions. The General Law on Telecommunications provides that the conditions for interconnection are to be freely agreed among the parties while the government has the authority to establish the minimum conditions for interconnection agreements, which must be included in all interconnection agreements. On July 24, 1998, the government issued a Royal Decree elaborating the regulations relating to interconnection. Where the parties are unable to reach an agreement, the Telecommunications Market Commission may impose the obligation to interconnect upon the conditions it dictates. Similarly, the Telecommunications Market Commission may release certain network owners, temporarily and on a case-by-case basis, from the obligation to interconnect where there are technical or commercial alternatives to such interconnection.

Although under the General Law on Telecommunications interconnection prices may be freely negotiated, prices charged by Telefónica de España, as the dominant operator, are determined by an Interconnection Offer Framework approved by the government. In 1998, we proposed an initial Interconnection Offer Framework, which was subsequently modified and approved by the Ministry of Science and Technology. Under our proposal and in accordance with the principles set forth in the Interconnection Offer Framework, interconnection prices charged to Telefónica de España’s competitors would be consistent with Telefónica de España’s actual costs. However, the Ministerial Order dated October 29, 1998, which approved the Interconnection Offer Framework, and its subsequent modifications provide for interconnection prices that are below Telefónica de España’s actual costs. Because Telefónica de España continues to provide interconnection services to its competitors at prices below its costs, Telefónica de España’s ability to compete is effectively limited which has contributed to its decline in market share for certain services, such as domestic long-distance and international long-distance, since 1999. Consequently, Telefónica de España has filed an appeal with the *Sala de lo Contencioso Administrativo de la Audiencia Nacional Sección VII* against the Interconnection Offer Framework.

In August 2001, the Telecommunications Market Commission approved modifications to the Interconnection Offer Framework, which include among other things, new interconnection prices that are between 20% and 30% below previously existing interconnection prices. Consequently, on September 11, 2001, Telefónica de España filed a petition with the Telecommunications Market Commission against the new interconnection prices, claiming that they are below Telefónica de España’s actual costs, as measured in accordance with accounting criteria approved by the Telecommunications Market Commission. On November 2, 2001, the Telecommunications Market Commission dismissed Telefónica de España’s petition, except with respect to interconnection rates in connection with Internet

access. As a result, Telefónica de España is seeking relief through administrative litigation. See “—Interconnection Prices”.

The modifications to the Interconnection Offer Framework approved in August 2001 provide for interconnection based on capacity as well as time. In early 2002, the Telecommunications Market Commission introduced further modifications to the Interconnection Offer Framework with respect to intelligent network services and the establishment of prices for the interconnection of circuits, which were reduced by approximately 25%.

*Service Standards.* Quality of service standards are governed by the state contract of 1991, the General Law on Telecommunications, the Ministerial Order dated October 14, 1999 on Quality and the Ministerial Order dated December 21, 2001 on Universal Service. This regulatory framework establishes quality of service standards for a range of telecommunications services, including fixed-line telephony, mobile telephony and Internet access services.

*Public Service Obligation.* The General Law on Telecommunications provides that the owners of public telecommunications networks, as well as operators rendering telecommunications services on the basis of an individual license, are subject to certain public service obligations. In addition, some of these obligations may be imposed on operators whose services require a general authorization.

The public service obligations include:

- the universal service obligation, which is elaborated in the Royal Decree of July 31, 1998
- the compulsory services obligation
- other public service obligations

The universal service obligation consists of the obligation to provide basic telephony to all end users within Spain, free telephone directory services, sufficient public pay phones throughout Spain and access to telephony services for disabled people. These services must be provided by the dominant operator in each territory, or in certain cases, by another operator, pursuant to regulations yet to be issued. As of the date of this Annual Report, we are the dominant operator in each territory and, according to the General Law on Telecommunications, we will be considered to be the dominant operator until at least 2005. If meeting the universal service obligation in a particular territory is loss-producing, all operators in that territory could be obligated to contribute to meeting this obligation through the National Fund for Universal Service.

The compulsory services obligation enables the government to appoint a telecommunications operator to provide certain essential telecommunications services, such as emergency call services and telex, telegraphic and maritime communications. We were designated as the provider of maritime communications services through April 2002, and we are currently negotiating the extension of our contract with the government pursuant to which we provide these services. We may in the future be designated as the provider of other telecommunications services. The Spanish government may establish further public service obligations to the extent that the government determines that such services are not adequately provided, are in the public interest or are necessary for national defense.

In December 2001, the Spanish government adopted a ministerial order that governs certain aspects of the universal service obligation, including among others:

- maximum time periods for the provision of initial interconnection to telecommunications networks
- requirements with respect to the guarantee of continuing fixed-line telephone service to the public
- criteria with respect to the information included in public telephone directories
- standards for the quality of service and systems for measuring the quality of services

*Terminal Equipment.* The General Law on Telecommunications provides that consumers may freely purchase or lease any terminal equipment, including telephone sets, and connect that equipment to the telecommunications network. All terminal equipment is required by the General Law on Telecommunications to meet certain technical

specifications and safety requirements and is subject to the prior approval of the Secretary of State for Telecommunications and Information Society.

*Ownership Limitations.* Pursuant to the General Law on Telecommunications, direct or indirect investments in us and Telefónica Móviles by foreign persons may not exceed 25% of our and its respective share capital unless otherwise provided for by the applicable international treaties or agreements, including the Fourth Protocol of the General Agreement on Trade in Services (GATS), or authorized by the Spanish government. Pursuant to European Union directives, citizens of other European Union member states, including entities domiciled in such countries, are not considered foreign persons for the purposes of this provision. However, under Spanish law any foreign investment by non-European Union governments and state-owned and state-controlled entities (regardless of the amount of such investment) requires the Council of Ministers' prior approval unless otherwise provided for in the applicable treaties. See "Item 10—Additional Information—Exchange Controls—Exchange Controls and Other Limitations Affecting Security Holders". For purposes of computing the 25% threshold, only holdings of capital stock in excess of 5% and holdings that would entitle the foreign investor to designate a member of our or Telefónica Móviles' Board of Directors are taken into account. The 25% threshold does not apply to our subsidiaries generally. However, certain of our subsidiaries may be subject independently to similar constraints. For example, pursuant to the Private Television Law, no person may own, directly or indirectly, more than 49% of the capital stock of any private commercial television station. Antena 3 holds a private commercial television station license, and is therefore subject to this ownership limitation. Foreign persons who are not residents or citizens of a European Union member state may hold an interest in a commercial television licensee only if the member state in which such person resides, or of which such person is a citizen, permits residents and citizens of Spain to hold similar interests in such state's commercial television licensees. Foreign persons permitted to hold interests in commercial television licensees are subject to the 49% limitation described above.

#### *Cable Telecommunications*

Law 42/1995, the Cable Telecommunications Law, formerly governed the exchange of video, audio and other telecommunications over the cable telecommunications network. The Cable Telecommunications Law has been repealed by the General Law on Telecommunications, except for those provisions dealing with cable television, which remain in effect. As part of the repeal of the Cable Telecommunications Law, the licenses pursuant to which telecommunications services via cable were previously provided have been amended to authorize the provision of telecommunications services via cable under the General Law on Telecommunications.

Spain has been divided into 43 geographic regions for cable television regulatory purposes. We may commence providing cable television in all 43 regions due to the fact that the applicable 24-month waiting period has expired, so long as the technology we will use to provide the cable television services complies with the relevant regulations.

#### *Royal Decree 7/2000*

In June 2000, the government issued a new Royal Decree relating to the provision of and prices for certain telecommunication services. Under the decree, we are required, as a dominant operator, to:

- as of January 2001, facilitate segregated and shared access to our local loop pursuant to the conditions and prices established by separate ministerial orders
- as of November 1, 2000, offer 600 minutes of local calls between 6:00 p.m. and 8:00 a.m. for approximately €4.21 per month and 600 minutes of local calls during all hours for approximately €8.41 per month
- as of November 1, 2000, offer Internet access between 6:00 p.m. and 8:00 a.m. Monday through Friday and all weekend for approximately €16.53 per month

#### *Competition*

In June 1997, Retevisión, S.A. received a national license to provide fixed-line telephone services. It began providing domestic and international long-distance services in January 1998. Retevisión is controlled by a consortium consisting of Endesa, S.A., Unión Eléctrica Fenosa, S.A. and Banco Santander Central Hispano. In April 1999, the Spanish government sold its remaining 30% stake in Retevisión, completing its privatization.

Retevisión provides domestic and international long-distance services to residential and business customers in Spain. Retevisión reaches local customers by interconnecting with Telefónica de España's network pursuant to the terms of an interconnection agreement finalized in December 1997. Retevisión will have to build its own local loop in order to provide local service.

As of December 1, 1998, fixed-line public voice telephone services in Spain have been open to competition, subject to basic licensing requirements as provided for in the General Law on Telecommunications. In May 1998, the consortium Lince, comprised of France Telecom and Editel, S.A., a consortium which includes Multitel Cable, S.A. and Ferrovial Telecomunicaciones, received the third license for the provision of fixed-line telephone services in Spain. Lince commenced operations in December 1998 under the trade name UNI2. In 2001, France Telecom acquired its consortium partners' interests in Lince, as a result of which Lince is now wholly-owned by France Telecom. Although cable operators have been permitted to use their networks to provide local telephone service since January 1998, they only began to operate on a limited scale in 2000. Cable operators have acquired approximately 4% of the local telephone service market as of the date of this Annual Report.

The Ministerial Order dated September 22, 1998 sets forth the rules applicable to individual licensees for telecommunications services and networks in addition to the terms and conditions applicable to such licensees. The Ministerial Order provides for two different types of licenses for the provision of fixed-line public voice telephone services:

- *Type B license:* This license authorizes the provision of fixed-line telephone service through the establishment or operation of a fixed public telephone network by the licensee. This type of license also permits the licensee to lease its circuits to third parties. Two different categories of Type B licenses are contemplated:
  - a Type B1 license for fixed-line public voice telephone services through the establishment or operation of a fixed telephone network
  - a public Type B2 license for the provision of such services through the establishment or operation of a wireless network
- *Type A license:* This license authorizes the provision of fixed-line public voice telephone service through the use of third-party switching and transmission equipment without the corresponding obligation or right to establish and operate a network as in the case of the Type B license. The Ministerial Order CTE/601/2002 dated March 14, 2002, which modifies certain provisions of the Ministerial Order dated September 22, 1998 relating to licenses, introduced a new type of license for the provision of mobile telephony to the public (i.e., a virtual mobile operator), as a result of which there are now two categories of Type A licenses:
  - a Type A1 license for the provision of fixed-line public telephone voice services
  - a Type A2 license for the provision of public mobile telephone services

In addition, a third type of license, a Type C license, authorizes the establishment or operation of public networks, but the holder of such license may not provide fixed-line telephone services to the public. Type C licensees will compete with Telefónica de España in providing network access to Type A and B licensees.

At January 2, 2002, the following licenses had been granted:

- 45 Type A licenses
- 17 Type B1 national licenses
- 58 Type B1 restricted licenses
- 6 Type B2 licenses
- 123 Type C1 licenses

- 31 Type C2 licenses

The government has also granted 75 licenses to the cable operators formerly operating under concessions. Each of these operators received Type B1 licenses.

Telefónica de España is currently the only significant provider of comprehensive local service. This is expected to change gradually as cable operators develop their networks. In addition, in March 2000, the government issued six new licenses (in addition to those previously awarded to Retevisión and Lince) for the provision of local multipoint distribution services (LMDS), and the new licensees have begun to deploy their networks. The new licensees are expected to compete with Telefónica de España in the local access market.

Pursuant to a Royal Decree adopted in December 2000, Telefónica de España is required to implement local loop unbundling, line sharing and sub loop unbundling. Local loop unbundling enables other telecommunications operators to provide telecommunications services, including DSL-type services, to end customers using Telefónica de España's existing local loop (i.e., the connections between the customers' premises and the exchange) to connect with their customers. Other operators may install their own equipment either in Telefónica de España's exchanges or in nearby buildings to provide this service. Telefónica de España has offered local loop unbundling since January 2001. Line sharing similarly enables other telecommunications operators to provide telecommunications services using a high frequency portion of Telefónica de España's copper loop on an unbundled basis. Therefore, shared access to the local loop enables a consumer to retain Telefónica de España for voice services and use a competing operator for high speed data services. Telefónica de España introduced line sharing in January 2001.

In January 2001, Telefónica de España published its local loop unbundling offer. The tariffs were initially approved by the Delegate Commission for Economic Affairs of the Spanish government and later revised by the Telecommunications Market Commission in certain respects. The monthly tariff for direct access to the local loop is €12.6, the monthly tariff for shared access is €4.8 and the monthly tariff for indirect access is between €22 and €90 depending on the speed of the connection.

As of the date of this Annual Report, there has been limited demand for direct and shared access to Telefónica de España's local loop. The greatest demand has been for indirect access to the local loop for the provision of data transmission services, particularly Internet access. In April 2002, there were more than 500,000 indirect access connections, approximately 100,000 of which were maintained by competitors of Telefónica de España.

Competition in domestic and international long-distance services, particularly in the residential segment, is based on access through interconnection with Telefónica de España. Since 2001, Telefónica de España's customers have been able to select alternative providers of domestic and international long-distance services without having to dial a designated code prior to making each call. Preselection allows customers to choose their preferred local, long-distance, international long-distance and fixed-to-mobile carrier. As of December 31, 2001, 1,342,854 Spanish customers had preselected alternative providers of one or more services. Approximately 844,000 of these customers had preselected alternative providers for all services (local, long-distance, data services and Internet access).

Telefónica de España also faces indirect competition in international long-distance services from a number of sources, including calling cards, call-back services and call rerouting by other international operators. In addition, Telefónica de España competes with a number of international operators for the provision of closed user group communications services to multinational and large corporate customers and with a number of providers of data transmission services.

Competition in the market for fixed-line public voice telephone services is likely to be based on such distinct factors as:

- the financial strength and operating capacity of competitors
- market conditions, applicable Spanish and European Union regulations with respect to telecommunications services and basic telecommunications infrastructure
- regulations in effect with respect to tariff structures and interconnection rates
- the effectiveness of our efforts to withstand increased competition

Because our capacity to compete will be affected by factors not fully within our control, we cannot predict the degree of any resulting adverse effect on our business and results of operations.

Telefónica de España is fortifying its ability to compete in fixed-line telecommunications services by:

- improving its customer service
- expanding its catalog of products and services and improving the quality of its services
- modernizing its network infrastructure and management systems
- streamlining its investments
- containing costs, particularly personnel expenses which have been reduced significantly during the past several years through workforce reductions

### ***The Tariff Structure and Pricing for Principal Services***

#### *Tariff Structure*

The state contract established a structure for tariffs and regulated prices intended to ensure the overall financial balance under the contract while safeguarding the principle of universality in the rendering of services. In this context, historically, Telefónica de España's rates were structured so that local telephone services and access lines were subsidized by domestic long-distance and international services. Under the framework of the state contract and prior to the adoption of the General Law on Telecommunications, rates for basic telephone service were approved by the Spanish government at the proposal of the Ministry of Science and Technology and, since the creation of the Telecommunications Market Commission, after a hearing of the Telecommunications Market Commission.

The General Law on Telecommunications established in principle the freedom of telecommunications operators to set tariffs. However, it also provided that the Delegate Commission for Economic Affairs, at the proposal of the Ministry of Development and after a hearing of the Telecommunications Market Commission, could establish fixed tariffs, maximum or minimum tariffs, or the criteria by which tariffs are established, taking into account the actual costs of rendering the services and the degree of competition in the market for the relevant services.

The General Law on Telecommunications also recognized the existence of an imbalance in the rates in effect as of the date of its publication and the need to rebalance the rates, as well as the possibility of compensating the dominant operator (i.e., Telefónica de España) for the access deficit which may result from the existing rate imbalance. In view of the rate imbalance, the Ministerial Order of July 31, 1998 established new prices for basic telephone services and approved a plan for discounting principal services. Per-line monthly charges and local tariffs were increased by an average of 16% and 13%, respectively, while prices for provincial, interprovincial and international long-distance calls were decreased by 5%, 15% and 12%, respectively.

We believed that the then-existing rate imbalance was not offset by the prices established in the Ministerial Order of July 31, 1998, which we considered to have been only the first step in the rate rebalancing required for a fully competitive market. In October 1998, the Spanish government adopted a Ministerial Order which approved the interconnection offer framework proposed by the Telecommunications Market Commission. This Ministerial Order of October 29, 1998 also granted to the Ministry of Development the authority to determine how to compensate Telefónica de España for its access deficit. Accordingly, we presented to the Spanish government an estimate of our access deficit and sought further tariff adjustments in order to avoid harming our competitive position. See “—Regulation—The General Law on Telecommunications—Tariffs”.

In 1999, tariffs for local calls, domestic and international long-distance calls and fixed-to-mobile tariffs continued to decrease through the adoption of Decree-Law 6/99, issued in April 1999, and Decree 16/99, issued in October 1999. Decree 16/99 was adopted in order to combat inflation and to foster competition. Decree 16/99 nevertheless featured a rate rebalancing measure which provided for three separate increases of €0.60 each in the per-line monthly charge, which increases took effect in August 2000, March 2001 and August 2001.

The Urgent Measures Decree Law of April 16, 1999 granted jurisdiction to the Ministry of Development to develop a new framework for the regulation of Telefónica de España's prices. During a transitional period, these



prices will be subject to price ceilings, also known as “price caps”, that may be revised on an annual basis. Accordingly, the Ministerial Order of July 31, 2000, established new tariffs for fixed-line telephone services, fixed-to-mobile calls and leased lines, featuring limits on annual price increases for these services during 2001 and 2002. In May 2001, the period during which the “price caps” would apply was extended through 2003 by the Ministerial Order of May 10, 2001.

In addition, in May 2001, the following measures adopted by the Delegate Commission for Economic Affairs of the Spanish government at its meeting in April 2001 became effective. Among other things, the Delegate Commission for Economic Affairs approved the following rate rebalancing measures, which we believe will eliminate the access deficit by 2003:

- aggregate tariff reductions of 14.3% through 2003, due in part to the following reductions in the consumer price index percentage increases per year: a 9 percentage point reduction in 2001, an 8 percentage point reduction in 2002 and a 4 percentage point reduction in 2003
- an increase in the monthly subscription rate to €12.62 in 2003
- the elimination of mandatory reductions for fixed-to-mobile tariffs in 2003

Additionally, the Delegate Commission for Economic Affairs of the Spanish government approved:

- the establishment of a two-month period for the review and approval of discount plans relating to Internet connection, service packages, subscription fees, metropolitan service and discounts of more than 25% for interprovincial and international long-distance services and the approval of new services
- the reduction in the time period for the communication of prices to 10 days from 15 days and the “price cap” to 25 days from 30 days
- the introduction of more flexibility in the approval of discount plans relating to provincial, interprovincial and international long-distance services, including the reduction of the approval period to 25 days if the discounts are less than 15%
- the postponement to January 1, 2002 of the change in billing for public pay telephones to seconds from minutes

#### *Pricing for Principal Services*

In 2001, the first year in which the “price cap” mechanism was applied, prices for Telefónica de España’s services were significantly reduced. For example, the price per minute for

- provincial and interprovincial calls each decreased by an aggregate of 30.0%
- international long-distance calls decreased by an aggregate of 19.9%

In addition, the price per minute for fixed-to-mobile calls terminating in Telefónica Móviles’ networks decreased by an aggregate of approximately 14.4%.

The tables below show the tariffs in effect for Telefónica de España’s principal services at year-end 2001 and at or for the other periods indicated. The prices at year-end 2001 are the nominal prices set by Telefónica de España in accordance with the “price cap” mechanism. Telefónica de España may apply discounts to these prices through calling plans which have been approved by the regulatory authorities.

The following table sets forth fees (excluding value-added taxes) for access to Telefónica de España’s most common services at the dates indicated.

Rate Category	At December 31,		
	1999	2000	2001
		(euro)	
<b>Connection fee:</b>			
Individual telephone line and integrated service			
digital network link.....	127.72	127.72	95.00
Primary access .....	3,606.07	3,606.07	3,606.07
Basic access .....	168.28	168.28	168.28
<b>Monthly subscription fee:</b>			
Individual telephone line.....	8.67	9.27	10.47
Integrated service digital network:			
Primary access .....	342.58	342.58	342.58
Basic access .....	22.84	22.84	22.84
4 Km 64KB/s digital circuit.....	263.06	263.06	255.31

On January 1, 2002, the monthly subscription fee for individual telephone lines increased approximately 11.5% to €11.68 in accordance with the “price cap” mechanism.

The table below sets forth Telefónica de España’s pricing structure at December 31, 2001 for local and domestic long-distance calls.

	Connection Charge	Euro cents for Three-Minute Calls(1)(2)	
	(euro cents)	Standard Rate(3)	Reduced Rate(4)
Local .....	6.85(5)	7.65	7.18
Provincial .....	8.33	25.24	20.41
Interprovincial.....	8.33	39.72	27.05

- (1) Includes call connection charge.
- (2) Calls are billed per second.
- (3) For local calls weekdays from 8 a.m. to 6 p.m., and for provincial and interprovincial calls from 8 a.m. to 8 p.m. on weekdays.
- (4) For remaining time periods and national holidays.
- (5) Includes 160 seconds of talk time.

As of January 1, 2002, the price per minute for provincial calls during business hours (i.e., 8:00 a.m. to 8:00 p.m.) on weekdays decreased approximately 14.7%, and interprovincial calls during business hours on weekdays decreased approximately 19.6%. As of that date, during other weekday times and weekends, the price per minute for provincial calls decreased approximately 8.1%, and the price per minute for interprovincial calls decreased approximately 5.0%.

During 2001, prices for fixed-to-mobile calls decreased an average of 13.3%. The following table sets forth prices at December 31, 2001 for fixed-to-mobile calls originating in Telefónica de España’s network and terminating in the respective networks of the two dominant operators, Telefónica Móviles and Vodafone.

Network	Connection Charge	Euro cents Per Minute(1)		
	(euro cents)	Tariff A(2)	Tariff B(3)	Tariff C(3)
Telefónica Móviles .....	6.85	23.25	23.25	13.22
Vodafone.....	6.85	26.25	25.54	13.22

- (1) First minute is billed in full. Subsequent minutes are billed per second.
- (2) For weekday calls from 8 a.m. to 10 p.m. and Saturdays from 8 a.m. to 2 p.m.
- (3) For remaining time periods and national holidays.

The table below sets forth Telefónica de España’s average prices for a three-minute international call to the indicated regions at peak hours at the dates specified.

	At December 31,					
	1999		2000		2001	
	Standard Rates(1)(2)	Discount Rates(1)(3)	Standard Rates(1)(2)	Discount Rates(1)(3)	Standard Rates(1)	Discount Rates
	(euro)					
Western Europe.....	1.02	0.91	1.02	0.91	0.65	n.a.
Rest of Europe and North Africa .....	1.71	1.42	1.71	1.42	1.37	n.a.
United States.....	1.18	1.09	1.18	1.09	0.65	n.a.
Latin America .....	2.45	2.09	2.45	2.09	1.87	n.a.
Japan and Australia.....	3.22	2.95	3.22	2.95	2.93	n.a.
Rest of the world.....	3.62	3.29	3.62	3.29	3.29	n.a.

- (1) Includes flat connection charge.
- (2) Applies weekdays from 8 a.m. to 8 p.m.
- (3) Applies weekdays from 8 p.m. to 8 a.m., weekends and national holidays.

Telefónica de España's marketing efforts in response to competition have focused on quality of service and relied on discount plans and the introduction of new services in order to increase consumption. Accordingly, since 1998, Telefónica de España has introduced a number of discount plans for its residential and business segment customers. During 2001, the number of calling plans subscribed by Telefónica de España's customers increased by 1,372,089 to 15,517,153 at December 31, 2001. Because the plans are not necessarily exclusive, the same customer can take advantage of more than one plan. Each discount plan must be submitted by Telefónica de España to the regulatory agency for prior administrative approval.

The following table sets forth the composition of Telefónica de España's revenues for 1999, 2000 and 2001 for the categories shown below.

	Percentage of Telefónica de España's Revenue		
	1999	2000	2001
	(Percentages)		
Monthly subscription fee and connection fee .....	32.9	35.3	37.0
Local calls(1) .....	17.4	18.1	16.5
Provincial calls.....	6.2	5.8	3.8
Interprovincial calls .....	12.8	10.6	7.2
International calls(2) .....	7.3	11.1	10.2
Fixed-to-mobile .....	14.5	16.3	15.0
Other(3).....	8.9	2.8	10.3

- (1) Metropolitan calls and calls to access the Internet.
- (2) Includes incoming international calls.
- (3) Includes sales of terminals, surcharges from calls placed from public pay telephones, intelligent network calls, maritime service and other revenues, deducting discounts in connection with calling plans.

During 1999, revenues from interprovincial and international calls were adversely affected by increased competition and discounted pricing. The trend continued in 2000 with respect to provincial and interprovincial calls, but revenues from international calls improved in 2000 due to a strong increase in traffic. In 2001, revenues from monthly subscription fees increased relative to revenues from network traffic. In addition, other revenues increased as a percentage of total revenues. These revenues include principally the sale of terminals, services to other telecommunications operators and other traffic-related revenues such as mobile-to-fixed traffic, international carrier services and interconnection charges. Since the beginning of 1999, following the introduction of competition, Telefónica de España has experienced some loss of market share for provincial and fixed-to-mobile calls.

#### *Comparative Pricing Information*

The table below provides comparative monthly subscription fee pricing information (excluding value-added taxes) with respect to the other principal European operators at December 31, 2001.

	Telefónica	Deutsche Telekom	France Telecom	Telecom Italia	British Telecom(1)
			(euro)		
Residential .....	10.47	10.94	10.49	10.69	14.68
Business .....	10.47	10.94	12.65	14.62	22.32

Source: Eurodata, Tarifica and the operators.

(1) Prices translated into euro from British pounds at the average exchange rate for December 2001.

The table below shows the prices (excluding value-added taxes) for three minute calls during business hours of other principal European operators at December 31, 2001.

	Telefónica	Deutsche Telekom	France Telecom	Telecom Italia	British Telecom(1)
			(euro)		
Local .....	0.08	0.11	0.13	0.10	0.17
Domestic long-distance.....	0.40	0.32	0.27	0.35	0.33
International long-distance.....	0.65	0.32	0.62	0.80	1.16

Source: Eurodata, Tarifica and the operators.

(1) Prices translated into euro from British pounds at the average exchange rate for December 2001.

The table above shows that rates charged by Telefónica de España are generally higher than those charged by the other principal European operators for domestic long-distance calls and lower for local calls. This reflects the failure to complete the rate rebalancing prior to the liberalization of the fixed-line telecommunications market in accordance with European Union directives. Nevertheless, the prices Telefónica de España charges for international long-distance calls and its monthly access line subscription fee are now more in line with the median prices and fees charged by the other principal European operators as a result of the rate rebalancing measures adopted by the Spanish government in 2001.

### **Interconnection Prices**

Under the General Law on Telecommunications, interconnection prices may be freely negotiated between telecommunications operators. However, prices charged by Telefónica de España, as the dominant operator, are determined by the Interconnection Offer Framework, which was initially proposed by us in 1998 and subsequently modified and approved by the Ministry of Science and Technology. Under our proposal, interconnection prices charged to Telefónica de España's competitors were consistent with Telefónica de España's costs. However, the Ministerial Order dated October 29, 1998, which approved the Interconnection Offer Framework, and its subsequent amendments or modifications, provide for interconnection prices that are below Telefónica de España's actual costs. In addition, pursuant to a Ministerial Order dated November 26, 1998, interconnection prices charged to wireless operators for terminating calls in Telefónica de España's network were brought in line with those approved for the fixed-line operators, effective as of July 1, 1999. Because Telefónica de España continues to provide interconnection services to its competitors at prices below its own costs, Telefónica de España is not able to compete as effectively since the prices these companies can therefore charge their customers may be below that which Telefónica de España charges its customers. This has contributed to Telefónica de España's loss of market share for such services since 1999.

The table below sets forth interconnection prices per minute for switched traffic established by the Ministerial Order dated October 29, 1998. These prices, which have been converted into euro at the irrevocably-fixed rate of exchange as of January 1, 1999, were in effect through June 16, 2000.

	Peak Rate(1)	Standard Rate(2)	Discounted Rate(3)
	(hundredths of euro)		
<b>Type B licenses:</b>			
Local .....	0.99	0.99	0.63
Single transit(4).....	1.59	1.39	0.97
Double transit(5)(6) .....	3.07	2.67	1.87
<b>Type A licenses:</b>			

	<u>Peak Rate(1)</u>	<u>Standard Rate(2)</u>	<u>Discounted Rate(3)</u>
		(hundredths of euro)	
Single transit(4).....	2.07	1.80	1.26
Double transit(5).....	3.99	3.47	2.43

- (1) Applies weekdays and Saturdays during peak hours.
- (2) Applies weekdays during off-peak hours.
- (3) Applies Sundays and national holidays, Saturdays (except peak hours) and other weekdays at night.
- (4) Principally provincial service.
- (5) Principally interprovincial service.
- (6) Applies only to operators with a Type B national license.

On May 25, 2000, the Telecommunications Market Commission approved new interconnection tariffs, which became effective on June 17, 2000, and which established uniform interconnection tariffs for operators with Type A and B licenses. These tariffs, which were in effect through August 18, 2001, are set forth below.

	<u>Interconnection Tariffs (Access and Termination) per minute</u>	
	<u>Standard Rate(1)</u>	<u>Discounted Rate(2)</u>
	(hundredths of euro)	
Local .....	0.90	0.63
Single transit .....	1.50	1.17
Double transit.....	2.16	1.86

	<u>Interconnection Tariffs (Transit) per minute</u>	
	<u>Standard Rate(1)</u>	<u>Discounted Rate(2)</u>
	(hundredths of euro)	
Unicentral .....	0.41	0.32
National.....	1.86	1.45
National with local extension.....	2.16	1.86

- (1) Applies weekdays from 8:00 a.m. to 8:00 p.m.
- (2) Applies on Saturdays, Sundays and national holidays, and weekdays from 8:00 p.m. to 8:00 a.m.

On August 9, 2001, the Telecommunications Market Commission approved new interconnection prices which include

- volume discounts
- new interconnection rates for local traffic
- interconnection rates in connection with flat rate Internet access plans
- interconnection rates based on capacity rather than time

The interconnection prices approved by the Telecommunications Market Commission are between 20% and 30% below previously existing interconnection prices. Consequently, on September 11, 2001, Telefónica de España filed a petition with the Telecommunications Market Commission against the new interconnection prices, claiming that they are below Telefónica de España's actual costs, as measured in accordance with accounting criteria approved by the Telecommunications Market Commission. On November 2, 2001, the Telecommunications Market Commission dismissed Telefónica de España's petition, except with respect to interconnection prices in connection with Internet access. As a result, Telefónica de España is seeking relief through administrative litigation.

The tables below set forth the new interconnection prices approved by the Telecommunications Market Commission on August 9, 2001, which became effective on August 19, 2001.

<b>Interconnection Tariffs (Access and Termination) per minute</b>		
	<b>Standard Rate(1)</b>	<b>Discounted Rate(2)</b>
(hundredths of euro)		
Local .....	0.76	0.46
Single transit .....	1.16	0.70
Double transit.....	2.22	1.33
Metropolitan .....	1.05	0.63

<b>Interconnection Tariffs (Access and Termination) per minute</b>		
	<b>Standard Rate(1)</b>	<b>Discounted Rate(2)</b>
(hundredths of euro)		
Unicentral .....	0.42	0.23
National.....	1.91	1.04
National with local extension.....	2.22	1.33

(1) Applies weekdays from 8:00 a.m. to 8:00 p.m.

(2) Applies on Saturdays, Sundays and national holidays, and weekdays from 8:00 p.m. to 8:00 a.m.

<b>Interconnection Tariffs by Capacity per month</b>		
	<b>Price for 64 Kbps circuit</b>	<b>Price for 2 Mbps local loop</b>
(euro)		
Local .....	44.17	1,326.11
Metropolitan .....	55.83	1,675.29
Single transit .....	67.58	2,027.58
Double transit.....	129.12	3,873.80

Telefónica de España expects that the application of interconnection charges based on capacity will adversely affect its competitive position beginning in mid-2002, when it anticipates that new interconnection agreements will be entered into with its competitors based on this new pricing model.

### **Customer Service**

In order to adequately respond to the new competitive environment, we have undertaken considerable efforts since 1998 to improve the quality of our customer service. We have segmented our customers so that the specific needs of each segment could be served best. In addition, we have increased our call-center capacity to focus further on customer service. In connection with our efforts to improve customer service and meet the needs of our customers, in 2001 we introduced 103 new products and services. Most notably, we introduced a number of limited flat rate plans for various types of calls (e.g., metropolitan, provincial, interprovincial and certain international calls). Telefónica de España has also introduced a variety of Internet access plans, including flat rate Internet access plans. Together, these plans have helped mitigate Telefónica de España's loss of market share due to increased competition. In 2001, Telefónica de España has also concentrated its efforts on expanding its offering of asymmetric digital subscriber lines, or ADSL, service. At December 31, 2001, Telefónica de España was capable of providing this service through approximately 16.5 million lines, and at that date, 187,025 customers subscribed to this service, an increase of approximately 316% from year-end 2000.

The business customer service model developed by Telefónica de España, which is aimed at achieving the highest degree of efficiency in customer service, includes the following:

- A 24-hour personal customer service line for purchasing any type of product and service, as well as for handling customer queries
- The *Tiendas Telefónica* ("Telefónica stores") where customers can test and buy all of the products marketed by Telefónica

- Telefónica's "virtual" store, accessible from the Internet, which offers the ability to order and purchase online all of the services and products offered by Telefónica
- Catalog sales through which any customer can buy a product by placing a toll-free call to a commercial customer service number

Telefónica is devoting special attention to the corporate customer market, with a sales force that exclusively handles this segment and seeks customized solutions for each type of customer.

### ***Telefónica Telecomunicaciones Públicas***

Telefónica Telecomunicaciones Públicas, S.A. is a wholly-owned subsidiary of Telefónica de España, S.A. which operates pay telephones in outdoor and indoor locations, including airports, bus stations, train stations, recreational parks, hospitals and gas stations. In addition, Telefónica Telecomunicaciones Públicas:

- manages phone booths in public thoroughfares and public payphones that are contracted from Telefónica de España
- markets prepaid telephone cards
- generates revenues from advertising on public phone booths and prepaid telephone cards

Telefónica de España continues to own the public phone booths although such assets may be transferred to Telefónica Telecomunicaciones Públicas in the future.

Public telephone services on private premises are open to full competition and are not subject to price regulation. The provider is under no obligation to extend this service beyond what the provider considers to be in its business interest, and the provider is free to choose the terminal used, provided that it meets European Union specifications.

At December 31, 2001, Telefónica Telecomunicaciones Públicas had 35,476 pay telephones installed in indoor locations and 64,557 pay telephones installed in outdoor locations.

For the year ended December 31, 2001, Telefónica Telecomunicaciones Públicas sold 6.8 million prepaid cards for a net total of €51.2 million, a decrease from €70.8 million for the year ended December 31, 2000. Revenues from advertising totaled €10.2 million for the year ended December 31, 2001, a decrease from €11.20 million for the year ended December 31, 2000.

As a result of the decrease in revenues from Telefónica Telecomunicaciones Públicas' historical products and services due to increased competition from Type A and B licensees as well as from wireless communications operators and the resulting decrease in traffic, Telefónica Telecomunicaciones Públicas is attempting to diversify its business. For example, it opened a total of six Internet centers in some of the major Spanish cities in 2001.

### **Worldwide Wireless Communications Services – Telefónica Móviles**

We conduct our worldwide wireless operations principally through Telefónica Móviles. Telefónica Móviles is a leading provider of wireless communications services in Spain and Latin America and one of the ten largest wireless operators in the world, based upon its total customers at December 31, 2001. Telefónica Móviles was incorporated in February 2000 as the holding company for the Telefónica Group's wireless communications operations. In November 2000, Telefónica Móviles completed an initial public offering of approximately 8% of its ordinary shares. At December 31, 2001, Telefónica, S.A. and other Telefónica Group companies held an aggregate of 92.7% of Telefónica Móviles' outstanding share capital.

Telefónica Móviles has operating companies in Spain, Brazil, Mexico, Perú, Argentina, El Salvador and Guatemala and holds non-controlling interests in other wireless companies that it solely or jointly manages in Brazil and Morocco. Telefónica Móviles also manages the Telefónica Group's wireless operations in Chile and Puerto Rico. Telefónica Móviles has significant interests in the consortia that acquired UMTS licenses in Germany and Italy and owns wireless companies that acquired UMTS licenses in Austria and Switzerland.

The following table provides a summary overview of our wireless operations.

Country	Name of Company	Service Territory	Ownership Interest at December 31, 2001(1)	POPS (in millions)	Total Customers at December 31, 2001 (in millions)
Spain	Telefónica Móviles España ..	Nationwide	92.70%	40	16.8
Germany	Group 3G.....	Nationwide	53.02%	83	-
Italy	IPSE 2000.....	Nationwide	46.34%	58	-
Austria	3G Mobile GmbH.....	Nationwide	92.70%	8	-
Switzerland	3G Mobile AG.....	Nationwide	92.70%	7	-
Brazil	Tele Sudeste Celular.....	Rio de Janeiro/ Espírito Santo	77.17%	18	3.0
	Celular CRT .....	Rio Grande do Sul	27.44%	10	1.8
	Tele Leste Celular .....	Bahia/Sergipe	23.55%	15	0.8
Mexico	Baja Celular Mexicana	Four wireless regions (Northern Mexico)			
	Movitel del Noroeste				
	Telefonia Celular del Norte				
	Celular de Telefonía .....		92.70%(2)	21	1.2
El Salvador	Telefónica Móviles El Salvador.....	Nationwide	42.69%	7	0.2
Guatemala	Telefónica Centroamérica				
	Guatemala .....	Nationwide	47.28%	12	0.2
Morocco	Medi Telecom .....	Nationwide	28.27%	29	1.1
Perú	Telefónica Móviles Perú .....	Nationwide	90.82%	26	1.1
Argentina	Telefónica Comunicaciones Personales.....	Nationwide	90.78%	38	1.8
Chile	Telefónica Móvil(3) .....	Nationwide	43.64%	16	1.6
Puerto Rico	Newcomm Wireless Services(4).....	Intra island	n.a.	4	0.2
Total	.....		n.a.	392	29.7

- (1) Represents the ownership interest of the Telefónica Group.
- (2) Except for Movitel del Noroeste, in which we hold a 83.42% interest.
- (3) Startel, which operates under the trade name Telefónica Móvil, is a subsidiary of Compañía Telecomunicaciones de Chile in which we held a 43.6% interest at December 31, 2001 through Telefónica Internacional. Startel's operations are managed by Telefónica Móviles.
- (4) Our interest is in the form of a note convertible into up to 49.9% of the capital stock of Newcomm Wireless Services, subject to the receipt of necessary U.S. regulatory authorizations. Newcomm Wireless Services' operations are managed by Telefónica Móviles. We plan to transfer our investment in Newcomm Wireless Services, which is held through Telefónica Internacional, to Telefónica Móviles as soon as practicable.

### Services and Products

Telefónica Móviles' operating companies and managed operations offer a wide variety of wireless and related services and products to consumer and business customers. Although the products available vary from country to country, the following are Telefónica Móviles' principal services and products:

- **Wireless Voice Services.** Telefónica Móviles' principal service in all of its markets is mobile wireless telephony, and most of Telefónica Móviles' other services and products involve enhancements and additional features for its wireless customers. Telefónica Móviles offers convenient and affordable wireless service with a variety of payment plans and packages, including payment on a contract and pre-paid basis. Telefónica Móviles' networks are designed and managed to provide high quality wireless voice services throughout its markets.
- **Enhanced Calling Features.** Customers in most of Telefónica Móviles' markets now have access to a range of enhanced calling features including voice mail, call hold, call waiting, call forwarding and three-way calling. Customers may receive a number of these services bundled



with basic voice service, while other customers may choose to order them as optional supplements to their basic voice service.

- *Wireless Data Transmission.* Telefónica Móviles' networks and systems allow customers to use their handsets for data transmission, including to send messages to other customers, to receive selected information, such as news, sports scores and stock quotes and to provide wireless connectivity for devices such as laptops and personal digital assistants. These offerings are at different stages of development in each of Telefónica Móviles' markets.
- *Wireless Internet.* As part of Telefónica Móviles' strategy to become a leader in the wireless Internet sector, Telefónica Móviles offers Internet access using wireless application protocol technology in a growing number of its service areas, primarily under the *e-moción* brand. *e-moción* was the first wireless Internet access service in the Spanish language and, in Brazil, the first wireless Internet access service in Portuguese. Through wireless Internet access, Telefónica Móviles' customers are able to send and receive e-mail, browse web pages, purchase goods and services in m-commerce transactions and use Telefónica Móviles' other data services. Telefónica Móviles launched GPRS services in Spain for customers in 2001. Additionally, Terra Mobile offers services and applications through its wireless Internet portal.
- *M-payment.* On May 30, 2001, Telefónica Móviles, Banco Bilbao Vizcaya Argentaria, Banco Santander Central Hispano and Vodafone agreed to integrate their respective mobile payment systems to form a single mobile payment standard. The new payment system is an open system, which other financial institutions, wireless operators (such as Amena) and payment processing companies in Spain have joined. This system is being developed in Spain through Mobipay España, S.A. and outside Spain through Mobipay International, S.A.
- *Corporate Services.* Telefónica Móviles provides business solutions, including wireless infrastructure in offices, private networking and portals for corporate customers that provide flexible on-line billing. This market is rapidly developing in Spain through *MoviStar Corporativo 2000*, a service creating wireless virtual private networks for companies.
- *Trunking and Paging.* Telefónica Móviles provides digital wireless services for closed user groups of clients in Argentina and paging services in Spain and Guatemala.
- *Roaming.* Telefónica Móviles has roaming agreements that allow its customers to use their handsets when they are outside of their service territories, including on an international basis. Telefónica Móviles' Spanish operating company was the first operator worldwide to offer international roaming services to pre-paid customers.
- *Other Services.* Telefónica Móviles also has the technology available to provide other value-added wireless services such as location-based services and telematics. Location-based services permit the precise location of the handset to be determined by Telefónica Móviles' networks, which will permit users to receive and access information specific to such location. Telefónica Móviles believes that this technology will be widely used in fleet management, logistics, security monitoring and consumer markets. Telematics applications enable data to be collected from machines such as cars, trucks and vending machines.

### ***Telefónica Móviles' Operations***

Telefónica Móviles' operations currently are conducted in three distinct geographic areas:

- Western Europe
- Latin America
- the Mediterranean basin (Morocco).

## Western Europe

### Spain

Telefónica Móviles is the leading wireless operator in Spain with approximately 16.8 million customers at December 31, 2001.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles' operations in Spain:

	Year ended December 31,		
	1999	2000	2001
Total customers (in millions at period end) .....	9.1	13.7	16.8
Pre-paid customers (in millions at period end) .....	5.5	8.9	11.5
Average monthly revenue per customer (euro).....	44	34	31
Average monthly revenue per customer increase (decrease) compared to prior year .....	n.a.	(23)%	(9.5)%
Population in service territory (in millions at period end) .....	40	40	40

We have offered wireless services in Spain since 1982 with the launch of analog wireless services. Digital wireless services were launched in 1995 under the *MoviStar* brand name, which has since become one of the most widely recognized brands in Spain. In March 2000, having achieved the highest rating in the awards process, Telefónica Móviles was awarded a third generation wireless, or UMTS, license covering the Spanish national territory for €131 million. In 2001 Telefónica Móviles launched GPRS commercial services.

*Network and Technology.* Telefónica Móviles' licenses and concessions in Spain permit it to operate both analog and digital networks. Telefónica Móviles also holds one of four nationwide licenses for UMTS services in the country.

Telefónica Móviles' digital network in Spain is based upon the GSM standard, which has been adopted by more than 130 countries worldwide, including all member countries of the European Union. The prevalence of the GSM standard, together with Telefónica Móviles' international roaming agreements, enables its *MoviStar* customers to make and receive calls throughout Western Europe and in more than 100 countries worldwide. Telefónica Móviles' GSM-based network provides its customers with access to many of the most advanced wireless handsets and a full panoply of services and products.

Telefónica Móviles' concessions and licenses entitle it to 52 MHz of spectrum in the 900 MHz band and 26 MHz of spectrum in the DCS-1800 MHz band, which Telefónica Móviles may increase to up to 50 MHz by 2003. Telefónica Móviles believes that this spectrum is adequate for its requirements. Pursuant to the terms of Telefónica Móviles' GSM 1800 license, which provides that by December 31, 2002, the 25 MHz of spectrum must have been made available to it, Telefónica Móviles received 5 MHz from the Spanish authorities, pending receipt of the remaining 5 MHz. Under the terms of Telefónica Móviles' UMTS license, Telefónica Móviles is authorized to operate using two paired, or two-way, 15 MHz channels plus one unpaired, or one-way, 5 MHz channel.

*Regulation.* Prior to the enactment of the General Law on Telecommunications, wireless telephone services were considered to be public services and, as such, were provided pursuant to a system of administrative concessions, which granted to operators the right to provide wireless telephone services and construct and operate the networks required to do so. One of Telefónica Móviles' rights is still held in the form of an administrative concession that is governed by legislation applicable prior to the enactment of the General Law on Telecommunications. Telefónica Móviles has requested to the relevant authorities the early termination of this concession.

At present, Telefónica Móviles holds an administrative concession to provide wireless services in the analog form on the 900 MHz band. Telefónica Móviles' analog service concession expires on January 1, 2007. Under this concession, Telefónica Móviles is required to maintain quality standards and respect the principles of neutrality and non-discrimination. Telefónica Móviles is also subject to certain obligations under each of its concessions, including the payment of certain fees to the Spanish government, contributions to the universal service fund, notification of its rates, and the avoidance of cross subsidization between its services, among others.

The Ministry of Science and Technology is empowered to amend Telefónica Móviles' concession, for public interest reasons, subject to the Spanish Public Procurement Law and regulations thereunder. However, if an amendment is financially harmful to Telefónica Móviles, it may be entitled to compensation. This compensation would not, however, cover any harm resulting from the authorization of new competitors.

A concession is subject to revocation or fines and lesser sanctions, upon the occurrence of certain events such as the bankruptcy of the company, transfer of the concession without administrative authorization, failure to abide by the terms of the concession, laws or regulations or reallocation of allotted frequencies on the radioelectric spectrum (in which latter case, Telefónica Móviles would be entitled to compensation).

Telefónica Móviles holds 18 individual licenses under the General Law on Telecommunications, covering the following:

- nationwide digital services
- nationwide UMTS services
- trunking, or closed user group, services
- paging services
- fixed-line telephony

Telefónica Móviles' digital licenses expire in 2010 and 2023, its UMTS license in 2020, its trunking licenses in 2014, 2016 and 2020, its paging license in 2012 and its fixed-line license in 2019. Telefónica Móviles' licenses can be extended for at least 10 years, except its digital licenses, which may be extended for a period of five years. In March 2002, Telefónica Móviles requested to the relevant authority that its trunking licenses be terminated due to changes in technical, economic and market conditions since the licenses were granted.

Telefónica Móviles' rights and obligations under the individual licenses are similar to those under its administrative concessions, though they generally require more disclosure of rates and product information to the Spanish regulatory authorities and the public and also require Telefónica Móviles to keep separate accounts for each of its activities and services. Telefónica Móviles' licenses also impose some additional obligations, including an obligation to provide bank guarantees totaling €1,100 million to secure commitments assumed in its UMTS license application. Telefónica Móviles will forfeit all or part of these bank guarantees if it does not satisfy these assumed commitments.

In the case of Telefónica Móviles' UMTS license, Telefónica Móviles paid to the Spanish Treasury a one-time fee of €131 million in connection with the issuance of that license in 2001. The Spanish government adopted legislation imposing additional fees totaling approximately €233.3 million for the year 2001 for use of spectrum both for new UMTS licenses as well as existing analog and digital concessions and other uses. In 2001, the Spanish government adopted new legislation reducing such fees by 75% for the year 2002 and setting a framework for the determination of the amount of such fees for the next five years. In June 2002, Telefónica Móviles fulfilled the Spanish government's requirements regarding initial roll-out of its UMTS network. In addition, the Spanish government has announced that it may, when UMTS technology is a reality, award additional licenses permitting the offer of wireless services, subject to spectrum availability.

Telefónica Móviles' licenses may be amended or revoked. Telefónica Móviles' licenses may be amended only for "objective" cause, including a change in law or for "public interest" reasons. Telefónica Móviles would not be entitled to any compensation in the event of an amendment to a license. Amendments to the applicable laws may also result in changes to the obligations of a license holder. Telefónica Móviles' licenses may be revoked if it fails to comply with any of the specified obligations or commitments in these licenses as well as for reasons similar to those applicable to its administrative concessions, as discussed above. In addition, any infringements defined in the General Law on Telecommunications may result in the imposition of sanctions including fines.

Under the General Law on Telecommunications, non-European Union individuals or entities cannot own, directly or indirectly, more than 25% of Telefónica Móviles' assets or share capital, unless such ownership is permitted by authorization of the Spanish government, in cases of reciprocal treatment between Spain and a non-

European Union country, or by specific agreement between Spain and a non-European Union country. Spain has ratified the Telecoms Annex to the General Agreement on Trade in Services, or GATS, pursuant to which specific authorization will not be required so long as direct or indirect control of 25% or more of Telefónica Móviles' assets or share capital is owned by persons or entities domiciled in countries party to the Telecoms Annex to GATS. Until 2007, the Spanish government holds approval rights for specified fundamental corporate transactions affecting Telefónica Móviles and its Spanish operating company. These approval rights, which were adopted by several European governments in the context of the privatization of major national enterprises, are currently subject to challenge by the European Commission before the European Court of Justice.

*Rates.* Wireless operators are generally free to fix customer rates for the provision of services under the General Law on Telecommunications, except with respect to analog wireless services for which the Government Commission for Economic Affairs has prescribed maximum rates. In accordance with the General Law on Telecommunications, the Government Commission for Economic Affairs may prescribe temporary fixed, maximum and minimum rates, or criteria for establishing rates, based on actual costs of the services rendered and the degree of competition in the market. The Government Commission for Economic Affairs has imposed rate regulations for analog wireless services but it has not regulated rates of digital wireless services to date. The Ministry of Science and Technology is reviewing methods of promoting increased competition in the Spanish telecommunications market. We cannot assure you that the Ministry of Science and Technology will not make recommendations affecting the pricing of wireless services in Spain or other aspects of Telefónica Móviles' business.

*Interconnection.* Because Telefónica Móviles has been classified by the Telecommunications Market Commission as an operator with "significant market power" in the wireless communications and interconnection markets (a classification that is generally defined as the attainment of a market share of more than 25% measured by income tax generated by networks and services in the previous year), Telefónica Móviles is required, among other obligations, to facilitate cost-oriented interconnection rates on a non-discriminatory and transparent basis and report to the Ministry of Economy and the Ministry of Science and Technology regarding its compliance.

*Competition.* Telefónica Móviles currently has two competitors in the Spanish market for wireless communications service: Vodafone, a subsidiary of Vodafone AirTouch, and Retevisión Móvil, which operates under the trade name *Amena* and in which Endesa and Unión Fenosa have significant interests. At December 31, 2001, Telefónica Móviles' Spanish operating company had approximately 16.8 million customers. According to figures published by the Telecommunications Market Commission, in June 2001, Telefónica Móviles' Spanish operating company had a 56.1% market share. Although Telefónica Móviles anticipates that its market share will continue to decline as its competitors pursue new customers, Telefónica Móviles believes that, to date, it has been successful in preserving and expanding its advantage in terms of absolute numbers of customers and quality of average customer in terms of minutes of usage. In 2001 Telefónica Móviles' customers in Spain increased by 22%, mainly due to its customer loyalty and retention programs.

In early 2000, the Spanish government awarded four third generation wireless, or UMTS, licenses, which cover the entire country of Spain. Telefónica Móviles was awarded one of these licenses, while the others were awarded to Amena, Vodafone and the Xfera consortium, which Vivendi controls and in which Sonera has a minority stake. Telefónica Móviles' UMTS network in Spain fulfilled as of June 2002 the minimum coverage requirements of the Spanish authorities as of that date. The Spanish government has announced that it may, when UMTS technology is a reality, award additional licenses permitting the offer of wireless services, subject to spectrum availability. Telefónica Móviles is likely to seek compensation from the government if the government reallocates to new licensees spectrum previously licensed to Telefónica Móviles.

#### *Germany*

Group 3G UMTS Holding GmbH ("Group 3G") a consortium in which Telefónica Móviles holds a 57.2% interest, was awarded through its subsidiary Group 3G UMTS GmbH a UMTS license in Germany in August 2000 for a total purchase price of €8,471 million. Sonera Oy, the leading Finnish wireless communications company, holds the other 42.8% interest in Group 3G through Sonera 3G Holding B.V. Telefónica Móviles' pro rata share of the total purchase price for the UMTS license was €4,845 million.

*Business Plan.* Since the UMTS license was awarded to Group 3G in August 2000, the wireless sector and the German wireless market have experienced significant changes. In this context, Group 3G has reviewed its strategy

and business plan, adapting them to the new scenario and gaining flexibility for the future. Telefónica Móviles and Sonera have continued to revise Group 3G's business plan, in order to improve the company's financial projections.

The new strategy has been reflected in the commercial launch of operations prior to the dates initially anticipated through the provision of GSM/GPRS services under a nationwide roaming agreement with E-Plus. Group 3G expects to subsequently roll-out UMTS-based services when the UMTS technology is available, and commercially viable.

Group 3G, which operates under the brand name *Quam*, has carried out a soft commercial launch targeted at specific market segments to position its brand name and to attract and build an initial customer base. Group 3G began offering its products and services in November 2001 through a sales network with 15 proprietary stores and more than 2,000 points of sale. Group 3G has designed a multichannel distribution strategy to reach targeted segments.

Group 3G's current business plan incorporates the benefits derived from the network sharing agreement entered into with E-Plus in 2001. The agreement involves sharing radio network sites and radio equipment and area sharing of network deployment in certain areas. This agreement is expected to reduce both companies' initially estimated capital expenditures and operating expenses in UMTS-related infrastructure. Under the agreement, Group 3G will own 50% of one of the three main UMTS networks that will likely be built in Germany. Group 3G has entered into non-recourse vendor financing agreements with its UMTS suppliers in Germany, which will finance a significant portion of its capital expenditures and reduce its financial exposure.

Telefónica Móviles periodically reviews the performance of its operations in Germany to align the level of activity with its objectives.

*Concession.* Under the terms of Telefónica Móviles' nationwide UMTS license in Germany, Telefónica Móviles is authorized to operate using two paired, or two-way, 5 MHz channels to provide wireless services, including voice and data. Telefónica Móviles is also authorized to operate a single unpaired, or one-way, 5 MHz channel which can be used for wireless data applications. Telefónica Móviles' UMTS license is valid for a term of 20 years.

*Agreements.* Under its shareholders' agreement with Sonera (as amended in November 2001), upon a change of control of either party that results in that party being controlled by a competitor of the other party, a call right is triggered under which the party which was not the subject of the change of control may, provided that it holds more than 50% of Group 3G, purchase the other party's interest. Sonera has agreed to be acquired by Telia, a Swedish telecommunications company. Since Telia would qualify as a competitor of Telefónica Móviles, such acquisition would entitle Telefónica Móviles to exercise such purchase right. In addition, the shareholders' agreement provides that, if the acquiring competitor holds a UMTS license and the German regulator issues an order stating that it will revoke Group 3G's license unless the party which was the subject of the change of control divests from Group 3G, this party may, provided that it holds less than 51% of Group 3G, compel the party which was not the subject of the change of control to acquire its interest in Group 3G at fair market value, as determined by an independent expert.

In 2001, Group 3G entered into an agreement with E-Plus for the sharing of infrastructures and the division of the territory to deploy the UMTS network, which will generate significant savings in Telefónica Móviles' initially estimated investments and operating costs. Group 3G has also entered into national roaming agreements with E-Plus that have enabled the launch of GSM/GPRS services.

On April 10, 2002, Telefónica Móviles entered into agreements for the provision of UMTS infrastructure and network construction services with Ericsson and Nortel, and related non-recourse financing agreements. These agreements will provide Telefónica Móviles with a total of between €500-600 million for the period 2002-2003.

*Competition.* In addition to the license awarded to Telefónica Móviles through Group 3G, five other UMTS licenses were awarded in August 2000, including four UMTS licenses that were awarded to the incumbent wireless service providers in Germany. The other wireless service providers in Germany are:

- T-Mobil, owned by Deutsche Telekom
- Mannesmann A.G., owned by the Vodafone Group

- E-Plus, which KPN N.V. owns
- Viag Interkom, which is controlled by mmO2
- Mobilcom, owned principally by Gerhard Schmid and France Telecom

Mannensmann and T-Mobil are the two market leaders in Germany with in the aggregate over three quarters of the wireless market at December 31, 2001.

### *Italy*

The IPSE 2000 consortium, in which Telefónica Móviles holds a 45.6% interest, was awarded one of the two UMTS licenses with broadcast bandwidth in Italy in November 2000 for a total payment of €3,269 million, to which Telefónica Móviles contributed its pro rata share of €1,490 million. We have an additional indirect 4.1% interest in IPSE 2000 through our holding in Atlant, an Italian company. Telefónica Móviles' partners in this consortium include the following: Sonera, Telefónica Móviles' partner in Group 3G in Germany, which has a 12.55% interest; Banca di Roma, which has 10%; Xera, a technology company, which has 5%; Syntek, a financial company with strategic investments in the technology field, which has 4.8%; Acea, an Italian multi-utility company, which has 3.96% through Atlant; Fiat, which has 3.96% through Atlant; Montedison, which has 5%; e-planet, which has 0.5%; and 29 other partners, which have an aggregate of 4.55%.

*Business Plan.* In January 2002, the shareholders of IPSE 2000 decided to implement a business model based on UMTS technologies and services. The decision was based on prevailing market conditions. Delaying the launch of operations until UMTS is commercially viable allows IPSE 2000 to continue exploring roaming and network sharing agreements that could significantly improve IPSE 2000's business plan.

In the meantime, IPSE 2000 is reviewing its activities and structure so that they meet the needs of the new business model. IPSE 2000 has established a budget for 2002 adjusted to the new business model. The shareholders of IPSE 2000 have agreed that the company will initially be financed through shareholder loans. Telefónica Móviles' subsidiary, Telefónica Móviles España, has agreed with IPSE 2000 to loan up to €250 million to it in order to preserve its activities and permit the launching of UMTS services in Italy when the technology becomes commercially feasible. However, the smaller size and decreased activity of IPSE 2000 prior to the launch of commercial operations will limit the financing needs for the project in the short-term.

Telefónica Móviles intends to continue to manage its operations in Italy and other Western European countries in order to obtain improvements in the business plans in each country, reduce significantly the resources required, maintain the necessary flexibility to face changes in the regulatory and competitive environment and improve the optionality of the positions taken in each country.

*Concession.* Under the terms of the nationwide UMTS license which IPSE 2000 won in the auction, it will be authorized to operate using two paired, or two-way, 10 MHz channels, a further two paired 5 MHz channels and one unpaired, or single, 5 MHz channel to provide wireless services, including voice and data services. The UMTS license in Italy is valid for a term of 15 years and its extension to 20 years is underway.

*Agreements.* Under the terms of Telefónica Móviles' consortium agreement in Italy (as amended on January 30, 2002), a change of control affecting Sonera and a finding by the Italian regulator that such change of control would be prejudicial to the holding of the UMTS license and that, consequently, the person acquiring such control cannot hold an interest in the consortium, would trigger a right for Telefónica Móviles to purchase Sonera's interest and a right for Sonera to sell its interest to Telefónica Móviles, in both cases at terms agreed upon between Telefónica Móviles and Sonera at such time. In addition, Telefónica Móviles is permitted by the terms of the agreement to transfer up to 5% of its interest in IPSE 2000 to Suez Lyonnaise des Eaux.

*Competition.* In addition to the license awarded to IPSE 2000, four other UMTS licenses were awarded in November 2000, including three UMTS licenses that were awarded to the incumbent wireless service providers in Italy. The other wireless service providers in Italy are:

- Telecom Italia Mobile, owned by Telecom Italia
- Omnitel, owned by the Vodafone Group

- Wind, owned by Enel, France Telecom and a consortium consisting of Tiscali, Hutchinson and CIR
- H3G, owned by Hutchinson Whampoa and other shareholders

Telecom Italia Mobile and Omnitel are the two market leaders in Italy with in the aggregate over three quarters of the wireless market at December 31, 2001.

#### *Austria*

On November 2, 2000, Telefónica Móviles was awarded a UMTS license in Austria at a cost of €117 million. Telefónica Móviles holds a 100% interest in this license.

*Business Plan.* Given the geographical proximity, Telefónica Móviles is currently analyzing the possibility of managing its activities in this country with its German operations to achieve synergies. Telefónica Móviles is waiting to progress with roaming and network sharing agreements to assess the advisability of launching commercial operations. Telefónica Móviles intends to continue to manage its operations in Austria and other Western European countries in order to obtain improvements in the business plans in each country, reduce significantly the resources required, maintain the necessary flexibility to face changes in the regulatory and competitive environment and improve the optionality of the positions taken in each country.

*Concession.* Under the terms of the UMTS license, Telefónica Móviles is authorized to operate two sets of two paired 5 MHz channels to provide wireless services in Austria.

*Competition.* In addition to the UMTS license awarded to Telefónica Móviles, six other UMTS licenses were awarded in November 2000, including three licenses that were awarded to incumbent wireless service providers in Austria. The principal wireless service providers are:

- Mobilkom, owned by Austria Telecom and Telecom Italia
- max.mobil, owned by Deutsche Telekom through T-Mobil
- Connect Austria/One, owned by Viag, Orange, TeleDanmark, Telenor and other shareholders
- tele.ring, owned by Western Wireless
- Hutchinson 3G, owned by Hutchinson Whampoa, NTT DoCoMo and KPN

At December 31, 2001, Mobilkom and max.mobil were the two market leaders within the aggregate over three quarters of the wireless market.

#### *Switzerland*

In January 2001, Telefónica Móviles was awarded, through 3G Mobile AG, following an auction process, a UMTS license in Switzerland for a total payment of €32.5 million.

*Business Plan.* Given the geographic proximity, Telefónica Móviles is currently analyzing the possibility of managing its activities in this country with its German operations to achieve synergies. Telefónica Móviles is waiting to progress with roaming and network sharing agreements to assess the advisability of launching commercial operations. Telefónica Móviles intends to continue to manage its operations in Switzerland and other Western European countries in order to obtain improvements in the business plans in each country, reduce significantly the resources required, maintain the necessary flexibility to face changes in the regulatory and competitive environment and improve the optionality of the positions taken in each country.

*Concession.* Under the terms of the UMTS license, Telefónica Móviles is authorized to operate using two sets of two paired 15 MHz channels to provide wireless services in Switzerland. Telefónica Móviles is also authorized to operate a single unpaired, or one-way, 5 MHz channel which can be used for wireless data applications.

*Competition.* In addition to the license awarded to Telefónica Móviles, three other licenses were awarded in January 2001 to the incumbent wireless service providers in Switzerland. These three incumbent wireless service providers are:

- Sunrise, owned by TeleDanmark and other shareholders
- Orange
- SwissCom Mobile, owned by Swisscom and the Vodafone Group

At December 31, 2001, SwissCom Mobile was the market leader in Switzerland with an estimated market share of approximately two-thirds.

### ***Latin America***

#### ***Brazil***

Telefónica Móviles is the leading wireless operator in Brazil based upon the total number of customers of companies that it controls or manages. At December 31, 2001, the companies in which Telefónica Móviles had interests and managed had approximately 5.6 million wireless customers. The population of the wireless regions in which Telefónica Móviles' operating companies and an additional company in which Telefónica Móviles had an interest in totals approximately 41 million. At December 31, 2001, Telefónica Móviles' interests in wireless companies in Brazil consist of the following:

<u>Region</u>	<u>Company</u>	<u>Interest</u>	<u>Economic Ownership Interest</u>	<u>Customers at December 31, (millions)</u>	<u>Managers</u>
Rio de Janeiro/Espírito Santo....	Tele Sudeste Celular	75.73%	82.02%	3.0	Yes
Rio Grande do Sul.....	Celular CRT	60.01%	38.20%	1.8	Yes
Bahia/Sergipe.....	Tele Leste Celular	21.89%	10.75%	0.8	Yes

Telefónica Móviles manages Telerj, Telest, Telebahía, Telergipe and Celular CRT, its five operating companies. Tele Sudeste Celular, Tele Leste Celular and Celular CRT are publicly held companies.

Brazil is one of the largest countries in the world, with a surface area of 8.5 square million kilometers and a population of approximately 173 million people. At December 31, 2001, with 28.5 million wireless subscribers, Brazil ranked first in Latin America in terms of number of wireless telephone users. At that date, Brazil had a wireless penetration rate of 16.5% and a fixed line penetration of 21%. Brazil experienced a 55% increase in the number of wireless telephone users in 2001.

The Brazilian wireless communications market is highly fragmented with 18 wireless service providers operating under wireless licenses at December 2001. Nine of these wireless operators are former incumbent operators of which eight were created in the 1998 privatization of Telebrás, the former Brazilian state-sponsored monopoly telecommunications provider.

*Agreement with Portugal Telecom.* On January 23, 2001, we, Telefónica Móviles, S.A., Portugal Telecom and PT Moveis, S.G.P. agreed to create a joint venture to consolidate our wireless businesses in Brazil with those of Portugal Telecom. Our goal is to create the leading wireless operator in Brazil, benefiting from expected synergies, enhanced market positioning and improved valuations derived from the combination of our wireless businesses. If fully consummated, including the anticipated contribution of Telefónica Móviles' interest in Tele Leste Celular as discussed below, the joint venture will be the leading wireless operator in Brazil based on the total number of customers at December 31, 2001 with a total of 11.6 million controlled customers and covering a potential market of 56% of Brazil's population. Its licensed areas include five of the six largest regions in Brazil in terms of gross domestic product and regions accounting for approximately 71% of Brazil's gross domestic product.

Each of the Telefónica Group and the Portugal Telecom Group has agreed to contribute to a 50:50 joint venture certain of our respective wireless businesses in Brazil, including interests in operating companies and holding companies that own cellular or wireless licenses in Brazil as well as other assets or business that are operated for the benefit of those companies. The wireless assets to be contributed by the Telefónica Group include our direct and



indirect interests in Tele Sudeste Celular Participações S.A. , Celular CRT Participações S.A and Tele Leste Celular Participações S.A. The wireless assets to be contributed by Portugal Telecom include its direct and indirect interests in Telesp Celular S.A. and Global Telecom S.A. If there is a difference in the value of the contributions in-kind represented by the wireless businesses contributed by the Telefónica Group and the Portugal Telecom group, the party whose contribution in-kind is of a lower value will contribute cash to make up such difference.

The consummation of the joint venture is subject to significant regulatory approvals, including the approval of Anatel, the Brazilian telecommunications commission. We cannot assure you that we will obtain the necessary approvals or that the failure to obtain these approvals will not have a material adverse effect on our results of operations. In addition, we, Telefónica Móviles, S.A. and Portugal Telecom are currently negotiating definitive documentation relating to the joint venture. This definitive documentation may contain provisions or obligations different from or in addition to those of the joint venture framework agreement.

*Agreement with Iberdrola.* On April 15, 2001, Telefónica, S.A. entered into an agreement with Iberdrola, S.A. and certain of its affiliates pursuant to which Telefónica, S.A. acquired in December 2001 and March 2002 in exchange for shares of Telefónica, S.A., the Iberdrola group's shares in the Brazilian wireless operators, or the holding companies that control such wireless operators, in which we and Iberdrola each participate. In accordance with this agreement, Telefónica, S.A. acquired:

- 7% of TBS Celular Participações S.A., the holding company that controls Celular CRT Participações S.A.
- 7% of SudesteCel Participações S.A., the holding company that controls Tele Sudeste Celular Participações S.A., as well as an additional interest in Tele Sudeste Celular Participações S.A.
- 62% of Iberoleste Participações S.A., the holding company that controls Tele Leste Celular Participações S.A., as well as an additional direct interest of 3.38% of Tele Leste Celular Participações S.A.

In May 2002, we transferred the shares in the Brazilian wireless operators that we acquired from Iberdrola, S.A. to Telefónica Móviles in exchange for 26,801,494 Telefónica Móviles ordinary shares. We expect Telefónica Móviles to contribute the shares it acquired from us to the joint venture with Portugal Telecom.

*Rio de Janeiro/Espírito Santo—Tele Sudeste Celular Participações S.A.*

Telefónica Móviles is the leading wireless operator in the Rio de Janeiro/Espírito Santo region of Brazil with approximately 3.0 million customers at December 31, 2001, which represents one million customers more than its competitor. Telefónica Móviles' operations in the region are conducted through Telerj Celular S.A. and Telest Celular S.A., the two wholly-owned operating subsidiaries of Tele Sudeste Celular Participações S.A. and Tele Sudeste Celular, which is Telefónica Móviles' 83.56%-owned subsidiary.

The remaining ownership interest in Tele Sudeste Celular is held, indirectly, by Itochu Corporation and NTT DoCoMo, Inc., as well as other minority shareholders. Telefónica Móviles holds its ownership interest in Tele Sudeste directly, as well as through Sudestecel, a consortium that it controls, and through Tagilo Participações, S.A., one of Telefónica Móviles' wholly-owned subsidiaries. Telefónica Móviles is subject to a shareholders' agreement with Itochu Corporation and NTT DoCoMo.

Telefónica Móviles manages Tele Sudeste Celular's two operating subsidiaries in exchange for an annual fee of 1% of its net revenues from wireless operations.

The following table presents, at the dates and for the years indicated, selected statistical data relating to Telefónica Móviles' operations in Rio de Janeiro/ Espírito Santo:

	Year ended December 31,		
	1999	2000	2001
Total customers (in millions at period end) .....	1.9	2.5	3.0
Pre-paid customers (in millions at period end) .....	0.8	1.5	2.0
Average monthly revenue per customer (euro).....	38	31	23
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency).....	n.a.	(27.8)%	(7.6)%
Population in service territory (in millions at period end) .....	17	17	18

*Network and Technology.* Telefónica Móviles' licenses in Rio de Janeiro/Espírito Santo permit it to operate both an analog network and a digital network, which is based upon the CDMA standard. Due to the absence of nationwide licenses in Brazil and current regulations restricting ownership of licenses by a single entity in multiple regions, roaming agreements within Brazil are important for operators. Telefónica Móviles' roaming agreements with other networks in Brazil and abroad enable its customers to make and receive calls throughout Brazil and in over 100 countries worldwide.

Telefónica Móviles' licenses entitle it to 25 MHz of spectrum in the 800 MHz band. Telefónica Móviles believes that this spectrum is adequate for its requirements.

Telefónica Móviles invested a total of approximately €481.4 million in building out and enhancing its network in Rio de Janeiro/Espírito Santo in 2000 and 2001.

*Competition.* Telefónica Móviles currently has one competitor in the Rio de Janeiro/Espírito Santo market for wireless communications service: Algar Telecom Leste S.A., or ATL, which is controlled by Telecom Americas Ltd. ATL began operations in December 1998 using the TDMA D-AMPS digital standard. At December 31, 2001, Telefónica Móviles's Rio de Janeiro/Espírito Santo operations had 3.0 million customers, compared to an estimated 1.8 million for ATL.

*Rio Grande do Sul—Celular CRT Participações S.A.*

Telefónica Móviles is the leading wireless operator in the Rio Grande do Sul region of Brazil through Celular CRT, S.A, in which Telefónica Móviles, directly and indirectly, holds a 38.6% equity interest but controls through its ownership of the majority of ordinary shares. The remaining ownership interest in Celular CRT is held, directly or indirectly, by us, subsidiaries of Portugal Telecom and Banco Bilbao Vizcaya Argentaria, S.A., as well as various minority shareholders. Celular CRT had approximately 1.8 million customers at December 31, 2001, representing, according to Telefónica Móviles' estimates, more than two times the number of customers of the other wireless operator in the region.

Telefónica Móviles manages Celular CRT under a Services Agreement with TBS Celular Participações, S.A., which entitles Telefónica Móviles to an annual fee of 1% of Celular CRT's net revenues, provided that Telefónica Móviles meets certain network quality standards set out in the agreement.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles' operations in Rio Grande do Sul:

	Year ended December 31,		
	1999	2000	2001
Total customers (in millions at period end) .....	1.0	1.4	1.8
Pre-paid customers (in millions at period end) .....	0.4	0.9	1.2
Average monthly revenue per customer (euro).....	32	28	20
Average monthly revenues per customer increase (decrease) compared to previous year (in local currency).....	n.a.	(23.6)%	(12.6)%
Population in service territory (in millions at period end) .....	10	10	10

*Network and Technology.* Telefónica Móviles' licenses in Rio Grande do Sul permit it to operate both an analog network and digital network, which is based upon the TDMA standard. Telefónica Móviles' roaming

agreements with other networks in Brazil and abroad enable its customers to make and receive calls throughout Brazil and in over 100 countries worldwide.

Telefónica Móviles' licenses entitle it to 25 MHz of spectrum in the 800 MHz band. Telefónica Móviles believes that this spectrum is adequate for its requirements.

*Competition.* Telefónica Móviles currently has one competitor operating in the Rio Grande do Sul market for wireless communications services: Telet S.A., which is owned by Bell Canada International, Tele Systems International and Telecom Americas, as well as other minority shareholders. At December 31, 2001, Telefónica Móviles' Rio Grande do Sul operations had approximately 1.8 million customers compared to 0.8 million for Telet. Telet began its operations in March 1999. Telefónica Móviles estimates that during 2001 the overall Rio Grande do Sul market for wireless communications increased at a rate of 30.4%.

*Bahia/Sergipe—Tele Leste Celular Participações S.A.*

Tele Leste Celular, in which Telefónica Móviles currently holds directly and indirectly a 27.71% equity interest, is the leading wireless operator in the Bahia/Sergipe region of Brazil with approximately 0.8 million customers at December 31, 2001, or, according to Telefónica Móviles' estimates, approximately 77% more customers than the other wireless operator in the region. Tele Leste Celular's operations in Bahia/Sergipe are conducted through its two operating subsidiaries, Telebahia Celular S.A. and Telergipe Celular S.A. Tele Leste Celular Participações is 21.9% owned by Iberoleste Participações S.A., an equity investment company that Telefónica Móviles wholly owns. In addition, Telefónica Móviles holds a further 2.42% through its wholly-owned subsidiary Tagilo Participações, Ltda., and the remaining 3.38% directly. Telefónica Móviles manages Tele Leste Celular's two operating subsidiaries under management agreements that entitle it to 1% of net revenues from wireless operations.

As described above, we transferred to Telefónica Móviles Iberdrola Investimentos Sociedade Unipessoal, Ltda.'s 62% interest in Iberoleste Participações, the holding company which controls Tele Leste Celular as well as an additional 3.4% interest in Tele Leste Celular Participações S.A. in March 2002. See “—Brazil—Agreement with Iberdrola” above.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Tele Leste Celular's operations in Bahia/Sergipe. Telefónica Móviles accounts for its interest in Tele Leste Celular under the equity method.

	Year ended December 31,		
	1999	2000	2001
Total customers (in millions at period end) .....	0.5	0.7	0.8
Pre-paid customers (in millions at period end) .....	0.2	0.3	0.5
Average monthly revenue per customer (euro).....	28	28	21
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	(14.5)%	(4.7)%
Population in service territory (in millions at period end) .....	15	15	15

*Network and Technology.* Tele Leste Celular operates both analog and digital networks. Tele Leste Celular's digital network is based upon the CDMA standard. Tele Leste Celular invested a total of approximately €132 million in building out and enhancing its network in Bahia/Sergipe in 2000 and 2001. At December 31, 2001, Tele Leste Celular's network consisted of four digital switching centers, 267 digital radio base stations, five analog switching centers and 273 analog base stations, giving coverage to over 62% of the population.

*Competition.* Telefónica Móviles currently has one competitor in the Bahia/Sergipe market for wireless communications service: Maxitel, which is controlled by Telecom Italia. At December 31, 2001, Tele Leste Celular operations had approximately 0.8 million customers, representing approximately 75% more customers than the other wireless operator in the region at that date.

## Perú

Telefónica Móviles, S.A.C., or Telefónica Móviles Perú, is the leading wireless operator in Perú with approximately 1.1 million customers at December 31, 2001, or approximately 62% more than the number of customers of the other three operators in the country combined.

In accordance with the resolution of the shareholders of Telefónica del Perú to divide the company along business lines, Telefónica del Perú spun-off its wireless operations in the form of shares of Telefónica Móviles, S.A.C. and its data operations in June 2001. Telefónica Móviles had agreed previously with other members of the Telefónica Group who were shareholders of Telefónica del Perú to exchange, following such spin-offs, the shares of such data operations that Telefónica Móviles received in its spin-off, as well as the shares Telefónica Móviles held in Telefónica del Perú, for the shares in Telefónica Móviles, S.A.C. that they received in its spin-off. Following the spin-off and share exchanges, and additional share purchases Telefónica Móviles holds indirectly a 97.97% interest in Telefónica Móviles, S.A.C. and does not hold any interest in such data operations or Telefónica del Perú.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles Perú.

	Year ended December 31,		
	1999	2000	2001
Total customers (in millions at period end) .....	0.7	0.9	1.1
Pre-paid customers (in millions at period end) .....	0.5	0.7	0.9
Average monthly revenue per customer (euro).....	n.a.	25	20
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	n.a.	(15.3)%
Population in service territory (in millions at period end) .....	25	26	26

*Network and Technology.* Telefónica Móviles Perú operates both analog and digital networks. Its digital network is based upon the CDMA standard. It has roaming agreements enabling Telefónica Móviles Perú's contract customers to make and receive calls in over 100 countries, including most of the Americas.

Telefónica Móviles Perú's licenses entitle it to 25 MHZ of spectrum in the 800 MHZ band. Telefónica Móviles Perú believes that this spectrum is adequate for its requirements.

*Competition.* Telefónica Móviles Perú currently has three competitors in the Peruvian market for wireless communications service: BellSouth; Stet Mobile Holdings Perú; and Nextel Perú. At December 31, 2001, Telefónica Móviles Perú had approximately 1.1 million customers, compared to approximately 420,000 customers for BellSouth, 150,000 customers for Stet Mobile Holdings Perú and 100,000 for Nextel Perú.

## Argentina

Telefónica Comunicaciones Personales S.A. is the second largest wireless operator in Argentina with approximately 1.8 million customers at December 31, 2001.

In accordance with the resolution of the shareholders of Telefónica de Argentina S.A. to divide the company along business lines, Telefónica de Argentina S.A. spun-off its wireless operations in the form of shares of Telefónica Comunicaciones Personales S.A. and its data operations in November 2001. Telefónica Móviles had agreed previously with other members of the Telefónica Group who are shareholders of Telefónica de Argentina S.A. to exchange, following such spin-offs, the shares of such data operations that it receives in the spin-off, as well as the shares Telefónica Móviles holds in Telefónica de Argentina S.A., for the shares of Telefónica Comunicaciones Personales that the other members of the Telefónica Group receive in the spin-off. Following the spin-offs and share exchanges, Telefónica Móviles holds a 97.93% interest in Telefónica Comunicaciones Personales S.A. and does not hold any interest in such data operations or Telefónica de Argentina S.A.

For a discussion of general macroeconomic conditions in Argentina, as well as the impact of the macroeconomic and political crisis in Argentina on our results of operations, see "Item 5—Operating and Financial Review and Prospects—Operating Results—Recent Developments—Argentina".

The following table presents, at the dates and for the period indicated, selected statistical data relating to Telefónica Comunicaciones Personales.

	Year ended December 31(1),		
	1999(2)	2000(2)	2001(2)
Total customers (in millions at period end) .....	1.1	1.7	1.8
Pre-paid customers (in millions at period end) .....	0.5	1.0	1.2
Average monthly revenue per customer (euro).....	n.a.	42	30
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	n.a.	(33.8)%
Population in service territory (in millions at period end) .....	37	37	37.5

- (1) In the fourth quarter of 2001, the fiscal year end of Telefónica Comunicaciones Personales was changed from September 30 to December 31. As a result, our consolidated financial statements for the year ended December 31, 2001 incorporate the financial statements of Telefónica Comunicaciones Personales for the same period. This change does not give rise to material differences.
- (2) Information for prior periods has been provided based on the 12 months ended December 31, 1999 and 2000, as the case may be.

Telefónica Comunicaciones Personales provides wireless services in each of Argentina's three service regions: Greater Buenos Aires; Southern Argentina; and Northern Argentina.

*Network and Technology.* Telefónica Comunicaciones Personales operates both analog and digital networks. Its digital network is based upon the TDMA standard. It has roaming agreements enabling its customers to make and receive calls in over 100 countries worldwide.

Telefónica Comunicaciones Personales' licenses entitle it to 12.5 MHz of spectrum in the 800 MHz band and 30 MHz of spectrum in the 1900 MHz band in Greater Buenos Aires, 25 MHz of spectrum in the 800 MHz band and 20 MHz of spectrum in the 1900 MHz band in Southern Argentina and 40 MHz of spectrum in the 1900 MHz band in Northern Argentina. Telefónica Móviles believes that Telefónica Comunicaciones Personales' spectrum is adequate for its requirements.

*Competition.* Telefónica Comunicaciones Personales is the second largest wireless operator in Argentina with approximately 1.8 million customers at December 31, 2001. Telefónica Comunicaciones Personales currently has three competitors in the Argentine market for wireless communications service, each of which provides services on a nationwide basis: Telecom Personal, which is controlled by France Telecom and Telecom Italia through Telecom Argentina, BellSouth's Movicom and CTI Móvil.

#### *Mexico*

In July 2001, we transferred to Telefónica Móviles interests in four wireless operators in Mexico, which we acquired from Motorola, Inc. in June 2001. We acquired such operators in exchange for an aggregate of U.S.\$1,835.5 million in our shares and U.S.\$10.5 million in cash, and transferred them to Telefónica Móviles in exchange for approximately 203 million of Telefónica Móviles' shares. At December 31, 2001, these operating companies had an aggregate of approximately 1.2 million wireless customers. The operating companies in Mexico, which operate primarily in the north of the country, are Baja Celular Mexicana, S.A. de C.V., or Bajacel; Movitel del Noroeste, S.A. de C.V., or Movitel; Telefonía Celular del Norte, S.A. de C.V., or Norcel; and Celular de Telefonía, S.A. de C.V., or Cedetel. Telefónica Móviles' interests in these wireless operations consist of the following:

Region	Company	Ownership Interest
Baja California/Baja California Sur/parts of Sonora.....	Bajacel	100%
Sinaloa/parts of Sonora .....	Movitel	90%
Chihuahua/Durango/parts of Coahuila.....	Norcel	100%
Nuevo León/Tamaulipas/parts of Coahuila .....	Cedetel	100%

The following table presents, at the dates and for the period indicated, selected statistical data relating to Telefónica Móviles Mexico:

	<b>July 1 to December 31, 2001</b>
Total customers (in millions at period end) .....	1.2
Pre-paid customers (in millions at period end) .....	1.0
Average monthly revenue per customer (euro).....	30
Population in service territory (in millions at period end) .....	21.3

*Network and Technology.* Telefónica Móviles Mexico offers both analog and digital networks. Its digital networks are based upon the CDMA standard. At December 31, 2001, Telefónica Móviles' digital network in Mexico consisted of 11 switching centers and 263 network sites, and its analog network sites consisted of 408 network sites, providing coverage to approximately 86% of the population.

*Acquisition of Pegaso Telecomunicaciones, S.A. de C.V.* On April 26, 2002, Telefónica Móviles signed agreements to purchase, subject to regulatory approval, 65% of Pegaso Telecomunicaciones, S.A. de C.V., a wireless operator with approximately 800,000 customers at December 31, 2001, from Sprint, Leap Wireless, Qualcomm and other financial investors. The purchase price under the agreements is comprised of \$87 million and a commitment to subscribe to 65% of a capital increase of between \$326 million and \$488 million to be carried out by Pegaso. Telefónica Móviles has also agreed to cause Pegaso to pay approximately \$586 million in existing debt obligations and any amount drawn down from \$100 million in additional interim financing provided by a third party within 30 to 60 days of the closing of the acquisition. The total value of Pegaso has been set at \$1,360 million, including existing debt obligations. Telefónica Móviles plans to contribute its entire interest in Pegaso and its current Mexican operations to a newly formed entity of which it will own between 90% and 92%, depending on the definitive amount of Pegaso's capital increase. The Burillo Group, which owns 35% of Pegaso, will own the remaining percentage. After these transactions are consummated, Telefónica Móviles will become Mexico's second-largest wireless operator, with over two million active customers and access to the entire Mexican territory through a distribution network of more than 3,500 points of sale and presence in 12 of the main Mexican cities. Pegaso operates a digital network based upon the CDMA standard and uses spectrum in the 1900 MHz band, the same technology Telefónica Móviles uses in Mexico. These factors are expected to give rise to economies of scale and synergies in aspects such as brand name, network deployment and technology or services development. The consummation of these transactions is subject to receipt of regulatory approvals and certain other conditions. The transactions are expected to close in the third or fourth quarter of 2002.

*Competition.* The Mexican wireless operators currently have a variety of competitors in the region for wireless telecommunications services, several of which are affiliated with international telecommunications companies. Its principal competitor is Telcel, which is owned by América Móvil.

#### *Chile*

Although we may elect to do so in the future, we have elected not to transfer our wireless operations in Chile to Telefónica Móviles due to business considerations relating to the minority shareholders of that operation. Telefónica Móviles instead manages our wireless operations in Chile pursuant to a management agreement.

Our Chilean wireless operator, which operates under the trade name Telefónica Móvil, is the second largest wireless operator in Chile with approximately 1.6 million customers at December 31, 2001 or 400,000 fewer customers than the leading operator.

The following table presents, at the dates and for the period indicated, selected statistical data relating to Telefónica Móvil.

	<b>Year ended December 31,</b>	
	<b>2000</b>	<b>2001</b>
Total customers (in millions at period end) .....	1.2	1.6
Pre-paid customers (in millions at period end) .....	0.9	1.2
Average monthly revenue per customer (euro).....	23	18
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	(7.9%)

	Year ended December 31,	
	2000	2001
Population in service territory (in millions at period end) .....	15.3	15.5

*Network and Technology.* Telefónica Móvil operates a fully digital nationwide network based upon the TDMA standard. It has roaming agreements enabling its contract customers to make and receive calls in over 100 countries including most of the Americas.

Telefónica Móvil's licenses entitle it to 25 MHz of spectrum in the 800 MHz band.

*Competition.* Telefónica Móvil currently has three competitors in the Chilean market for wireless communications service: Bell South, Entel, an affiliate of Telecom Italia, and Smartcom, an affiliate of Endesa, S.A.

### **Central America**

Telefónica Móviles operates in El Salvador and Guatemala through TES Holdings, S.A. and TCG Holding, S.A., respectively, two holding companies in which Telefónica Móviles participates jointly with Mesoamérica Telecom, a private fund of Central American investors. These holding companies hold Telefónica Móviles' interests in its operating companies in these countries. Telefónica Móviles' strategy is to enter the region's market as a new competitor offering state-of-the-art technology and a broad range of services.

In August 2001, Telefónica Móviles entered into an agreement with Mesotel de Costa Rica, S.A., a subsidiary of Mesoamérica Telecom, to acquire its direct and indirect interests in Telefónica Móviles El Salvador and Telefónica Centroamérica Guatemala, Telca Gestión, S.A. and Telca Gestión Guatemala, S.A., and other companies in which Telefónica Móviles has shared holdings in exchange for approximately 21.9 million of Telefónica Móviles' ordinary shares. In January 2002 Telefónica Móviles amended this agreement and acquired one-third of Mesotel de Costa Rica, S.A.'s interests in exchange for 7.3 million of Telefónica Móviles' ordinary shares. As a result of this acquisition Telefónica Móviles now holds 60.7% of Telefónica Móviles El Salvador and 67.3% of Telefónica Centroamérica Guatemala. The remaining two-thirds will be delivered by Mesotel de Costa Rica, S.A. no later than August 2, 2002, at which time Telefónica Móviles will issue and transfer the remaining 14.6 million of its ordinary shares to Mesotel de Costa Rica, S.A. Following consummation of such transaction, Telefónica Móviles will hold a 90.3% indirect interest in Telefónica Móviles El Salvador and a 100% indirect interest in Telefónica Centroamérica Guatemala.

### **El Salvador**

Telefónica Móviles is the second largest of the three wireless operators in El Salvador, with approximately 239,000 customers at December 31, 2001, or an estimated 40,000 customers fewer than the largest operator. Telefónica Móviles' operations in El Salvador are conducted through Telefónica Móviles El Salvador, S.A. de C.V., in which Telefónica Móviles indirectly holds a 46.05% interest.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles' operations in El Salvador:

	Year ended December 31,		
	1999	2000	2001
Total customers (at period end) .....	132,052	230,319	238,605
Pre-paid customers (at period end) .....	33,007	83,292	91,293
Average monthly revenue per customer (euro).....	27	29	22
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	(5.6)%	(26.1)%
Population in service territory (in millions at period end) .....	6.2	6.2	6.3

*Network and Technology.* Telefónica Móviles' digital network in El Salvador is based upon the CDMA standard. Telefónica Móviles' licenses entitle it to 25 MHz of spectrum in the 800 MHz band. During 2000 and 2001, Telefónica Móviles has invested a total of approximately €127 million in building out and enhancing its networks in El Salvador. At December 31, 2001, Telefónica Móviles' digital network in El Salvador consisted of one switching center and 130 network sites giving coverage to over 80% of the population. In August 2000, Telefónica Móviles launched wireless application protocol services in El Salvador under the *e-moción* brand name.

*Competition.* Telefónica Móviles currently competes in the El Salvador market for wireless communications service with Telemóvil, which is controlled by Millicom, and CTE Telecom which is controlled by France Telecom. At December 31, 2001, Telefónica Móviles had an approximately 35% market share of the El Salvador wireless market, compared to approximately 41% for Telemovil. Telemovil began operations in 1992, and CTE Telecom began operations in 1999. Telefónica Móviles estimates that, during 2001, the overall El Salvador market for wireless communications increased by 38%.

### ***Guatemala***

Telefónica Móviles had approximately 156,000 customers in Guatemala at December 31, 2001, representing approximately 15% of the existing wireless customers in Guatemala at that date. Telefónica Móviles' Guatemala operations are conducted through Telefónica Centroamérica Guatemala, S.A.

The following table presents, at the dates and for the periods indicated, selected statistical data relating to Telefónica Móviles' operations in Guatemala:

	<b>Year ended December 31,</b>	
	<b>2000</b>	<b>2001</b>
Total customers (at period end) .....	141,915	156,178
Pre-paid customers (at period end) .....	22,597	31,309
Average monthly revenue per customer (euro).....	25	37
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency).....	(12.1)%	(34.9)%
Population in service territory (in millions at period end) .....	12	12.3

*Network and Technology.* In Guatemala Telefónica Móviles operates a digital network, which is based upon the CDMA standard. Telefónica Móviles' licenses entitle it to 30 MHz of spectrum in the 900 MHz band. In 2000 and 2001, Telefónica Móviles invested a total of approximately €117 million in building out and enhancing its network in Guatemala. At December 31, 2001, Telefónica Móviles' digital wireless network in Guatemala consisted of two switching centers and 221 network sites giving coverage to over 76% of the population. In August 2000, Telefónica Móviles launched wireless application protocol services in Guatemala under the *e-moción* brand name.

*Competition.* Telefónica Móviles currently has three competitors in the Guatemala wireless market. At December 31, 2001, Comcel, which is controlled by Millicom, had an approximately 37% market share in Guatemala, followed by Telgua, which is controlled by Telmex, with approximately 34% and BellSouth, which commenced operations in the fourth quarter of 2000. At such date, Telefónica Móviles had an approximately 20% market share. Comcel began operations in Guatemala in 1989, and Telgua began operations in 1999. During 2001, the overall Guatemalan market for wireless communications grew by 47%.

### ***Puerto Rico***

We plan to transfer to Telefónica Móviles, after receipt of regulatory approval and resolution of a pending regulatory proceeding, our investment (through Telefónica Internacional, S.A.) in NewComm Wireless Services, Inc., a Puerto Rican wireless operator with approximately 187,000 customers at December 31, 2001. This investment has been made through several convertible securities in an aggregate amount of a U.S.\$44 million that are convertible into up to 49.9% of the capital stock of NewComm Wireless, subject to receipt of necessary U.S. regulatory authorizations. In addition, we, with a view to holding a controlling interest in NewComm Wireless Services, have entered into an agreement with ClearComm to purchase a further 0.2% interest in NewComm Wireless Services. Telefónica Móviles currently manages the day-to-day operations of NewComm Wireless under a management agreement entered into between Telefónica Internacional and NewComm Wireless.

### ***Mediterranean Basin (Morocco)***

Medi Telecom, S.A., in which Telefónica Móviles holds a 30.5% interest and shares management responsibilities, is the second largest wireless operator in Morocco with approximately 1.1 million customers at December 31, 2001, compared with an estimated approximately 1.8 million for the former monopoly telecommunications provider.



The following table presents, at the dates and for the periods indicated, selected statistical data relating to Médi Telecom:

	Year ended December 31,	
	2000	2001
Total wireless customers (in millions at period end) .....	0.50	1.1
Pre-paid customers (in millions at period end) .....	0.49	1.0
Average monthly revenue per customer (euro).....	28	22
Average monthly revenue per customer increase (decrease) compared to previous year (in local currency) .....	n.a.	(19.7)%
Population in service territory (in millions at period end) .....	29	29

*Network and Technology.* Médi Telecom’s network in Morocco is based upon the GSM standard. Telefónica Móviles’ licenses entitle us to 50 MHz spectrum in the 900 MHz band. In 2000 and 2001, Médi Telecom invested a total of approximately €400 million in building out and enhancing its digital network in Morocco. At December 31, 2001, Médi Telecom’s digital network in Morocco consisted of nine switching centers and 120 base stations giving coverage to over 80% of the population.

*Competition.* Médi Telecom currently competes with Maroc Telecom, the former state monopoly provider of all telecommunications services in Morocco. At December 31, 2001, Maroc Telecom had an estimated approximately 1.8 million customers, compared to an estimated approximately 1.1 million for Médi Telecom. Telefónica Móviles estimates that in the twelve months of Médi Telecom’s operations through December 31, 2001, the overall Moroccan market for wireless communications increased by 47%.

### **Wireless Internet and Data Initiatives**

#### *E-moción—Wireless Internet Service Provider*

In June 2000, Telefónica Móviles launched *e-moción*, its wireless Internet service provider. *E-moción* offers Telefónica Móviles’ customers wireless access to the Internet, including the ability to browse any wireless application protocol site and access to a broad and fast growing menu of links to wireless content providers, which, in the case of Spain, number more than 250 at December 31, 2001. All of Telefónica Móviles’ operating companies have launched *e-moción*.

#### *Terra Mobile—Wireless Portal*

Terra Mobile is a joint venture between Telefónica Móviles, which currently holds an 80% interest, and Terra Networks, which holds the remaining 20% interest, to create a major wireless Internet portal with presence in the United Kingdom, Germany, Spain and Brazil. In December 2001, Terra Mobile adopted a new business model focused on

- offering products and services and developing applications that take greater advantage of synergies with wireless networks
- significantly reducing costs
- concentrating on the most significant markets (i.e., Spain, Germany and the United Kingdom).

Accordingly, Terra Mobile has reorganized its global structure to concentrate its European operations on markets with larger customer bases and discontinued operations in certain smaller markets. In addition, Terra Mobile reduced its headcount by 50%. At December 31, 2001, Terra Mobile had approximately 5.8 million registered users.

### **Wireless Data Services**

*m-Payment Services.* Telefónica Móviles is working with merchants and financial institutions to develop m-payment services that will increase the use of its network.

*Mobile Payment System.* Telefónica Móviles, Banco Bilbao Vizcaya Argentaria, S.A., Banco Santander Central Hispano, S.A., Vodafone (formerly Airtel) and Amena and other financial institutions are jointly developing a new, simple, fast, low cost and secure mobile payment system under the *Mobipay* brand. See “—Services and Products” above.

## **Worldwide Audiovisual Content and Media – Admira Media**

Admira Media, formerly known as Telefónica Media, conducts our worldwide audiovisual content and media business. Admira Media is a premier producer and distributor of audiovisual content and provider of audiovisual services to the Spanish- and Portuguese-speaking world. The Admira Media group develops and distributes audiovisual content through traditional media and new technology platforms. Admira Media is divided into three business areas:

- Free-to-air television and radio
- Audiovisual content
- Pay television

### ***Free-to-air television and radio***

#### *Antena 3*

At December 31, 2001, Admira Media directly owned 47.5% of Antena 3, one of the leading private commercial television stations in Spain. In 2001, Antena 3’s operating margin was adversely affected by decreased advertising revenues as a result of soft demand in the advertising market and increased competition from TVE, another leading Spanish station. Consequently, Antena 3’s operating margin decreased to €96.5 million in 2001 from €180.3 million in 2000. In addition, Antena 3’s net profits decreased to €67.9 million in 2001 from €128.5 million in 2000. We account for our interest in Antena 3 by the equity method.

Antena 3’s objectives are three-fold:

- strengthen its leadership among private Spanish television stations, especially among the most attractive audiences for advertisers. According to market research conducted by Sofres, Antena 3 had a market share of 20.5% in 2001, which is similar to that held by the other private Spanish television stations in the free-to-air segment. In 2001, Antena 3 was the leader among viewers who are 44 years of age and under and those who are in the middle class. As a result, Antena 3 was able to capture 27.4% of the television advertising market in 2001 and improved its power ratio (i.e., its share of the television advertising market divided by its total viewer market share) to 1.34.
- improve Antena 3’s cost structure
- diversify into new areas of business such as theme channels and interactive television

The development of new audiovisual broadcasting technologies such as digital terrestrial television as well as the granting of licenses to new television operators may adversely affect Antena 3’s advertising revenues as advertisers reallocate their advertising budgets.

Antena 3 and Vía Digital entered into an agreement in April 2002 under which Antena 3 obtained the rights to broadcast certain World Cup matches, including the opening match, all matches in which Spain plays and the final. Antena 3 is the first private commercial television station in Spain to broadcast World Cup matches.

#### *Telefé*

In 1998, the Telefónica Group acquired an initial stake in Atlántida de Comunicaciones, an Argentine holding company, which owns the publishing company Atlántida and the Argentine television channels, Telefé and Televisoras Provinciales, as well as Radio Continental. In 2000, we acquired in several steps the remaining interest in Atlántida de Comunicaciones in exchange for our shares.

Telefé is the principal television network operating in the free-to-air segment in the greater Buenos Aires area. In 2001 Telefé had an estimated average audience share of 40.6% and captured an estimated 43.0% of television advertising spending in Argentina. In addition, Telefé operates seven free-to-air television stations in Argentina's interior provinces. Telefé's signal reaches over 12 million homes in Argentina through its open signal, its broadcasting affiliates and subscription television. Telefé also produces motion pictures and television programming, some of which is distributed throughout Latin America and in the United States and Europe. The free-to-air television market in Argentina depends to a significant extent on advertising revenues. The advertising market generally, and the television advertising market specifically, has been characterized by softness of demand due to the general macroeconomic and political crisis in Argentina. As a result, spending on advertising has decreased, which has had and continues to have an adverse effect on Telefé's results of operations. For a discussion of the impact of the macroeconomic and political crisis in Argentina, see "Item 5—Operating and Financial Review and Prospects—Operating Results—Recent Developments—Argentina".

#### *Azul TV*

At December 31, 2001, Admira Media held a 50.0% stake in Telearte, S.A., which is commercially known as Azul TV. Azul TV is the third largest free-to-air television network in Argentina. Admira Media must sell its stake in Azul TV by year-end 2002 in order to comply with the requirements of the Argentine Broadcasting Commission. Softness in demand in the Argentine television advertising market has had and continues to have an adverse effect on Azul TV's result of operations. For a discussion of the impact of the macroeconomic and political crisis in Argentina, see "Item 5—Operating and Financial Review and Prospects—Operating Results—Recent Developments—Argentina".

#### *Onda Cero Radio Network*

In 1999, we acquired all of the shares of Uniprex, which owns the Onda Cero radio network, and Cadena Voz de Radiofusión, S.A. These companies maintain radio network coverage through more than 200 proprietary or affiliated radio stations which carry the programming of Onda Cero Radio, Europa FM, Onda Melodía, Onda Cero Radio Internacional, Radio Voz and Onda Rambla. In 2001, according to a survey by Estudio General de Medios, Onda Cero Radio ranked second in the Spanish conventional radio station market in terms of listening audience. In July 2001, Onda Cero entered into an alliance with Radio Blanca for the development of new projects in the commercial radio segment. As a result of this agreement, Onda Cero expanded its urban coverage in the FM band to an additional 70 radio stations operated by Radio Blanca in Spain's provincial capitals. The alliance has a term of 10 years.

At the end of 2001, Admira Media entered into an agreement to sell its 100% interest in Uniprex, S.A. to Antena 3 Televisión. This acquisition by Antena 3 Televisión will permit it to achieve synergies as a result of extending Antena 3's management experience and technological advances to Onda Cero's operations, as well as from the resulting joint control of content and commercial activities. This acquisition is in the process of finalization.

#### *Radio Continental*

Admira Media owns 100.0% of Radio Continental, a chain of AM and FM radio stations in Argentina that it acquired in connection with its acquisition of Atlántida de Comunicaciones S.A. See "—Telefé" above.

#### *Audiovisual content*

##### *Endemol Entertainment*

In July 2000, we acquired 99.2% of Endemol Entertainment Holding N.V., one of Europe's leading television producers, through an exchange offer outside the United States. See "—Public Takeover Offers" below. Endemol develops and produces audiovisual programming for free-to-air television, pay television and the Internet.

##### *Telefónica Sport*

Through Telefónica Sport, Admira Media holds certain sports-related rights. In particular, Admira Media owns 70% of Euroleague Marketing which owns broadcasting, merchandising and other rights relating to Euroleague basketball pursuant to an agreement which expires at the end of the 2007/2008 season, unless terminated earlier at

the end of the 2004/2005 season by Euroleague Marketing. In addition, Admira Media has a 40% interest in Audivisual Sport which owns audiovisual rights to certain European soccer matches, which rights expire at the end of the 2002/2003 season. Audiovisual Sport offers these matches on a pay-per-view basis and also licenses the broadcast rights to other companies.

#### *Torneos y Competencias*

Torneos y Competencias, in which Admira Media held a 20% stake at December 31, 2001, holds broadcasting rights for certain Argentine soccer matches.

#### *Other Interests*

Admira Media owns a 100.0% interest in ST-Hilo which produces and transmits specialized audio channels and a 70.0% interest in Lola Films, one of Spain's leading motion picture production companies. Admira Media also holds a 25% interest in Media Park, a Spanish production company, and a 51% interest in the Venezuelan company, Rodven, S.A., which owns a record label, Líderes, and sponsors artistic events.

#### *Pay Television*

We offer direct-to-home ("DTH") satellite television service in Spain through DTS Distribuidora de Televisión Digital, S.A. ("DTS"), a joint venture along with a number of television broadcasters. DTS markets its services under the Vía Digital trademark. At December 31, 2001, Vía Digital had approximately 806,000 subscribers compared to 633,059 subscribers at December 31, 2000. For the year ended December 31, 2001, Vía Digital had operating revenues of €272.3 million and a net loss of €334.3 million compared to operating revenues of €213.0 million and a net loss of €254.0 million for the year ended December 31, 2000. In order to achieve profitability, Vía Digital must acquire a sufficient number of subscribers to offset the high cost of content in this area of business. We account for our interest in Vía Digital by the equity method.

During 1999, we increased our ownership interest in Vía Digital to 68.6%. In January 2000, Vía Digital issued additional ordinary shares. We purchased some of these shares, but fewer than our proportionate interest in the company. As a result, our interest in Vía Digital declined to 48.6%. As part of the capital increase, we gave three shareholders of Vía Digital who subscribed for the majority of the capital increase the right to require that we either repurchase, if legally permitted, or identify a buyer who will purchase, their respective interest in Vía Digital at the price paid by each of them plus interest, as provided in the agreement. In the case of one of these shareholders, we may be required to purchase its shares on June 30, 2003, while in the case of the other two shareholders we may be required to purchase their shares between June 30, 2003 and June 30, 2004.

Vía Digital offers more than 65 television broadcast channels and 30 audio channels, as well as interactive services through its nationwide DTH satellite television service. Vía Digital's programming offerings and interactive television service provide its subscribers with an integrated offering of high-quality entertainment, information and services.

In March 1999, Vía Digital acquired the exclusive rights to broadcast the United European Football Association Champions League on pay per view through the 2002/2003 season. In June 1999, Sogecable and Admira Media entered into an agreement relating to joint broadcast rights for the "National Championship Soccer League" and the "King's Cup of Spain" through the 2008-2009 season. As part of this agreement, Admira Media granted to Sogecable joint rights to broadcast the United European Football Association Champions League.

In May 2002, Admira Media entered into an agreement with Sogecable to integrate Vía Digital and Canal Satelite Digital, which is the pay television and satellite broadcast platform of Sogecable. Sogecable's shareholders include Grupo Prisa, a Spanish media company, Canal Plus France and other financial shareholders. The integration is subject to the satisfaction of certain conditions, including the approval of 100% of the shareholders of Vía Digital to subscribe a capital increase through a share exchange and the receipt of several administrative authorizations. Under the agreement, Sogecable will issue 28,981,121 new shares in exchange for the total issued and outstanding shares of Vía Digital at the date of the exchange. Existing Sogecable shareholders will own 77% of the resulting company, and existing Vía Digital shareholders, including Admira Media, will own 23% of the resulting company.

### *Telefónica Servicios Audiovisuales and Hispasat*

Telefónica Servicios Audiovisuales is the principal provider in Spain and Latin America of satellite and television audiovisual technical services and signal compression and up-links for satellites. Admira Media also holds a 17.3% interest in Hispasat, Spain's satellite communications system.

### **Other Investments**

In 1999, we acquired a 5% stake in Pearson plc for €621.4 million and sold our 20% stake in Recoletos Compañía Editorial to Pearson plc. We have announced our intention to sell our stake in Pearson plc.

### **Fixed-Line Telecommunications Services in Latin America – Telefónica Internacional**

Our fixed-line telecommunications services business in Latin America is conducted through Telefónica Internacional. The following tables set forth information with respect to the fixed-line telecommunications services provided by the telecommunications operators that are members of the Telefónica Internacional group. Information is given at December 31, 2001, unless otherwise specified.

<u>Company</u>	<u>Country</u>	<u>Population at December 31, 2001(1)</u> (millions)	<u>Principal Fixed-Line Telecommunications Services Provided</u>	<u>Competition</u>
Telecomunicações de São Paulo–TELESP	Brazil	37.4	Data transmission Basic telephony Intrastate long-distance Public telephony Value-added services	All existing telephone services in Brazil are deregulated.
Compañía de Telecomunicaciones de Chile	Chile	15.5	Basic telephony Domestic long-distance International long-distance Public telephony Leasing and sale of equipment and terminals	All existing telephone services in Chile are deregulated.
Telefónica de Argentina	Argentina	37.6	Basic telephony Domestic long-distance International long-distance Value-added services Internet Paging	All existing telephone services in Argentina are deregulated.
Telefónica del Perú	Perú	26.1	Basic telephony Domestic long-distance International long-distance Cable television Data transmission Paging	All existing telephone services in Perú are deregulated, except for new PCS licenses which have been awarded on an exclusive basis for a three-year period.
Telefónica Larga Distancia de Puerto Rico	Puerto Rico	4.0	Long-distance services	Free competition.

(1) Population of coverage area.

The following table sets forth additional information regarding the principal telecommunications operators that are members of the Telefónica Internacional group. Information is at December 31, 2001.

Company	Year Acquired	Interest	Management
Telecomunicações de São Paulo—TELESP	1998	86.7%	Telefónica Internacional manages Telesp pursuant to a management contract.
Compañía de Telecomunicaciones de Chile	1990	43.6%	Telefónica Internacional appoints a majority of board members.
Telefónica de Argentina	1990	98.0%	Telefónica Internacional controls Telefónica de Argentina through its stake in COINTEL. In addition, Telefónica Internacional manages Telefónica de Argentina pursuant to a management contract.
Telefónica del Perú	1994	97.1%	Telefónica Internacional appoints a majority of board members and manages Telefónica del Perú pursuant to a management contract.
Telefónica Larga Distancia de Puerto Rico	1992	98.0%	Telefónica Internacional appoints a majority of board members.

### *Telecomunicações de São Paulo—Telesp*

Telesp provides fixed-line and other telecommunications services in the Brazilian state of São Paulo under concessions and licenses from Brazil’s federal government. We acquired our initial interest in Telesp in 1998 as part of a consortium that acquired a majority interest in Telesp in connection with the privatization of Telebrás, the former Brazilian state-owned telecommunications monopoly. In mid-2000, we completed an exchange offer for the Telesp shares and ADSs held by minority investors. In July 2000, we agreed to exchange our interest in Portelcom Participações S.A., the holding company which controls Telesp Celular, for Portugal Telecom’s minority interest in SP Telecomunicações S.A., the holding company through which we control Telesp. In addition, we paid an aggregate of approximately U.S.\$60 million to Portugal Telecom pursuant to the terms of the agreement. In December 2001, we acquired an additional 3.5% of SP Telecomunicações S.A. from the Iberdrola group. See “—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Brazil—Agreement with Iberdrola”. As a result, at December 31, 2001, we held an 86.7% interest in Telesp.

At December 31, 2001, Telesp managed approximately 12.6 million access lines in service, representing an increase of 19.1% over 2000. During 2001, Telesp installed an average of 309,000 lines per month. In 2001, the digitalization of Telesp’s network increased to 96.0% and its productivity ratio increased to 1,198 lines in service per employee at December 31, 2001 from 790 lines in service per employee at December 31, 2000, principally due to the significant increase in lines in service and workforce reductions in 2001.

The following table provides information with respect to Telesp’s fixed-line telecommunications network at and for the periods indicated.

	At December 31,			Percentage
	1999	2000	2001	Increase/(Decrease)
Lines installed (thousands) .....	9,548	12,480	14,347	14.9%
Lines in service (thousands).....	8,251	10,596	12,616	19.1%
Penetration rate in São Paulo .....	23.8%	29.5%	33.8%	4.3 p.p.
Lines in service per employee.....	566	790	1,198	51.7%
Average days between application and installation .....	34	12	0.5	(95.0)%

Telesp is subject to competition for local telephone services from a “mirror” license holder, who was granted rights similar to those granted to Telesp as part of the privatization of Telebrás. It is subject to competition for interprovincial long-distance services from a “mirror” license holder, Embratel and Embratel’s “mirror” license holder.

Anatel, the Brazilian telecommunications regulator, certified in Law No. 1/3/2002, published in the *Diário Oficial da União* on March 4, 2002, that Telesp achieved the quality and expansion targets established in Telesp’s

concession contract. As a result, according to Brazilian regulation, the Telefónica Internacional group has the right to operate fixed-line telecommunications services throughout the entire national territory of Brazil.

Telefónica Internacional has entered into a management contract pursuant to which Telefónica Internacional received 1% of Telesp's revenues until 2000, which amount was reduced to 0.5% through 2002, and will then be reduced to 0.2% beyond that date. The contract expires December 31, 2003 and may be renewed.

Equity securities of Telesp trade on the New York Stock Exchange under the symbol "TSP" and on the principal Brazilian stock exchanges under the symbol "TLPP".

### ***Compañía de Telecomunicaciones de Chile***

Compañía de Telecomunicaciones de Chile, in which we held a 43.6% stake at December 31, 2001, is the largest telecommunications operator in Chile. As of December 31, 2001, Compañía de Telecomunicaciones de Chile owns approximately 82% of all telephone lines in Chile. Compañía de Telecomunicaciones de Chile provides a broad range of telecommunication and other services throughout Chile, including local telephone service, mobile telephone service, mobile communications services (including paging, radio trunking and mobile data transmission), domestic long-distance service and international long-distance service, data transmission, dedicated lines, terminal equipment sales and leasing, public telephone service, directory advertising, interconnection services and certain value-added services. For a description of Compañía de Telecomunicaciones de Chile's wireless operations, see "—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Chile".

Compañía de Telecomunicaciones de Chile holds licenses to provide local telephone service and data transmission services throughout Chile. It also holds licenses to provide long-distance service throughout Chile and internationally through certain of its subsidiaries. Compañía de Telecomunicaciones de Chile provides local telephone service, interconnection of domestic and international long-distance telecommunications providers to central switches, and other services provided to carriers through its own digital telecommunications network.

Compañía de Telecomunicaciones de Chile managed approximately 2.7 million lines in service at December 31, 2001 and had an access line penetration rate of approximately 23% at that date. Compañía de Telecomunicaciones de Chile's productivity ratio increased to 803 lines per employee in 2001 from 582 lines per employee in 2000, principally as a result of a 20.0% decrease in personnel due to workforce reductions in 2001.

In 2000, Compañía de Telecomunicaciones de Chile sold its 40% stake in Metrópolis-Intercom, the second largest cable TV provider in Chile, to Cordillera.

Equity securities of Compañía de Telecomunicaciones de Chile trade on the Santiago and New York stock exchanges under the symbol "CTC".

### ***Telefónica de Argentina***

Telefónica de Argentina is a leading provider of fixed-line public telecommunications services and basic telephone services in Argentina. Telefónica de Argentina is licensed to provide local and domestic long-distance and international services and domestic and international telex services throughout Argentina. During 2000, we increased our stake in Telefónica de Argentina through a public exchange offer for Telefónica de Argentina shares and ADSs held by minority investors and our acquisition of 50% of Compañía de Inversiones en Telecomunicaciones (COINTEL), which held a 52.9% stake in Telefónica de Argentina. At December 31, 2001, we held a 98.0% interest in Telefónica de Argentina.

As part of our reorganization along global lines of business, in 2001 we spun off the wireless operations of Telefónica de Argentina, held by Telefónica Comunicaciones Personales, S.A., to Telefónica Móviles Argentina in exchange for shares of Telefónica de Argentina. Additionally, we spun off the data transmission operations of Telefónica de Argentina (held by Advance Telecommunications S.A.) to Telefónica Data.

At December 31, 2001, Telefónica de Argentina's telecommunications network had approximately 4.6 million lines in service, an increase of 5.3% from approximately 4.3 million at December 31, 2000, and an access line penetration rate of 12.2%. At that date, its estimated market share for local telephony was 52%, its market share for domestic long-distance was 40% and its estimated market share for international long-distance was 47% compared to estimated market shares of approximately 52%, 41% and 47%, respectively, at December 31, 2000.

We have a management contract with Telefónica de Argentina under which we have agreed to manage Telefónica de Argentina's business and provide services and expertise regarding Telefónica de Argentina's entire range of activities in return for a percentage of Telefónica de Argentina's operating margin equivalent to 9% of its gross margin prior to amortization and interest expense. This contract is due to expire in 2003, unless it is extended through 2008 pursuant to its terms.

Telefónica de Argentina provides basic telephone services throughout Argentina. Similarly, Telecom Argentina, Compañía de Teléfonos del Interior S.A., an affiliate of GTE Mobile International Inc., and Compañía de Teléfonos del Plata S.A., an affiliate of BellSouth, were awarded licenses to provide the same basic telephone services throughout Argentina as of October 10, 1999. Since November 2000, other principal competitors, including Impset Corp. and AT&T, have also entered the market as well as smaller regional competitors.

The Argentine telecommunications market was fully liberalized in November 2000. Interconnection prices were reduced by 50%, and in order to increase competition in the long-distance market, consumers are permitted to select their long-distance carrier. Telefónica de Argentina expects that the introduction of full competition in the Argentine telecommunications market will result in a loss of market share.

Telefónica de Argentina's results of operations in 2001 have been materially adversely affected by the impact of the liberalization of the telecommunications market in November 2000 and the political and economic crisis currently affecting the country and emergency measures adopted by the Argentine government in response to this crisis. Due to the continuing economic instability in Argentina and in order to manage its liquidity risk, in May 2002 Telefónica de Argentina, S.A. commenced an exchange offer outside the United States for certain outstanding debt obligations, which exchange offer expired on June 21, 2002. On that date, Telefónica de Argentina, S.A. announced that it would accept all validly tendered notes. For a discussion of the risks associated with these events and the impact on our results of operations, see "Item 3—Key Information—Risk Factors" and "Item 5—Operating and Financial Review and Prospects—Operating Results—Recent Developments—Argentina".

Equity securities of Telefónica de Argentina trade on the Buenos Aires and New York stock exchanges under the symbol "TAR".

### ***Telefónica del Perú***

Telefónica del Perú is the leading global telecommunications operator in Perú. Telefónica del Perú offers fixed local and domestic and international long-distance services throughout Perú as well as a wide range of other telecommunication services including public telephone, cable television and data communications.

At May 31, 2002, the Peruvian government had granted 57 concessions for long-distance service, 29 concessions for local carrier service and 8 concessions for local fixed telephony service. Within the Lima metropolitan area, Telefónica del Perú had approximately 94% market share with BellSouth as its only competitor. Outside the Lima metropolitan area, Telefónica del Perú is the only provider of public telephone service. In addition, Telefónica del Perú provides cable television in the Lima metropolitan area and seven other cities through its wholly-owned subsidiary, Telefónica Multimedia S.A.C.

In mid-2000, we completed an exchange offer for the Telefónica del Perú shares and ADSs held by minority investors. Following our acquisition in September 2001 of an additional 10% interest in Telefónica del Perú Holding from Wiese Telefónica S.A. and IGM Teléfonos, S.A. for a total of €227.3 million, we held an approximately 97.1% interest in Telefónica del Perú at December 31, 2001.

As part of our reorganization along global lines of business, in 2001 we spun-off the data transmission business of Telefónica del Perú to Telefónica Data. In addition, we spun-off the wireless business of Telefónica del Perú to Telefónica Móviles.

At December 31, 2001, Telefónica del Perú had approximately 1.7 million lines in service, including public telephone lines operated by Telefónica del Perú, and 341,700 cable television subscribers. Telefónica del Perú's access line penetration rate was 6.6% at December 31, 2001. The increase in the number of access lines in service was due to the successful marketing of prepaid products such as "*teléfono popular*" which offers fixed-line service with limited consumption. In 2001, the degree of digitalization of Telefónica del Perú's network remained unchanged at 96%.



Under a management contract between Telefónica Internacional and Telefónica del Perú, Telefónica Internacional provides Telefónica del Perú with management and technical support in exchange for management and technology transfer fees equivalent to 9% of its operating margin before depreciation and amortization and 1% of its revenues. This contract expires in 2014.

### ***Telefónica Larga Distancia de Puerto Rico***

At December 31, 2001, we held a 98% interest in Telefónica Larga Distancia de Puerto Rico, Inc. In 2001, Telefónica Larga Distancia's customers consumed 425.4 million minutes compared to 429.3 million minutes in 2000.

### ***Other Investments***

#### *Compañía Anónima de Teléfonos de Venezuela (CANTV).*

CANTV, in which the Telefónica Group held a 6.9% stake at December 31, 2001, is the leading provider of telecommunications services in Venezuela. At December 31, 2001, CANTV had approximately 2.7 million access lines in service and approximately 2.5 million wireless customers.

#### *Cablevisión S.A.*

In May 2001, we exercised our option to sell and sold our shares of Cablevisión, an Argentine cable company, to an affiliate of Citicorp Equity Investments for approximately U.S.\$712 million.

#### *Infonet Services Corporation.*

At December 31, 2001, we held a 14.3% stake in Infonet Services Corporation, a data telecommunications firm that uses telecommunications tools to electronically link offices within a multinational company and to speed the transfer of information between them. The remaining shares in Infonet are publicly held.

### **Worldwide Corporate Data Transmission – Telefónica Data**

Telefónica Data manages our data transmission business on a global basis. As part of our reorganization along global lines of business, in 2000 we transferred to Telefónica Data, Acea Telefónica, our joint venture to provide voice, data and Internet services in Lazio, Italy, and the data transmission operations of European Telecom International in Austria. In addition, in 2001 we spun off the data transmission operations of our integrated telecommunications operators in Brazil, Argentina and Perú to Telefónica Data. Together with Telefónica Data's other operations in Colombia, Mexico, Uruguay and the United States, Telefónica Data offers a unique network platform for the provision of corporate data transmission services to multinational clients in Latin America. With the acquisition in January 2001 of mediaWays, the operator of the second largest communications network based on the Internet Protocol (IP) in Germany and a provider of IP network services in the United Kingdom, Telefónica Data has also expanded its presence in Europe.

At December 31, 2001, Telefónica Data had operations in 14 countries. Telefónica Data's strategy in each country depends on the state of development of its network and its market share. In those countries in which the Telefónica Group holds a leading position, Telefónica Data concentrates on offering "one-stop shopping" services and customized communications solutions to corporate customers, with particular emphasis on value-added services, such as hosting, content delivery and e-solutions. We refer to these markets as our "incumbent markets". In those countries where Telefónica Data is a new entrant, Telefónica Data offers a complete portfolio of IP services and packaged solutions to the most attractive market segments, such as small or medium-sized enterprises, Internet service providers and other Telefónica Group companies. We refer to these markets as our "expansion markets".

As part of its strategy to increase the level of value-added services that it provides, Telefónica Data began operating in September 2001 a data center in Miami from which it provides network services and hosting services, principally to large corporate customers and new technology companies. This center, together with the connectivity provided by the Telefónica de España Group's network, offers Telefónica Data's customers high levels of security and redundancy.

## ***Incumbent Markets***

### *Spain*

Telefónica Data provides a variety of corporate communication services such as:

- *Iberpac Básico* – a data transmission service based on X.25 protocol which enables a reliable interchange of information between multiple destinations
- *UNO Service* – a data transmission service based on the X.25 protocol and on the Virtual Private Network (VPN), which is marketed to large corporate customers such as banks and insurance companies
- *Frame Relay* – a data transmission service designed to satisfy the use and interconnection requirements of Local Area Networks (LAN)
- *InfoInternet* – a gateway to Internet service using the IP Network. Users access the Internet through a permanent connection to the IP Network
- *UNO IP Voz* – enables the transportation of voice and data using an exclusive line on the IP Network
- *Data&Voz* – permits integration of voice and data transmission in one single line

In June 1998, Telefónica Data launched the new Internet Protocol network, which enhances our ability to market value-added services such as e-mail and other messaging and posting services. Telefónica Data has established itself as a leading provider of global services based on the Internet Protocol and value-added services for corporate customers. In addition, Telefónica Data is responsible for traditional data transmission services, maximizing their value and managing service migration within the Internet Protocol environment.

In July 1999, Telefónica Data España, Telefónica Data's operating subsidiary in Spain, obtained an individual Type A license, which permits it to offer its corporate customers bundled voice and data services packages via one single connection. The license also allows interconnection with other operators and their users. Telefónica Data España also holds a Type C license, which permits it to render data transmission services.

At December 31, 2001, Telefónica Data's network in Spain had wide geographic coverage with 395 points of presence (POPs) and approximately 160,000 end user connections. In addition, Telefónica Data had 41,100 ADSL subscribers at December 31, 2001. Most data transmission services are currently provided through a switch network that is independent from our fixed-line network.

### *Other Incumbent Markets*

Telefónica Data's other incumbent markets include Brazil, Argentina, Chile and Perú. In Chile, Telefónica Data manages the data operations of the Telefónica Group. During 2001, Telefónica Data increased its catalog of services in each of these countries and expanded its network. At December 31, 2001, Telefónica Data had 211 POPs and approximately 91,000 end user connections in Brazil, 88 POPs and approximately 13,000 end user connections in Argentina, 21 POPs and 6,000 end user connections in Peru and 64 POPs and 32,000 end user connections in Chile.

In June 2001, the Telefónica Group and Banco Itaú, one of Brazil's largest financial institutions, formed an alliance for the provision of telecommunications services. As part of this agreement, we began managing Banco Itaú's corporate communications network, thereby increasing our presence in the Latin American market for corporate data transmission. Pursuant to our 2001 business plan, we expect to invest up to €18 million to improve Banco Itaú's corporate communications network as well as to roll out its services outside of the São Paulo metropolitan area over the next three years. Banco Itaú's customer base includes over 500,000 corporate clients and 7 million individuals.

## ***Expansion Markets***

### *Rest of Europe*

Telefónica Data's expansion markets in Europe include Germany, Austria, Italy and the United Kingdom. At December 31, 2001, Telefónica Data had 403 points of presence (POPs) in Europe and more than 302,000 end user connections. In addition, Telefónica Data had approximately 19,000 ADSL lines in service outside Spain, principally in Italy and Germany.

In 2000, Acea Telefónica merged with Telexis, a member of the Fiat group. As a result of the merger, we own 34% of the resulting company, Atlanet, and have management control. We invested approximately €100 million as part of the transaction. In Italy, Telefónica Data has continued to develop its network in order to offer a complete catalog of data and voice services for corporate customers.

In January 2001, we acquired from Bertelsmann AG its affiliate, mediaWays GmbH, for a total purchase price of €1,479.2 million. mediaWays specializes in Internet services, data transmission and other value-added services for businesses. Its product portfolio is comprised of one-stop solutions for Internet service providers, full-scale application hosting and corporate communications solutions. mediaWays has provided services in Germany since 1996 and in the United Kingdom since 2001.

### *Rest of Latin America and the United States*

Telefónica Data's other expansion markets include Colombia, Mexico, Uruguay, Puerto Rico and the United States. At December 31, 2001, Telefónica Data had 76 points of presence (POPs) and 9,528 end user connections in these expansion markets. Despite the commencement of operations at Telefónica Data's data center in Miami in September 2001, which has enabled Telefónica Data to begin providing hosting services in the United States (principally in Florida), Telefónica Data's results of operations in these expansion markets were adversely affected by the decline of new technology companies and the economic recession in the United States.

### ***Certain Agreements***

In October 2000, Telefónica Data entered into an agreement with Banco Santander Central Hispano to manage the banking group's international data network, which covers more than 20 countries throughout Europe and Latin America. Telefónica Data has also entered into agreements with respect to the management of Repsol YPF's international data network and Banco Bilbao Vizcaya Argentaria's international data back-up network.

In December 2000, Telefónica Data entered into an agreement with America Online to provide network services (national switched access and international network capacity) to America Online's principal companies in key markets in Latin America and Europe.

In February 2001, Telefónica Data entered into an agreement with Akamai Technologies to provide enhanced infrastructure capabilities to enable Akamai to optimize the speed, functionality and availability of its value-added services.

In May 2001, Telefónica Data entered into an agreement with Sol Meliá to develop its "SolNet" network that will connect all of Sol Meliá's hotels and corporate offices worldwide. Pursuant to the agreement, Telefónica Data and Sol Meliá will also engage in joint sales and marketing activities.

In June 2001, Telefónica Data España, a member of the Telefónica Data Group, which provides corporate communication services in Spain, entered into an agreement with Fiat Auto España to develop a data transmission network which will link more than 100 Fiat dealerships in Spain and Andorra.

## **Worldwide Internet-Related Services – Terra Networks**

Our worldwide Internet-related services business is led by Terra Networks. Terra Networks is one of the most popular Internet networks in the United States, Europe and Asia and the leading portal to Spanish and Portuguese-speaking markets. It is the result of the combination in October 2000 of Terra Networks, a global Internet company and the leading provider of Internet access and interactive content and services to the Spanish and Portuguese-speaking world, and Lycos, Inc., the Internet's leading multi-brand network.

We created Terra Networks in December 1998 to operate the Spanish residential and small office/home office Internet access business carried on by the Telefónica group since December 1995. In November 1999, Terra Networks completed an initial public offering of approximately 30% of its ordinary shares. In 2000, Terra Networks acquired Lycos, Inc. in a share exchange. We account for our interest in Terra Networks on a consolidated basis because we exercise effective control over Terra Networks as a result of our 37.03% ownership interest at December 31, 2001.

Terra Networks offers a suite of Internet services in a variety of languages that provides its users throughout its core markets in Europe, Latin America, North America and Asia with:

- access to the Internet (in Spain and certain countries in Latin America)
- portal and network services that incorporate a wide variety of content individually-tailored for each market and featuring enhanced functionality
- a range of online advertising, marketing and e-commerce opportunities
- multiple solutions for customers' Internet needs, such as web design and hosting and communication

Through its portals and network of separately-branded websites and joint venture partnerships, Terra Networks has the largest global footprint of any Internet portal or network with portals in 43 countries and more than 120 websites. Its portals and network of separately-branded sites generated more than 500 million average daily page views in December 2001. Terra Networks currently holds a leading position in the following markets:

- Spain
- Latin America
- the U.S. Hispanic market

Through its joint ventures and other interests, Terra Networks also holds a leading position in:

- Europe (Lycos Europe)
- Canada (Sympatico-Lycos)
- Asia (Lycos Asia)
- Japan (Lycos Japan)

Terra Networks is also a leading interactive services provider in Spain and Latin America, offering Internet access and local-language interactive content and services to more than 4.3 million customers in Spain, Brazil, Mexico, Peru, Chile and Guatemala. In 2001, Terra Networks was one of the leading broadband services and content providers in Spain, Brazil and Mexico.

Terra Networks has achieved growth through:

- its assumption of direct management responsibility for the Internet activities of the Telefónica group companies in Spain in April 1999, and in Chile and Perú in October 1999
- its acquisition of strong local providers of Internet services, including:
  - the leading Spanish portal, which was acquired in April 1999
  - a leading Brazilian portal and Internet service provider and an e-commerce provider, which was acquired in June 1999

- a leading Mexican portal and an Internet service provider and e-commerce provider, which Terra Networks agreed to acquire in October 1999
- most significantly, 100% of Lycos, Inc., the Internet's leading multi-brand network, in October 2000
- the growth of the business lines that it operates

In connection with Terra Networks' acquisition of Lycos, we, Terra Networks and Bertelsmann, one of the largest media companies in the world, entered into strategic alliance agreements pursuant to which Bertelsmann agreed to pay \$325 million to Terra Networks for services (on terms no less than terms provided to third parties) during the first and second years from the date of the combination of Terra Networks and Lycos. During the third, fourth and fifth years after the date of such combination, Bertelsmann has agreed to purchase up to \$675 million of services from Terra Networks. As described in our Annual Report on Form 20-F for the fiscal year ended December 31, 2000, we have agreed to purchase, if necessary, any portion of those services that Bertelsmann does not buy, up to \$675 million. In addition, in connection with such acquisition we agreed to underwrite a €2.2 billion rights offering completed by Terra Networks in September 2000. Pursuant to such rights offering, we acquired 35,380,101 newly-issued shares of Terra Networks for an aggregate of approximately €2.2 billion.

In 2001, Terra Networks adopted a new business strategy and model in order to enhance its profitability. A key component of this strategy is to monetize its services by migrating customers from free services to value-added pay services such as multimedia content offerings through the implementation of the "Open, Basic and Premium" model across each of its businesses.

## Other Lines of Business

### *Telefónica Publicidad e Información — Directory Publishing*

Telefónica Publicidad e Información publishes and develops and sells advertising in telephone directories. In addition to printed directories, it offers directories online and in telephone-based format. Telefónica Publicidad e Información has operations in Spain, Brazil and Chile, and in February 2002 acquired the directory publishing business of Telefónica del Perú for U.S.\$31.2 million. Telefónica Publicidad e Información also manages the directory publishing business of Telinver, a wholly-owned subsidiary of Telefónica Internacional, in Argentina. In June 1999, Telefónica Publicidad e Información completed an initial public offering of approximately 35% of its ordinary shares to institutional and retail investors. Telefónica Publicidad e Información's shares trade on the Spanish stock exchanges under the symbol "TPI". Telefónica Publicidad e Información was the first Spanish advertising company and Internet service provider to be traded publicly. At December 31, 2001, we held a 59.87% interest in Telefónica Publicidad e Información.

#### *Spain*

Telefónica Publicidad e Información's core products in Spain are:

- *Páginas Amarillas* ("Yellow Pages"), an annual advertising directory containing certain information on all companies, businesses and professionals in a particular geographical area classified by sector, location and alphabetical order. The directory contains approximately 1.6 million listings and 305,000 paid advertisements. *Páginas Amarillas* was consulted by over 21 million users (over 20 million residential users and over one million businesses) in 2001, according to market research carried out by Emer GfK on behalf of Telefónica Publicidad e Información. According to this research, there were more than 1 million daily consultations during 2001. In 2001, there were a total of 64 books published and over 15 million copies printed.
- In 2001, Telefónica Publicidad e Información introduced a new product known as *Páginas Amarillas de Bolsillo* ("Pocket Yellow Pages") through the initial distribution on a limited basis in Madrid and the area of Sevilla-Cádiz-Huelva. This new product is designed for use outside the home and permits the user to carry conveniently the directory. The objective of this new product is to increase the use of the yellow pages directories, through new modes of usage and increased frequency of usage, and to increase the number of paid advertisers.

- *Páginas Blancas* (“White Pages”), which includes residential, professional and business telephone numbers in a particular geographic area, classified by location and alphabetical order. The directory has been redesigned and new content and information has been added, offering information of general interest to users. In 2001, approximately 24 million users consulted the directory, of which 23 million were residential users and one million were businesses. During 2001, there was a total of 61 white page guides published and 15 million copies printed.
- *Páginas Amarillas Online* (PAOL) (“Yellow Pages Online”) is one of the largest and most complete online databases of Spanish businesses in terms of number of listings. The number of *Páginas Amarillas Online* advertisers quadrupled in 2001 to 245,000. The number of page views in 2001 increased 95% to 452.4 million, while the number of registered visits increased 76.6% to 19.9 million. *Páginas Amarillas Online* also offers supplementary information, including job listings, international directory listings (with access to yellow page listings in other countries) and street guides to more than 300 Spanish cities.
- *Páginas Amarillas Habladas* (operator-assisted Yellow Pages) offers 24-hour operator-assisted information over the telephone for all companies, businesses, professionals, products and services located in the *Páginas Amarillas*. This service also provides a wide range of additional information, including stock quotes, weather reports and theater listings. In 2001, this service received 1.5 million calls, representing an increase of 9.6% over 2000.
- *Europages*, available in paper, CD-Rom and over the Internet is the most comprehensive trans-European directory containing information on major European export companies, classified by activity and then grouped by country of origin. The *Europages* are edited annually by Euredit, a company in which Telefónica Publicidad e Información has a 5% stake. Telefónica Publicidad e Información is responsible for managing the advertising business and the distribution of the directory in Spain.

In May 1999, Telefónica Publicidad e Información entered into an agreement with us to publish, distribute, market and sell advertising in *Páginas Blancas*. Under this agreement, Telefónica Publicidad e Información pays us a commission based on the revenues generated from advertising and the costs associated with the *Guías Básicas de Referencia* (“Basic Guides”). Such fees were approximately €28.0 million in 2000 and €27.2 million in 2001. Additionally, Telefónica Publicidad e Información pays us a variable fee based on the number of registers and individual updates. Such fees were approximately €3.2 million in 2000 and €3.5 million in 2001.

#### *Latin America*

*Brazil.* Telefónica Publicidad e Información commenced its operations in Brazil in 1999. Telefónica Publicidad e Información publishes a yellow pages directory in the Brazilian cities of São Paulo, Guarulhos, Riberão Preto and Curitiba under the name “GuiaMais”, and in 2002, it began publishing “GuiaMais” in Osasco-Barueri and the ABCD region. It also offers its directories online, in telephone-based format and through wireless access protocol (WAP).

Telefónica Publicidad e Información also publishes a white pages directory in Brazil. It published eight of these directories in 2001 for Telesp, our fixed-line operator in the Brazilian state of São Paulo. In July 2001, Anatel, the Brazilian telecommunications regulator, temporarily suspended for a period of six months to one year the telecommunications operators’ obligation to distribute printed copies of white pages directories to its customers so long as it offers an alternative service and its customers do not request a printed copy. Consequently, Telesp has reduced significantly the number of orders for white pages directories in 2002. In 2001, Telefónica Publicidad e Información had revenues of €17.1 million from the publication of the white pages directory for Telesp, which revenue will decrease substantially for as long as the suspension is in place.

In 2001, Telefónica Publicidad e Información published 24 white pages directories and 31 yellow pages directories pursuant to its agreement with Listel, a Brazilian publisher of directories and an affiliate of BellSouth Corporation. In August 2001, Listel announced its intention to terminate this contract beginning in 2002. As of the date of this Annual Report, Listel has not yet terminated the contract, but Telefónica Publicidad e Información does not expect to obtain any revenue from the contract in 2002.

*Chile.* At December 31, 2001, Telefónica Publicidad e Información held a 51.0% interest in Impresora y Comercial Publiciguías, S.A. Compañía de Telecomunicaciones de Chile, our fixed-line operator in Chile, held another 9.0% of Impresora y Comercial Publiciguías, S.A. at that date. In 2001, Impresora y Comercial Publiciguías, S.A. and Compañía de Telecomunicaciones de Chile renegotiated the contract governing the publication, marketing and sale of yellow pages and white pages directories in Chile. In connection with this agreement, Compañía de Telecomunicaciones de Chile will provide billing and collection services for its sale of advertising in the yellow pages and white pages directories and will receive a percentage of the revenues generated by Impresora y Comercial Publiciguías, S.A. as a result of such sales. In addition Impresora y Comercial Publiciguías, S.A. will pay Compañía de Telecomunicaciones de Chile a variable fee based on the number of directories published and the number of individual updates. The agreement has a term of five years, expiring in June 2006. As a result of the early termination of the preexisting contract between the companies that was scheduled to expire in December 2002, Impresora y Comercial Publiciguías, S.A. paid Compañía de Telecomunicaciones de Chile a one-time fee of approximately U.S.\$31.6 million. We expect that the new contract will enable Impresora y Comercial Publiciguías, S.A. to improve its profitability.

In early 2001, the Chilean regulatory authority modified the requirement to publish and distribute annually white pages directories to its customers. As a result, white pages directories are only required to be published every other year with a supplement being distributed in the year of non-publication. Impresora y Comercial Publiciguías, S.A. and Compañía de Telecomunicaciones de Chile believe that this new regulation applies only with respect to the distribution of residential white pages directories in Santiago, Chile. In 2001, Telefónica Publicidad e Información published an addendum to the Santiago residential white pages directories, and it plans to publish a complete directory in 2002.

*Peru.* Telefónica Publicidad e Información purchased the directory publishing business of Telefónica del Peru in February 2002 for U.S.\$31.2 million.

*Argentina.* Telefónica Publicidad e Información also conducts the directory publishing business of Telinver in Argentina.

#### ***Atento — Call Centers***

We formed Atento in 1999 to hold and develop our call center business. Atento offers integrated telephone assistance services as well as sophisticated “customer relationship management” services such as the development and implementation of customer loyalty programs, telemarketing services and market research. In addition, Atento provides staff and rents call center positions to third parties. Atento currently operates in 13 countries on four continents, including Europe (Spain), Latin America, Northern Africa (Morocco) and Asia (Japan).

In 2001, Banco Bilbao Vizcaya Argentaria agreed to transfer its telephonic customer services operations in Spain and its telephonic banking and telesales services business outside Spain to Atento in exchange for up to a 9% stake in Atento. See “—International Strategic Partnerships—Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria”.

#### ***Business-to-Business Marketplaces — Katalyx***

In 2000, we created Katalyx to develop and operate electronic business-to-business (B2B) marketplaces, known as e-marketplaces, in Spain and Latin America. In 2001, we undertook a restructuring of Katalyx’s operations in Spain, Argentina, Brazil and Mexico, significantly reducing costs in response to the adverse market conditions affecting new technology companies and the slowdown in the implementation of B2B initiatives. Nevertheless, in 2001, Katalyx participated in the following initiatives:

- *Adquira* – a horizontal e-marketplace for indirect goods and services with operations in Spain, Argentina, Mexico and Brazil.
- *Vía Katalyx* – an initiative aimed at providing supply chain management services, utilizing sophisticated modular technology.
- *Katalyx Food* – a vertical e-marketplace for the food industry with operations in Spain, Argentina and Mexico.

- *Katalyx Catalogs* – a company that develops and manages e-catalogs in Spanish and Portuguese for Spanish and Latin American companies that want to participate in e-commerce activities.
- *Katalyx Construcción* – a vertical e-marketplace for the construction industry in Spain and Latin America.

### ***Submarine Cable — Emergia***

We formed Emergia to provide broadband telecommunications services through a high capacity fiber optic submarine cable that will seamlessly connect Latin America, the United States and the Caribbean. The first phase of the network commenced operating in the third quarter of 2000. During the first quarter of 2001, Emergia completed the installation of its fiber optic ring, consisting of more than 25,000 terrestrial and submarine kilometers of fiber optic cable and representing an investment of more than €1,400 million. Emergia's network has the capacity to deliver initially up to 40 gigabits per second which may be increased to 1.9 terabits per second. Following the completion of the fiber optic ring, Emergia sought to expand its network by entering into capacity exchange agreements that will permit Emergia to offer connections to Europe. Emergia also expanded its fiber optic network in Rio de Janeiro in Brazil.

In addition to its fiber optic network, Emergia provides broadband infrastructure services to the wholesale market, including international carriers, Internet service providers and communications-intensive businesses, providing city-to-city and door-to-door connectivity between Latin America, the United States and Europe. Emergia is also conducting tests for the transmission of television signals through its fiber optic network.

The market for fiber optic capacity has been characterized by softness in demand in 2002. One Emergia customer has confirmed to Emergia that it will not renew its agreement with Emergia to lease fiber optic capacity when the current agreement expires, and additional Emergia customers may do the same in the future. As a result, Emergia has implemented a cost containment plan to reduce operating expenses, pursuant to which Emergia has reduced travel and other expenses, as well as decreased its marketing budget for the second half of 2002. In addition, Emergia has renegotiated its agreements with local loop providers and with its maintenance suppliers.

### **International Strategic Partnerships**

#### ***Portugal Telecom***

In January 2001, we and Telefónica Móviles entered into a joint venture agreement with Portugal Telecom to consolidate certain of our wireless operations in Brazil with those of Portugal Telecom. For a description of the terms of the joint venture agreement, which is subject to regulatory and other approvals, see “—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Brazil—Agreement with Portugal Telecom”.

#### ***Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria***

In February 2000, we announced a broad strategic global alliance with Banco Bilbao Vizcaya Argentaria, S.A., which we believe was the first of its kind between a major telecommunications company and a bank. The strategic alliance provides a broad framework that must be implemented under specific agreements in order to pursue the identified projects. We describe below the most significant developments as of the date of this Annual Report.

#### ***Mobile Payment Systems***

On May 30, 2001, Telefónica Móviles, Banco Bilbao Vizcaya Argentaria, Banco Santander Central Hispano and Vodafone agreed to integrate their respective mobile payment systems to form a single mobile payment standard. For a description of the new payment system, see “—Worldwide Wireless Communications Services—Telefónica Móviles—Services and Products”.

#### ***Uno-e Bank***

In August 2001, Terra Networks acquired a 49% share in Uno-e for €160 million. Uno-e bank, Spain's first Internet bank, was launched in March 2000 and pursues a financial supermarket strategy, offering its own financial products as well as those of third parties. At December 31, 2001, Uno-e bank had over 100,000 customers and managed a total of approximately €750 million in assets. In May 2002, Banco Bilbao Vizcaya Argentaria and Terra



Networks executed a memorandum of understanding relating to a merger of Uno-e with BBVA Finanzia, Banco Bilbao Vizcaya Argentaria's consumer finance business. Following the merger, Uno-e expects to have more than 2.2 million customers and managed assets of approximately €1.4 billion. Banco Bilbao Vizcaya Argentaria will own approximately 67% of the merged entity and Terra Networks will own the remaining approximately 33%.

#### *Call Centers*

In December 2001, Banco Bilbao Vizcaya Argentaria agreed to transfer its domestic and international call center business to Atento, our subsidiary that conducts our call center business, in exchange for up to a 9% stake in Atento. The parties are in the process of effecting the transfer of Banco Bilbao Vizcaya Argentaria's call center operations to Atento through the formation of a new holding company, Atento N.V., a company organized under the laws of the Netherlands. In connection with this transfer, Atento will enter into contracts for the provision of call center services to the Banco Bilbao Vizcaya Argentaria group in Spain, Portugal and nine Latin American countries. Banco Bilbao Vizcaya Argentaria's anticipated 9% interest in Atento may be subject to adjustment based upon such contracts and the amount of business transacted between the parties pursuant to such contracts.

#### *Electronic Ticketing*

In September 2001, we acquired through Admira Media a 47.5% stake in Tick Tack BBVA Ticket, Banco Bilbao Vizcaya Argentaria's electronic ticketing business, which sells tickets to entertainment events.

#### *E-commerce*

Banco Bilbao Vizcaya Argentaria acquired a 40% interest in Adquira España, S.A., our business-to-business electronic commerce subsidiary, which is part of the Katalyx Group.

#### *Other*

Banco Bilbao Vizcaya Argentaria has one vice-chairman on our Board of Directors and we have one board member on Banco Bilbao Vizcaya Argentaria's Board of Directors. For a list of all our directors, including additional directors nominated by Banco Bilbao Vizcaya Argentaria, see "Item 6—Directors, Senior Management and Employees—Directors and Senior Management".

#### *Microsoft*

In December 2001, we and Microsoft entered into a strategic agreement to collaborate in the development of technology (including wireless, broadband and software) and the marketing of products and services.

### **Capital Expenditures and Divestitures**

We have invested over €36,860 million in capital expenditures since January 1, 1999 (€46,580 million including financial investments). Of this amount, €8,420.9 million was invested in 2001 (€11,344 million including financial investments). Tangible (property and equipment) and intangible asset divestitures in 1999, 2000 and 2001 were not material.

#### *Year Ended December 31, 2001*

Our principal capital expenditures in 2001 were investments made by Telefónica de España in the development of its broadband services, investments made by Telefónica Data in the development of its emerging businesses in Europe and Latin America and investments made by Telesp in connection with the roll-out of its network:

- intangible investments (€1,650.1 million)
- tangible investments made by Telefónica Internacional (€3,123.7 million)
- tangible investments made by Telefónica de España (€1,560.4 million)
- tangible investments made by Telefónica Móviles (€1,419.3 million)

- tangible investments made by Atento (€71.6 million)

#### ***Year Ended December 31, 2000***

Our principal capital expenditures in 2000 were investments made by Telefónica Móviles in connection with the acquisition of licenses to provide UMTS services in Western Europe, investments made by Telesp in connection with the roll-out of its network and investments made by our fixed-line operators to upgrade their networks to facilitate the provision of broadband services:

- intangible investments (€13,112.0 million), including €12,171.6 million paid in the aggregate by Telefónica Móviles and the relevant consortia for the acquisition of UMTS licenses by Telefónica Móviles in Spain, Germany, Italy and Austria, €105.90 million in research and development expenses and €515.0 million in software licenses and development
- tangible investments made by Telefónica Internacional (€4,045.2 million)
- tangible investments made by Telefónica de España (€1,436.5 million)
- tangible investments made by Telefónica Móviles (€1,002.8 million)
- tangible investments made by Atento (€722.5 million)

In 2000, Telefónica Móviles had capital expenditures of approximately €6,611.1 million related to its acquisition alone or through consortia of UMTS licenses in Germany, Italy, Spain and Austria. Telefónica Móviles expects to make substantial additional capital expenditures to build out UMTS networks and roll-out operations in countries in which it has been awarded licenses. Telefónica Móviles' participation in additional competitions for UMTS licenses in other countries would require significant additional funding requirements. Because UMTS technology is new and has not yet been built-out for commercial operations, there remains significant uncertainty regarding the final cost of network build-outs. See "Item 3—Key Information—Risk Factors".

#### **Financial Investments and Divestitures**

Our principal financial investments in 2001 were made by Telefónica Data (€1,534.5 million), Telefónica Móviles (€1,166.1 million), Telefónica, S.A. (€756.2 million), Admira Media (€676.4 million) and Terra Networks (€198.2 million). Our principal financial divestitures in 2001 were divestitures by Admira Media of 5.4% of its holding in Hispasat, S.A. for €35.2 million and by Telefónica Internacional of its 35.86% holding in Cablevisión, S.A., which we did not consolidate in our financial statements for 2001, for €255.9 million. Admira Media maintains a 17.34% holding in Hispasat, S.A.

#### **Public Takeover Offers**

In mid-2000 we completed separate exchange offers under which we offered to exchange our shares and ADSs for the outstanding ordinary shares, preferred shares and American depositary receipts of Telecomunicações de São Paulo S.A. — TELESP, Tele Sudeste Celular Participações S.A., Telefónica de Argentina S.A. and Telefónica del Perú, S.A. In connection with these exchange offers, we issued 700,774,917 new shares (in the form of shares and ADSs).

In July 2000, we acquired approximately 99.2% of Endemol Entertainment Holding N.V., one of Europe's leading television producers, in an exchange offer outside the United States for 100% of the outstanding shares of Endemol Entertainment Holding N.V. We issued 6.2 of our shares for each Endemol share for an aggregate amount of 213,409,097 new shares. See "—Worldwide Audiovisual Content and Media—Admira Media—Audiovisual Content—Endemol Entertainment".

In October 2000, Terra Networks acquired Lycos, Inc., a leading web media company and the owner of Lycos Network, one of the most visited hubs on the Internet, for 302,031,974 shares of Terra Networks. See "—Worldwide Internet-Related Services—Terra Networks".

In February 2001, Telefónica Móviles announced its intention to launch an exchange offer under which Telefónica Móviles would offer to exchange its Brazilian depositary receipts or American depositary shares for

100% of the outstanding ordinary shares and preferred shares of Celular CRT Participações S.A. not owned by Telefónica Móviles or its affiliates. As a result of the significant change in the normal functioning of the international capital markets following September 11, 2001 and the subsequent market volatility, Telefónica Móviles cancelled the proposed exchange offer in September 2001.

## C. ORGANIZATIONAL STRUCTURE

Please see “—History and Development of the Company—Overview”.

## D. PROPERTY, PLANTS AND EQUIPMENT

### Description of Property

#### *Domestic Network*

##### *Fixed-line Network*

In order to provide residential and other telecommunications services in Spain, we operate a full service telecommunications network. We benefit from an intensive capital investment program carried out over the last decade, which focused on network expansion as well as network upgrading. As a result, we now have:

- a network consisting of fiber optic cable to the curb in every Spanish city with a population of more than 50,000
- switching including synchronous digital hierarchy
- an asynchronous transfer mode roll-out
- System 7 signaling throughout

Our infrastructure development objective is to achieve a fully-digital system which permits simultaneous voice, data, text and image transmission, and which permits cost-efficient network management and maintenance. Consistent with this aim, we are moving towards a simplified two-level network hierarchy through the use of remote units, and we are presently increasing operational efficiencies through centralization of our network monitoring and management functions. The local digitalization rate in our network has increased from 56.7% in 1995 to 86.8% at December 31, 2001, and our long-distance lines are now 100% digitalized. All international services are also 100% digitalized.

We have continued to increase the number of integrated service digital network lines in our network. At December 31, 2001, we had approximately 2.1 million integrated service digital network lines, a 25.1% increase compared with the number of integrated service digital network lines in service at December 31, 2000. This will enable provision of a further range of services over the network, including simultaneous image transmission and voice telephony over the same line. Currently, we are marketing integrated service digital network primarily to commercial and high-usage residential customers. We expect that integrated service digital network costs will decline significantly in the coming years, thereby making integrated service digital network services more attractive to a larger customer base and increasing overall traffic over our network.

In carrying out our infrastructure development program, we have increased the use of fiber optic cables in our network. The table below shows the total length of the four basic types of cable in our network as of the dates indicated.

	At December 31,				
	1997	1998	1999	2000	2001
Coaxial cable (km).....	10,120	9,990	5,059	4,787	4,756
Fiber optic cable (km).....	47,030	49,653	52,511	54,920	58,156
Copper cable in domestic long-distance lines (km) .....	58,141	57,802	57,430	57,259	57,095
Subscriber networks (thousand km-par)(1).....	65,490	66,237	66,713	67,554	68,563

- (1) The transmission cables in the subscriber networks contain a variable number of conducting filaments, which are insulated from each other and grouped in pairs. Each such pair is called a “par”.

In carrying out our infrastructure development program we have consistently used a core group of primary equipment suppliers, including AT&T/Lucent Technologies, Ericsson and Alcatel, in order to maintain technological compatibility while at the same time decreasing dependence on any one vendor. We believe that our relationships with our primary vendors are stable and exhibit a high degree of cooperation with respect to our particular infrastructure needs.

Spain’s demographic makeup and topography present significant challenges to the provision of basic telephone service throughout the country, particularly in rural areas. Our continuing rural expansion program has been funded in part by local Spanish authorities. We are able to use alternative technologies in order to extend service into remote and thinly populated areas in compliance with our universal service obligation, and we have installed wireless access where this is more cost-efficient than extending fixed-line service.

#### *Wireless Network*

Telefónica Móviles España’s digital network in Spain is based upon the GSM standard, which has been adopted by more than 130 countries worldwide, including all member countries of the European Union. The prevalence of the GSM standard, together with its international roaming agreements, enables Telefónica Móviles España’s customers to make and receive calls throughout Western Europe and in more than 100 countries worldwide. Telefónica Móviles España’s GSM-based network provides its customers with access to many of the most advanced wireless handsets and a full panoply of services and products. In addition, in 2001 Telefónica Móviles España launched general packet radio service, or GPRS, which permits faster packet-based technology for the transmission of data and improved network utilization than circuit-switched technology.

At December 31, 2001, Telefónica Móviles España’s network in Spain, which consisted of approximately 110 switching centers and more than 13,300 base stations, provided coverage to approximately 99% of the population and 97% of the national territory.

Telefónica Móviles España offers analog service on the ETACS 900, or extended total access communications system, in Spain. Its analog network has 29 switching centers and over 3,000 base stations.

#### ***International Network***

##### *Fixed-Line Networks*

Telefónica Internacional operates full service telecommunications networks in Argentina, Brazil, Chile, Peru and Puerto Rico through its subsidiaries. Telefónica Internacional’s principal properties consist of numerous buildings and telecommunications installations, including exchanges of various sizes, transmission equipment, cable networks, base stations for cellular networks and equipment for radio communications. Telefónica Internacional intends to digitalize its telecommunications networks fully. In Brazil, Telefónica Internacional’s subsidiaries have digitalized 96% of their access lines. As of December 31, 2001, Telefónica Internacional had approximately 12.6 million access lines in service in the Brazilian state of São Paulo, 4.6 million access lines in service in Argentina, 2.7 million access lines in service in Chile and 1.7 million access lines in service in Peru.

##### *Wireless Networks*

Telefónica Móviles owns or leases numerous properties used to provide wireless communications services, including switching centers and network sites, in the countries in which it provides or plans to provide wireless communications services. Telefónica Móviles currently provides GSM digital service in Germany and Morocco. In addition, Telefónica Móviles, either independently or through consortia, has secured UMTS licenses in Germany, Italy, Austria and Switzerland. Substantial additional investments will be required over the next several years if Telefónica Móviles is to establish a customer base, gain market share and develop new services and products in each of Germany, Italy, Austria and Switzerland.

Telefónica Móviles operates its digital networks based on the CDMA standard in Peru, Mexico, El Salvador, Guatemala and the Brazilian regions of Rio de Janeiro/Espírito Santo and Bahia/Sergipe. Telefónica Móviles also controls digital networks based on the TDMA standard in Argentina and the Brazilian region of Rio Grande do Sul.

Telefónica Móvil, a subsidiary of Compañía de Telecomunicaciones de Chile, operates our wireless digital network in Chile based on the TDMA standard, and our digital network in Puerto Rico is based on the CDMA standard. In each Latin American market in which Telefónica Móviles operates or manages our wireless operations, except Chile, El Salvador, Guatemala and Puerto Rico, it also provides analog wireless services.

#### *Satellite Communications*

We have interests in five international satellite communications organizations or companies, including:

- Intelsat (0.7%), the global satellite consortium
- Inmarsat (1.2%), the maritime satellite organization
- Eutelsat (2.1%), the European regional satellite organization
- Hispasat (16.5%), the communications satellite organization which carries the Vía Digital direct-to-home (DTH) satellite television service and has a license to operate a new satellite system in Brazil (Amazonas)
- New Skies Satellites (0.8%), the communications satellite company that was formerly part of Intelsat

#### *Submarine Cable*

We are also one of the world's leading submarine cable operators. We are currently participating in the following projects: SAT-3/WASC/SAFE/PENCAN-7, ALPAL-2 and TAT 14. We currently participate in 46 international underwater cable systems (13 of which are moored in Spain) and own 14 domestic fiber optic cables.

The SAT-3, a fiber optic undersea cable system linking southern Europe, the West Coast of Africa and the South Coast of Asia, was built by a consortium which consists of Telefónica de España, Marconi, Telekom South Africa, Concert and more than 20 other carriers. We funded \$34.5 million of the estimated \$665 million cost of the project, which will span 14,580 nautical miles. The system commenced operations in April 2002.

The ALPAL-2, a fiber optic undersea cable system linking Argel (Algeria) and Mallorca (Spain), was built by a consortium which consists of Telefónica de España, France Telecom, Telecom Italia and the Algerian Ministry of Post and Telecommunications. We funded €2.0 million of the €16.1 million cost of the project, which spans 164 nautical miles. The system commenced operations in April 2002.

In July 1999, Tyco Submarine Systems Ltd. agreed with Telefónica Internacional to build and install a fiber optic network comprised of submarine and terrestrial cable. The ring covers approximately 25,000 kilometers, including 1,600 kilometers of terrestrial fiber optic cables, with landing stations in major cities throughout Latin America, the United States and Puerto Rico.

The SAM-1, a submarine cable, handles optical transport in and around South, Central and North America. This cable will start in Las Toninas, Argentina and Valparaiso, Chile and end in Boca Raton, Florida. Pursuant to an agreement dated December 22, 1999, the submarine cable is owned and operated by our affiliate, Emergia, S.A., in which Tyco Submarine Systems Ltd. currently has a 6.0% stake and in which we hold the remaining stake. The total cost for the marine and terrestrial parts of this installation reached \$1.25 billion, of which we provided a capital contribution of \$300 million and a line of credit of \$1.1 billion, of which amount \$993 million has been used at December 31, 2001. Cable operations began in March 2001. In 2002, Emergia has begun to expand its fiber optic ring and has entered into capacity exchange arrangements which will permit Emergia to offer connection to Europe.

#### *Transfers of Real Property*

In November 2001, we requested authorization from the Ministry of Science and Technology to transfer from Telefónica de España, S.A. to our wholly-owned subsidiary Telefónica Inmobiliaria all of Telefónica de España's real property, including office buildings, commercial sites, storage space, garages and other real property. As part of such transfer, Telefónica de España will not transfer any strategic assets of the Telefónica de España Group. We are currently in negotiations with the Ministry of Science and Technology with respect to the conditions which may be

imposed by such Ministry on the proposed transfer to ensure Telefónica de España fulfills its Universal Service obligations and its obligations relating to its designation as the dominant provider of fixed-line telephony services in Spain.

## **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

### **A. OPERATING RESULTS**

#### **Presentation of Financial Information**

The information in this section should be read in conjunction with our consolidated financial statements, and the notes thereto, included elsewhere in this Annual Report. Our consolidated financial statements have been prepared in accordance with Spanish GAAP, which differ in certain respects from U.S. GAAP. Please refer to note 25 to our consolidated financial statements for a discussion of these differences.

#### *Changes in the Composition of the Group Affecting the Comparison of our Results*

During 2000 and 2001, several changes occurred in the composition of the Telefónica Group that affect the comparability of our historical operating results. Please see note 2 to our consolidated financial statements for a discussion of the principles of consolidation and a description of the principal changes in the composition of the group affecting our financial statements during the periods covered by the consolidated financial statements.

#### *Year ended December 31, 2001*

In January 2001, pursuant to an agreement entered into in May 2000, we acquired all the shares of mediaWays, GmbH for €1,473.1 million from the German company Bertelsmann AG, giving rise to goodwill of €1,474.7 million. As a result, we consolidated this company in our financial statements for 2001.

In June 2001, we acquired from Motorola certain wireless operators in Mexico in exchange for approximately 122.6 million of our ordinary shares. As a result, we consolidated these companies in our financial statements for 2001 as from the date of their acquisition.

Telefónica Internacional acquired an additional holding of 10% in Telefónica Perú Holding, S.A. for €227.3 million, giving rise to goodwill in consolidation of €46.3 million. As a result of this acquisition, Telefónica Internacional became the sole stockholder of this company, which continues to be consolidated by us.

In August 2001, Terra Networks acquired a 49% holding in Uno-e Bank, S.A. for €160.4 million, giving rise to goodwill of €130.3 million. We carry Uno-e Bank by the equity method.

In addition, in the third quarter of 2001, Telefónica Móviles changed the method by which it accounts for its interest in IPSE 2000 from the global integration method to the equity method because it more accurately reflects Telefónica Móviles' participation in IPSE 2000's decision-making process. As a result, in 2001, we did not deduct for minority interests in the losses of this company.

#### *Year ended December 31, 2000*

In 2000, as a result of the completion of exchange offers for some of our Latin American affiliates, we increased our shareholdings in Telesp to approximately 86.6%, Tele Sudeste to approximately 75.6%, Telefónica de Argentina to approximately 92.9% (including shares acquired indirectly outside the exchange offer in 2000) and Telefónica del Perú to approximately 93.2%. Although we previously consolidated these entities, the increase in our ownership interest resulted in a reduction in minority interests.

We also made several other acquisitions during 2000, the most significant of which were our acquisition of 99.2% of Endemol Entertainment Holding N.V., Terra Networks' acquisition of 100.0% of Lycos, Inc. and our acquisition of 80.9% of CEI Citicorp Holdings S.A., which held 50% of COINTEL, which in turn held 52.8% of Telefónica de Argentina S.A.

### ***Other Significant Accounting Changes***

In 2001, Telefónica de Argentina changed its fiscal year end from September 30 to December 31. As a result, our results of operations for the year ended December 31, 2001 include a non-recurring extraordinary three-month period of results from Telefónica de Argentina for October 1, 2000 to December 31, 2000. Under U.S. GAAP the effect of this change in respect of the additional three-month period is a credit to retained earnings. See note 25 to our consolidated financial statements.

### **Critical Accounting Policies**

The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Consequently, our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our financial statements. The profile of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors you should consider in connection with your review of our financial statements and the discussion of our financial condition and results of operations below. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our financial statements and the uncertainties that could impact our financial condition, results of operations and cash flow.

The accounting policies under Spanish and U.S. GAAP applied by Telefónica are described in notes 4 and 25, respectively, to our consolidated financial statements. Our management has discussed the development and selection of these critical accounting estimates with the audit committee of our Board of Directors, and the audit committee has reviewed the company's disclosure relating to these critical accounting policies in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### ***Accounting for Long-lived Assets, Including Goodwill***

Property, plant and equipment and purchased intangible assets other than goodwill are recorded at acquisition cost. The acquisition cost of UMTS licenses includes the financial expenses incurred directly for their acquisition, from the granting of the license to the time when the technology required to operate the service becomes available, provided such costs do not exceed the realizable value of such assets. The financial expenses capitalized in 2001 amounted to €271.4 million for financing arranged by Telefónica, S.A. and Telefónica Móviles, S.A. and to €236.4 million for the financing granted by other stockholders of the companies holding the UMTS licenses. A total amount of €172.1 million were capitalized in this connection in 2000. The acquisition costs of these licenses and such financial expenses will begin being amortized upon commencement of commercial operations. If such assets are acquired in a business combination, the purchase price is allocated to the estimated fair value of the acquired property, plant and equipment and intangible assets. Property, plant and equipment are depreciated or amortized on a straight-line basis over their estimated useful lives, and licenses included in the intangible assets are depreciated or amortized using an amortization method based on the estimated capacity to generate revenues during the concession period.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining: (a) the fair value at the acquisition date, especially in the case of such assets acquired in a business combination, and (b) the useful lives of the assets over that will be used to determine the future amortization to be charged to the income statement.

When an impairment in the value of assets occurs, nonscheduled write-downs are made. We assess the impairment of identifiable intangibles and long-lived assets whenever there is reason to believe that the carrying value may exceed the fair value and where a permanent impairment in value is anticipated. The determination if impairments of long-lived and intangible assets is necessary involves the use of estimates that include but are not limited to the determination of its cause, its timing and estimation of the amount of the impairment. The determination if an impairment is necessary is based on a broad measure of factors. Among other things, we typically consider technological obsolescence, discontinuance of services and other changes in circumstances that indicate an impairment.

A significant change in the above mentioned facts and circumstances may trigger the requirement of recording an impairment and may have a material adverse impact on our operating results and financial condition.

Goodwill resulting from business combinations is amortized on a straight-line basis over its useful life. The consideration paid for acquisitions in excess of the underlying book value of each acquired subsidiary at the purchase date and not directly allocable to the companies' assets is recorded as goodwill in consolidation and amortized on a straight-line basis during the period in which such goodwill contributes to the obtainment of revenues by the companies for which the goodwill was recorded. The maximum goodwill amortization period is 20 years.

Nonscheduled write-downs are provided when an impairment in the value of goodwill occurs. We review, on a regular basis, the performance of our subsidiaries. When there is reason to believe that the goodwill arising from the acquisition of that subsidiary is impaired and that the impairment is of a permanent nature, we compare the carrying amount of that subsidiary to its fair value. The determination of the fair value of a subsidiary involves extensive use of estimates, depending on the method used. Significant management judgment is involved. Methods commonly used by us for valuations include discounted cash flow methods and quoted stock market prices, if available.

Factors affecting estimated fair values typically include discount rates, future cash flows, market prices and control premiums. These estimates, including the methodologies used, are important in determining fair value and ultimately the amount of any goodwill write-down.

A significant reduction in these estimates may have a material adverse impact on our operating results and financial condition.

To assess impairment of intangible assets and property, plant and equipment and related goodwill under U.S. GAAP, we apply SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". If management has concluded that impairment indicators exist, we test for impairment by comparing the sum of the future undiscounted cash flows derived from an asset or a group of assets to their carrying value. If the carrying value of the asset or the group of assets exceeds the sum of the future undiscounted cash flows, impairment is considered to exist. If an impairment is considered to exist on the basis of undiscounted cash flows, the impairment charge is measured using an estimation of the assets' fair value, typically using a discounted cash flow method. The identification of impairment indicators, the estimation of future cash flow and the determination of fair values for assets or groups of assets requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows and applicable discount rates. If actual results differ from these estimates, or if we adjust these estimates in future periods, operating results could be significantly affected.

Nevertheless, according to APB 17, "Intangible Assets", any goodwill which is not identified with assets that are subject to an impairment loss should be tested for recoverability at the enterprise level by a comparison with its fair value according to discounted cash flows, a method which is similar to the one applied under Spanish GAAP.

Any carrying amounts that exceed its fair value should be immediately written off. Provisions under Spanish GAAP considered temporary or which did not qualify as goodwill impairment under U.S. GAAP were reverted and any other impairment according to U.S. GAAP requirements were recorded.

### ***Devaluation in Argentina***

In view of its international presence, the Telefónica Group, like other corporations, has been affected by the economic situation in Argentina through the various Telefónica Group companies operating there. As of December 31, 2001, the Telefónica Group's exposure at the various Argentine companies amounted to €3,582.0 million, including the asset value assignable to those investments, related goodwill and intercompany financing.

Argentine exchange markets closed on December 23, 2001 and remained closed through January 11, 2002, during which period the official exchange rate remained at 1.0 pesos/US\$1.00. Accordingly, as of December 31, 2001, the closing date of our consolidated financial statements for 2001, there was no explicit Argentine peso/euro exchange rate that could be taken as representative.

Taking into account Spanish accounting legislation, the express communications from the Spanish Accounting and Audit Institute (ICAC) regarding the way in which this devaluation should be treated at year-end 2001 and the international accounting rulings in force, in preparing its consolidated financial statements the Telefónica Group used peso/euro and peso/U.S. dollar exchange rates of 1.5149 pesos/€1.00 and 1.70 pesos/U.S.\$1.00 at year-end as the initial representative exchange rates prevailing in the market after December 31, 2001, following the



aforementioned devaluation. This exchange rate corresponds, approximately, to the highest price reached by the dollar during the first session of the Argentine exchange markets in 2002, when the one-to-one peg of the peso to the dollar ended. These exchange rates were used to include in the consolidated financial statements the assets and liabilities of the Argentine subsidiaries and associated companies and to assess the status of their assets as regards their solvency, the value of their investments, their viability and the recoverability of goodwill, among others.

In accordance with the foregoing, these consolidated financial statements reflect an adverse impact on consolidated earnings and on the “Stockholders’ Equity - Translation Differences in Consolidation” caption of €369.0 million and €1,424.1 million, respectively. The effect of using more up-to-date exchange rates is detailed in note 23 to our consolidated financial statements.

The matters still not resolved include the necessary renegotiations with the Argentine government of the future rates due to the effect of the provisions of Law 25.561. Accordingly, although the book value of the operating fixed assets was maintained on the basis of estimates based on the information currently available, neither the results of the negotiations relating to rate levels nor, therefore, the future sales revenues and cash flows can be predicted.

Also, the measures adopted by the Argentine government and the effect thereof on the financial statements may lead, in certain circumstances, to financial and net worth imbalances such as situations of negative net worth, the inability to meet short-term foreign currency loan repayment obligations due to limitations on exchanging pesos and the need to make early repayments of the financing received.

Given that the aforementioned circumstances had not occurred at the date of preparation of the consolidated financial statements and that it is not certain that they will occur, it was not possible to quantify their effect, if any, on the consolidated financial statements as of December 31, 2001.

Facts, circumstances and uncertainties that may affect economies and currencies of the countries in which we operate could have a material impact on our operating results and financial condition.

#### ***Net investment hedge***

In order to reduce foreign currency exposure of net investments in foreign operations, Telefónica, as a matter of policy, attempts to finance its activities in the same currencies as those used for its foreign investments. This policy is implemented either by financing in the related currency or using derivatives, such as currency swaps, which provide a synthetic effect of a foreign currency loan, thereby reducing the exchange risk.

For the year ended December 31, 2001, we recorded under Spanish GAAP approximately €322.5 million of net losses related to the effective portion of non-derivative instruments and derivative instruments used as net investment hedges included as a cumulative translation adjustment in equity. These net gains or losses principally offset the net gains (losses) recorded on the respective net investments in foreign currencies being hedged. Under Spanish GAAP, the requirements to qualify a net investment differ from those of U.S. GAAP. The main differences relate to the measurement of the hedge ineffectiveness. We re-designated all hedging relationships anew for U.S. GAAP purposes at December 31, 2000. Those economic hedge instruments under Spanish GAAP that were not assigned as a net investment hedge under U.S. GAAP were recorded at fair value through earnings. Additionally, all differences relating to net investment hedges under Spanish GAAP and U.S. GAAP (economic hedges not assigned and ineffectiveness) were recorded in earnings for the year ended December 31, 2001. Both of these impacts represented a loss of €193.4 million, gross of tax and minority interests. We have calculated the ineffectiveness of our net investment hedges by comparing an appropriate “hypothetical” derivative and non-derivative contracts with the actual instruments being used.

The determination of the fair value of each derivative and the assessment of hedge effectiveness require the use of estimates regarding discount rates and market prices, among others. A significant change in these estimates may preclude our ability to assign hedging relationships and/or increase the amounts of ineffectiveness and, therefore, produce a material adverse impact on our operating results and financial condition.

#### **Recent Developments – Argentina**

Argentina’s economy is in its fourth straight year of recession. In January 2002, the Argentine government removed the peg of the Argentine peso to the U.S. dollar, resulting in a significant devaluation of the peso against the dollar. The Argentine government has also defaulted on the payment of its debt obligations. Whether

companies doing business in Argentina will default on their obligations depends upon their own financial condition, and, in the case of U.S. dollar obligations, continued access to the foreign exchange markets. The default by the Argentine government and its decision to devalue the currency have resulted in considerable uncertainty about the government's political stability, its management of the economy and the current exchange rate regime. Economic activity slowed sharply in the last weeks of 2001, and real GDP declined 3.9% for the year. Argentina's economic outlook is poor for 2002 with real GDP expected to decrease another 8.0% - 9.0%. Argentina is also likely to experience significantly increased inflation as a consequence of the currency devaluation.

As described above, as a result of the devaluation of the Argentine peso in January 2002, in accordance with Spanish accounting regulations we created various provisions and allowances against our net income for 2001 and adjusted the "translation differences in consolidation" account in our consolidated balance sheet at December 31, 2001. Accordingly, the devaluation of the Argentine peso resulted in a decrease in net income of €369.0 million in 2001 and a reduction in shareholders' equity of €1,793.1 million at December 31, 2001 (including the decrease in net income). These provisions and allowances were made applying the rate of exchange of €1.00 = 1.5149 Argentine pesos, which is equivalent to the rate of U.S.\$1.00 = 1.7 Argentine pesos at January 11, 2002, which is the date the Argentine currency markets first opened following the decision by the Argentine Central Bank to close such markets on December 21, 2001. At March 31, 2002, the rate of exchange had fallen to €1.00 = 2.4862 Argentine pesos, resulting in a decrease in net income of €25.4 million during the first quarter of 2002 and a reduction in shareholders' equity of €1,093.0 million at March 31, 2002. Our financial condition and results of operations may be adversely affected by any further declines in the value of the Argentine peso or declines in the values of the currencies of other Latin American countries where we operate.

Due to the continuing economic instability in Argentina and in order to manage its liquidity risk, in May 2002 Telefónica de Argentina, S.A. commenced an exchange offer outside the United States for certain outstanding debt obligations, which exchange offer expired on June 21, 2002. On that date, Telefónica de Argentina, S.A. announced that it would accept all validly tendered notes.

In addition, the deepening recession and mounting unemployment has led to a reduction of wages in real terms and a reduction in disposable income across all class sectors of the Argentine population. This has resulted in and may continue to result in lower use of our services in Argentina and a deterioration in the collection of accounts receivable, as a result of which our revenues from operations and cash flows in Argentina may decrease further. Further, as part of the measures adopted by the Argentine government in response to the economic crisis, the government annulled the semi-annual adjustments in accordance with the U.S. Consumer Price Index applied to the rates we charge in Argentina for measured services and authorized the government to renegotiate these rate agreements. If future rates evolve at a pace below increases in general price levels as a result of inflation, this would adversely affect our future financial condition and results of operations as well as the recoverability of the value of our fixed assets in Argentina through cash flows.

Furthermore, sources of third-party financing are no longer available to our Argentine fixed-line operator in amounts sufficient for it to meet its debt obligations. Should no third-party financing be available, or if we do not provide additional financing to it, or it does not succeed in refinancing its indebtedness, our Argentine fixed-line operator may be unable to meet its current obligations with local and foreign creditors and may be unable to continue as a going concern.

Additionally, the Central Bank of Argentina has imposed a prohibition, without its prior authorization, on transfers of funds outside Argentina by private sector parties when such transfers relate to debt principal repayments and distributions of income or dividends, except for certain debts, including those involving multilateral lending entities and official or officially-recognized credit agencies. This prohibition remains in effect as of the date of this Annual Report. If the restrictions on funds transfers remain in effect and the Central Bank does not authorize the remittance of funds abroad by our Argentine fixed-line operator, its debt obligations may become immediately due and payable, unless new financing is funded outside Argentina and is available for it to pay its foreign creditors or it is able to refinance the indebtedness that is subject to the restrictions. If our Argentine fixed-line operator fails to secure such financing or it does not succeed in refinancing such indebtedness, it may not be able to continue as a going concern.

## Operating Environment and Business Trends

The discussion below should be considered in light of the following important economic, business and regulatory and competitive developments that affected our group during the periods discussed below and that may affect our future financial condition and results of operations.

### *Economic Developments and Outlook*

#### *Spain*

Our results of operations are dependent, to a large extent, on the level of demand for our services in Spain. As of December 31, 2001, revenues from our operations in Spain represented 50.2% of our consolidated revenues. Demand for our services in Spain is related to the performance of the Spanish economy. Spain's real gross domestic product (GDP) growth slowed to 2.8% in 2001, and real GDP is estimated to be around 2% in 2002, reflecting weaker domestic and external demand. Inflation is expected to decrease to 2.4% in 2002 from 3.6% in 2001. The current-account deficit, which stood at 2.7% of GDP in 2000, is expected to decrease as a proportion of GDP in 2002 and beyond. The unemployment rate was 13.6% at December 31, 2001.

#### *Latin America*

Results of operations from our Latin American operations are impacted by macroeconomic conditions in the region. Since the United States economy entered into a recession in March 2001, economic conditions in Latin America have worsened. As of December 31, 2001, revenues from our Latin American operations represented approximately 43.4% of our consolidated revenues. The depreciation of several Latin American currencies against the euro, in particular the Brazilian real, which declined 21.8% against the euro during the 2001 fiscal year, resulted in a 4.8% decrease in revenues from our Latin American operations in 2001. Our future results of operations from our Latin American operations will depend in part on the evolution of economic conditions in Latin America.

#### *Brazil*

Brazil's GDP growth slowed markedly in the second half of 2001 due mostly to a decline in industrial production during the third quarter. Real GDP growth for the year was approximately 1.5%. Monetary policy has been kept tight by the Brazilian government in order to limit inflation and to bolster the currency. The Brazilian real depreciated approximately 40.0% relative to the U.S. dollar in mid-2001, but rebounded to finish the year down 17.0%. Economic growth of approximately 1.5% is expected in 2002.

#### *Argentina*

Economic activity slowed sharply in the last weeks of 2001, and real GDP declined 3.9% for the year. For a discussion of general macroeconomic conditions in Argentina, as well as the impact of the macroeconomic and political crisis in Argentina on our results of operations, see "—Recent Developments—Argentina".

#### *Chile*

Chile's real GDP growth slowed to 2.8% in 2001 from 5.4% growth in 2000. In 2001, inflation stood at 2.6%, as opposed to a 4.5% inflation rate in 2000. The Chilean peso, which floats freely, depreciated approximately 12.5% against the U.S. dollar in 2001. Chile's unemployment rate remained in the 8-10% range in 2001. Despite Chile's recent labor troubles, wages have on average risen faster than inflation over the last several years as a result of higher productivity, boosting national living standards. Real GDP growth in 2002 is expected to be approximately 2.0%.

#### *Peru*

Peru's real GDP growth slowed to 0.2% in 2001 from 3.6% growth in 2000. Peru experienced deflation in 2001, with prices declining 0.1% as measured by the "IPC", the Peruvian equivalent of the U.S. Consumer Price Index, and the Peruvian central bank cut interest rates significantly in the second half of 2001 without a corresponding depreciation in the Peruvian nuevo sol. Unemployment averaged approximately 9.4% in 2001 and reached approximately 10.0% at year-end 2001. Real GDP growth is expected to reach approximately 3.3% in 2002.

## ***Significant Business Developments***

### *Year ended December 31, 2001*

- As a result of the devaluation of the Argentine peso in January 2002, in accordance with Spanish accounting regulations we recorded an exchange loss and created various allowances against our net income for 2001 and adjusted the “translation differences in consolidation” account in our consolidated balance sheet at December 31, 2001. Accordingly, the devaluation of the Argentine peso resulted in a decrease in net income of €369.0 million in 2001 and a reduction in translation differences in consolidation of €1,424.1 million at December 31, 2001. For a discussion of general macroeconomic conditions in Argentina, as well as the impact of the macroeconomic and political crisis in Argentina on our results of operations, see “—Recent Developments—Argentina”.
- Due to the revision of existing estimates and projections during 2001, we wrote down goodwill associated with our acquisition of mediaWays in the amount of €249 million.
- Terra Networks generated substantial amounts of goodwill from its acquisitions, most importantly its acquisition of Lycos, Inc. In 2001, Terra Networks conducted a study of the evolution of the business plans of its acquired companies, as a result of which it wrote down goodwill related to its prior acquisitions by €35.0 million. At December 31, 2001, it had goodwill of €1,819 million, equal to 29.8% of its total assets at that date. As from July 1, 2001, Terra Networks amortizes the goodwill of its acquired businesses on a straight-line basis over 10 years. Previously, it amortized goodwill over a five-year period.
- Due to technological difficulties relating to the development and deployment of UMTS services, the commercial launch of UMTS services has been delayed.

### *Year ended December 31, 2000*

- The Spanish market for wireless communications services grew significantly during 2000. Our wireless subscribers in Spain increased by approximately 51.0% to 13.7 million at December 31, 2000 from 9.1 million at December 31, 2000.
- In 2000, we acquired newly-issued UMTS licenses, individually or as part of consortia, in Germany, Italy, Austria and Switzerland, at an aggregate cost of approximately €6,611.1 million. We may make substantial additional capital expenditures to build our UMTS networks and roll out operations in countries in which we have been awarded UMTS licenses.
- In 2000, Telefónica Móviles conducted an initial public offering, and we divested some non-strategic assets.

## ***Valuation of Selected Investments***

In line with the recommendations made by the SEC, we may obtain the assistance of competent and knowledgeable independent third parties to cooperate with us in the assessment and verification of the valuations of selected investments. This process may start in the second half of 2002.

As a result of this process we may be required to review the carrying value of selected investments, which could adversely affect our business, financial condition or result from operations.

## ***Regulatory and Competitive Developments***

The discussion below should be considered in light of recent changes in the regulatory framework and the competitive environment for fixed-line public telephone services (which consists of local, long-distance and international telephone services) and wireless communications services in Spain. See “Item 4—Information on the Company”.

*Fixed-Line Public Telephone Services.* In 1998, Retevisión commenced providing domestic and international long-distance services and local telephone services in Spain, marking the end of our monopoly in such services.

Additionally, in 1998 regionally-licensed cable operators began providing cable television as well as offering local telephone service and access lines. In December 1998, a second domestic operator, Lince, commenced offering national and international long-distance telephone services in Spain under the trade name UNI2. During 1999 new competitors entered the market such as Jazztel, RSL Com, British Telecom, Comunitel, and COLT, among others.

Since December 1, 1998, the provision of fixed-line services has been open to competition from all market entrants, subject to basic regulatory licensing requirements. Also as of that date, the Telecommunications Market Commission has the exclusive responsibility for regulating the telecommunications market. At December 31, 2001, the Telecommunications Market Commission had granted:

- 45 Type A licenses
- 17 Type B1 national licenses
- 58 Type B1 restricted licenses
- 6 Type B2 licenses
- 123 Type C1 licenses
- 31 Type C2 licenses

The government has also granted 75 licenses to the cable operators formerly operating under concessions. Each of these operators received Type B1 licenses. See “Item 4—Information on the Company—Business Overview—Fixed-line Telecommunications Services in Spain—Telefónica de España—Competition”. In addition, in March 2000, the government issued six new licenses for the provision of local multipoint distribution services (LMDS). The new licensees are expected to compete with Telefónica de España in the local access market, though as of the date of this Annual Report the amount of competition has not been significant. Moreover, certain of our competitors, including Retevisión and Lince, have common shareholders with the cable operators and have entered into collaboration agreements.

The Telecommunications Market Commission has tended to apply policies favoring new entrants into the telecommunications market. Moreover, as the dominant operator, we will be subject to certain obligations through December 31, 2005, including the requirement to provide our competitors access to our network. Interconnection prices which we charge our competitors for access to our network are currently lower than our costs, and our competitive position may be further harmed by the new interconnection pricing model based on capacity approved by the Telecommunications Market Commission in August 2001. Consequently, our competitors have been able to obtain a sufficient operating margin for long-distance services and capture a large volume of traffic with limited investment.

The full liberalization of the telecommunications market was undertaken in December 1998 without the rate rebalancing that we considered necessary. As a result, tariffs have not been in line with our real costs. Instead, tariffs are presently below our real costs for those services for which competition does not yet exist and above our costs for those services, such as long-distance, that are highly competitive. The maintenance of a charge for access lines below our costs has led to an access deficit. We believe, however, that rate rebalancing measures approved by the Delegate Commission for Economic Affairs of the Spanish government in June 2000 will eliminate the access deficit by 2003. See “Item 4—Information on the Company—Business Overview—Fixed-line Telecommunications Services in Spain—Telefónica de España—The Tariff Structure and Pricing for Principal Services”.

Further, in June 2000 the Spanish government issued a new Royal Decree relating to the provision of and prices for certain telecommunication services. Under this decree, we are required, as a dominant operator, to:

- facilitate segregated and shared access to our local loop pursuant to the conditions and prices established by separate ministerial orders
- facilitate the use of alternative carriers by persons placing local telephone calls

- offer 600 minutes of local calls between 6:00 p.m. and 8:00 a.m. for €4.21 per month and 600 minutes of local calls during all hours for €8.41 per month
- offer Internet access between 6:00 p.m. and 8:00 a.m. Monday through Friday and all weekend for €16.53 per month

In order to maintain competitive prices, we have applied discounts which totaled over €270 million in 1999, €630 million in 2000 and €440 million in 2001. We anticipate that in the near future we will lose some market share in access lines and local traffic when cable operators deploy their networks and other operators begin to lease their connections to Telefónica de España's local loop in significant amounts. Additionally, loss of market share for domestic and international telephone services may be significant if we remain subject to restrictions by virtue of our position as the dominant operator and as long as the current tariff structure remains in place.

We also anticipate that, as a consequence of competition, prices for liberalized services will decline and operating margins may diminish. The exact scope of increased competition and any adverse effects on our results and market share will depend on a variety of factors that cannot be assessed with precision and that are beyond our control.

*Wireless Communications Services.* We face competition in the market for wireless communications services from Vodafone (formerly known as Airtel) and Retevisión Móvil, which operates under the trade name Amena. Since Amena entered the market in January 1999, our market share has declined from an estimated approximately 70% market share to an estimated approximately 56.6% market share at December 31, 2001. We will face competition from a fourth competitor, Xfera, a consortium in which Sonera and Vivendi are participants, under the UMTS standard, beginning when handsets and equipment are available. On April 8, 2002, the Secretary of State for Telecommunications and Information Society approved a definitive resolution setting forth the criteria with which wireless communications operators must comply in order to roll out their UMTS services in cities with more than 250,000 inhabitants. As of June 1, 2002, wireless communications operators may launch their UMTS services commercially at any time so long as they comply with the relevant minimum services standards.

Telefónica Móviles and Vodafone have been declared dominant operators in the wireless communications and interconnection markets by the Telecommunications Market Commission. As a result, the price Telefónica Móviles and Vodafone charge to other operators terminating calls in their respective networks must be related to the costs of providing the service. In addition, the Telecommunications Market Commission may set the maximum price that Telefónica Móviles may charge such operators. On March 20, 2002, a Ministerial Order was published, which provides that virtual mobile operators will negotiate the terms and conditions of their use of network mobile operators' networks, including Telefónica Móviles España's network, directly with such mobile network operator. In the case of any dispute regarding access, the Telecommunications Market Commission may intervene to resolve the dispute.

In 2000, Telefónica Móviles paid a one-time fee of €131 million in connection with Telefónica Móviles' acquisition of a new third generation wireless license in Spain, which will allow Telefónica Móviles to deploy the new UMTS technology. Telefónica Móviles is required to pay the Spanish treasury an annual fee for the use of the radioelectric spectrum. During 2000, Telefónica Móviles paid approximately €19 in such fees to the Spanish treasury. In 2000, the Spanish government increased substantially the fees for use of radioelectric spectrum both for new UMTS license as well as Telefónica Móviles' existing analog and digital concessions and other uses. As a result, Telefónica Móviles paid fees of approximately €236 million in 2001 for the use of the radioelectric spectrum. Telefónica Móviles and its competitors have filed claims with the *Audiencia Nacional* challenging the increase in fees. As of the date of this Annual Report, the *Audiencia Nacional* has not ruled on such claims.

Pursuant to Law 23/2001 dated December 27, 2001, new fees were adopted for use of radioelectric spectrum for 2002 through 2006, subject to annual increases of 5% for mobile services and LMDS and 2% for other services. These new fees represent an approximately 75% decrease over the fees which Telefónica Móviles paid in 2001 for similar use of radioelectric spectrum. The largest decrease relates to the fees which Telefónica Móviles pays in connection with its UMTS license. In 2002, Telefónica Móviles is required to pay fees of €21 million in connection with its UMTS licenses, which represents a decrease of over 87% from the fees of €162 million in 2001, which represented more than 68.7% of the total licensing fees Telefónica Móviles paid in 2001. Additionally, the Spanish government has adopted uniform pricing for MHz. See "Information on the Company—Worldwide Wireless Communications Services—Telefónica Móviles—Spain—Regulation".

## Results of Operations

A summary of our results of operations during 1999, 2000 and 2001 are shown below.

	Year ended December 31,		
	1999	2000	2001
	(in millions of euro, except per share data)		
Revenue from operations .....	22,957.0	28,485.5	31,052.6
EBITDA(1) .....	10,885.4	11,918.8	12,804.2
Operating profit.....	4,776.6	4,958.0	5,430.3
Pretax income (loss).....	(32.7)	2,867.7	2,033.9
Net income .....	69.6	2,504.8	2,106.8
Net income per share .....	0.02	0.58	0.45
Number of shares outstanding (millions).....	3,262.8	4,340.7	4,671.9

- (1) Earnings before interest, taxation, depreciation and amortization. EBITDA has been included to provide additional information relating to our ability to generate cash from operations. EBITDA is not a measure of financial performance under Spanish or U.S. GAAP and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles. Management believes EBITDA is useful to an investor in evaluating our company because it is widely used in the telecommunications industry as a measure to evaluate a company's operating performance before debt expense and its cash flow. EBITDA is not calculated identically by all companies and the presentation here may not be comparable to other similarly titled measures of other companies. Management's discretionary use of funds depicted by EBITDA may be limited by working capital, debt service and capital expenditure requirements and by restrictions related to legal requirements, commitments and uncertainties.

The table below sets forth certain consolidated revenue and expense items as a percentage of consolidated revenue from operations for the periods indicated.

	Year ended December 31,		
	1999	2000	2001
Revenue from operations .....	100.0%	100.0%	100.0%
Goods purchased.....	(18.0)	(21.0)	(23.2)
External services and local taxes .....	(17.0)	(20.0)	(17.8)
Personnel costs.....	(19.0)	(18.0)	(17.0)
Provision for depreciation and amortization .....	(27.0)	(24.0)	(24.0)
Trade provisions .....	(2.0)	(3.0)	(3.2)
Other operating revenue.....	5.0	4.2	3.1
Other operating expenses.....	(1.0)	(0.4)	(0.2)
Total operating costs before financial expenses and goodwill amortization .....	(84.0)	(87.0)	(86.0)
Operating profit.....	21.0	17.0	17.4
Financial income (expense) .....	(6.0)	(6.5)	(5.1)
Exchange gains (losses) .....	2.0	(0.9)	(2.5)
Income (loss) from associated companies.....	0.0	(0.6)	(1.2)
Amortization of goodwill on consolidation .....	(1.0)	(1.8)	(2.7)
Profit from ordinary activities.....	15.0	8.6	5.9
Extraordinary income .....	9.0	15.1	3.1
Losses on sale of fixed assets.....	(1.0)	(0.7)	(0.7)
Extraordinary expenses .....	(23.0)	(13.6)	(1.7)
Income (loss) before tax and minority interests .....	(0.1)	(10.1)	(6.5)
Corporate income tax .....	3.0	(0.9)	(0.6)
Minority interests.....	3.0	(0.4)	0.8
Net income .....	0.3	8.8	6.8

### *Year Ended December 31, 2001 Compared with Year Ended December 31, 2000*

Prior to the year ended December 31, 2001, the results of operations of our different lines of business were presented on the basis of the legal entities owned by the holding companies that head our respective lines of

business. The fiscal year ended December 31, 2001 marked the first full year following the reorganization of our business along global business lines. For the year ended December 31, 2001, the results of operations of each consolidated operating subsidiary are presented under the line of business to which it relates, regardless of whether the legal entity has been transferred to the holding company that heads such line of business, except for the results of Startel, our Chilean wireless operator, and our Puerto Rican wireless operations, both of which are included under “Other subsidiaries”. Solely for purposes of our comparison of results of operations for the fiscal year ended December 31, 2001 versus the fiscal year ended December 31, 2000, we have modified the results of operations of our different lines of business for the fiscal year ended December 31, 2000 to reflect our new business structure and make such results of operations comparable to those for the year ended December 31, 2001. Therefore the tables and the discussion of our results of operations by line of business included under “—Year Ended December 31, 2001 Compared with Year Ended December 31, 2000” show the results of operations of each consolidated operating subsidiary under the line of business to which it relates, regardless of whether the legal entity has been transferred to the holding company that heads such line of business, except for the results of Startel, our Chilean wireless operator, and our Puerto Rican wireless operations, both of which are included under “Other subsidiaries”. The above modification has no effect on the consolidated results of operations of the Telefónica Group. However, the results shown for our different lines of business may differ from those reported by our subsidiaries such as Telefónica Móviles and Terra Networks, which are reporting companies in the United States. They will also differ from the results of operations reported by those companies because they are not wholly-owned by us and because certain transactions they enter into with other members of the Telefónica Group are eliminated in consolidation. We intend to continue to use this presentation in the future because it more accurately reflects the way in which management evaluates the performance of our different lines of business. We have retained the historical comparison of results of operations for the fiscal year ended December 31, 2000 versus December 31, 1999 included below under “—Year Ended December 31, 2000 Compared with Year Ended December 31, 1999” because the comparison correctly reflects our historical business structure and the restatement of operating results by line of business for 1999 on the same basis of presentation as the results of operations for 2001 (and the results of operations for 2000 for purposes of the comparison of results of operations for the fiscal year ended December 31, 2001 versus the fiscal year ended December 31, 2000) is not practicable.

The table below sets forth an analysis of consolidated revenue from operations for each of our principal lines of business for 2000 and 2001 before and after adjustments for sales to other members of the Telefónica Group.

	Year ended December 31,			
	2000(1)	2001(1)	2000(2)	2001(2)
	(millions of euro)			
Basic fixed-line telephone service (3).....	4,831.8	4,658.2	n.a.	n.a.
Leased circuits (3) .....	973.8	933.2	n.a.	n.a.
Interconnection (3) .....	295.1	427.9	n.a.	n.a.
ISDN (3) .....	1,128.5	1,368.3	n.a.	n.a.
Pay telephone service (3) .....	723.7	604.8	n.a.	n.a.
Other (3) .....	2,230.0	2,227.9	n.a.	n.a.
<b>Total revenue from operations for</b>				
<b>Telefónica de España</b> .....	10,182.9	10,220.4	9,194.3	9,208.5
Telefónica Internacional .....	10,371.3	10,137.4	10,218.6	9,821.5
Telefónica Móviles .....	7,401.2	8,411.1	6,064.3	7,080.2
Telefónica Data.....	1,123.7	1,849.7	814.3	1,244.1
Admira Media .....	723.9	1,403.1	721.2	1,395.5
Terra Networks .....	304.0	690.0	277.4	660.7
Telefónica Publicidad e Información.....	607.7	619.5	521.4	559.5
Atento .....	526.9	643.8	165.7	219.6
Other subsidiaries (4).....	816.9	1,145.3	508.2	862.9
<b>Total revenue from operations for consolidated</b>				
<b>subsidiaries</b> .....	32,058.5	35,120.2	28,485.5	31,052.6
Intercompany sales .....	(3,573.1)	(4,067.6)	-	-
<b>Total revenue from operations</b> .....	28,485.4	31,052.6	28,485.5	31,052.6

- (1) Includes revenue from operations before adjustments for sales to other members of the Telefónica Group.
- (2) Includes revenue from operations after adjustments for sales to other members of the Telefónica Group.
- (3) Telefónica de España does not calculate revenue from this line item after adjustment for sales to other members of the Telefónica Group.
- (4) Includes revenue from operations from Katalyx, Emergia and other subsidiaries.



The table below shows the contribution to our total revenue from operations of each of our principal lines of business for 2000 and 2001 before and after adjustments for sales to other members of the Telefónica Group.

	Year ended December 31,			
	2000(1)	2001(1)	2000(2)	2001(2)
Basic fixed-line telephone service (3).....	17.0%	15.0%	n.a.	n.a.
Leased circuits(3) .....	3.4%	3.0%	n.a.	n.a.
Interconnection(3) .....	1.0%	1.4%	n.a.	n.a.
ISDN(3) .....	2.5%	1.9%	n.a.	n.a.
Pay telephone service(3) .....	4.0%	4.4%	n.a.	n.a.
Other(3) .....	7.8%	7.2%	n.a.	n.a.
Revenues from operations for Telefónica de España.....	35.7%	32.9%	32.3%	29.7%
Telefónica Internacional .....	36.4%	32.6%	35.9%	31.6%
Telefónica Móviles .....	26.0%	27.1%	21.3%	22.8%
Telefónica Data.....	3.9%	6.0%	2.9%	4.0%
Admira Media .....	2.5%	4.5%	2.5%	4.5%
Terra Networks .....	1.1%	2.2%	1.0%	2.1%
Telefónica Publicidad e Información.....	2.1%	2.0%	1.8%	1.8%
Atento .....	1.8%	2.1%	0.6%	0.7%
Other subsidiaries(4) .....	2.9%	3.7%	1.8%	2.8%
<b>Total revenue from operations for consolidated subsidiaries .....</b>	<b>112.5%</b>	<b>113.1%</b>	<b>100.0%</b>	<b>100%</b>
Intercompany sales .....	(12.5)%	(13.1)%	-	-
<b>Total revenue from operations .....</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

- (1) Includes revenue from operations before adjustments for sales to other members of the Telefónica Group.  
(2) Includes revenue from operations after adjustments for sales to other members of the Telefónica Group.  
(3) Telefónica de España does not calculate revenue from this line item after adjustment for sales to other members of the Telefónica Group.  
(4) Includes revenue from operations from Katalyx, Emergia and other subsidiaries.

The table below shows the contribution to our consolidated net income of each of our principal business lines in 2000 and 2001.

	Year ended December 31,	
	2000	2001
	(millions of euro)	
Telefónica de España .....	216.6	1,077.6
Telefónica Internacional .....	447.4	1,274.9
Telefónica Móviles .....	590.7	893.4
Telefónica Data.....	(49.1)	(486.2)
Admira Media .....	(627.4)	(347.3)
Terra Networks .....	(555.2)	(566.3)
Telefónica Publicidad e Información.....	55.0	48.0
Atento .....	(111.8)	(109.5)
Katalyx.....	(69.5)	(31.4)
Emergia.....	(27.2)	(183.6)
Holding and other subsidiaries.....	(202.4)	(93.3)
Adjustments in consolidation.....	2,837.9	630.5
Consolidated net income.....	2,504.8	2,106.8

#### *Revenue from operations*

Our revenue from operations, which accounted for 96.9% and 95.9% of our consolidated total revenue for 2001 and 2000, respectively, increased 9.0% to €31,052.6 million in 2001 from €28,485.4 million in 2000. The growth in revenue from operations was primarily attributable to increased revenues from operations of Telefónica Móviles, Telefónica Data and Admira Media, offset in part by decreased revenues from operations of Telefónica Internacional. Whereas we calculate revenues from operations both before and after adjustments for sales to other

members of the Telefónica Group, our analysis of revenue from operations is strictly limited to revenues from operations before adjustments for sales to other members of the Telefónica Group. Accordingly, in the following sections we disclose revenues from operations both before and after adjustments for sales to other members of the group and limit our discussion solely to revenues before adjustments for sales to other members of the Telefónica Group. In the aggregate, we believe that sales to other members of the Telefónica Group did not have a significant impact on the percentage fluctuations during the periods discussed.

*Telefónica de España.* Telefónica de España's revenues from operations (including sales to other members of the Telefónica Group) increased 0.4% to €10,220.4 million in 2001 from €10,182.9 million in 2000. This increase was principally due to an increase in revenues from ISDN, other revenues and revenues from interconnection, offset in part by a decrease in revenues from basic fixed-line telephone service and pay telephone service.

- Revenues from basic fixed-line telephone service include revenues received from customers for connection fees, subscription fees and traffic charges. Revenues from basic fixed-line telephone service decreased 3.6% to €4,658.2 million in 2001 from €4,831.8 million in 2000 mainly due to tariff reductions, discounts in connection with calling plans (including volume discounts and flat rate plans) and decreased revenues from local traffic as a result of increased competition. This decrease was offset in part by:
  - an increase in revenues from monthly subscription fees as a result of the €0.60 increase in per-line monthly subscription fees implemented in March 2001, followed by a further €0.60 increase in August 2001;
  - a 47.8% increase in dial-up traffic for Internet access to 35,499 million minutes in 2001 from 24,020 million minutes in 2000; and
  - a 10.1% increase in fixed-to-mobile traffic to 5,470 million minutes in 2001 from 4,968 million minutes in 2000.
- Revenues from leased circuits include revenues received from leasing our circuits, both domestic and international, to customers and other telecommunications operators. Revenues from leased circuits decreased 4.2% to €933.2 million in 2001 from €973.8 million in 2000.
- Revenues from interconnection include revenues received from charges to other telecommunications operators for interconnection with our fixed-line network. Revenues from interconnection increased 45.0% to €427.9 million in 2001 from €295.1 million in 2000, principally as a result of the 209.0% increase in the volume of interconnection traffic with other fixed-line operators to 29,995 million minutes in 2001 from 12,775 million minutes in 2000, offset in part by an approximately 21.0% decrease in interconnection prices effective as of August 2001. We expect that revenues from interconnection in the second half of 2002 will be adversely affected as we enter into new interconnection agreements with other operators based on capacity. See "Item 4—Information on the Company—Business Overview—Fixed-line Telecommunications Services in Spain—Telefónica de España—Interconnection Prices".
- Revenues from integrated services digital network, or ISDN, include revenues from connection fees, subscription fees and traffic charges relating to our ISDN lines. Revenues from ISDN increased 21.2% to €1,368.3 million in 2001 from €1,128.5 million in 2000, mainly due to a 25.1% increase in the number of ISDN lines to approximately 2.1 million in 2001 from approximately 1.7 million in 2000.
- Revenues from pay telephone service include revenues received from calls made from public telephone booths owned by us and public telephones operated by us on private premises. Revenues from pay telephone service decreased 16.4% to €604.8 million in 2001 from €723.7 million in 2000, mainly due to a decrease in traffic as a result of increased competition from wireless communications services and increased competition from other operators. We expect that revenues from pay telephone service will continue to be adversely affected by increased competition from wireless communications service providers.

- Other revenues include revenues from the lease, sale and maintenance of terminals and other equipment that connects to our fixed-line network, as well as operating revenues from other subsidiaries of Telefónica de España. Other revenues decreased 0.1% to €2,227.4 million in 2001 from €2,230.0 million in 2000 due in part to a 28.5% decrease in operating revenue at Telefónica Telecomunicaciones Públicas and a 23.7% decrease in operating revenue at Telyco offset in part by a 10.6% increase in revenues from the lease, sale and maintenance of terminals to €700.8 million in 2001 from €633.7 million in 2000 principally as a result of the sale of single line terminals.

Telefónica de España's revenues from operations (excluding sales to other members of the Telefónica Group) increased 0.15% to €9,208.5 million in 2001 from €9,194.3 million in 2000.

*Telefónica Móviles.* Telefónica Móviles' revenue from operations (including sales to other members of the Telefónica Group) increased 13.6% to €8,411.1 million in 2001 from €7,401.2 million in 2000. This increase was principally due to a 28.6% increase in its customer base, a 26.7% increase in the number of minutes consumed and a 178% increase in short messaging revenue, partially offset by a 14.7% decrease in average revenue per user. Net revenues from Telefónica Móviles' operations in Spain (including sales to other members of the Telefónica Group) increased 19.6% to €5,736.0 million in 2001 from €4,796.5 million in 2000 due to an increase of 22.9% in wireless subscribers to 16.8 million at December 31, 2001 from 13.7 million at December 31, 2000, partially offset by a 9% decline in average revenue per user to €31 in 2001 from €34 in 2000 which was principally attributable to rate reductions and to a change in the customer mix as the number of pre-paid customers increased to 68% of Telefónica Móviles' customer base in Spain at December 31, 2001. Net revenues from Telefónica Móviles' Latin American wireless operations (including sales to other members of the Telefónica Group) increased 4.3% as measured in euro (or 14.4% excluding the impact of the devaluations of local currencies) to €2,686.0 million in 2001 from €2,574.1 million in 2000 due to an increase of 33.2% in wireless subscribers to approximately 9.3 million at December 31, 2001 from 7.0 million at December 31, 2000, partially offset by lower average revenues per user as measured in local currencies and the depreciation of the Latin American currencies relative to the euro. In 2001, average revenues per user, as measured in local currency, decreased 7.6% at Tele Sudeste Celular, 12.6% at Celular CRT, 4.7% at Tele Leste Celular, 15.3% at Telefónica Móviles Perú, 33.8% at Telefónica Comunicaciones Personales, 26.1% at Telefónica Móviles' El Salvador operations and 34.9% at Telefónica Móviles' Guatemala operations.

Telefónica Móviles' revenue from operations (excluding sales to other members of the Telefónica Group) increased 16.8% to €7,080.2 million in 2001 from €6,064.3 million in 2000.

*Telefónica Internacional.* Telefónica Internacional's revenues from operations (including sales to other members of the Telefónica Group) decreased 2.3% to €10,137.4 million in 2001 from €10,371.3 million in 2000 principally as a result of the devaluation of the Brazilian real and the Chilean peso during 2001 and the effect of Argentina's economic crisis, offset in part by increased revenues from operations of Telesp and Compañía de Telecomunicaciones de Chile, as measured in local currency.

- Revenue from operations generated by Telesp denominated in euro decreased 0.4% to €4,311.3 million in 2001 from €4,326.6 million in 2000, principally due to the depreciation of the Brazilian real against the euro of approximately 24.4% on average. This decrease was offset in part by a 24% increase in revenues from operations, as measured in Brazilian reais, mainly due to a 28% increase in average number of lines in service, a 10.4% increase in tariffs for local calls (as measured in local currency) effected in June 2001, an 11.1% increase in long-distance traffic to 7,509.6 million minutes in 2001 and a 385% increase in the number of ADSL lines in service to 198,306 lines.
- Revenue from operations generated by Compañía de Telecomunicaciones de Chile denominated in euro decreased 4.8% (an increase of 5.4% as measured in Chilean pesos) to €1,421.1 million in 2001 from €1,492.8 million in 2000, principally due to the depreciation of the Chilean peso against the euro of approximately 10.7% on average. This increase in revenues from operations, as measured in Chilean pesos, was mainly due to:
  - a 23% increase in revenues from domestic long-distance services as a result of a 12.2% increase in domestic long-distance traffic to 779.3 million minutes in 2001 and the introduction of new products such as semi-flat rate plans, which resulted in an increase of

493.8% in the number of customers and a significant increase in domestic long-distance traffic through semi-flat rate plans to 167.6 million minutes in 2001 from 14.5 million minutes in 2000; and

- a 0.8% increase in the number of lines in service, particularly the number of prepaid lines in service which grew by 197%.
- Revenue from operations generated by Telefónica de Argentina denominated in euro decreased 5.5% (8.3% as measured in Argentine pesos) to €2,981.4 million in 2001 from €3,154.9 million in 2000, principally due to:
  - lower revenues from measured service (including mainly local and domestic long-distance) as a result of the introduction of discount plans for domestic long-distance service in response to the new competitive environment, a decrease in the effective rate for certain local and long-distance segments and decreases in the average number of billable domestic long-distance lines and billable local lines in service as a result of the entry of new competitors; and
  - lower revenues from international long-distance services as a result of a decrease in average tariffs and commercial discounts pursuant to discounted calling plans introduced in response to the new competitive environment.

Telefónica de Argentina's results of operations were also adversely affected by Argentina's economic crisis.

- Revenue from operations generated by Telefónica del Perú denominated in euro increased approximately 1.7% (a decrease of 3.6% as measured in Peruvian nuevo soles) to €1,334.2 million in 2001 from €1,311.9 million in 2000, principally due to the appreciation of the Peruvian nuevo sol against the euro of approximately 5.1% on average. The decrease in revenues from operations, as measured in Peruvian nuevo soles, was mainly due to:
  - an average reduction of 3% in tariffs as a result of the implementation of the new price cap in September 2001;
  - a 42% reduction in interconnection prices effected in January 2001 and an additional reduction of 17% in June 2001; and
  - lower revenues from long-distance services as a result of the loss of market share due to increased competition and the introduction of reduced tariffs pursuant to discounted calling plans adopted in response to the new competitive environment.

Telefónica Internacional's revenue from operations (excluding sales to other members of the Telefónica Group) decreased 3.9% to €9,821.5 million in 2001 from €10,218.6 million in 2000.

*Telefónica Data.* Telefónica Data's revenue from operations (including sales to other members of the Telefónica Group) increased 64.6% to €1,849.7 million in 2001 from €1,123.7 million in 2000 principally due to increased revenues from high margin services in Spain, including Internet traffic carried through Telefónica Data's network, Internet hosting services and IP solutions, and the inclusion of the results of operations of mediaWays which we acquired in January 2001 for financial reporting purposes. These increases were offset by lower revenues from international services in 2001 as a result of lower amounts of international IP traffic and a downward trend in rates.

Telefónica Data's revenue from operations (excluding sales to other members of the Telefónica Group) increased 52.8% to €1,244.1 million in 2001 from €814.3 million in 2000.

*Terra Networks.* Terra Networks' revenue from operations (including sales to other members of the Telefónica Group) increased 127.0% to €690.0 million in 2001 from €304.0 million in 2000. This increase was principally due to:

- a 71.7% increase in access revenues (which include subscription fees paid by Terra Networks' customers for dial-up and ADSL access to Terra Networks' Internet access service and value-added service fees) to €203.8 million in 2001 from €118.7 million in 2000 as a result of a 58.0% increase in the average number of subscribers to 4.4 million in 2001 from 2.8 million in 2000 due in part to greater market penetration as a result of the increase in online users in the countries where Terra Networks offers Internet access services; and
- a 206.4% increase in advertising revenues to €405.8 million in 2001 from €132.4 million in 2000, mainly due to the inclusion of a full year of advertising revenues of Lycos, Inc., which Terra Networks acquired in October 2000 for financial reporting purposes.

At December 31, 2001, Terra Networks had approximately 4.35 million subscribers compared to approximately 4.10 million subscribers at December 31, 2000. It generated more than 500 million average daily page views during December 2001.

Terra Networks' revenue from operations (excluding sales to other members of the Telefónica Group) increased 138.2% to €660.7 million in 2001 from €277.4 million in 2000.

*Admira Media.* Admira Media's revenue from operations (including sales to other members of the Telefónica Group) increased 93.8% to €1,403.1 million in 2001 from €723.9 million in 2000, principally due to the inclusion of a full year of results of operations of each of Endemol, which we acquired in August 2000 for financial reporting purposes, and Atlántida de Comunicaciones, which we acquired in May 2000 for financial reporting purposes, offset in part by decreased revenues from advertising as a result of adverse macroeconomic conditions and a decrease in revenues from the Admira Media group's production companies due to decreases in prices charged for programming as a result of the soft advertising market.

Admira Media's revenue from operations (excluding sales to other members of the Telefónica Group) increased 93.5% to €1,395.5 million in 2001 from €721.2 million in 2000.

#### *Operating expenses*

Operating expenses, which consist of increase in inventories (net), goods purchased, external services, local taxes, personnel costs and other operating expenses (provisions), increased 7.4% to €18,146 million in 2001 from €16,883.5 million in 2000, principally due to increased operating expenses at Terra Networks, Telefónica Data and Admira Media, offset in part by decreased operating expenses at Telefónica de España.

*Telefónica de España.* Telefónica de España's operating expenses decreased 3.1% to €5,703.4 million in 2001 from €5,884.8 million in 2000, mainly due to decreased operating expenses at Telyco and Telefónica Comunicaciones Públicas as a result of a decrease in commercial activity due to lower sales as a result of increased competition from wireless communications services, offset in part by expenses of €188.6 million related to the expansion of Telefónica de España's ADSL network in connection with the development of its retail ADSL business. Telefónica de España expects to continue to incur significant expenses in connection with the expansion of this business during the next two to three years. Goods purchased by Telefónica de España's fixed-line operator in Spain increased 2.8% to €2,226.9 million in 2001 from €2,166.9 million in 2000, principally due to a 98.9% increase in interconnection costs related to fixed-to-fixed interconnections as a result of increased traffic with other networks and the purchase of ADSL modems. External services increased 7.3% to €908.4 million in 2001 from €846.5 million in 2000, due to the increased use of outsourcing of activities as a result of workforce reductions. Personnel expenses decreased 5.3% to €2,039.9 million in 2001 from €2,154.6 million in 2000, as a result of the streamlining of Telefónica de España's workforce, which had 40,856 employees at December 31, 2001, a slight decrease of 0.8% from the number of employees at December 31, 2000, which resulted in a decrease of 9.7% in payroll offset in part by a 3.4% increase in wages in accordance with the Spanish consumer price index pursuant to the collective bargaining agreement in effect at Telefónica de España. As a result, Telefónica de España had a productivity ratio of 505 lines per employee at December 31, 2001, a 2.5% improvement over the productivity ratio of 493 lines per employee at December 31, 2000.

*Telefónica Móviles.* Operating expenses at Telefónica Móviles increased 1.8% to €5,029.4 million in 2001 from €4,942.6 million in 2000, principally due to a 56.2% increase in personnel costs to €533.8 million in 2001 from €341.8 million in 2000, which is mainly due to the personnel costs associated with our new wireless operations in

Mexico and Europe and a 5.9% increase in the costs of goods purchased to €1,899.3 million in 2001 from €1,793.8 million in 2000.

- Goods purchased (including interconnection costs) at Telefónica Móviles' Spanish operations increased 26.5% to €1,236 million from €977 million in 2000, mainly due to the introduction of the centralized handset procurement model, in which Telefónica Móviles buys and sells handsets in the market in connection with its customer expansion and customer loyalty activities. As a percentage of net revenues from operations generated by Telefónica Móviles' Spanish operations, goods purchased increased to 21.5% for 2001 from 20.4% for 2000. External services at Telefónica Móviles' Spanish operations decreased 19% to €1,521 million in 2001 from €1,871.1 million in 2000, principally due to a 36% increase in subscriber acquisition costs, including advertising costs and distributor commissions. As a percentage of net revenues from operations generated by Telefónica Móviles' Spanish operations, external services decreased to 27% for 2001 from 39% for 2000. Personnel expenses at Telefónica Móviles' Spanish operations increased 29.3% to €212 million in 2001 from €164 million in 2000, principally due to a 10% increase in personnel to 4,372 people at year-end 2001 from 3,982 people at year-end 2000. As a percentage of net revenues from operations generated by Telefónica Móviles' Spanish operations, personnel expenses increased to 3.7% for 2001 from 3.4% for 2000.
- Goods purchased (including interconnection costs) at Telefónica Móviles' Latin American operations decreased 24% to €581 million in 2001 from €723 million in 2000 mainly due to lower commercial activity. As a percentage of net revenues from operations generated by Telefónica Móviles' Latin American operations, goods purchased decreased to 21.6% in 2001 from 28% in 2000. External services at Telefónica Móviles' Latin American operations increased 11.8% to €1,023 million in 2001 from €915 million in 2000 mainly due to increased costs due to the inclusion of the results of operations of Bajacel, Movitel, Norcel and Cedetel, which we acquired in July 2001 for financial reporting purposes. As a percentage of net revenues from operations generated by Telefónica Móviles' Latin American operations, external services increased to 38% in 2001 from 35% in 2000. Personnel expenses at Telefónica Móviles' Latin American operations increased 38% to €220 million in 2001 from €159 million in 2000 principally due to the inclusion of the wireless operations in Mexico, which resulted in a 59.7% increase in the number of personnel to 8,115 people at year-end 2001 from 5,081 people at year-end 2000. As a percentage of net revenues from operations generated by Telefónica Móviles' Latin American operations, personnel expense increased to 8.2% in 2001 from 6.2% in 2000.

*Telefónica Internacional.* Telefónica Internacional's operating expenses remained flat at €5,246.9 million in 2001 compared with €5,230.7 million in 2000, principally as a result of the devaluation of the Brazilian real and the Chilean peso during 2001 and a decrease in operating expenses at Telesp and Compañía de Telecomunicaciones de Chile due to decreases in personnel expenses as a result of workforce reductions. As a percentage of Telefónica Internacional's net revenues from operations, Telefónica Internacional's operating expenses increased to 51.8% for 2001 from 50.4% for 2000. The percentage increases or decreases below were calculated based on local currency amounts as opposed to amounts that have been converted into euro.

- Telesp's operating expenses increased 29.3% in 2001, mainly due to a 49.6% increase in interconnection expense as a result of increased traffic with other networks and an increase in the provision for bad debt as a result of the application in 2001 of a more conservative policy relating to provisions for bad debt. This increase was partially offset by a decrease of 12.2% in personnel expenses due to a reduction in Telesp's workforce in the fourth quarter of 2001.
- Compañía de Telecomunicaciones de Chile's operating expenses decreased 5.4% in 2001 mainly due to a 6% decrease in personnel expenses as a result of workforce reductions which reduced the number of employees by 22% in 2001 and cost control and rationalization measures implemented during 2001. This reduction was partially offset by an increase in interconnection expense of 6.2%.
- Telefónica de Argentina's operating expenses decreased 1.2% in 2001, principally due to cost reduction efforts, including a decrease in personnel expenses of 11.1% and a decrease in goods purchased of 28%, offset in part by a significant increase of 99.2% in provisions for bad debt to 181.8 million Argentine pesos in 2001 from 91.3 million Argentine pesos in 2000.

- Telefónica del Perú's operating expenses remained flat in 2001, principally as a result of a 13.8% increase in goods purchased, offset by a 6.2% decrease in personnel expenses and a 3.8% decrease in external expenses.

*Telefónica Data.* Telefónica Data's operating expenses increased 70.9% to €1,841.6 million in 2001 from €1,077.5 million in 2000, mainly due to the inclusion of results of operations of mediaWays which we acquired in January 2001 for financial reporting purposes and increases in goods purchased and personnel expenses in connection with the expansion of operations into new markets in Europe (Germany, Austria, Italy and the United Kingdom) and the Americas (Colombia, Mexico, Uruguay, Puerto Rico and the United States).

*Terra Networks.* Terra Networks' operating expenses increased 43.0% to €953.6 million in 2001 from €666.9 million in 2000, principally due to the inclusion of a full twelve months of operating expenses of Lycos, Inc., whose operating expenses are included as of the date of its acquisition for financial reporting purposes in October 2000. Goods purchased increased 81.8% to €352.0 million in 2001 from €193.6 million in 2000, principally due to the inclusion of a full twelve months of costs of goods purchased of Lycos, Inc. and increased communication costs in Spain to €108.6 million in 2001 from €29.0 million in 2000, principally due to the increase in Terra Networks' average number of access subscribers. As a percentage of net revenues from operations generated by Terra Networks, goods purchased decreased to 50.8% for 2001 from 63.0% for 2000. Personnel expenses increased 75.4% to €205.0 million in 2001 from €116.9 million in 2000, principally due to an increase in the total number of employees, principally due to a full year of Lycos, Inc. personnel expenses, offset in part by workforce reductions. As a percentage of net revenues from operations, personnel expenses decreased to 29.6% for 2001 from 38.0% for 2000. Other operating expenses increased 11.3% to €396.5 million in 2001 from €356.3 million in 2000. As a percentage of net revenues from operations generated by Terra Networks, other operating expenses decreased to 57.2% for 2001 from 115.9% for 2000, principally due to successful cost containment measures.

*Admira Media.* Admira Media's operating expenses increased approximately 77% to €1,258 million in 2001 from €709 million in 2000, principally due to the inclusion of a full year of results of operations of each of Endemol, which we acquired in August 2000 for financial reporting purposes, and Atlántida de Comunicaciones, which we acquired in May 2000 for financial reporting purposes.

#### *EBITDA*

EBITDA consists of revenue from operations plus other operating revenue and internal expenditures capitalized, less operating expenses, trade provisions and other operating expenses. Our EBITDA increased 7.4% to €12,804.2 million in 2001 from €11,918.7 million in 2000, principally due to increased revenues from operations, despite a slowdown in the rate of growth of such revenues, and strict control of operating expenses, offset in part by the negative effect of exchange rate variations as a result of decreases in local Latin American currencies relative to the euro and increased provisions for bad debt, particularly in Latin America. An increase in EBITDA from Telefónica Móviles, Telefónica de España and new lines of business helped to offset a decrease in EBITDA from Telefónica Internacional as a result of adverse exchange rate fluctuations and Telefónica Data as a result of its expansion into new markets and the cost of developing its international network.

*Telefónica de España.* Telefónica de España's EBITDA increased 1.3% to €4,508.2 million in 2001 from €4,448.4 million in 2000. This increase was mainly due to decreases in operating expenses, in particular a 5.8% decrease in personnel costs.

*Telefónica Móviles.* Telefónica Móviles' EBITDA increased 36.0% to €3,333.7 million in 2001 from €2,451.1 million in 2000. As a percentage of net revenues from operations, EBITDA increased to 39.6% for 2001 from 33.1% for 2000. EBITDA for Telefónica Móviles' Spanish operations increased 57.3% to €2,816.9 million for 2001 from €1,790.6 million for 2000. As a percentage of net revenues from Telefónica Móviles' Spanish operations, EBITDA for Telefónica Móviles' Spanish operations increased to 49.1% for 2001 from 37.3% for 2000. EBITDA for Telefónica Móviles' Latin American operations accounted for 20.5% of Telefónica Móviles' EBITDA in 2001 compared to 28.4% of Telefónica Móviles' EBITDA in 2000. As a percentage of net revenues from Latin American operations, EBITDA for Telefónica Móviles Latin American operations decreased to 25.5% for 2001 from 27.1% in 2000.

*Telefónica Internacional.* Telefónica Internacional's EBITDA decreased 3.7% to €5,163.0 million in 2001 from €5,359.3 million in 2000, principally as a result of the decrease in EBITDA from Telefónica de Argentina due

to the adverse economic and competitive environment in Argentina, offset in part by increased EBITDA from Compañía de Telecomunicaciones de Chile.

- Telesp's EBITDA decreased 1.6% in 2001 to €2,314.5 million in 2001 from €2,352.3 million in 2000 (an increase of 22.5% as measured in Brazilian reais), principally due to higher interconnection expenses and provisions for bad debt, offset in part by the growth in the average number of lines in service, tariff increases that became effective in June 2001 and increased revenues from long-distance traffic.
- Compañía de Telecomunicaciones de Chile's EBITDA increased 11.5% in 2001 to €600.5 million in 2001 from €538.5 in 2000 (an increase of 23.5% as measured in Chilean pesos), principally due to increased revenues from long-distance services and increased traffic and decreases in operating expenses.
- Telefónica de Argentina's EBITDA decreased 12.9% in 2001 to €1,457.9 million in 2001 from €1,674.6 million in 2000 (a decrease of 15.6% as measured in Argentine pesos), principally due to increased competition, the adverse regulatory environment and the macroeconomic crisis in Argentina.
- Telefónica del Perú's EBITDA decreased 0.4% in 2001 to €611.8 million in 2001 from €614.4 million in 2000 (a decrease of 5.6% as measured in Peruvian nuevo soles), principally due to the new regulatory environment, including the introduction of new price caps in September 2001, and loss of market share as a result of increased competition.

*Telefónica Data.* Telefónica Data's EBITDA decreased 68.5% to €23.6 million in 2001 from €75.0 million in 2000, mainly due to start-up costs in connection with the expansion of operations into new markets and decreased earnings as a result of a reduction in technology-related investments by corporate customers in light of the adverse macroeconomic environment and the combined effect of a decrease in international IP traffic and a reduction in rates for such services.

*Terra Networks.* Terra Networks had negative EBITDA of €260.0 million in 2001 compared to negative EBITDA of €359.2 million in 2000 due to the inclusion of a full year of results of operations of Lycos, Inc., which we acquired for financial reporting purposes in October 2000.

*Admira Media.* Admira Media's EBITDA increased significantly to €152.5 million in 2001 from €13.6 million in 2000, mainly due to the inclusion of a full year of results of operations of Endemol, which we acquired in August 2000 for financial reporting purposes and Atlántida de Comunicaciones, which we acquired in May 2000 for financial reporting purposes.

#### *Operating profit*

Operating profit, which consists of revenue from operations, internal expenditures capitalized, operating expenses, other operating revenue, provision for depreciation and amortization (but not amortization of goodwill on consolidation), other operating expenses and trade provisions, increased 9.5% to €5,430.3 million in 2001 from €4,958.0 million in 2000 principally due to increased operating profit from Telefónica Móviles and Telefónica de España due in part to a decrease in amortization expense as a result of a decrease in investments, offset in part by increased operating losses at Telefónica Data and Telefónica Internacional.

*Telefónica de España.* Operating profit of Telefónica de España increased 10.1% to €1,703.7 million in 2001 from €1,547.2 million in 2000, mainly due to a 1.3% increase in EBITDA and a 3.3% decrease in the depreciation of fixed assets as a result of the write-off or acceleration of the amortization of certain assets in 1999.

*Telefónica Móviles.* Operating profit of Telefónica Móviles increased 47.0% to €2,076.0 million in 2001 from €1,412.0 million in 2000, mainly due to a 36.0% increase in EBITDA, offset in part by a 21% increase in depreciation expense.

*Telefónica Internacional.* Operating profit at Telefónica Internacional decreased 6.2% to €2,537.3 million in 2001 from €2,705.9 million in 2000, mainly due to a 3.7% decrease in EBITDA, offset in part by a 1% decrease in depreciation and amortization expense.

*Telefónica Data.* Telefónica Data's operating loss in 2001 was approximately €166.2 million compared to an operating loss of €16.1 million during 2000 mainly due to the fact that EBITDA decreased by 68.5% and



amortization expense increased as a result of our acquisition of mediaWays in January 2001 for financial reporting purposes and certain investments in Brazil in connection with its data service business.

*Terra Networks.* Terra Networks' operating loss in 2001 was €417.4 million compared to an operating loss of €442.8 million during 2000, mainly due to the decrease in negative EBITDA.

*Admira Media.* Operating profit of Admira Media was €77.1 million in 2001 compared to an operating loss of €35.2 million in 2000, mainly due to the inclusion of a full year of results of operations of Endemol, which we acquired in August 2000 for financial reporting purposes.

#### *Profit from ordinary activities*

Profit from ordinary activities, which consists of operating profit, amortization of goodwill on consolidation, financial income (expense), exchange (losses) gains and income (loss) from associated companies, decreased 25.2%, to €1,821.1 million in 2001 from €2,435.7 million in 2000, mainly due to:

- a significant increase of 133.3% in losses from associated companies to €376.5 million in 2001 from €161.4 million in 2000, principally related to losses from Lycos Europe, Vía Digital, Antena 3 and Medi Telecom;
- a 68.1% increase in amortization of goodwill in consolidation to €841.6 million in 2001 from €500.6 million in 2000 principally related to the inclusion of a full year of amortization of goodwill related to our acquisitions of Lycos, Endemol, Atlántida de Comunicaciones and mediaWays. This increase was offset in part by the change in the amortization period for goodwill to 10 years from 5 years at Terra Networks, beginning in the second half of 2001, which resulted in €197.1 million less of goodwill amortization expense than if the goodwill amortization period had not been changed; and
- a 28.5% increase in financial expense to €2,391.1 million in 2001 from €1,860.3 in 2000, principally due to the effect of the devaluation of the Argentine peso, which amounted to €528.8 million in financial expense in 2001, without which financial income would have been similar to that of 2000. Our average indebtedness increased 21% in 2001, principally due to the inclusion of new companies in consolidation and certain investments made in 2000 and 2001, offset in part by the 1.3% decrease in average cost of debt.

#### *Income (loss) before tax and minority interest*

Income (loss) before tax and minority interest consists of profit from ordinary activities, extraordinary income, losses on sales of fixed assets and extraordinary expenses. Income before tax and minority interest decreased 29.1% to €2,033.9 million in 2001 from €2,867.7 million in 2000, principally due to the decrease in net extraordinary results which were €212.8 million in 2001 compared to net extraordinary results of €431.9 million in 2000. In 2001, extraordinary income was €1,167.1 million, including gains due to the sales of Cablevision S.A. (€255.9 million) and Hispasat, S.A. (€35.2 million) and the receipt of certain indemnity payments totaling €63.1 million. Losses on sales of fixed assets were €233.0 million in 2001 compared to €239.9 million in 2000, and extraordinary expenses were €721.3 million in 2001 compared to €3,630.5 million in 2000 as a result of writeoffs of the value of certain fixed assets, fines and other penalties paid and amounts paid to executive management personnel upon termination of their service contracts.

#### *Corporate income tax*

Provision for corporate income tax expense at the consolidated level was €198.1 million in 2001 compared to €242.2 million in 2000, principally due to reductions relating to deferred capital gains taxes.

#### *Minority interests*

Loss attributable to minority interests was €271.0 million in 2001 compared to income attributable to minority interests of €120.6 million in 2000, primarily due to our decreased participation in the losses of Terra Networks as a result of the increase in the ownership interest of third parties following Terra Networks' acquisition of Lycos and a reduction in minority interests in the income of Telesp, Compañía de Telecomunicaciones de Chile, Telefónica de

Argentina and Telefónica del Perú due to the increase in our interests in such entities, offset in part by the change in the method by which we account for our interest in IPSE 2000 from the global integration method to the equity method in the third quarter of 2001.

*Net income*

Consolidated net income decreased €398.0 million, to €2,106.8 million in 2001 from €2,504.8 million in 2000. This increase was due to the various factors described above.

***Year Ended December 31, 2000 Compared with Year Ended December 31, 1999***

The tables and discussion below reflect the historical comparison of our results of operations by line of business for 2000 and 1999 consistent with the presentation in our Annual Report on Form 20-F for the fiscal year ended December 31, 2000. This presentation is not comparable to the tables presented and the discussion above of results of operations by line of business for 2001 and 2000 for the reasons stated above. See “—Year Ended December 31, 2001 Compared with Year Ended December 31, 2000”.

The tables below set forth an analysis of consolidated revenue from operations for each of our principal lines of business for 1999 and 2000.

	Year ended December 31,	
	1999	2000
	(millions of euro)	
Basic fixed-line telephone service .....	5,518.8	5,167.9
Leased circuits .....	436.9	475.0
Interconnection .....	264.6	295.0
ISDN .....	760.9	1,142.5
Pay telephone service.....	775.1	724.3
Other .....	1,887.1	1,788.0
<b>Total revenue from operations for Telefónica de España .....</b>	<b>9,643.6</b>	<b>9,592.9</b>
Telefónica Internacional .....	9,708.7	12,583.8 (1)
Telefónica Móviles .....	3,738.9	5,249.1 (1)
Telefónica Data.....	574.7	920.2
Admira Media .....	96.5	723.9
Terra Networks .....	40.1	303.9
Telefónica Publicidad e Información .....	334.8	409.3
Atento .....	202.0	526.9
Other subsidiaries .....	1,681.4	1,748.2
<b>Total revenue from operations for consolidated subsidiaries .....</b>	<b>26,021.1</b>	<b>32,058.5</b>
Intercompany sales .....	(3,064.1)	(3,573.1)
<b>Total revenue from operations .....</b>	<b>22,957.0</b>	<b>28,485.5</b>

The table below shows the contribution to our total revenue from operations of each of our principal lines of business for 1999 and 2000.

	Year ended December 31,	
	1999	2000
Basic fixed-line telephone service .....	21.2%	16.1%
Leased circuits .....	1.7%	1.5%
Interconnection .....	1.0%	0.9%
ISDN .....	2.9%	3.6%
Pay telephone service.....	3.0%	2.3%
Data transmission(1) .....	—	—
Other .....	7.3%	5.6%
Revenues from operations for Telefónica de España.....	37.1%	29.9%
Telefónica Internacional .....	37.3%	39.3%
Telefónica Móviles .....	14.5%	16.4%
Telefónica Data.....	2.2%	2.9%
Admira Media .....	0.4%	2.3%

	Year ended December 31,	
	1999	2000
Terra Networks .....	0.2%	0.9%
Telefónica Publicidad e Información.....	1.3%	1.3%
Atento .....	0.8%	1.6%
Other subsidiaries .....	6.5%	5.5%
Total revenue from operations for consolidated subsidiaries.....	100.0%	100.0%

- (1) During 2000, as part of the reorganization of the Telefónica group along global business lines, Telefónica Internacional transferred to Telefónica Móviles shares representing its interest in: Tele Sudeste Celular; Celular CRT; Tele Leste Celular; and two holding companies that own 86.7% and 100.0% of Telefónica El Salvador and Telefónica Centroamérica Guatemala, respectively. In addition, Telefónica Intercontinental transferred to Telefónica Móviles shares representing its interest in Medi Telecom.

The table below shows the contribution to our consolidated net income of each of our principal business lines in 1999 and 2000.

	Year ended December 31,		
	1999	2000	
	(millions of euro)		
Telefónica de España .....	(1,896.4)	245.2	
Telefónica Internacional .....	380.8	694.5	(1)
Telefónica Móviles .....	562.7	643.1	(1)(2)
Telefónica Data.....	35.4	(50.3)	
Admira Media .....	(103.0)	(622.1)	
Terra Networks .....	(77.5)	(555.2)	
Telefónica Publicidad e Información.....	(12.8)	-	(2)
Holding and other subsidiaries.....	666.9	(98.2)	
Adjustments in consolidation.....	513.3	2,247.8	
Consolidated net income.....	69.6	2,504.8	

- (1) During 2000, as part of the reorganization of the Telefónica group along global business lines, Telefónica Internacional transferred to Telefónica Móviles shares representing its interest in: Tele Sudeste Celular; Celular CRT; Tele Leste Celular; and two holding companies that own 86.7% and 100.0% of Telefónica El Salvador and Telefónica Centroamérica Guatemala, respectively.
- (2) During 2000, as part of the reorganization of the Telefónica group along global business lines, Telefónica Intercontinental transferred to Telefónica Móviles shares representing its interest in Medi Telecom.

#### *Revenue from operations*

Our revenue from operations, which accounted for 95.9% and 95.5% of our consolidated total revenue for 2000 and 1999, respectively, increased 24.1% to €28,485.5 million in 2000 from €22,957.0 million in 1999. The growth in revenue from operations was primarily attributable to increased results of operations from Telefónica Internacional (particularly Telesp and Telefónica de Argentina) and Telefónica Móviles.

Whereas we calculate revenues from operations both before and after adjustments for sales to other members of the Telefónica Group, our analysis of revenues from operations is strictly limited to revenues from operations before adjustments for sales to other members of the Telefónica Group. Accordingly, in the following sections we disclose revenues from operations both before and after adjustments for sales to other members of the group and limit our discussion solely to revenues before adjustments for sales to other members of the Telefónica Group. In the aggregate, we believe that sales to other members of the Telefónica Group did not have a significant impact on the percentage fluctuations during the periods discussed.

*Telefónica de España.* Telefónica de España's revenues from operations (including sales to other members of the Telefónica Group) decreased 0.5% to €9,592.9 million in 2000 from €9,643.6 million in 1999. This decrease was principally due to a decrease in revenues from basic fixed-line telephone service and other revenues, offset in part by an increase in revenues from ISDN and revenues from interconnection.

- Revenues from basic fixed-line telephone service include revenues received from customers for connection fees, subscription fees and traffic charges. Revenues from basic fixed-line telephone service decreased 6.4% to €5,167.9 million in 2000 from €5,518.8 million in 1999, mainly due to tariff reductions, discounts in connection with calling plans (including volume discounts and flat rate plans) and decreased revenues from local traffic as a result of increased competition. This decrease was offset in part by an increase in revenues from monthly subscription fees as a result of the €0.60 increase in the per-line monthly subscription fees implemented in August 2000, a 112.6% increase in dial-up traffic for Internet access to 24,020 million minutes in 2000 from 11,300 million minutes in 1999 and a 96.1% increase in incoming traffic from other telecommunications operators to 20,600 million minutes in 2000 from 10,500 million minutes in 1999.
- Revenues from leased circuits include revenues received from leasing our circuits, both domestic and international, to customers and other telecommunications operators. Revenues from leased circuits increased 8.7% to €475.0 million in 2000 from €436.9 million in 1999.
- Revenues from interconnection include revenues received from charges to other telecommunications operators for interconnection with our fixed-line network. Revenues from interconnection increased 11.5% to €295.0 million in 2000 from €264.6 million in 1999, principally as a result of the 209.0% increase in the volume of interconnection traffic with other fixed-line operators to 12,775 million minutes in 2000 from 4,134 million minutes in 1999, offset in part by an approximately 20.0% decrease in interconnection prices effective August 2000.
- Revenues from ISDN include revenues from connection fees, subscription fees and traffic charges relating to our ISDN lines. Revenues from ISDN increased 50.2% to €1,142.5 million in 2000 from €760.9 million in 1999 mainly due to a 71.0% increase in the number of ISDN lines to approximately 1.7 million in 2000 from approximately 1.0 million in 1999.
- Revenues from pay telephone service include revenues received from calls made from public telephone booths owned by us and public telephones operated by us on private premises. Revenues from pay telephone service decreased 6.6% to €724.3 million in 2000 from €775.1 million in 1999, mainly due to a decrease in traffic, principally due to increased competition from wireless communications devices, and increased competition from other operators.
- Other revenues include revenues from the lease, sale and maintenance of terminals and other equipment that connects to our network. Other revenues decreased 5.3% to €1,788.0 million in 2000 from €1,887.1 million in 1999, mainly due to a decrease of 31.9% in revenues from the lease, sale and maintenance of terminals.

Telefónica de España's revenues from operations (excluding sales to other members of the Telefónica Group) decreased 1.1% to €8,567.4 million in 2000 from €8,660.6 million in 1999.

*Telefónica Móviles.* Telefónica Móviles' revenue from operations (including sales to other members of the Telefónica Group) increased 40.4% to €5,249.1 million in 2000 from €3,738.9 million in 1999. This increase was principally due to the consolidation in 2000 of Tele Sudeste Celular and Celular CRT, which were transferred to Telefónica Móviles by other members of the Telefónica Group. Revenues from the Latin American operations transferred to Telefónica Móviles by other Telefónica Group companies are included as of their respective date of transfer in October 2000. Net revenues from Telefónica Móviles' operations in Spain (including sales to other members of the Telefónica Group) increased 29.7% to €3,506.9 million in 2000 from €2,703.6 million in 1999 due to an increase of 51% in wireless subscribers to approximately 13.7 million at December 31, 2000 compared with approximately 9.1 million at December 31, 1999, partially offset by a 23% decline in average revenue per user which was principally attributable to rate reductions and to a change in the customer mix as the number of pre-paid customers increased to 65.1% of Telefónica Móviles' customer base in Spain. Due to lower average minutes of use than contract customers, prepaid customers generally contribute to lower average revenue per customer.

Telefónica Móviles' revenue from operations (excluding sales to other members of the Telefónica Group) increased 45.3% to €3,955.8 million in 2000 from €2,722 million in 1999.

*Telefónica Internacional.* Telefónica Internacional's revenues from operations (including sales to other members of the Telefónica Group) increased 29.6% to €12,583.8 million in 2000 from €9,708.7 million in 1999. Telefónica Internacional's revenues from operations in 2000 include the results from its Latin American wireless operations transferred to Telefónica Móviles through their respective date of transfer in October 2000. The increase in 2000 was principally due to the following:

- Revenue from operations generated by Telefónica del Perú denominated in euro increased 24% to €1,440.2 million in 2000 from €1,165.7 million in 1999. Revenues from operations denominated in local currency increased 7.9% in 2000. The increase in revenues in euro was higher than the increase in local currency due to the appreciation of the U.S. dollar against the euro, which was partially offset by the depreciation of the Peruvian nuevo sol against the U.S. dollar of approximately 0.5% on average. The increase in revenues from operations was mainly due to a 12% increase in local fixed-line traffic and a 26% increase in the number of wireless subscribers, offset partially by the decrease in long-distance traffic.
- Revenue from operations generated by Telefónica de Argentina denominated in euro increased 43.1% to €3,924.1 million in 2000 from €2,734.6 million in 1999, while revenue denominated in local currency increased 23.9% in 2000. The increase in revenues in euro was higher than the increase in local currency due to the appreciation of the U.S. dollar against the euro. The increase in revenue from operations was mainly due to a 67.2% increase in wireless subscribers and, to a lesser extent, an 8.3% increase in fixed-line customers. Revenues from operations were offset in part by negative macroeconomic conditions in Argentina and the entry of new competitors into the marketplace.
- Revenue from operations generated by Compañía de Telecomunicaciones de Chile denominated in local currency decreased 0.7% in 2000, while revenues in euro increased 5.9% to €1,572.3 million in 2000 from €1,484.5 million in 1999. This 0.7% decrease was due principally to a 2.3% decrease in revenues from fixed-line telephony principally due to a 13.1% decrease in revenues from long-distance services. The decrease was offset in part by a 1.1% increase in revenues from wireless communications services as a result of a 35.1% increase in interconnection revenues due to the growth in the number of wireless subscribers. Revenues, as measured in euro, increased due to the appreciation of the U.S. dollar against the euro of approximately 15.5% on average, which was partially offset by the depreciation of the Chilean peso against the U.S. dollar of approximately 8.3% on average.
- Revenue from operations generated by Telesp denominated in Brazilian reais increased 37.4% in 2000, while revenues in euro increased 57.2% to €4,349.6 million in 2000 from €2,767.8 million in 1999. This increase was due principally to a 28.4% increase in the number of lines in service and an increase in local fixed-line traffic. The increase in revenues in euro was higher than the increase in the local currency due to the appreciation of the U.S. dollar against the euro, which was partially offset by the depreciation of the Brazilian real against the U.S. dollar of approximately 1% on average.

Telefónica Internacional's revenue from operations (excluding sales to other members of the Telefónica Group) increased 32.3% to €12,554.0 million in 2000 from €9,486.8 million in 1999.

*Telefónica Data.* Telefónica Data's revenue from operations (including sales to other members of the Telefónica Group) increased 60.1% to €920.2 million in 2000 from €574.7 million in 1999, principally due to increases in the number of end user connections and Internet traffic through its network.

*Terra Networks.* Terra Networks' revenue from operations (including sales to other members of the Telefónica Group) increased 657.9% to €303.9 million in 2000 from €40.1 million in 1999. This increase was principally due to a 530.6% increase in access revenues to €119.0 million and a 2,916.5% increase in advertising revenues to €109.0 million. These increases were due in part to the inclusion of a full year of financial results of companies Terra Networks acquired in 1999 and the results of Lycos, Inc., which was acquired in October 2000 for financial reporting purposes. At December 31, 2000, Terra Networks had approximately 4.1 million subscribers. It generated more than 350 million average daily page views during December 2000.

Terra Networks' revenue from operations (excluding sales to other members of the Telefónica Group) increased 635.7% to €277.4 million in 2000 from €37.7 million in 1999.

#### *Operating expenses*

Operating expenses, which consist of increase in inventories (net), goods purchased, external services and local taxes and personnel costs, increased 35.3% to €16,883.5 million in 2000 from €12,443.1 million in 1999, principally due to increased expenses at our operating companies that are in the development and expansion phase of their business and the consolidation of companies we acquired or in which we increased our stakes during 2000, including Atlántida de Comunicaciones S.A. and Endemol Entertainment Holding N.V., and newly-formed companies, including Katalyx, Emergia and Terra Mobile.

*Telefónica de España.* The Telefónica de España Group's operating expenses increased 9.2% in 2000 to €5,883.9 million from €5,391.1 million in 1999. Telefónica de España's operating expenses increased 7.4% to €5,335.1 million in 2000 from €4,967.5 million in 1999. Goods purchased at Telefónica de España increased 26.5% to €2,166.9 million in 2000 from €1,713.2 million in 1999, principally due to a 25.1% increase in interconnection costs related to fixed-to-mobile interconnections. External services increased 11.6% to €846.5 million in 2000 from €758.4 million in 1999, mainly due to the outsourcing of activities as a result of workforce reductions. Personnel expenses decreased 7.0% to €2,154.6 million in 2000 from €2,316.3 million in 1999, principally as a result of the streamlining of Telefónica de España's workforce, which had 41,193 employees at December 31, 2000, a decrease of 11.6% from the number of employees at December 31, 1999. As a result, Telefónica de España had a productivity ratio of 493 lines per employee at December 31, 2000, a 19.6% improvement over the productivity ratio of 412 lines per employee at December 31, 1999.

*Telefónica Móviles.* Operating expenses at Telefónica Móviles increased 45.4% to €3,551.5 million in 2000 from €2,443.9 million in 1999, principally due to the consolidation in 2000 of companies transferred to Telefónica Móviles by members of the Telefónica Group. Operating expenses at the Latin American operations transferred to Telefónica Móviles by other Telefónica Group companies are included as of their respective date of transfer in October 2000.

- Goods purchased at Telefónica Móviles' Spanish operations increased 24.3% to €986.2 million in 2000 from €793.5 million in 1999, mainly due to the higher cost of handsets, interconnection costs and roaming costs as a result of the increase in the number of customers. As a percentage of net revenues from operations generated by Telefónica Móviles' Spanish operations, goods purchased decreased to 28.1% for 2000 from 29.3% for 1999. External services at Telefónica Móviles' Spanish operations increased to 25.4% to €1,844.6 million in 2000 from €1,471.3 million in 1999, principally due to higher commercial activity and distributor incentives. As a percentage of net revenues of operations generated by Telefónica Móviles' Spanish operations, external services decreased to 52.6% for 2000 from 54.1% for 1999. Personnel expenses at Telefónica Móviles' Spanish operations increased 40.9% to €164.3 million in 2000 from €116.6 million for 1999, principally due to an 18.1% increase in personnel to 3,937 people at year-end 2000 from 3,372 people at year-end 1999. As a percentage of net revenues from operations generated by Telefónica Móviles' Spanish operations, personnel expenses increased to 4.7% for 2000 from 4.3% for 1999.
- Goods purchased at Telefónica Móviles' Latin American operations were €171.0 million in 2000. Goods purchased represented 39% of net revenues from operations generated by Telefónica Móviles' Latin American operations in 2000. External services at Telefónica Móviles' Latin American operations were €88.6 million in 2000. External services represented 20.2% of net revenue from operations generated by Telefónica Móviles' Latin American operations in 2000. Personnel expenses at Telefónica Móviles' Latin American operations were €26.3 million in 2000. Personnel expense represented 6% of net revenues from operations generated by Telefónica Móviles' Latin American operations in 2000.

*Telefónica Internacional.* Telefónica Internacional's operating expenses increased 24.2% to €6,458.3 million in 2000 from €5,200.8 million in 1999, principally for the reasons described below. Telefónica Internacional's operating expenses in 2000 include the operating expenses of its Latin American wireless operations transferred to Telefónica Móviles through their respective date of transfer in October 2000. The percentage increases or decreases

below were calculated based on local currency amounts as opposed to amounts that have been converted into pesetas.

- Telefónica del Perú's operating expenses increased 4.5% in 2000, principally as a result of a 7.3% increase in external services, mainly due to a 77% increase in marketing expenses relating to the fixed-line telephony business and a 16.4% increase in professional services related to its wireless business.
- Telefónica de Argentina's operating expenses increased 33.8% in 2000, principally due to a 266.9% increase in goods purchased mainly due to expenses incurred as a result of the liberalization of the telecommunications market, which resulted in a 267.1% increase in interconnection costs.
- Telesp's operating expenses increased 31.3% in 2000, mainly due to an increase in goods purchased as a result of an increase in interconnection costs due to the growth in fixed-to-mobile traffic.

The increase in operating expenses of Telefónica Internacional was partially offset by an 8.0% decrease in Compañía de Telecomunicaciones de Chile's operating expenses in 2000, mainly due to a 10.6% decrease in personnel expenses and a 33.8% decrease in external services. The decrease in personnel expenses was due in part to a reduction in the number of employees in Compañía de Telecomunicaciones de Chile's fixed-line telephony business.

*Telefónica Data.* Telefónica Data's operating expenses increased 99.0% in 2000 to €908.0 million from €454.0 million in 1999, mainly due to:

- a 177% increase in personnel expenses due to a 169% increase in headcount to 2,292 individuals at December 31, 2000 compared to 850 individuals December 31, 1999; and
- an 84% increase in external services in 2000, principally due to increased marketing expenses.

*Terra Networks.* Terra Networks' operating expenses increased by 431.4% to €750.3 million in 2000 from €141.2 million in 1999, principally due to:

- a 524.5% increase in goods purchased to €193.6 million in 2000 from €31.0 million in 1999;
- a 487.4% increase in personnel expenses to €116.9 million in 2000 from €19.9 million in 1999; and
- a 324.7% increase in other operating expenses to €356.3 million in 2000 from €83.9 million in 1999.

These increases were due in part to the inclusion of a full year of operating expenses of companies Terra Networks acquired in 1999 and the operating expenses of Lycos, Inc., which was acquired in October 2000 for financial reporting purposes.

#### *EBITDA*

EBITDA consists of revenue from operations plus other operating revenue and internal expenditures capitalized, less operating expenses, trade provisions and other operating expenses. Our EBITDA increased 9.5% to €11,918.8 million in 2000 from €10,885.4 million in 1999, principally due to the growth of our wireless operations and fixed-line telephony in Latin America, offset by decreased margins in fixed-line telephony in Spain and increased expenses in connection with development costs.

*Telefónica de España.* Telefónica de España's EBITDA decreased 10.6% to €4,492.5 million in 2000 from €5,026.7 million in 1999. This decrease was mainly due to tariff reductions affecting Telefónica de España's results.

*Telefónica Móviles.* Telefónica Móviles' EBITDA increased 36.0% to €1,834.1 million in 2000 from €1,348.6 million in 1999. As a percentage of net revenues from operations, EBITDA decreased to 46.4% for 2000 from 49.5% for 1999. EBITDA for Telefónica Móviles' Spanish operations increased 32.3% to €1,790.6 million for 2000 from €1,353.5 million for 1999. As a percentage of net revenues from Telefónica Móviles' Spanish operations, EBITDA for Telefónica Móviles' Spanish operations increased to 51.1% for 2000 from 50.1% for 1999. EBITDA for Telefónica Móviles' Latin America operations accounted for 7.7% of Telefónica Móviles' EBITDA in 2000. EBITDA for Telefónica Móviles' Latin American operations represented 32.2% of net revenues from Telefónica Móviles' Latin American operations.

*Telefónica Internacional.* Telefónica Internacional's EBITDA increased 35.6% to €6,005.9 million in 2000 from €4,427.6 million in 1999. Telefónica de Argentina's EBITDA increased 28.0% to €1,815.4 million in 2000 from €1,418.4 million in 1999. As measured in local currency, EBITDA of Telefónica Argentina increased 10.8% to 1,674 million Argentine pesos in 2000 due to increased operating revenues as a result of the increase in the number of wireless subscribers and an increase in local fixed-line traffic, offset partially by an increase in operating expenses as a result of the introduction of competition for fixed-line telephony, higher connection charges and an increase in advertising, sales and equipment expenses. Telefónica del Perú's EBITDA increased 28.3% to €734.1 million in 2000 from €572.2 million in 1999. As measured in local currency, EBITDA of Telefónica del Perú increased 11.6% to 2,386 million nuevo soles in 2000 due to a 7.5% increase in operating income as a result of an increase in local fixed-line traffic and an increase in the number of wireless subscribers. Compañía de Telecomunicaciones de Chile's EBITDA increased 10.8% to €627.4 million in 2000 from €566.3 million in 1999. As measured in local currency, EBITDA of Compañía de Telecomunicaciones de Chile decreased 0.2% to 332,039 million Chilean pesos in 2000 due to the 2.3% decrease in revenues from local fixed-line telephony as a result of tariff reductions and the negative impact of the change from billing in minutes to billing in seconds which took effect in February 2000 and mainly affected revenues from wireless and long-distance services, offset in part by the 8.0% decrease in expenses as a result of the company's cost control efforts. Telesp's EBITDA increased 63% to €2,327.9 million in 2000 from €1,428.4 million in 1999. As measured in local currency, EBITDA of Telesp increased 42.5% to 3,934 million Brazilian reais in 2000 due to a 28.4% increase in the number of lines in service.

*Telefónica Data.* Telefónica Data's EBITDA decreased 63% to €44.8 million in 2000 from €120.0 million in 1999, mainly due to the inclusion of subsidiaries that are still in their start-up phases, which have yet to generate income.

*Terra Networks.* Terra Networks had negative EBITDA of €359.2 million in 2000 compared to negative EBITDA of €84.7 million in 1999, mainly due to the inclusion of a full year of results of operations of companies Terra Networks acquired in 1999 and three months of results of operations of Lycos, Inc., which was acquired in October 2000 for financial reporting purposes.

#### *Operating profit*

Operating profit, which consists of revenue from operations, internal expenditures capitalized, operating expenses, other operating revenue, provision for depreciation and amortization (but not amortization of goodwill on consolidation), other operating expenses and trade provisions, increased 3.8% in 2000 to €4,958.0 million from €4,776.6 million in 1999, principally due to a 9.5% increase in EBITDA, offset in part by a 13.9% increase in depreciation costs in connection with our fixed-line operations in Latin America.

*Telefónica de España.* Operating profit of Telefónica de España decreased 14.9% to €1,591.3 million in 2000 from €1,870.4 million in 1999.

*Telefónica Móviles.* Operating profit of Telefónica Móviles increased 30.6% to €1,173.4 million in 2000 from €898.6 million in 1999.

*Telefónica Internacional.* Operating profit of Telefónica Internacional increased 43.7% to €2,859.9 million in 2000 from €1,991.2 million in 1999.

*Telefónica Data.* Telefónica Data's operating loss in 2000 was €30.3 million during 2000 compared to an operating profit of €62.3 million in 1999.

*Terra Networks.* Terra Networks' operating loss in 2000 was €442.8 million during 2000 compared to an operating loss of €90.9 million in 1999.



### *Profit from ordinary activities*

Profit from ordinary activities, which consists of operating profit, amortization of goodwill on consolidation, financial income (expense), exchange (losses) gains and income (loss) from associated companies, decreased 30.9% to €2,435.7 million in 2000 from €3,522.3 million in 1999. Losses from associated companies increased significantly to €161.4 million in 2000 from €3.9 million in 1999 as a result of negative contributions by companies associated with Telefónica Móviles, Admira Media and Terra Networks, respectively. Amortization of goodwill on consolidation increased 158% to €500.6 million in 2000 from €194.3 million in 1999 principally due to acquisitions by Terra Networks and Admira Media during 2000. Financial expense increased 8.2% to €1,611.8 million in 2000 from €1,490.4 million in 1999 due to the increase in debt related to the acquisition of UMTS licenses and the strengthening of the U.S. dollar, in which the majority of the debt of the Telefónica Group's Latin American subsidiaries is denominated, together with an increase in U.S. interest rates.

### *Income (loss) before tax and minority interest*

Income (loss) before tax and minority interest consists of profit from ordinary activities, extraordinary income, losses on sales of fixed assets and extraordinary expenses. Income before tax and minority interest was €2,867.7 million in 2000 compared to a loss before tax and minority interest of €32.7 million in 1999, principally due to extraordinary gains of €2,898.1 million realized in connection with the revaluation of our interest in Telefónica Móviles in connection with its initial public offering and €453.6 million from our sale of 3% of Terra Networks, offset in part by the recording of pre-retirement and early retirement provisions of €1,610.6 million in 2000. Loss before tax and minority interest of €32.7 million in 1999 was due principally to the recording of pre-retirement and early retirement provisions of €2,669.5 million.

### *Corporate income tax*

Provision for corporate income tax at the consolidated level was €242.2 million in 2000 compared to a corporate income tax credit of €758.0 million in 1999, principally due to an increase in non-deductible expenses such as the amortization of goodwill and the inability to deduct the losses of companies accounted for by the equity method from our taxable income.

### *Minority interests*

Income attributable to minority interests decreased 81.6% to €120.6 million in 2000 from €655.7 million in 1999, primarily due to the increase in our ownership interest in Telesp, Tele Sudeste, Telefónica de Argentina and Telefónica de Perú as a result of the completion of our exchange offers for these Latin American affiliates.

### *Net income*

Consolidated net income increased significantly to €2,504.8 million in 2000 from €69.6 million in 1999. This increase was due to the various factors described above.

### ***Principal Differences Between U.S. GAAP and Spanish GAAP***

The principal differences between U.S. GAAP and Spanish GAAP relevant to us are discussed below. See also note 25 to the consolidated financial statements included elsewhere herein.

- We have performed in 2001 and prior years some business combinations accounted for under Spanish GAAP using the pooling of interest method. Under U.S. GAAP, these acquisitions were recorded using the purchase accounting method. In the case where a capital increase in a subsidiary is carried out to effect a business combination that is part of a broader corporate reorganization and which is accounted for using the purchase accounting method, under U.S. GAAP Telefónica recognizes the increase in its investment as a result of the capital increase by crediting shareholders' equity.
- Prior to 1988, Spanish GAAP permitted the revaluation of fixed assets. As a result of such revaluation, in years prior to 1988, we stated our property, plant and equipment at the then current replacement cost less accumulated depreciation, and credited the revaluations to the surplus account shown on the balance sheet under "other reserves". Depreciation was calculated each

year based on the then current gross replacement cost using estimated remaining useful lives. Between 1988 and 1995, Spanish GAAP did not permit such revaluations, and we used historical cost basis accounting. In 1996, new legislation permitted us to write-up the value of certain of our assets. This write-up was reversed in the reconciliation to U.S. GAAP of shareholders' equity.

- In accordance with Spanish GAAP, interest incurred during periods exceeding 12 months in which assets are under construction may be capitalized. However, interest incurred during periods in which qualifying assets are under construction are capitalized and amortized over such qualifying asset's expected life under U.S. GAAP.
- Start-up costs are capitalized under Spanish GAAP, but expensed under U.S. GAAP.
- Spanish GAAP requires that research and development expenses and capital increase expenses be capitalized and amortized over a period not exceeding five years. Such expenses are expensed in current periods and reduced from capital proceeds, respectively, under U.S. GAAP.
- Under Spanish GAAP, provisions are recorded for early retirement expenses in the period during which management announces the early retirement programs. Under U.S. GAAP, early retirement provisions are recorded in the period during which an agreement is reached with the employee.
- Under Spanish GAAP exchange gains may be deferred. Under U.S. GAAP, exchange gains are included in income on a current basis.
- Under Spanish GAAP, revenues and expenses are recognized on accrual basis, i.e., when the goods and services are actually provided, regardless of when the resulting monetary or financial flow occurs. Under U.S. GAAP, according to SAB 101, some revenues and related costs must be deferred.
- SFAS No. 115 requires certain investments in financial assets to be classified on the basis of the purpose for which they were acquired (held-to-maturity securities, trading securities or available-for-sale securities). The treatment of the unrealized gains and losses differs depending on the classification:
  - unrealized gains and losses (other than permanent diminutions in value) on securities that we consider held-to-maturity are not recorded
  - unrealized gains and losses on securities considered available-for-sale are not recorded in the income statement but included as a separate equity caption
  - unrealized gains or losses on trading securities are recorded in the income statement

These criteria differ from Spanish GAAP.

- Under Spanish GAAP derivatives not assigned as hedge are accounted at lower of their cost or market value and those assigned as hedge, basically are considered a change in hedge item characteristics. Under U.S. GAAP all derivatives are accounted at fair value through earnings and all derivatives assigned as hedge instruments may have a different accounting or require its hedge item also to be accounted at fair value. Additionally, measuring hedge ineffectiveness differs in Spanish and U.S. GAAP.

Under U.S. GAAP, shareholders' equity was €23,019.4 million at December 31, 2001 compared with €25,861.6 million under Spanish GAAP. Under U.S. GAAP, shareholders' equity was €44,357.8 million at December 31, 2000 compared with €25,930.5 million under Spanish GAAP.

Under U.S. GAAP, net income was €28,278.3 million at December 31, 2001 compared with €2,106.8 million under Spanish GAAP. Under U.S. GAAP, net income was €1,856.0 million at December 31, 2000 compared with €2,504.8 million under Spanish GAAP.

For additional information concerning significant differences between U.S. GAAP and Spanish GAAP, as well as a reconciliation of net income and shareholders' equity to U.S. GAAP, please see note 25 to the consolidated financial statements included elsewhere herein.

### ***New U.S. Accounting Pronouncements***

#### *Accounting for Business Combinations, Goodwill and other Intangible Assets*

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 replaces Accounting Principles Board Opinion No. 16 (APB 16), *Business Combinations*, and requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangible assets will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations in the periods in which the recorded value of goodwill and certain intangibles exceeds its fair values. The provisions of SFAS No. 141 and SFAS No. 142, which apply to goodwill and intangible assets acquired prior to June 30, 2001, will be adopted by us on January 1, 2002. We are currently assessing the potential impact of these standards on our financial position and results of operations. In addition, goodwill on prior business combinations will cease to be amortized for U.S. GAAP reporting purposes. Had we adopted SFAS No. 142 at January 1, 2001, we would not have recorded a goodwill amortization charge of €1,970.0 million under U.S. GAAP.

#### *Accounting for Asset Retirement Obligations*

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as an operating item in the statement of income. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. We do not anticipate that adoption of SFAS No. 143 will have a material impact on our results of operations or financial position.

#### *Accounting for Impairment and Disposal of Certain Assets*

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*, which supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, and certain provisions of Accounting Principles Board Opinion No. 30 (APB 30), *Reporting Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The provisions of SFAS No. 144, which are effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with early adoption permitted, will be adopted by us on January 1, 2002. We have not yet estimated whether the adoption of SFAS No. 144 will have a material impact on our financial position or results of operations.

*Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections*

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS No. 145 rescinds SFAS No. 4, *Reporting Gains and Losses from Extinguishments of Debt*, SFAS No. 64, *Extinguishments of Debt made to Satisfy Sinking Fund Requirements*, and SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*. The statement also amends SFAS No. 13, *Accounting For Leases*, to eliminate certain inconsistencies within that statement. SFAS 145 also makes certain technical corrections or clarifications to other authoritative pronouncements. Certain provisions of SFAS No. 145 are effective for transactions occurring after May 15, 2002. We do not anticipate that adoption of SFAS No. 145 will have a material impact on our results of operations or financial position.

### **Introduction of the Euro**

In April 1997, we created the Office for the Euro Project, which was responsible for determining and evaluating the potential impact of the conversion to the euro as well as planning and coordinating the necessary changes.

The majority of our information systems and applications were modified during 1998 in order to offer information in both pesetas and euro as of January 1, 1999. In addition, during 1999 we began developing a plan to modify such systems and applications in order to commence operating exclusively in euro as of January 1, 2002. These modifications were successfully introduced throughout 2001.

The total cost of changes to our information systems and applications made in order to accommodate the conversion to the euro amounted to €24 million. In addition, we were required to modify our approximately 67,000 outdoor pay phones and our approximately 35,000 indoor pay phones in order for them to accept euro coins. These modifications were completed by the end of January 2002. The cost associated with these modifications totaled approximately €24.9 million.

## **B. LIQUIDITY AND CAPITAL RESOURCES**

### **Cash Flow Analysis**

The table below sets forth our consolidated cash flows for the periods indicated. Positive figures refer to cash inflows and negative figures or those in brackets refer to cash outflows.

	Year ended December 31,			
	1999	2000	2001	2001
	(millions of euro)			(millions of dollars)
Net cash inflow from operating activities .....	9,540.5	10,511.9	10,685.8	9,522.1
Net cash outflow for interest paid less dividends and interest charged .....	(1,781.6)	(1,515.0)	(1,857.1)	(1,654.8)
Net cash outflow for capital expenditures.....	(7,523.2)	(17,513.1)	(8,348.0)	(7,438.9)
Net cash outflow for investments in affiliates.....	(2,077.7)	(206.4)	(1,547.4)	(1,378.8)
Net cash outflow before financing activities.....	(1,842.0)	(8,722.6)	(1,066.6)	(950.5)
Net cash inflow (outflow) from financing activities .....	2,332.0	14,320.9	(1,321.1)	(1,177.3)
Effects of exchange rate changes on cash.....	(111.9)	(319.2)	(107.0)	(95.4)
Net increase (decrease) in cash and cash equivalents .....	<u>378.1</u>	<u>5,279.2</u>	<u>(2,494.8)</u>	<u>(2,223.1)</u>

#### *Net Cash Inflow from Operating Activities*

Net cash inflow from operating activities increased 1.6% to €10,685.8 million in 2001 from €10,511.9 million in 2000, principally due to the increase in EBITDA from Telefónica Móviles and the increase in EBITDA from Telefónica de España, partially offset by a 3.7% decrease in EBITDA from Telefónica Internacional. Net cash inflow from operating activities increased 10.2% to €10,511.9 million in 2000 from €9,540.5 million in 1999. The increase in 2000 was principally due to the positive performance of Telefónica Móviles and Telefónica Internacional.

### *Net Cash Outflow for Interest Paid Less Dividends and Interest Charged*

Net cash outflow for interest paid less dividends and interest charged increased 22.6% in 2001 to €1,857.1 million from €1,515.0 million in 2000, principally due to the increase in net interest paid, the main component of net cash outflow, to €2,304.7 million in 2001 from €2,022.9 million in 2000. Net cash outflow for interest paid less dividends and interest charged decreased 15.0% to €1,515.0 million in 2000 from €1,781.6 million in 1999. The decrease was principally due to the decrease in net interest paid to €2,022.9 million in 2000 from €2,203.3 million in 1999.

### *Net Cash Outflow for Capital Expenditures*

Net cash outflow for capital expenditures decreased 52.3% to €8,348.0 million from €17,513.1 million in 2000. Tangible capital expenditure payments for 2001 amounted to €6,369.6 million, mainly consisting of investments made by Telefónica Internacional (particularly Telesp), Telefónica Móviles and Telefónica de España. Intangible capital expenditures for 2001 amounted to €1,171.8 million, principally consisting of investments by Telefónica de España and investments by Telefónica Móviles in connection with its acquisition of UMTS licenses. Net cash outflow for capital expenditures increased by 132.8% to €17,513.1 million in 2000 from €7,523.2 million in 1999. Tangible capital expenditure payments for 2000 amounted to €8,016.6 million, mainly consisting of capital expenditures by Telefónica Internacional, Telefónica de España and Emergia. Intangible capital expenditures for 2000 amounted to €9,229.7 million, principally consisting of investments by Telefónica Móviles in connection with its acquisition of UMTS licenses.

### *Net Cash Outflow for Investments in Affiliates*

Net cash outflow for investments in affiliates increased in 649.7% to €1,547.4 million 2001 from €206.4 million in 2000. Our main investments in affiliates during 2001 were our acquisition of 100% of the shares of mediaWays GmbH for €1,473.1 million and our subscription of shares in connection with a capital increase by mediaWays for €62.5 million.

The principal transaction in 2001 which generated cash inflow from affiliates was the sale by Telefónica Internacional of its 35.9% holding in the Argentine company Cablevisión, S.A. which amounted to €731.7 million.

Net cash outflow for investments in affiliates decreased 90.1% to €206.4 million in 2000 from €2,077.7 million in 1999.

Our main investments in affiliates during 2000 were:

- the acquisition of an additional interest in DTS Distribuidora de Televisión Digital, S.A., which resulted in a cash outflow of €189.3 million
- the acquisition of an additional interest in Media Park, S.A., which resulted in a cash outflow of €63.1 million
- the acquisition of a 51% stake in the Venezuelan Rodven Group, which resulted in a cash outflow of €51.3 million
- the acquisition of a 27.7% interest in OneTravel.com, which resulted in a cash outflow of €16.0 million

The principal transactions in 2000 which generated cash inflow from affiliates were:

- the public offering of 7.9% of Telefónica Móviles, S.A. which resulted in cash inflow of €3,304.9 million
- the sale of a 3% interest in Terra Networks, which resulted in a cash inflow of €453.6 million
- the sale of a 16.7% interest in Companhia Riograndense de Telecomunicações S.A., which resulted in a cash inflow of €60.0 million

- the sale of shares of Emergia Holding, N.V., which resulted in a cash inflow of €33.2 million
- the sale of a 0.3% stake in Infonet Services Corporation, which resulted in a cash inflow of €24.1 million
- the sale of a 6.1% stake in Amper, S.A., which resulted in a cash inflow of €5.4 million

#### *Net Cash Outflow Before Financing Activities*

In 2001, net cash outflow before financing activities decreased 87.8% to €1,066.6 million in 2001 from €8,722.6 million in 2000, principally due to the significant decrease in capital expenditures following the unusually high levels in 2000 as a result of the acquisition of UMTS licenses by Telefónica Móviles and expenditures by Telefónica Internacional, Telefónica de España and Emergia. In 2000, net cash outflow before financing activities increased 373.5% to €8,722.6 million in 2000 from €1,842.0 million in 1999, principally due to the significant increase in net cash outflow for capital expenditures in 2000 as a result of the above, which more than offset the increase in cash inflow from operating activities and the decrease in net cash outflow for investments in affiliates.

#### *Net Cash Inflow (Outflow) from Financing Activities*

Net cash outflow from financing activities amounted to an outflow of €1,321.1 million in 2001 compared to net cash inflow of €14,320.9 million in 2000. Net cash outflow from financing activities in 2001 was principally the result of repayments of loans, credit facilities and notes payable in the amount of €7,773.4 million. Net cash inflow from financing activities amounted to an inflow of €14,320.9 million in 2000 compared to an inflow of €2,332.0 million in 1999. Net cash inflow from financing activities in 2000 was principally the result of debenture issues of U.S.\$10 billion, €650 million and 66,200 million Japanese yen. We had net cash inflow from financing activities in 1999 principally as a result of debenture issues in the Spanish market of €500 million, €300 million and €30 million, respectively, and floating rate notes totaling €500 million with one year maturity and an interest rate linked to 3-month EURIBOR outside Spain. Of our €28,941.6 million of consolidated debt at December 31, 2001, approximately 2.0% represented zero-coupon obligations, and the average interest rate on net debt was 6.34%.

### **Anticipated Uses of Funds**

#### *Capital Requirements*

We expect to spend 57% of our capital expenditures budget for 2002 on our fixed-line telephony and data services businesses (including broadband services which are expected to account for approximately 24% of our fixed-line telephony expenditures in 2002 compared to 13.6% in 2001), 34% on our wireless services business and 13% on our other lines of business. Our anticipated amounts of capital expenditures and investments in affiliates and the underlying assumptions are subject to risks and uncertainties, and actual capital expenditures and investments in affiliates may be less than or exceed these amounts. See “Cautionary Statement Regarding Forward-Looking Statements”.

## Contractual Obligations and Commercial Commitments

The following table aggregates our contractual obligations and commitments with definitive payment terms which may require significant cash outlays in the future. The amounts payable are as of December 31, 2001.

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
	(millions of euro)(1)				
<b>Contractual Obligations</b>					
Debentures and bonds .....	15,325.0	944.1	3,224.1	2,980.6	8,176.2
Other negotiable instruments .....	1,680.3	1,600.3	80.0	—	—
Notes payable.....	120.9	7.2	14.0	6.7	92.9
Loans and credits .....	7,561.9	4,254.8	1,413.1	745.7	1,148.4
Loans in foreign currency .....	6,559.8	1,901.5	2,579.6	923.4	1,155.4
Financial guarantees(2).....	712.9	102.5	145.4	146.9	318.1
Terra Networks purchase obligation(3) .....	600.8	—	600.8	—	—
Total.....	<u>32,561.6</u>	<u>8,810.4</u>	<u>8,057</u>	<u>1822.7</u>	<u>2,714.8</u>

- (1) Contractual commitments denominated in dollars have been translated into euro at U.S.\$0.8901= €1.00, the noon buying rate for euro on December 31, 2001. Actual amounts paid in dollars may differ at the payment date.
- (2) We have provided guarantees to secure certain financial transactions totaling €712.9 million, mainly our financing commitments with respect to certain of IPSE 2000's accounts payable, which IPSE 2000 incurred in connection with the acquisition of its UMTS license in Italy. Under certain conditions, we could be obligated to pay up to an aggregate of €712.9 million over the next five years.
- (3) In connection with Terra Networks' acquisition of Lycos, Inc., Bertelsmann entered into an agreement to purchase advertising, placement and integration services from Terra Networks during the five-year period following the consummation of the acquisition, which occurred in October 2000. As described in our Annual Report on Form 20-F for the fiscal year ended December 31, 2000, according to this agreement, we agreed to purchase from Terra Networks, if necessary, any portion of the services that Bertelsmann does not buy pursuant to its agreement during the third, fourth and fifth years following the consummation of the acquisition, up to \$675 million (\$200 million in the third year, \$225 million in the fourth year and \$250 million in the fifth year).

Telefónica Móviles initially provided certain guarantees in an aggregate amount of €1,100 million to the Spanish government in connection with its acquisition of a UMTS license in Spain. These guarantees support certain network build-out, research and development and job creation requirements. Telefónica Móviles is released from these guarantees from time to time, as specified milestones are reached. Phase I of the build-out requirement has been completed, and we are currently in negotiations with the Spanish government to release Telefónica Móviles from a significant portion of these guarantees. At June 30, 2002, the aggregate amount of Telefónica Móviles' guarantees to the Spanish government in connection with its acquisition of a UMTS licence in Spain totalled €781 million.

For details of the composition of, and changes in, our debt, see notes 15 and 16 to our consolidated financial statements.

We are also party to certain contractual arrangements that could require us to make payments under certain circumstances, including the exercise of options by third parties that require us to purchase securities held by them. Our material commercial commitments are described below.

On April 26, 2002, Telefónica Móviles signed agreements to purchase, subject to regulatory approval, 65% of Pegaso Telecomunicaciones, S.A. de C.V. from Sprint, Leap Wireless and other financial investors. Under these agreements, Telefónica Móviles has agreed to pay \$87 million in cash and to cause Pegaso to pay approximately \$586 million in existing debt obligations and any amount drawn down from \$100 million in additional interim financing provided by a third party, within 30 to 60 days of the closing of the acquisition. In addition, \$280 million of Pegaso's existing non-recourse vendor financing would accelerate and become immediately due if Pegaso were to implement a change in its wireless technology. The payment of the accelerated vendor debt is guaranteed by Telefónica Móviles. In connection with the Pegaso acquisition, Telefónica Móviles has agreed to contribute its

interest in Pegaso and its other Mexican operators to a new company (“Newco”) formed with Pegaso’s other shareholder and subscribe for 65% of a capital increase of between \$326 million and \$488 million to be carried out by Pegaso simultaneously with the closing of the Pegaso acquisition.

Telefónica Móviles’ agreement to create Newco and combine its interests in Pegaso and its other Mexican operators with the Burillo Group’s interest in Pegaso includes exit mechanisms for its local partners. These exit mechanisms operate via certain put rights for the Burillo Group relating to the Burillo Group’s Newco shares. In addition, Telefónica Móviles also has call rights with regard to the Burillo Group’s Newco shares. The Burillo Group will have the right to require Telefónica Móviles to purchase its shares in Newco in 2007 or 2008, or if its interest in Newco decreases to less than 50% of its original holding, after the occurrence of the event that results in such a dilution of its interest. If the Burillo Group does not exercise its put rights, Telefónica Móviles has the right, after November 14, 2008, to require it to sell to Telefónica Móviles its entire interest in Newco. In each such case, the purchase price will be determined based on a valuation of Newco performed pursuant to specified procedures at the time the related right is exercised. If Telefónica Móviles is required to purchase the Burillo Group’s Newco shares under its put right, or if Telefónica Móviles purchases its Newco shares under its call right, Telefónica Móviles has agreed to pay a portion of the purchase price in cash in an amount based on the Burillo Group’s original investment of \$160 million to \$216 million in Newco, plus the annual cost of carry (which is equal to the annual U.S. dollar swap rate), less any cash distributions received by the Burillo Group, and any remaining amount, if any, in, at Telefónica Móviles’ option, cash or Telefónica Móviles shares or a combination thereof. Because the amounts payable by Telefónica Móviles pursuant to the foregoing put and call rights are based on a valuation of Newco at the time the related right is exercised in 2007 or 2008, and the actual interest of the Burillo Group (either 8% or 10%), we are not able to determine as of the date of this Annual Report Telefónica Móviles’ potential commitment pursuant to such rights.

Telefónica Móviles’ subsidiary, Telefónica Móviles España, has agreed with IPSE 2000 to loan up to €250 million to it in order to preserve its activities and permit the launching of UMTS services in Italy when the technology becomes commercially feasible.

Pursuant to an agreement dated September 29, 2000, between Telefónica, S.A. and Tyco, if Emergia Holding, N.V. has not initiated the process for launching a public offering of its shares on the New York Stock Exchange prior to December 31, 2002, Tyco will have the right to require Telefónica, S.A., or one of its subsidiaries, to purchase Tyco’s entire interest in Emergia Holding, N.V. at a purchase price equal to the amount paid by Tyco in connection with the acquisition of its interest in Emergia Holding, NV., which is equal to approximately €48.4 million.

In January 2000, Vía Digital issued additional ordinary shares. As part of the capital increase, we gave three shareholders of Vía Digital who subscribed for the majority of the capital increase the right to require that we either (i) repurchase, if legally permitted, or (ii) identify a buyer who will purchase, their respective interest in Vía Digital at the price paid by each of them (€143.4 million in the aggregate) plus interest, as provided in the agreement. In the case of one of these shareholders, we may be required to purchase its shares on June 30, 2003, while in the case of the other two shareholders we may be required to purchase their shares between June 30, 2003 and June 30, 2004.

Notwithstanding significant future cash outlays in connection with the repayment of our debt, we believe that we will be able to gradually reduce the level of this consolidated debt. In order to achieve this objective, we expect to:

- make future borrowings on significantly more favorable terms than in the past when much of our debt was at fixed rates substantially above current market rates and
- increase our reliance on self-financing.

### **Anticipated Sources of Liquidity**

Cash flows from operations are our primary source of cash funding for existing operations, capital expenditures and debt interest and principal payments. We also rely on external borrowings, including a variety of short- and medium-term financial instruments, principally bonds and debentures, and borrowings from financial institutions. We believe that our medium term note program and available lines of credit will provide us with substantial flexibility for our future capital requirements as existing debt is retired.



As of December 31, 2001, we had credit facilities provided by more than 40 banks for an aggregate amount of €4,600 million.

Our credit facilities require amortization payments of €2,000 million in 2002 and €2,588 million in 2003. An amount of €12 million of our credit facilities has no amortization schedule and is of indefinite duration. All of our credit facilities bear interest at a floating rate based on market indices, principally the Euro Interbank Offered Rate (EURIBOR), the London Interbank Offered Rate (LIBOR), the Madrid Interbank Offered Rate (MIBOR) and the Brazilian Selic, Brazil's prime rate.

The table below sets forth the ratings of our short-term and long-term debt as of the date of this Annual Report.

<u>Rating Agency</u>	<u>Issuer (1)</u>	<u>Long-Term Debt</u>	<u>Short-Term Debt</u>	<u>Outlook</u>	<u>Last Update</u>
Standard & Poor's	Telefónica, S.A.	A	A-1	Stable	February 5, 2002
Moody's	Telefónica, S.A.	A2	P-1	Negative	May 20, 2002
Fitch	Telefónica, S.A.	A+	F1	Negative	January 11, 2002

(1) Long-term and short-term debt issued by Telefónica Europe, B.V. is similarly rated to long-term and short-term debt issued by Telefónica, S.A.

Our ability to use external sources of financing will depend in large part on our credit ratings. We believe that we are well-positioned to raise capital in the public debt markets. However, a downgrade of any of the ratings of our debt by any of Moody's, Standard & Poor's or Fitch may increase the cost of our future borrowing or may make it more difficult to access the public debt markets. In connection with the credit rating agencies' review of our debt ratings, the rating agencies may give considerable weight to the general macroeconomic and political conditions in Latin America given our high degree of exposure in such region, the performance of our businesses in our domestic market, our financial exposure to development costs in connection with the expansion of our wireless business in Europe, particularly costs related to our UMTS licenses, and our ability to turn around our non-profitable businesses.

### **Intragroup Loans**

Telefónica, S.A. lends funds to its operating subsidiaries, directly or through holding companies that head its different lines of business. These funds are derived from retained cash flows, loans, bonds and other sources (such as asset disposals). Some of the subsidiaries receiving funds are located in Latin America countries. In fact, most of the Telefónica Group's exposure to Argentina, amounting to €3,581.9 million at December 31, 2001 (according to Spanish accounting criteria), is due to intragroup loans.

### **C. RESEARCH AND DEVELOPMENT**

Our research and development policy is aimed at:

- developing new products and services in order to gain market share
- fostering customer loyalty
- increasing revenues
- improving management
- improving business practices
- increasing the quality of our infrastructure and services to improve customer service
- reducing costs

Our research and development activities are principally conducted by Telefónica Investigación y Desarrollo, S.A.U. Telefónica Investigación y Desarrollo conducts experimental and applied research and product development to increase the range of our services and reduce operating costs. It also provides technical assistance to our Latin American operations. Telefónica Investigación y Desarrollo's activities include the following:

- the development of telephone services, particularly the development of new value-added services such as broadband, wireless communications and Internet services for the public, corporate, wireless and multimedia sectors, and the automation of customer services
- the development of interactive services, focusing on the development of information services and new infrastructure to provide such services, primarily in the Internet Protocol environment
- the development of management systems designed to strengthen infrastructure and its quality and to develop innovative solutions for the management of Telefónica's networks and services
- the development of business support systems intended to provide innovative solutions for business processes
- innovation in business services intended to reinforce technological skills in the areas of networks, software and information technologies

Approximately 52% in 2001 and 52% in 2000 of Telefónica Investigación y Desarrollo's research and development was for the benefit of Telefónica de España, while approximately 44% in 2001 and 40% in 2000 was for the benefit of the Telefónica Group's other subsidiaries, particularly Telefónica Móviles, Telefónica Data, Atento, Terra Lycos, Admira and Telefónica Internacional.

Our total research and development expenses (including those of Telefónica Investigación y Desarrollo) totaled €90.3 million, €105.9 million and €170.8 million in 1999, 2000 and 2001, respectively. These expenses represented 0.4%, 0.4% and 0.6% of our consolidated revenues in each of those years, respectively.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. DIRECTORS AND SENIOR MANAGEMENT

We are managed by our Board of Directors, which consists of a minimum of five and a maximum of 20 members. All members of the Board of Directors are elected to five-year terms by our shareholders during a general meeting of shareholders. Between general meetings, the Board of Directors may appoint directors to fill vacancies on the Board of Directors, subject to ratification at the next general meeting. The Board of Directors, which meets monthly, elects from among its own members the chairman and the vice chairmen, and delegates day-to-day management of the group to a standing committee of the Board of Directors which meets bi-weekly. The Board of Directors has also constituted an audit and control committee, a hiring and compensation committee, a human resources committee, a regulatory committee and a service quality and customer care committee, each of which is composed of between a minimum of three directors and a maximum of five directors, most of whom are independent directors.

#### Board of Directors

At June 26, 2002, the directors of Telefónica, S.A., their respective positions on the Board of Directors and the year they were appointed to such positions were as follows:

Name	Age	First Appointed	Current Term Ends	Current Position and Present Principal Occupation or Employment; Material Positions Held During Past Five Years*
César Alierta Izuel(1).....	56	1997	2007	Chairman and Chief Executive Officer, Telefónica, S.A. (since 2000); Director, Altadis, S.A.
Isidro Fainé Casas(1)(2).....	59	1994	2006	Vice Chairman, Telefónica, S.A.; General Manager, Caja de Ahorros y Pensiones de Barcelona; Chairman, Autopistas Concesionaria Española, S.A.; Vice Chairman, Sociedad General de Aguas de Barcelona, S.A.; Director, Banco Herrero, S.A.; Director, Gas Natural, S.A.; Director,

Name	Age	First Appointed	Current Term Ends	Current Position and Present Principal Occupation or Employment; Material Positions Held During Past Five Years*
José Ignacio Goirigolzarri Tellaache(3).....	48	2000	2005	Sociedad de Aparcamientos de Barcelona, S.A.; Director, Inmobiliaria Colonial, S.A. Vice Chairman, Telefónica, S.A.; Managing Director, Banco Bilbao Vizcaya Argentaria, S.A.; Vice Chairman, Repsol YPF, S.A.
Fernando Abril-Martorell Hernández(1).....	40	2000	2006	Managing Director, Telefónica, S.A.; Director, Telefónica Móviles, S.A.; former General Manager of Finance, Telefónica, S.A.
Maximino Carpio García(1)(4)(5) .....	56	1997	2007	Director, Telefónica, S.A.; Director, Economic and Social Council of Spain; Director, Telefónica Móviles, S.A.; Professor of Applied Economics, Universidad Autónoma de Madrid
Carlos Colomer Casellas(1)(8) .....	58	2001	2006	Director, Telefónica, S.A.; Chairman, The Colomer Group; Director, Altadis, S.A.
José Antonio Fernández Rivero(3)(4)(7) .....	52	2002	2007	Director, Telefónica, S.A.; General Manager, Banco Bilbao Vizcaya Argentaria, S.A.
Alfonso Ferrari Herrero(5)(9).....	60	2001	2006	Director, Telefónica, S.A.; Director, Telefónica Móvil de Chile, S.A.; Director, Compañía de Telecomunicaciones de Chile, S.A.
Luiz Fernando Furlán.....	55	2000	2006	Director, Telefónica, S.A.; Chairman, Sadia, S.A.; Director, Panamco Pan American Beverages; Director, IBM Latin America; Director, ABN AMRO Bank (Brazil)
Gonzalo Hinojosa Fernández de Angulo(4)(8).....	56	2002	2007	Director, Telefónica, S.A.; Chairman and Managing Director, Cortefiel, S.A.; Director, Altadis, S.A.; Director, Portland Valderrivas, S.A.
Miguel Horta e Costa(6) .....	54	1998	2003	Director, Telefónica, S.A.; Vice Chairman, Portugal Telecom, S.A.; President, Executive Committee of Portugal Telecom, S.A.; President, Executive Committee of Portugal Telecom International, S.A.; Director, Portugalia Airlines
Pablo Isla Álvarez de Tejera(5)(9).....	38	2002	2007	Director, Telefónica, S.A.; Chairman, Altadis, S.A.; Chairman, Logista, S.A.; Director, Iberia Líneas Aéreas de España, S.A.; Director, Red Eléctrica de España, S.A.
Luis Lada Díaz.....	53	2000	2006	Director, Telefónica, S.A.; Chairman, Telefónica Móviles, S.A.
José Maldonado Ramos(1)(3)(7)(8).....	50	1999	2004	Director, Telefónica, S.A.; Director-General Secretary, Banco Bilbao Vizcaya Argentaria, S.A.
Antonio Massanell Lavilla(2)(4)(8)(9) .....	47	1995	2006	Director, Telefónica, S.A.; Assistant General Manager, Caja de Ahorros y Pensiones de Barcelona; Director, Telefónica Móviles, S.A.; Director, Inmobiliaria Colonial, S.A.
Enrique Used Aznar(7)(9).....	60	2002	2007	Director, Telefónica, S.A.; Chairman Amper, S.A.; Director, Terra Networks,

Name	Age	First Appointed	Current Term Ends	Current Position and Present Principal Occupation or Employment; Material Positions Held During Past Five Years*
Mario Eduardo Vázquez .....	66	2000	2006	S.A. Director, Telefónica, S.A.; Director, Banco Río de la Plata, S.A.; Chairman, Río Compañía de Seguros, S.A.; Director, Ríobank International; Director, Corporación Metropolitana de Finanzas, S.A.; Director, Heller Financiera Argentina, S.A.; Director, Heller-Sud Servicios Financieros, S.A.; Director, Motorcare Argentina, S.A.; Director, Acsa Loss Control, S.A.; Director, Central Puerto, S.A.
Antonio Viana-Baptista(1)(6) .....	44	2000	2005	Director, Telefónica, S.A., Chairman, Telefónica Internacional, S.A.; Director, Terra Networks, S.A., representing Telefónica DataCorp, S.A.
Gregorio Villalabeitia Galarraga(1)(3)(5).....	51	2002	2007	Director, Telefónica, S.A.; General Manager, Banco Bilbao Vizcaya Argentaria, S.A.; Director, Iberia Líneas Aéreas de España, S.A.; Director, Metrovacesa, S.A.; Director, Repsol YPF, S.A.; Director, IBV; Director, Gas Natural S.A.
Antonio Jesús Alonso Ureba(1)(7) .....	44	2001	2006	Director, Telefónica, S.A.; Secretary of the Board, Telefónica, S.A; former Secretary to the Board of the Spanish Securities Commission ( <i>Comisión Nacional del Mercado de Valores</i> ).
Joaquín de Fuentes Bardají .....	48	2001	—	Vice Secretary of the Board, Telefónica, S.A. Non-Director

- (1) Member of the Standing Committee of the Board of Directors.
- (2) Nominated by Caja de Ahorros y Pensiones de Barcelona.
- (3) Nominated by Banco Bilbao Vizcaya Argentaria, S.A.
- (4) Member of the Audit and Control Committee of the Board of Directors.
- (5) Member of the Hiring and Compensation Committee of the Board of Directors.
- (6) Citizen of Portugal.
- (7) Member of the Regulatory Committee of the Board of Directors.
- (8) Member of the Service Quality and Customer Care Committee of the Board of Directors.
- (9) Member of the Human Resources Committee of the Board of Directors.

\* Where no position is shown, principal occupation for past five years was as director of Telefónica.

Spanish law permits limited liability companies to serve as members of the Board of Directors. A company serving in such a capacity must appoint a natural person to represent it at the meetings of the Board of Directors.

A significant majority (15) of our current directors are non-managing directors. In accordance with the regulations of our Board of Directors, a minority of these directors (6) are appointed by our significant shareholders.

The Standing Committee is a body empowered to make decisions on general matters on behalf of the Board of Directors and has the delegated authority to carry out our Board of Directors' powers as permitted by our by-laws and Spanish corporate law. The members of the Standing Committee are César Alierta Izuel, Isidro Fainé Casas, Fernando Abril-Martorell Hernández, Maximino Carpio García, Carlos Colomer Casellas, José Maldonado Ramos, Antonio Viana-Baptista, Gregorio Villalabeitia Galarraga and Antonio Alonso Ureba.

The Audit and Control Committee is responsible for providing support to the Board of Directors in supervising the correct application of generally accepted accounting principles, reviewing compliance with internal control systems and maintaining the integrity of the preparation of individual and consolidated audits. The Audit and Control Committee is also responsible for retaining and terminating the company's independent auditors, subject to shareholder approval, and the monitoring of such auditors' qualifications and independence. The members of the Audit and Control Committee are Antonio Massanell Lavilla (president), Maximino Carpio García, José Antonio Fernández Rivero and Gonzalo Hinojosa Fernández de Angulo.

The Hiring and Compensation Committee is responsible for informing the Board of Directors of the proposals for naming Board of Directors members, members of Board of Directors committees and top members of management of Telefónica and its subsidiaries. In addition, the Hiring and Compensation Committee is responsible for approving contracts and compensation packages for top members of management, determining Directors' compensation, determining the basic criteria for the Chairman's compensation, informing the Board of Directors of incentive plans and developing and maintaining a register of information concerning Directors and top members of management. The members of the Hiring and Compensation Committee are Alfonso Ferrari Herrero (president), Maximino Carpio García, Pablo Isla Álvarez de Tejera and Gregorio Villalabeitia Galarraga.

The Human Resources Committee is responsible for making proposals to the Board of Directors regarding the adoption of agreements with personnel. The members of the Human Resources Committee are Pablo Isla Álvarez de Tejera (president), Alfonso Ferrari Herrero, Antonio Massanell Lavilla and Enrique Used Aznar.

The Regulatory Committee is responsible for making proposals to the Board of Directors regarding the adoption of policies in connection with regulatory matters. The members of the Regulatory Committee are Enrique Used Aznar (president), Antonio Jesús Alonso Ureba, José Antonio Fernández Rivero and José Maldonado Ramos.

The Service Quality and Customer Care Committee is responsible for assuring and monitoring the standards of quality of all services provided by the Telefónica Group and is committed to focusing on the customer satisfaction of all of its clients. The members of the Service Quality and Customer Care Committee are Gonzalo Hinojosa Fernández de Angulo (president), Carlos Colomer Casellas, José Maldonado Ramos and Antonio Massanell Lavilla.

### **Executive Committee**

The members of our executive management committee at May 29, 2002, and the years of their appointments to their respective positions were as follows:

<b>Name</b>	<b>Position</b>	<b>Appointed</b>	<b>Age</b>
César Alierta Izuel .....	Chairman of the Board of Directors and Chief Executive Officer, Telefónica, S.A.	2000	56
Fernando Abril-Martorell Hernández .....	Managing Director, Telefónica, S.A.	2000	40
Luis Abril Pérez .....	Chairman of the Board of Directors and Chief Executive Officer, Admira Media	2002	53
Joaquim Agut Bonsfills .....	Chairman of the Board of Directors and Chief Executive Officer, Terra Networks, S.A.	2000	46
José María Alvarez-Pallete Lopez .....	General Manager of Corporate Finance, Telefónica, S.A.	1999	38
Francisco de Bergia González .....	General Manager, Assistant to the Chairman, Telefónica, S.A.	2000	53
Joaquín Faura Batlle .....	General Manager of Content, Telefónica, S.A.	2002	51
Guillermo Fernández Vidal.....	General Manager, Assistant to the Managing Director of Telefónica, S.A.	1998	56
Alberto M. Horcajo Aguirre .....	Chairman of the Board of Directors and Chief Executive Officer, Atento	2001	38
Luis Lada Díaz.....	Chairman of the Board of Directors and Chief Executive Officer, Telefónica Móviles, S.A.	2000	53
Julio Linares López.....	Chairman of the Board of Directors and Chief	1998	56

Name	Position	Appointed	Age
	Executive Officer, Telefónica de España, S.A.		
Oscar Maraver Sánchez-Valdepeñas .....	General Manager of Human Resources, Telefónica, S.A.	2001	52
Antonio Palacios Esteban .....	General Manager of Resources, Telefónica, S.A.	2000	51
Calixto Ríos Pérez .....	General Manager of Institutional Relations, Telefónica, S.A.	2000	58
Antonio Viana-Baptista .....	Chairman of the Board of Directors and Chief Executive Officer, Telefónica Internacional, S.A.	1998	44
Angel Vilá Boix .....	General Manager of Corporate Development, Telefónica, S.A.	2000	37
Antonio Jesús Alonso Ureba.....	General Secretary and Secretary of the Board of Directors, Telefónica, S.A.	2001	44
Eduardo Caride .....	Chairman of the Board of Directors, Telefónica DataCorp, S.A.	2001	46

In addition to the above, the senior management of Telefónica, S.A. is comprised of one general manager, 11 deputy general managers and 26 assistant general managers of Telefónica, S.A.

## B. COMPENSATION

The following table shows the amounts of compensation to the Board of Directors of Telefónica, S.A. by Telefónica, S.A. and other members of the Telefónica Group in 2000 and 2001.

Type of Compensation	Year ended December 31,			
	2000		2001	
	Telefónica, S.A.	Rest of Group	Telefónica, S.A.	Rest of Group
	(millions of euro)			
Salary(1) .....	2.2	1.2	2.4	1.2
Variable Compensation(1) .....	1.5	1.6	2.0	0.40
Fees and allowances.....	2.2	1.2	2.6	1.1
In-kind compensation .....	0.04	0.3	0.03	0.2
Total.....	6.0	4.4	7.1	2.9

(1) Corresponds to directors with executive functions only.

We provide pension, retirement or similar benefits to our directors and executive officers. We set aside or accrued approximately €0.3 million (€0.26 million at Telefónica, S.A. and €0.04 million at other members of the Telefónica Group) during 2001 and €0.3 million (€0.2 million at Telefónica, S.A. and €0.1 million at other members of the Telefónica Group) during 2000 for these benefits.

In addition, the cost to the Telefónica Group of compensation plans linked to the market price of our shares in which directors participate as executives amounted to €1.3 million in 2001 and €1.1 million in 2000.

The following table shows the amounts of compensation paid to members of the Executive Committee (excluding those who are also members of the Board of Directors of Telefónica, S.A.) and senior management of Telefónica, S.A. by Telefónica, S.A. and other members of the Telefónica Group in 2000 and 2001.

Type of Compensation	Year ended December 31,			
	2000		2001	
	Telefónica, S.A.	Rest of Group	Telefónica, S.A.	Rest of Group
	(millions of euro)			
Salary .....	5.9	2.4	9.3	2.4
Variable Compensation.....	2.1	1.9	3.6	1.0
Fees and allowances.....	—	0.1	0.03	0.1

Type of Compensation	Year ended December 31,			
	2000		2001	
	Telefónica, S.A.	Rest of Group	Telefónica, S.A.	Rest of Group
	(millions of euro)			
In-kind compensation .....	0.1	0.1	0.3	0.1
Total.....	<u>8.2</u>	<u>4.5</u>	<u>13.2</u>	<u>3.5</u>

We provide pension, retirement or similar benefits to our directors with executive functions and to our executive officers. We set aside or accrued approximately €0.3 million (€0.3 million at Telefónica, S.A. and €0.04 million at other members of the Telefónica Group) during 2001 and approximately €0.2 million (€0.2 million at Telefónica, S.A. and €0.1 million at other members of the Telefónica Group) during 2000 for these benefits.

### Incentive Plans

We currently have two incentive compensation plans, approved by our general meeting of shareholders on April 7, 2000, in order to retain and motivate our officers and employees. The TOP plan, which is directed exclusively towards officers of the Telefónica group, requires eligible officers to purchase our shares in the open market at market prices and hold these shares for specified periods in order to receive additional cash compensation calculated on the basis of any increase in the value of our shares. The TIES plan, which is directed to all employees of the Telefónica group, requires eligible employees to purchase our shares at below market prices and to receive options, based on the number of shares purchased by each eligible employee, whose value will depend on any increase in the value of our shares over an initial reference value. In addition, we have a stock option plan for employees of Endemol, S.A. (the “EN-SOP Program”), which grants eligible employees at Endemol options on our shares. Finally, Telefónica Publicidad e Información, Terra Networks and Telefónica Móviles have incentive plans for their respective employees.

#### TOP

In May 1999, our Board of Directors approved a stock option plan called TOP proposed by its Hiring and Compensation Committee. This stock option plan is effective for a period of four years and three months from its June 28, 1999 commencement date and is open to up to 500 officers throughout the Telefónica Group. Our shareholders approved the TOP plan at our annual general shareholders’ meeting in April 2000.

All beneficiaries are required to acquire in the open market at market prices and hold, during the entire effective period, a specified number of shares in an amount corresponding to the beneficiary’s management responsibility. If all eligible officers elect to participate in the plan, the total number of shares acquired by them would be 270,237 shares, or 810,711 shares after giving effect to stock splits and anti-dilution provisions of the plan.

Under this management incentive plan, participating officers will receive the following number of options over our shares for each share acquired by such person and deposited under the plan:

- 10 type A options, with an exercise price of €46.18, which is equal to the market price of the shares on the date that the plan was initiated, as adjusted from time to time for stock splits and anti-dilution provisions
- 10 type B options, with an exercise price of €69.27, which is equal to the market price described above plus 50% of the market price

At December 31, 2001, the exercise price for the type A options initially granted adjusted for stock splits and anti-dilution provisions was equal to €14.50, and the exercise price for the type B options initially granted adjusted for stock splits and anti-dilution provisions was €21.75.

In October 2000 and February and April 2001, we granted new options under the TOP plan from the pool of remaining options under the plan. The general shareholder’s meeting of June 2001 approved these grants and granted authority to the Board of Directors to issue further new grants under the plan from the remaining pool, subject to certain restrictions. These options have the same characteristics as the options previously granted under the TOP plan, except that the exercise price for the type A options was fixed at the market price on the respective date of grant.

Participants in the plan may exercise these options:

- beginning in its second year following effectiveness in an amount equal to one-third of the total options granted
- again in each of the third and fourth years following effectiveness in an amount equal to one-third of the total options granted

As adjusted for all stock splits and stock dividends, a plan participant will, upon exercise of an option, receive, at our election, either:

- cash in an amount based on the difference between the average price of our shares on the Madrid Stock Exchange during the 10 business days prior to August 28, 2002 and September 28, 2003, depending on when the option was exercised, and the exercise price of such option; or
- one of our shares

Options granted under this plan are neither listed nor transferable. This incentive plan is subject to anti-dilution and other provisions customary for transactions of this type and to the condition that the participant not terminate his employment with the Telefónica group voluntarily and unilaterally prior to the exercise date.

At December 31, 2001, a total of 14,966,640 options had been granted under the TOP plan to 453 beneficiaries. Because of the incorporation of some of these beneficiaries under Telefónica Móviles' new stock option plan on January 2, 2002, as a result of which they are no longer eligible under the TOP plan, the number of options outstanding under the TOP plan was reduced to 12,158,820 and the number of beneficiaries decreased to 335 at that date.

In order to cover the economic exposure derived from the implementation of the TOP plan we have entered into hedging contracts with two financial institutions. The maximum total cost to us of the plan, assuming all eligible participants fully participate in the plan, will be approximately €72.1 million. Currently, there are 344 beneficiaries of the TOP plan, who hold in the aggregate 14,424,454 options. Consequently, the maximum total cost to us would be approximately €23.9 million as of June 5, 2002.

### ***TIES***

In February 2000, our Board of Directors approved a new stock option plan called Telefónica Incentive Employee Shares, which we refer to as TIES. The TIES plan is open to all eligible employees of Telefónica, S.A. and certain affiliates. Employees who participate in any other similar incentive plan or who are managers or general managers may not participate in the TIES plan.

The TIES plan, which was implemented in February 2001, consisted of two parts:

- *The Initial Allocation.* At the commencement of the TIES plan, eligible employees were able to subscribe for shares at the discounted price of €5 per share. The number of shares an eligible employee was able to subscribe for in the initial allocation was based on such employee's wage level. Such shares may not be sold during the entire life of the TIES plan. As part of the initial allocation, we offered 1,197,880 shares, of which 1,123,072 were subscribed.
- *The Variable Allocation.* Each eligible employee was able to receive a certain number of options to purchase shares of Telefónica, S.A., which the employee will be able to exercise in order to purchase an additional number of shares at the same discounted price of €5 per share. The options are non-negotiable and may not be assigned or transferred by the employee. The maximum number of shares issuable in respect of options assigned to employees is 31,504,244, of which a reserve of 4.5% is held for new beneficiaries.

The TIES plan will have a duration of four years from the date of delivery of the options. Participants in the plan may exercise the options in three stages:



- *First Stage:* on the first business day following the second anniversary of the date of delivery of the options.
- *Second Stage:* on the third anniversary of the date of the delivery of the options.
- *Third Stage:* on the first business day following the fourth anniversary of the date of the delivery of the options.

The number of options exercisable at each stage will be a function of:

- the revaluation of the price per share determined on the open market on each date of exercise with respect to an initial reference value of €20.50, such that the greater the revaluation per share on the exercise date, the greater the number of options the beneficiary will be able to exercise on that date; and
- the number of shares which make up the beneficiary's initial allocation

The following basic conditions, among others, apply to the exercise of the options:

- the beneficiary must retain the initial allocation until the relevant date of exercise of the options
- the beneficiary must not participate in any other similar incentive plan
- the beneficiary must have rendered his or her services continuously through the date of exercise of the options, as a permanent employee, except in certain circumstances

As of June 5, 2002, 80,310 persons participate in the TIES plan, with options to purchase 31,603,807 of our shares.

### ***EN-SOP***

In order to satisfy certain obligations in connection with our acquisition in 2000 of Endemol Entertainment Holdings, N.V., in April 2001 our Board of Directors approved the establishment of a new stock option plan, which we refer to as the "EN-SOP program", that is open to all permanent employees of Endemol Entertainment N.V. and its affiliated companies at January 1, 2001 who do not participate in a similar compensation plan. As part of the EN-SOP program, we will deliver to each eligible employee who is employed on January 1 of 2001, 2002, 2003 and 2004 a variable number of options to purchase shares of Telefónica, S.A. based on such employee's level and salary.

The options expire four years from their respective date of grant and may be exercised in equal amounts beginning in the third and fourth years from such date of grant. The total number of options granted each year pursuant to the plan will be determined by dividing €27.5 million by the exercise price, which price shall be equal to the weighted average of the price per ordinary share of Telefónica, S.A. on the automated quotation system of the Spanish stock exchanges during the five trading days prior to the meeting of the Board of Directors which convenes the annual shareholders' meeting.

The EN-SOP program is subject to anti-dilution and other provisions customary for stock option plans of this type and to the condition that the participant not terminate his employment voluntarily and unilaterally prior to the exercise date.

Pursuant to the EN-SOP program, in 2001 a total of 976 participants received an aggregate of 1,294,440 options with an exercise price of €19.2898 per share. In 2002, the exercise price will be €12.61 for all options granted under the EN-SOP program, which amount shall not exceed 2,180,809 options.

### **C. BOARD PRACTICES**

Please see "—Directors and Senior Management" above

## D. EMPLOYEES

### Employees and Labor Relations

The table below sets forth the number of employees at the dates indicated for the parent company of the Telefónica Group, each of the consolidated companies of the groups which comprise our different lines of business and other consolidated subsidiaries. The number of employees at year-end 2001 for some of groups which comprise our different lines of business, particularly Telefónica Internacional, may not be comparable to figures at year-end 2000 because of the reorganization of our business pursuant to which we spun off or transferred the wireless operations, data operations and directory publishing businesses of certain of our integrated Latin American operators to the respective groups which comprise those lines of business. The table below also reflects the growth in the number of employees of the Telefónica Móviles group, the Telefónica Data group and the Atento group as a result of their expansion in 2001 through organic growth and acquisitions.

Line of Business	Year Ended December 31,		
	1999	2000	2001
Telefónica, S.A. ....	542	641	727
Telefónica de España Group.....	48,709	43,009	42,425
Telefónica Móviles Group.....	3,364	7,093	13,459
Telefónica Internaciona Group.....	44,638	40,848	30,425
Telefónica Data Group.....	1,329	2,627	4,952
Admira Media Group.....	1,194	5,888	6,698
Terra Networks Group.....	2,119	3,170	2,907
Atento Group.....	23,985	40,773	49,940
Katalyx Group.....	-	368	220
Emergia Group.....	-	81	156
Telefónica Publicidad e Información Group.....	1,183	2,134	2,815
Other.....	130	2,075	6,803
Total Employees.....	<u>127,193</u>	<u>148,707</u>	<u>161,527</u>

Management believes that labor relations are generally good. In July 1999, Telefónica de España entered into a collective bargaining agreement that provided for increases in wage levels in accordance with anticipated increases in the Indices de Precios de Consumo (IPC), the Spanish consumer price index, and an additional productivity bonus per employee. In accordance with this agreement, in 1999 wage levels increased 2.9% and employees received an additional productivity bonus of approximately €300.5 per active employee and in 2000 wage levels increased 4.0% and employees received an additional productivity bonus of approximately €312.5 per active employee. In May 2001, Telefónica de España entered into a new two-year collective bargaining agreement that provides for similar increases in wages and productivity bonuses. Accordingly, in 2001 wage levels increased 2.7% and employees received an additional productivity bonus of approximately €372.6 per active employee.

Telefónica Móviles España and Telefónica Data España also entered into new collective bargaining agreements in 2001.

Our retired employees are provided with certain pension benefits. While Telefónica de España contributes the required amounts to fund these benefits over time, there remains an unfunded past service liability, which is estimated to be approximately €460 million. We have agreed to fund this obligation over a period ending in 2007.

In order to adapt to the new competitive environment, we have, among other things, implemented voluntary pre-retirement and early retirement plans in recent years. As a result of the agreements reached individually with Telefónica de España's personnel and as a result of the Labor Force Reduction Plan approved by the Ministry of Labor and Social Affairs and implemented in 1999 and 2000, an aggregate of 10,841 employees were terminated in 1999 and 2000.

In connection with our voluntary retirement programs, we recorded provisions of €168.5 million in 1999, €1,197.1 million in 2000 and €375.8 million in 2001, which were charged to results of operations in each respective year. The provision for pre-retirements and early retirements recorded at December 31, 2001, covers all the obligations assumed at that date in connection with our voluntary pre-retirement and early retirement plans.

## E. SHARE OWNERSHIP

At June 5, 2002, the following members of our Board of Directors beneficially owned an aggregate of 348,485 shares, representing approximately 0.007% of our capital stock.

Name	No. of Shares Beneficially Owned
César Alierta Izuel .....	162,706
Isidro Fainé Casas .....	1,533
José Ignacio Goirigolzarri Tellaeché .....	—
Fernando Abril-Matirell Hernández .....	30,895
Antonio Jesús Alonso Ureba .....	8,111
Maximino Carpio García .....	5,610
Carlos Colomer Casellas .....	500
José Antonio Fernández Rivero .....	111
Alfonso Ferrari Herrero .....	1,675
Luiz Fernando Furlán .....	12,010
Gonzalo Hinojosa Fernández de Angulo .....	36,485
Miguel Horta e Costa .....	318
Pablo Isla Alvarez de Tejera .....	372
Luiz Lada Díaz .....	28,600
José Maldonado Ramos .....	30
Antonio Massanell Lavilla .....	2,499
Enrique Used Aznar .....	37,438
Mario Eduardo Vázquez .....	10
Antonio Viana-Baptista .....	19,532
Gregorio Villalabeitia Galarraga .....	50

At June 5, 2002, members of or executive committee (excluding members of our Board of Directors listed above), our general managers, deputy general managers and assistant general managers beneficially owned an aggregate of 569,655 shares, representing approximately 0.011% of our capital stock.

None of our directors and executive officers beneficially owned shares representing one percent or more of our share capital at that date.

At June 5, 2002, the following members of our Board of Directors and executive officers held options to acquire our ordinary shares pursuant to our TOP plan. For a description of the terms of this plan, see Item 6.B above.

Name	No. of Type A Options	Exercise Price for each Type A Option	No. of Type B Options	Exercise Price for each Type B Option
		(euro)		(euro)
César Alierta Izuel .....	175,000	22.69	175,000	30.63
Fernando Abril-Martorell Hernández .....	125,000	22.69	125,000	30.63
Antonio Viana-Baptista .....	77,970	14.51	77,970	21.76
Antonio J. Alonso Ureba .....	77,970	18.20	77,970	24.57
José María Alvarez-Pallete López .....	77,970	14.5052	77,970	21.7554
Guillermo Fernández Vidal .....	77,970	14.5052	77,970	21.7554
Rafael Hernández García .....	77,970	14.5052	77,970	21.7554
Julio Linares López .....	77,970	14.5052	77,970	21.7554
Angel Vilá Boix .....	77,970	14.5052	77,970	21.7554
Antonio Palacios Esteban .....	77,970	14.5052	77,970	21.7554
Francisco Bergia González .....	45,270	14.5052	45,270	21.7554
	32,700	18.45	32,700	24.9075
Oscar Maraver Sánchez-Valdepeñas .....	45,270	14.5052	45,270	21.7554
	32,700	18.45	32,700	24.9075
Calixto Rios Pérez .....	77,970	18.45	77,970	24.9075
Luis Abril Pérez .....	77,970	13.50	77,970	18.22
Alberto M. Horcajo Aguirre .....	77,970	13.50	77,970	18.22

Joaquín Faura Batlle .....	45,270	18.45	45,270	24.9075
Eduardo Caride .....	45,270	15.0912	45,270	22.6343
	32,700	13.50	32,700	18.22

None of our Directors and executive officers held options in respect of shares representing one percent or more of our share capital at that date.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

#### General

At June 6, 2002, we had 4,860,661,286 shares outstanding, each having a nominal value of €1 per share. All outstanding shares have the same rights.

At June 6, 2002, according to information publicly available to Telefónica, S.A. beneficial owners of 5% or more of our voting stock were as follows:

Name of Beneficial Owner	Shares	
	Number	Percent
Banco Bilbao Vizcaya Argentaria, S.A.(1).....	263,022,186	5.519%
Chase Manhattan Bank, N.A.(2).....	395,199,496	8.131%

(1) Based on information obtained from a communication made to the CNMV on June 5, 2002.

(2) Held by Chase Manhattan Bank, N.A. on behalf of beneficial owners. Based on information obtained from a communication made to the CNMV on June 4, 2002.

As part of our strategic alliance with Banco Bilbao Vizcaya Argentaria, Banco Bilbao Vizcaya Argentaria agreed to increase its interest in us to up to 10% less one share through open market purchases of additional Telefónica shares. According to Banco Bilbao Vizcaya Argentaria's most recent public disclosure in respect of its ownership of our shares, no such purchases have been made.

#### Limitations on Certain Transactions

In January 1997, in connection with the final phase of our privatization, the Spanish government adopted a requirement of prior government approval with respect to a limited number of fundamental corporate and control transactions affecting us, including the acquisition of 10% or more of our capital stock or the capital stock of Telefónica Móviles and the sale of assets material to the provision of fixed telephone services. The approval requirement applied in connection with the transfer of certain assets of Telefónica, S.A. to our subsidiary Telefónica de España in November 1998 and will apply to subsequent transfers by Telefónica de España. This approval requirement expires in February 2007.

### B. RELATED PARTY TRANSACTIONS

As described in our Annual Report on Form 20-F for the year ended December 31, 2000, in February 2000, we entered into a strategic alliance with our significant shareholder, Banco Bilbao Vizcaya Argentaria, pursuant to which we entered into several transactions in 2001. These transactions are described in "Item 4—Information on the Company—Business Overview—International Strategic Partnerships—Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria".

### C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **Consolidated Financial Statements**

Please see Item 18.

### **Legal Proceedings**

We and various members of the Telefónica Group are party to various lawsuits arising in the ordinary course of our business. We do not believe that the outcome of any of these lawsuits, individually or in the aggregate, will have a significant effect on our consolidated financial position or results of operations.

One of our shareholders has initiated a legal proceeding to contest the validity of the resolutions adopted by our extraordinary shareholders' meeting of February 4, 2000. This proceeding derives from our alleged failure to comply with the shareholder plaintiff's right to information, our alleged failure to comply with the regulations relating to the celebration of shareholders' meetings and our alleged failure to comply with the necessary requirements to validly exclude pre-emptive rights in connection with the capital increases. We believe that this proceeding will be resolved in a manner satisfactory to Telefónica, S.A. This same shareholder has also brought another legal proceeding to contest the validity of certain resolutions adopted by our annual general shareholders' meeting held on June 15, 2001. In particular, the shareholder plaintiff seeks to nullify the resolutions relating to the approval of the annual accounts for the fiscal year ended December 31, 2000 and the management of the company during such year, the capital increase in connection with the acquisition of the Northern Mexico wireless operators from Motorola and the capital increase in connection with the company's stock option plan. The shareholder plaintiff alleges our failure to comply with the necessary requirements to validly exclude pre-emptive rights in connection with capital increases. We also believe that this proceeding will be resolved in a manner satisfactory to us.

In 2001, International Discount Telecommunications Corporation, Terra Networks' former joint venture partner, filed a lawsuit in the state court of New Jersey against us, Terra Networks, S.A., Terra Networks USA, Inc. and Lycos, Inc. alleging the breach of the joint venture agreement between Terra Networks and International Discount Telecommunications Corporation dated October 1999, the breach of the termination agreement between such parties, fraud and violation of U.S. securities laws. International Discount Telecommunications Corporation seeks damages in an unspecified amount in its amended complaint. We believe that the outcome of this litigation will not be unfavorable to us or Terra Networks. Nonetheless, we do not believe that an adverse resolution of this claim would materially affect our business. In 2001, International Discount Telecommunications Corporation also brought a demand for arbitration against Telefónica Internacional, S.A. before the American Arbitration Association. This demand for arbitration is based on the alleged breach of a letter of intent dated August 11, 1999 between International Discount Telecommunications Corporation and Telefónica Internacional, S.A. International Discount Telecommunications Corporation seeks an award in the amount of at least \$2.0 billion and specific performance in connection with the letter of intent. We believe that the outcome of this proceeding will not be unfavorable to us or Telefónica Internacional, S.A. Nevertheless, we also do not believe that an adverse resolution of this proceeding would materially affect our business or financial condition.

### **Proceedings and Convictions**

During the last five years, neither we nor, to the best of our knowledge, any person listed in Item 6 above:

- has been convicted in a criminal proceeding, excluding traffic violations or similar misdemeanors
- has been a party to a civil proceeding of a judicial or administrative body of competent jurisdiction and as a result of such proceeding was or is subject to a judgment, decree or final order enjoining future violations of, or prohibiting or mandating activities subject to, United States federal or state laws or finding any violation with respect to such laws

### **Dividend Information**

At the extraordinary general meeting of shareholders held in June 1998 we announced our dividend policy aimed at providing an alternative to cash dividend payments. The objective of this policy is to strengthen our

capacity to finance value-creating projects while enabling our shareholders to obtain liquidity by trading their shares. In connection with this policy during 1999 we carried out three capital increases charged to freely disposable reserves. At the annual general shareholders' meeting in April 2000, our shareholders approved two capital increases charged to freely disposable reserves. These capital increases were carried out in January 2001 and March 2001. At our annual general shareholders' meeting in June 2001, our shareholders approved two capital increases charged to freely disposable reserves. The first of these capital increases was carried out in January 2002 and the second was carried out in March 2002. The ratio for each of the share dividends has been one new share for every 50 then outstanding.

The table below sets forth the annual cash dividends per share paid by us during the past five years.

Fiscal Year ended December 31,	Cash Dividends per Share	
	Pesetas (1)	\$ (2)
2001 .....	—	—
2000 .....	—	—
1999 .....	—	—
1998 .....	—	—
1997 (3).....	102	.66 (4)

- (1) Peseta amounts reflect nominal amounts at date of payment.
- (2) Translated to dollars at the Noon Buying Rate on the date of payment. See "Item 3—Key Information—Selected Financial Data—Exchange Rate Information".
- (3) An interim dividend in respect of the fiscal year ended December 31, 1997 was paid in January 1998, and a final dividend was paid in May 1998.
- (4) The interim dividend payment has been translated into dollars at the Noon Buying Rate for the day following the interest payment date because the interest payment date was a national holiday in the United States as a result of which a Noon Buying Rate was not available on such date.

## ITEM 9. THE OFFERING AND LISTING

### A. OFFER AND LISTING DETAILS

#### General

Our ordinary shares, nominal value one euro each, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges under the symbol "TEF". They are also listed on various foreign exchanges such as the London, Frankfurt, Paris, Buenos Aires and Tokyo stock exchanges and are quoted through the Automated Quotation System of the Spanish stock exchanges and through the SEAQ International System of the London Stock Exchange. Our shares are eligible for deposit in the Euroclear system. Our BDSs are listed on the São Paulo Stock Exchange. Our ADSs are listed on the New York Stock Exchange and the Lima Stock Exchange.

The table below sets forth, for the periods indicated, the reported high and low quoted closing prices, as adjusted for all stock splits, for the shares on the Madrid Stock Exchange, which is the principal Spanish market for our shares.

	Per Share	
	High	Low
	(euro)	
<b>1997(1)</b> .....	9.71	5.95
<b>1998(1)</b> .....	16.05	9.00
<b>1999</b> .....	26.20	11.61
<b>2000</b>		
First Quarter.....	32.60	22.85
Second Quarter .....	26.78	20.15
Third Quarter .....	25.50	20.88
Fourth Quarter .....	23.80	17.50
<b>2001</b>		
First Quarter.....	21.10	15.95

	Per Share	
	High	Low
	(euro)	
Second Quarter .....	20.10	14.29
Third Quarter .....	15.16	10.11
Fourth Quarter .....	16.20	11.45
<b>2002</b>		
First Quarter.....	15.04	12.04
January.....	15.04	12.72
February.....	13.71	12.04
March.....	14.10	12.51
April.....	13.40	11.71
May.....	12.06	10.52
June (through June 27) .....	11.42	7.73

(1) Euro equivalent of the share price in pesetas translated at the irrevocably-fixed rate of exchange of Ptas 166.386 = €1.00.

On June 27, 2002, the closing price of our shares on the Automated Quotation System of the Spanish stock exchanges was €8.19 per share, equal to \$8.70 at the Noon Buying Rate for cable transfers in euro as certified for customs purposes by the Federal Reserve Bank of New York on that date.

Our ADSs are listed on the New York Stock Exchange under the symbol “TEF” and are quoted through SEAQ International. Citibank, N.A. is the Depository issuing ADRs evidencing the ADSs pursuant to the Deposit Agreement dated as of November 13, 1996, as amended as of December 3, 1999 and as of June 23, 2000, among Telefónica, the Depository and the holders from time to time of ADRs. Each ADS represents the right to receive three shares.

The table below sets forth, for the periods indicated, the reported high and low sales prices, as adjusted for all stock splits, of our ADSs on the New York Stock Exchange:

	Per ADS	
	High	Low
	(dollars)	
<b>1997</b> .....	28.266	20.016
<b>1998</b> .....	46.797	25.906
<b>1999</b> .....	76.766	38.109
<b>2000</b>		
First Quarter.....	91.250	66.688
Second Quarter .....	73.828	51.484
Third Quarter .....	69.563	53.344
Fourth Quarter .....	60.500	44.281
<b>2001</b>		
First Quarter.....	61.641	44.016
Second Quarter .....	56.125	48.375
Third Quarter .....	37.971	27.961
Fourth Quarter .....	42.559	29.912
<b>2002</b>		
First Quarter.....	41.912	31.422
January.....	41.912	34.127
February.....	35.490	31.422
March.....	37.010	32.990
April.....	35.650	31.590
May.....	33.110	29.000
June (through June 27) .....	31.950	23.470

Source: Dow Jones.

At December 31, 2001, approximately 266,997,654 of our shares were held in the form of ADSs by 1,203 holders of record, including Cede & Co., the nominee of The Depository Trust Company. The number of ADSs outstanding was 124,365,863 at December 31, 2001.

## Securities Trading in Spain

The Spanish securities market for equity securities consists of four stock exchanges located in Madrid, Bilbao, Barcelona and Valencia and the Automated Quotation System, or *Mercado Continuo*. During 2001, the Automated Quotation System accounted for the majority of the total trading volume of equity securities on the Spanish stock exchanges.

### *Automated Quotation System*

The Automated Quotation System links the four Spanish stock exchanges, providing those securities listed on it with a uniform continuous market that eliminates certain of the differences among the local exchanges. The principal feature of the system is the computerized matching of buy and sell orders at the time of entry of the order. Each order is executed as soon as a matching order is entered, but can be modified or canceled until executed. The activity of the market can be continuously monitored by investors and brokers. The Automated Quotation System is operated and regulated by Sociedad de Bolsas, S.A., a corporation owned by the companies that manage the stock exchanges. All trades on the Automated Quotation System must be placed through a brokerage firm, an official stock broker or a dealer firm that is a member of a Spanish stock exchange. Beginning January 1, 2000, Spanish banks were able to become members of a Spanish stock exchange and are therefore able to place trades on the Automated Quotation System.

In a pre-opening session held from 8:30 a.m. to 9:00 a.m. each trading day, an opening price is established for each security traded on the Automated Quotation System based on a real-time auction in which orders can be entered, modified or cancelled but are not executed. During this pre-opening session, the system continuously displays the price at which orders would be executed if trading were to begin. Market participants only receive information relating to the auction price (if applicable) and trading volume permitted at the current bid and offer price. If an auction price does not exist, the best bid and offer price and associated volumes are shown. The auction terminates with a random period of 30 seconds in which share allocation takes place. Until the allocation process has finished, orders cannot be entered, modified or cancelled. In exceptional circumstances (including the inclusion of new securities on the Automated Quotation System) and after giving notice to the National Securities and Markets Commission (the "CNMV"), the Sociedad de Bolsas may establish an opening price without regard to the reference price (the previous trading day's closing price), alter the price range for permitted orders with respect to the reference price and modify the reference price.

The computerized trading hours are from 9:00 a.m. to 5:30 p.m. During the trading session, the trading price of a security is permitted to vary up to a maximum so-called "static" range of the reference price, provided that the trading price for each trade of such security is not permitted to vary in excess of a maximum so-called "dynamic" range with respect to the trading price of the immediately preceding trade of the same security. If, during the trading session, there exist matching bid and ask orders over a security within the computerized system which exceed any of the above "static" and "dynamic" ranges, trading on the security is automatically suspended and a new auction is held where a new reference price is set, and the "static" and "dynamic" ranges will apply over such reference price. The "static" and "dynamic" ranges applicable to each particular security are set up and reviewed periodically by the Sociedad de Bolsas.

Between 5:30 p.m. and 8:00 p.m., trades may occur outside the computerized matching system without prior authorization of the Sociedad de Bolsas, at a price within the range of 5% above the higher of the average price and closing price for the day and 5% below the lower of the average price and closing price for the day if there are no outstanding bids or offers, respectively, on the system matching or bettering the terms of the proposed off-system transaction and, if, among other things, the trade involves more than €300,000 and more than 20% of the average daily trading volume of the stock during the preceding three months. These trades must also relate to individual orders from the same person or entity and be reported to the Sociedad de Bolsas before 8:00 p.m. At any time trades may take place (with the prior authorization of the Sociedad de Bolsas) at any price if:

- the trade involves more than €1.5 million and more than 40% of the average daily volume of the stock during the preceding three months
- the transaction derives from a merger or spin-off process, or from the reorganization of a group of companies



- the transaction is executed for the purposes of settling a litigation or completing a complex group of contracts or
- the Sociedad de Bolsas finds other justifiable cause

Information with respect to the computerized trades between 9:00 a.m. and 5:30 p.m. is made public immediately, and information with respect to trades outside the computerized matching system is reported to the Sociedad de Bolsas by the end of the trading day and published in the *Boletín de Cotización* and in the computer system by the beginning of the next trading day.

### ***Clearance and Settlement System***

Transactions carried out on the Spanish stock exchanges are cleared and settled through the *Servicio de Compensación y Liquidación de Valores, S.A.* (the “SCL”). Only members of the system are entitled to use it, and membership is restricted to authorized broker members of the Spanish stock exchanges, the Bank of Spain (when an agreement, approved by the Spanish Ministry of Economy and Finance, is reached with the SCL) and, with the approval of the CNMV, other brokers not members of the Spanish stock exchanges, banks, savings banks and foreign settlement and clearing systems. The SCL is owned by its members (excluding, if applicable, the Bank of Spain) and by the companies which manage the local exchanges. The clearance and settlement system and its members are responsible for maintaining records of purchases and sales under the book entry system. Shares of listed Spanish companies are held in book entry form. The SCL, which manages the clearance and settlement system, maintains a registry reflecting the number of shares held by each of its member entities (each, an *entidad adherida*) as well as the amount of such shares held on behalf of beneficial owners. Each member entity, in turn, maintains a registry of the owners of such shares. Spanish law considers the legal owner of the shares to be:

- the member entity appearing in the records of the SCL as holding the relevant shares in its own name or
- the investor appearing in the records of the member entity as holding the shares

The SCL has approved certain regulations introducing the so-called “T+3 Settlement System” by which the settlement of any transactions must be made three business days following the date on which the transaction was carried out.

Obtaining legal title to shares of a company listed on a Spanish stock exchange requires the participation of a Spanish official stockbroker, broker-dealer or other entity authorized under Spanish law to record the transfer of shares. To evidence title to shares, at the owner’s request the relevant member entity must issue a certificate of ownership. In the event the owner is a member entity, the SCL is in charge of the issuance of the certificate with respect to the shares held in the member entity’s name.

Brokerage commissions are not regulated. Brokers’ fees, to the extent charged, will apply upon transfer of title of shares from the Depositary to a holder of ADRs in exchange for such ADSs, and upon any later sale of such shares by such holder. Transfers of ADSs do not require the participation of an official stockbroker. The Deposit Agreement provides that holders depositing shares with the Depositary in exchange for ADSs or withdrawing shares in exchange for ADSs will pay the fees of the official stockbroker or other person or entity authorized under Spanish law applicable both to such holder and to the Depositary.

### **Securities Market Legislation**

The Securities Market Act of July 28, 1988 (Law 24/1988) which became effective in 1989, restructured the organization and supervision of the Spanish securities markets. This legislation and the regulations implementing it:

- established an independent regulatory authority, the CNMV, to supervise the securities markets
- established a framework to regulate trading practices, public offerings, tender offers and insider trading
- required stock exchange members to be corporate entities

- required companies listed on a Spanish stock exchange to file annual audited financial statements and to make public quarterly financial information
- established the legal framework for the Automated Quotation System
- exempted the sale of securities from transfer and value-added taxes
- deregulated brokerage commissions and
- provided for transfer of shares by book-entry or by delivery of evidence of title

Effective in November 1998, Law 24/1988 was amended by Law 37/1998, of November 16, 1998. The amendment introduced the following changes:

- The concept of the “investment services company” was created. Brokers, dealers and portfolio managing companies are considered to be investment services companies. These companies are entitled to render investment services and complementary activities. Banks are not considered to be investment services companies, although they may render investment services upon becoming members of the Spanish stock exchanges.
- An investment services company must be authorized by the Ministry of Treasury in order to render investment services and complementary activities. Once authorization is obtained, the founders of the investment services company must incorporate the company as a corporation (*sociedad anónima*) or a limited liability company (*sociedad de responsabilidad limitada*) and, once incorporated, the company must be registered with the Commercial Registry and the CNMV Registry. This registration must be published in the State Official Gazette.
- The European principle of “single passport” or “single license” was introduced within the Spanish legal system. Under this principle, an investment services company may render investment services and complementary activities within European Union member countries, either through a branch or directly. Any necessary authorizations and licenses must be obtained from the authorities of the country of domicile (the “home country principle”), but the applicable market conduct rules are those set forth in the legislation of the country in which the investment services company renders its services (the “host country principle”).
- Spanish investment services companies wishing to render their services overseas must be authorized to do so. However, in the event that they wish to provide services within the European Union, they need only give prior notice to the CNMV.
- An investment guarantee fund was created to protect investors from the insolvency of any investment services company. This fund has the same purpose as the deposit guarantee fund, which is currently in charge of refunding deposits made in insolvent Spanish financial entities. Spanish investment services companies are obligated to maintain a stake in the investment guarantee fund through participation in the share capital of the managing company of the fund.
- Finally, a number of amendments to the Spanish Corporations Law were included. Rights to issue preferred and non-voting stock were extended broadly. In addition, the amendments provided for the possibility of a new redeemable class of stock to be issued by listed companies.

## **B. PLAN OF DISTRIBUTION**

Not applicable.

## **C. MARKETS**

Please see “—Offer and Listing Details”.

#### **D. SELLING SHAREHOLDERS**

Not applicable.

#### **E. DILUTION**

Not applicable.

#### **F. EXPENSES OF THE ISSUE**

Not applicable.

### **ITEM 10. ADDITIONAL INFORMATION**

#### **A. SHARE CAPITAL**

Not applicable.

#### **B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

The following summary describes certain material considerations concerning our capital stock and briefly describes certain provisions of our by-laws (*estatutos*) and Spanish law.

##### **Corporate Objects**

Section 4 of Part I of our by-laws sets forth our corporate objects:

- delivery and exploitation of any and all kinds of public and private telecommunication services and, to such end, to design, install, preserve, repair, improve, acquire, dispose of, connect, administer, manage and perform whatever other activities other than those mentioned above with respect to any types of networks, lines, satellites, items of equipment, systems and items of technical infrastructure, both existing or to be created in the future, including the property upon which any and all of the above items are set up
- delivery and exploitation of any and all types of ancillary or supplementary services, as well as of any services that may stem from communication activities
- research and development, promotion and application of any and all component principles, items of equipment and systems which are directly or indirectly used in telecommunications
- manufacturing, production and, generally, any and all forms of industrial activities related to telecommunications
- acquisition, disposal and, generally, any and all forms of trade activities related to telecommunications

##### **Director Qualification**

In order to be elected as a Director, a person must have held a number of our shares representing a par value of no less than €3,000 for at least three years prior to his or her election. These shares may not be transferred so long as such person remains a Director. This requirement does not apply to any person who, at the time of his or her appointment, has either a labor or professional relationship with the company or is expressly exempted from such requirement by a vote of at least 85% of the Board of Directors.

A Director must retire upon reaching the age of 70. Such retirement shall take effect at the first board meeting following the general shareholders' meeting that approves the financial statements for the year in which such Director turned 70.

## **Description of Telefónica Capital Stock**

### *Description of Share Capital*

At June 6, 2002, our issued share capital consisted of 4,860,661,286 ordinary registered shares with a nominal value of €1.00 each. Our shareholders have delegated to the board of directors the authority to increase the share capital by up to 2,274,677,655. The board's authorization to increase the share capital expires on June 15, 2006.

### *Meetings and Voting Rights*

We hold our ordinary general shareholders' meeting during the first six months of each fiscal year on a date fixed by the board of directors. Extraordinary general shareholders' meetings may be called, from time to time, at the discretion of our board of directors or upon the request of shareholders representing 5% of our paid-in share capital. We publish notices of all ordinary and extraordinary general shareholders' meetings in the Official Gazette of the Commercial Registry and in at least one newspaper in Madrid at least fifteen days before the relevant meeting.

Each share of Telefónica entitles the holder to one vote. However, only registered holders of shares representing a par value of at least €300, which currently equals at least 300 shares because our shares have a par value of €1 each, are entitled to attend a general shareholders' meeting. Holders of shares representing a par value of less than €300, meaning less than 300 shares, may aggregate their shares by proxy and select a representative that is a shareholder to attend a general shareholders' meeting or delegate his or her voting rights by proxy to a shareholder who has the right to attend the shareholders' meeting. However, under our by-laws no shareholder may vote a number of shares exceeding 10% of the total outstanding voting capital.

Any share may be voted by proxy. Proxies must be in writing and are valid only for a single meeting.

Only holders of record five days prior to the day on which a general meeting of shareholders is scheduled to be held may attend and vote at the meeting. Under the deposit agreement for the ADSs, our depository accepts voting instructions from holders of ADSs. The depository executes such instructions to the extent permitted by law and by the terms governing the shares. The depository or its nominee, whichever is applicable, will be entitled to vote by proxy the shares represented by the ADSs.

Shareholders representing, in person or by proxy, at least 25% of our subscribed voting capital constitute a quorum for a general meeting. If a quorum is not present at the first meeting, then the meeting can be held on second call. Regardless of the number of shareholders present at the second meeting, they are deemed to constitute a quorum.

Shareholders representing, in person or by proxy, at least 50% of our subscribed voting capital constitute a quorum on a first call for shareholders' meetings at which shareholders will be voting on any of the following actions:

- issuance of bonds
- increase or reduction of share capital
- amendment of corporate purpose
- any other amendment of our by-laws
- merger, split or spin-off of Telefónica

When a quorum is present on the first call, these special resolutions must be adopted by the affirmative vote of shareholders representing a majority of our present subscribed voting capital.

If a quorum for the meeting is not present after the first call, upon a second call for the meeting, 25% of our subscribed voting capital will constitute a quorum. When shareholders representing less than 50% of the subscribed voting capital are in attendance, these special resolutions must be adopted by a vote of two-thirds of those shareholders present.

A shareholder who owns shares on the record date will not be entitled to vote his/her shares in a general meeting of shareholders if the shareholder, individually or as part of a group, has not complied with the notification requirements relating to the acquisition of additional shares beyond certain threshold amounts.

### ***Dividends***

Shareholders vote on final dividend distributions at the shareholders' meeting. Distributable profits are equal to:

- net profits for the year; plus
- profits carried forward from previous years; plus
- distributable reserves; minus
- losses carried forward from previous years; minus
- amounts allocated to reserves as required by law or by our by-laws.

The Board of Directors can make interim dividend payments without a prior shareholder vote on the issue. However, under those circumstances, the dividend is limited to distributable net profits of the current year and is subject to certain legal requirements.

### ***Registration and Transfers***

Our shares are in registered book-entry form. Transfers executed through stock exchange systems are implemented pursuant to the stock exchange clearing and settlement procedures carried out by the Spanish clearing institution. Transfers executed outside of stock exchange systems, that is over the counter, are implemented pursuant to the general legal regime for book-entry transfer, including registration by the Spanish clearing institution.

There are no restrictions with respect to the transfer of our shares.

### ***Liquidation Rights***

Under Spanish law, upon our liquidation the shareholders would be entitled to receive, on a pro rata basis, any assets remaining after the payment of our debts and taxes and liquidation expenses.

## **C. MATERIAL CONTRACTS**

### **Material Contracts**

In October 2000, we entered into an agreement to acquire the following interests in Motorola, Inc.'s wireless operators in Mexico: 100% of Baja Celular Mexicana, S.A. de C.V., or Bajacel, which has licenses to operate in the Mexican States of Baja California, Baja California Sur, and parts of Sonora; 90% of Movitel del Noroeste, S.A. de C.V., or Movitel, which has licenses to operate in the Mexican States of Sinaloa and parts of Sonora; 100% of Telefonía Celular del Norte, S.A. de C.V., or Norcel, which has licenses to operate in the Mexican States of Chihuahua, Durango, and parts of Coahuila; and 100% of Celular de Telefonía, S.A. de C.V., or Cedetel, which has licenses to operate in the Mexican States of Nuevo Leon, Tampaulipas, and parts of Coahuila. In June 2001, we issued 122,560,575 new shares to Motorola, Inc. in exchange for Motorola, Inc.'s Mexican wireless operators. These transactions are described in "Item 4—Information on the Company—Business Overview—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Mexico".

In January 2001, we, Telefónica Móviles, S.A. and Portugal Telecom announced an agreement to create a joint venture to consolidate our wireless assets in Brazil with those of Portugal Telecom, subject to the approval of Anatel, the Brazilian telecommunications commission. The terms of the joint venture are described in "Item 4—Information on the Company—Business Overview—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Brazil—Agreement with Portugal Telecom". In addition, as part of this agreement, we and Portugal Telecom expressed an interest in increasing our reciprocal shareholdings, subject to compliance with applicable statutory and by-laws requirements.

## **Other Important Agreements**

On April 26, 2002, Telefónica Móviles signed agreements to purchase, subject to regulatory approval, approximately 65% of Pegaso Telecomunicaciones, S.A. de C.V., a wireless operator with approximately 800,000 customers at December 31, 2001, from Sprint, Leap Wireless and other financial investors. The terms of these agreements are described in “Item 4—Information on the Company—Business Overview—Worldwide Wireless Communications Services—Telefónica Móviles—Latin America—Mexico” and “Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Contractual Obligations and Commercial Commitments”.

In May 2002, Admira Media entered into an agreement with Sogecable to integrate Vía Digital and Canal Satelite Digital, which is the pay television and satellite broadcast platform of Sogecable. The integration is subject to the satisfaction of certain conditions, including the approval of 100% of the shareholders of Vía Digital to subscribe a capital increase through a share exchange and the receipt of several administrative authorizations. Under the agreement, Sogecable will issue 28,981,121 new shares in exchange for the total issued and outstanding shares of Vía Digital at the date of the exchange. Existing Sogecable shareholders will own 77% of the resulting company, and existing Vía Digital shareholders, including Admira Media, will own 23% of the resulting company. See “Item 4—Information on the Company—Worldwide Audiovisual Content and Media—Admira Media”.

## **D. EXCHANGE CONTROLS**

### **Exchange Controls and Other Limitations Affecting Security Holders**

#### ***Restrictions on Foreign Investment***

Pursuant to the General Law on Telecommunications, direct or indirect investments in us by foreign persons may not exceed 25% of our share capital, unless otherwise provided for in any of the applicable treaties or authorized by the Spanish government. Pursuant to European Union directives, citizens of other European Union member states, including entities domiciled in such countries, are not considered foreign persons for the purposes of this provision. For purposes of computing the 25% threshold, only holdings of capital stock in excess of 5% and holdings that would entitle the foreign investor to designate a member of our Board of Directors are taken into account. See “Item 4—Information on the Company—Business Overview—Fixed-line Telecommunications Services in Spain—Telefónica de España—Regulation—The General Law on Telecommunications—Ownership Limitations”.

The Spanish stock exchanges and securities markets are open to foreign investors. Pursuant to Law 18/1992 on Foreign Investments and Royal Decree 664/1999, foreign investors may invest freely in shares of Spanish companies. Royal Decree 664/1999 provided for the liberalization of the legal regime for foreign investments in Spain. The only requirement is to give notice to the Foreign Investments Registry of the Treasury Ministry after making the investment, except that prior notice is required if the investor is domiciled in a tax haven.

Pursuant to a decree adopted in January 1997 in connection with our privatization, prior approval from the Spanish government is required for a limited number of fundamental corporate and control transactions affecting us, including the acquisition of 10% or more of our and Telefónica Móviles’ capital stock and the sale of assets material to the provision of fixed telephone services. The approval requirement applied in connection with the transfer of certain of our assets in Spain to our subsidiary Telefónica de España in November 1998 and will apply to subsequent transfers by Telefónica de España. These approval rights, which were adopted by several European governments in the context of the privatization of major national enterprises, are currently subject to challenge by the European Commission before the European Court of Justice.

#### ***Trading by Telefónica in its own Shares or Shares of Companies under its Control***

At December 31, 2001, we held 45,440,901 shares of treasury stock, representing 0.97% of our capital stock. At May 30, 2002, we held 53,969,331 shares of treasury stock, representing 1.1% of our capital stock.

The Spanish Corporations Law prohibits the purchase by us and our subsidiaries of shares in the secondary market except in the following limited circumstances:

- the purchase of shares must be authorized by a general meeting of shareholders of Telefónica and, in the case of a purchase of shares by a subsidiary, also by a general meeting of shareholders of the subsidiary
- the shares so purchased have no economic or voting rights while held by Telefónica and have no voting rights while held by its subsidiaries
- the purchaser must create reserves equal to the purchase price of any shares that are purchased and, if a subsidiary is the acquirer, the reserve must also be recorded by the parent company and
- the total number of shares held by Telefónica and its subsidiaries may not exceed 5% of the total capital of Telefónica

Any acquisition of shares of Telefónica exceeding, or that causes Telefónica's and its subsidiaries' holdings to exceed, 1% of Telefónica's share capital must be reported to the CNMV.

At a general meeting of shareholders held in April 2002, Telefónica's shareholders authorized the Board of Directors to acquire shares of Telefónica for a period of 18 months from the date of authorization. This authorization supersedes the unexecuted previous authorization to acquire up to 159,942,445 shares, which authorization was granted by the shareholders at the general meeting of shareholders held in June 2001. The new authorization also applies to companies under our control. Pursuant to the new authorization, the aggregate nominal value of the shares held by us or any of our subsidiaries cannot exceed 5% of our shareholders' equity. Consistent with applicable Spanish laws and regulations and the authorization of our shareholders, from time to time we or our affiliates engage in transactions involving securities of members of the Telefónica Group. These transactions may include purchases of shares of group members, forward contracts with respect to these shares and other similar transactions.

#### ***Other Restrictions on Acquisitions of Shares***

A person or group of persons that directly or indirectly exercises beneficial ownership or control of 5% or more of the outstanding shares, or which increases or decreases the number of shares which it owns or controls to an amount which equals or exceeds any multiple of 5% of such outstanding shares, must inform the following entities of such ownership:

- Telefónica
- the Stock Exchange Management Companies of the Spanish stock exchanges on which the shares are listed
- the CNMV
- in the case of a foreign person or group of persons, the General Directorate of Commercial Policy and Foreign Investments

A person or group that is a member of our Board of Directors must report any acquisition or transfer, regardless of size, of our capital stock. A person or group of persons that fails to inform any of the above entities after reaching any of the indicated thresholds may incur fines and penalties. Additionally, if a company fails to inform us after reaching ownership or control of 10% of the outstanding shares or increases the shares it controls to equal or exceed any successive multiple of 5%, the rights corresponding to those shares will be suspended until a proper notification to us is made. For reporting requirements concerning acquisitions by us or our affiliates of our shares, see “— Trading by Telefónica in its own Shares or Shares of Companies under its Control” above.

#### ***Dividend and Liquidation Rights***

At the extraordinary general meeting of shareholders held in June 1998, we announced a new dividend policy aimed at providing an alternative to cash dividend payments. The objective of this policy is to strengthen our capacity to finance value-creating projects while enabling our shareholders to obtain liquidity by trading their shares.

Payment of a final dividend is proposed by our Board of Directors but must be authorized by our shareholders at the general meeting of shareholders. According to Spanish law and our by-laws, dividends may only be paid out of profits or distributable reserves if the value of our net worth is not, and as a result of such distribution would not be, less than its capital stock. Pursuant to Spanish law, we are required to reserve 10% of our fiscal year net income until the amount in its legal reserve reaches 20% of our capital. Our legal reserve is currently at 20%.

Dividends payable by us to non-residents of Spain are subject to a Spanish withholding tax at the rate of 18%. The Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income entered into between Spain and the United States provides that certain holders of ADRs or shares that are residents for purposes of that treaty in the United States may be entitled to a reduced withholding tax and, therefore, a refund of any withholding levied in excess. See “—Taxation”.

Upon a liquidation of us, our shareholders would be entitled to receive pro rata any assets remaining after the payment of our debts and taxes and expenses of the liquidation. Any change in the rights of shareholders to receive dividends and payment upon liquidation would require an amendment to our by-laws by resolution adopted by a general meeting of shareholders. If there were more than one class of shares, such amendment would also require the approval of each class of shareholders affected by the amendment.

#### *Preemptive Rights and Increases of Share Capital*

Pursuant to the Spanish Corporations Law, shareholders and holders of convertible bonds have preemptive rights to subscribe for any new shares and for bonds convertible into shares. Such rights may not be available under special circumstances if precluded by a resolution passed at a general meeting of shareholders in accordance with Article 159 of the Spanish Corporations Law, or the Board of Directors, if authorized. Further, such rights, in any event, will not be available in the event of an increase in capital to meet the requirements of a convertible bond issue or a merger in which shares are issued as consideration. Such rights

- are transferable
- may be traded on the Automated Quotation System
- may be of value to existing shareholders because new shares may be offered for subscription at prices lower than prevailing market prices

Shares issuable upon exercise of rights must be registered under the Securities Act of 1933 in order to be offered to holders of ADRs. If we decided not to register the shares, the rights would not be distributed to holders of ADRs. Pursuant to the Deposit Agreement, however, holders of ADRs are entitled to receive their proportionate share of the proceeds, if any, from the sale by the Depository of any rights accruing to holders of ADRs.

## **E. TAXATION**

### *Spanish Tax Considerations*

The following summary describes the material Spanish tax consequences to United States Residents (as defined below) of the acquisition, ownership and disposition of ADSs or shares of Telefónica, S.A. This summary does not address all tax considerations that may be relevant to all categories of United States Residents, some of whom (such as life insurance companies, tax-exempt entities, dealers in securities or financial institutions) may be subject to special rules. In particular, the summary deals only with United States Residents that hold ADSs or shares as capital assets and who do not at any time own individually, nor are treated as owning, 10% or more of the shares, including ADSs, of Telefónica, S.A.

As used herein, the following terms have the following meanings:

- (1) “Treaty” means the Convention between the United States and Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on income together with a related Protocol.
- (2) “United States Resident” means a U.S. Holder (as defined below under “U.S. Tax Considerations”) that is a resident of the United States for purposes of the Treaty and entitled to the benefits of such



Treaty, whose holding is not effectively connected with (1) a permanent establishment in Spain through which such U.S. Holder carries on or has carried on a business, or (2) a fixed base in Spain from which such U.S. Holder performs or has performed independent personal services.

Holders of ADSs or shares who are not United States Residents should also consult their own tax advisors, particularly as to the applicability of any tax treaty. The statements regarding Spanish tax laws and the Treaty set out below are based on interpretations of those laws in force as of date of this Annual Report. Such statements also assume that each obligation in the Deposit Agreement and any related agreement will be performed in full accordance with its terms.

### ***Taxation of Dividends***

Under Spanish law, dividends paid by a Spanish resident company to a holder of shares or ADRs not residing in Spain for tax purposes and not operating through a permanent establishment in Spain are subject to an income tax withheld at source on the gross amount of dividends, currently at an 18% tax rate. However, under the Treaty, a United States Resident is subject to the Treaty-reduced rate of 15%.

To benefit from the Treaty-reduced rate of 15%, a United States Resident must provide:

- a certificate from the United States Internal Revenue Service (the “IRS”) that to the best knowledge of the IRS such holder is a United States Resident and
- a certificate from the Depository (in the case of holder of ADSs) or the holder’s broker (in the case of holders of shares) representing that, at the dividend payment date, such holder is the beneficial owner of the ADSs or shares

To get direct application of the Treaty-reduced rate of 15%, the certificates referred to above must be provided to us no later than the tenth day of the month next succeeding the relevant dividend payment date. Otherwise we will apply the normal 18% rate. Before dividends are paid, we will notify the Depository of the dividend to be paid and the steps to be followed to obtain the benefit of the reduced tax rate available under the Treaty.

If the certificates referred to above are not provided to us on or before the dividend payment date, the United States Resident may afterwards obtain a refund of the 3% withheld in excess.

### ***Spanish Refund Procedure***

The Royal Decree 326/1999 and Order of December 22, 1999 (the “Order”) prescribe the procedure for requesting from the Spanish taxing authorities a refund of the amount of income taxes withheld in excess of the Treaty-reduced rate. To pursue the refund claim, the Order requires the United States Resident to file:

- a Spanish “210 Form”
- the two certificates referred to above and
- a certificate issued by Telefónica, S.A. providing that Spanish income tax was withheld with respect to such United States Resident

The refund claim must be filed within two years from the date in which the withheld tax was collected by the Spanish tax authorities.

United States Residents are urged to consult their own tax advisors regarding refund procedures and any U.S. tax implications thereof.

### ***Taxation of Capital Gains***

Under Spanish law, any capital gains derived from securities issued by persons residing in Spain for tax purposes are considered to be Spanish source income and, therefore, are taxable in Spain. Spanish income tax is generally levied at a 35% tax rate on capital gains obtained by non-residents of Spain who are not entitled to the benefit of any applicable treaty for the avoidance of double taxation and who do not operate through a fixed base or

a permanent establishment in Spain. Spanish income tax will be levied at an 18% tax rate on capital gains if such gains arise from:

- dividends and other earnings derived from the participation in a company's equity
- interest and other earnings derived from the assignment of goods and
- earnings derived from the transfer or refund of shares and investments in "collective investment schemes" such as investment companies or investment funds

Capital gains realized by United States Residents arising from the disposition of shares or ADSs will not be taxed in Spain provided that the seller has not maintained a direct or indirect holding of at least 25% in our capital during the twelve months preceding the disposition of the stock. United States Residents may be required to establish that they are entitled to this exemption by providing to the relevant Spanish tax authorities an IRS certificate of residence in the United States, together with the corresponding Spanish tax form.

### ***Spanish Wealth Tax***

Individuals who hold shares or ADRs located in Spain are subject to the Spanish Wealth Tax (Spanish Law 19/1991), which imposes tax on property located in Spain on the last day of any year. Individuals who hold shares or ADRs located outside of Spain are not subject to the Spanish Wealth Tax. However, the Spanish tax authorities may argue that all shares of Spanish corporations and all ADRs representing such shares are located in Spain for Spanish tax purposes. If such a view were to prevail, non-residents of Spain who held shares or ADRs on the last day of any year would be subject to the Spanish Wealth Tax for such year at marginal rates varying between 0.2% and 2.5% of the average market value of such shares or ADRs during the last quarter of such year, as published by the Spanish Ministry of Economic Affairs. Non-residents of Spain should consult their tax advisors with respect to the Spanish Wealth Tax.

### ***Spanish Inheritance and Gift Taxes***

Transfers of shares or ADRs on death and by gift are subject to Spanish inheritance and gift taxes, respectively, if the transferee is a resident of Spain for tax purposes, or if the shares or ADRs are located in Spain at the time of death, regardless of the resident beneficiary. However, the Spanish tax authorities may seek to tax inheritances or gifts of shares or ADRs independently of the place or residence of the beneficiary. The applicable tax rate, after applying all relevant factors, ranges between 0% and 81.6% for individuals. Gifts of shares granted to corporations are subject to corporate tax which is generally levied at the rate of 35%.

### ***Expenses of Transfer***

Transfers of shares or ADRs will be exempt from any transfer tax (*Impuesto sobre Transmisiones Patrimoniales*) or value-added tax. Additionally, no stamp tax will be levied on such transfers.

### ***U.S. Tax Considerations***

The following summary describes material United States federal income tax consequences to U.S. Holders (as defined below) of the acquisition, ownership and disposition of ADSs or shares, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to acquire such securities. The summary applies only to U.S. Holders that hold ADSs or shares as capital assets for tax purposes and does not address special classes of holders, such as:

- certain financial institutions
- insurance companies
- dealers in securities or foreign currencies
- holders holding ADSs or shares as part of a hedge, straddle or other conversion transaction
- holders whose "functional currency" for U.S. federal income tax purposes is not the U.S. dollar

- holders liable for alternative minimum tax
- tax-exempt organizations
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes or
- a holder that owns or is deemed to own 10% or more of the ADSs or shares of Telefónica, S.A.

In addition, the summary is based in part on representations of the Depositary and assumes that each obligation provided for in or otherwise contemplated by the Deposit Agreement or any other related document will be performed in accordance with its terms. The U.S. Treasury has expressed concern that parties to whom ADRs are released may be taking action that are inconsistent with the claiming of foreign tax credits. Accordingly, the analysis of the creditability of Spanish taxes described below could be affected by actions that may be taken the U.S. Treasury.

The summary is based upon tax laws of the United States including the Internal Revenue Code of 1986, as amended to the date hereof (the “Code”), administrative pronouncements, judicial decisions and final, temporary and proposed Treasury Regulations, changes to any of which may affect the tax consequences described herein, possibly with retroactive effect. U.S. Holders of ADSs or shares should consult their own tax advisors as to the United States, Spanish or other tax consequences of the purchase, ownership and disposition of such securities in their particular circumstances, including the effect of any state or local tax laws.

As used in this particular section, a “U.S. Holder” is a beneficial owner of ADSs or shares that is, for United States federal income tax purposes:

- a citizen or resident of the United States
- a corporation created or organized in or under the laws of the United States or of any political subdivision thereof or
- an estate or trust the income of which is subject to United States federal income taxation regardless of its source.

For United States federal income tax purposes, U.S. Holders of ADSs will be treated as the owners of the underlying shares.

### ***Taxation of Distributions***

To the extent paid out of current or accumulated earnings and profits of Telefónica, S.A. (as determined in accordance with United States federal income tax principles), distributions made with respect to ADSs or shares (other than certain distributions of capital stock of Telefónica, S.A. or rights to subscribe for shares of capital stock of Telefónica, S.A.) will be includible in the income of a U.S. Holder as ordinary dividend income before reduction for any Spanish income tax withheld by us or our paying agent. Such dividends will not be eligible for the “dividends received deduction” generally allowed to corporations under the Code. To the extent that a distribution exceeds Telefónica, S.A.’s current and accumulated earnings and profits, it will be treated as a nontaxable return of capital to the extent of the U.S. Holder’s tax basis in the ADSs or shares, and thereafter as capital gain. The amount of the distribution will equal the U.S. dollar value of the pesetas or euro received, calculated by reference to the exchange rate in effect on the date such distribution is received (which, for holders of ADSs, will be the date such dividend is received by the Depositary), whether or not the Depositary or U.S. Holder in fact converts any pesetas or euro received into U.S. dollars at that time. Any gains or losses resulting from the conversion of pesetas or euro into U.S. dollars will be treated as ordinary income or loss, as the case may be, of the U.S. Holder and will be U.S. source. Dividends generally will constitute foreign source “passive” income for U.S. foreign tax credit purposes.

Subject to certain generally applicable limitations, a U.S. Holder will be entitled to a credit against its U.S. federal income tax liability, or a deduction in computing its U.S. federal taxable income, for Spanish income taxes withheld by us or our paying agent. However, any taxes withheld in excess of the rate provided in the Tax Treaty will not be eligible for credit against the U.S. Holder’s federal income tax liability unless such holder exhausts all remedies to recover such excess withholding, including the seeking of competent authority assistance from the

Internal Revenue Service, without obtaining a refund. See “—Spanish Tax Considerations—Taxation of Dividends and—Spanish Refund Procedure” above for a description of how a U.S. Holder can secure the Tax Treaty rate for withholding on dividends paid by us or obtain a refund if amounts withheld on dividends paid by us exceed the Tax Treaty rate. A U.S. Holder may be required to recognize ordinary income or loss attributable to currency fluctuations upon its receipt of a refund in respect of Spanish withholding tax to the extent that the U.S. dollar value of the refund differs from the U.S. dollar equivalent of the refund amount on the date the underlying dividend was received.

A U.S. Holder must satisfy minimum holding period requirements in order to be eligible to claim a foreign tax credit for foreign taxes withheld on dividends. A foreign tax credit is not allowed for foreign taxes withheld on dividends in circumstances where the U.S. Holder is under an obligation to make related payments in connection with positions in “substantially similar or related property”. U.S. Holders should consult their own tax advisers to determine whether they are subject to any special rules that may limit their ability to claim or make effective use of foreign tax credit.

### **Taxation of Capital Gains**

Gain or loss realized by a U.S. Holder on (i) the sale or exchange of ADSs or shares or (ii) the Depository’s sale or exchange of shares received as distributions on the ADSs will be subject to United States federal income tax as capital gain or loss in an amount equal to the difference between the U.S. Holder’s tax basis in the ADSs or shares and the amount realized on the disposition. Gain or loss, if any, will be U.S. source. U.S. Holders should consult their tax advisers regarding the United States federal tax treatment of capital gains, which may be taxed at lower rates than ordinary income for individuals, and losses, the deductibility of which is subject to limitations.

Deposits and withdrawals of shares in exchange for ADSs will not result in taxable gain or loss for United States federal income tax purposes.

#### *Passive Foreign Investment Company Rules*

We believe that we have not been, are not, and are not likely to become a “passive foreign investment company” (“PFIC”) for United States federal income tax purposes. However, since PFIC status depends upon the composition of a company’s income and assets and the market value of its assets (including, among others, less than 25 percent owned equity investments) from time to time, we cannot assure you that we will not be considered a PFIC for any taxable year.

If we were treated as a PFIC for any taxable year during which a United States Holder held an ADS or ordinary share, certain adverse consequences could apply to the United States Holder. If we are treated as a PFIC for any taxable year, gain recognized by such United States Holder on a sale or other disposition of the ADS or ordinary share would be allocated ratably over the United States Holder’s holding period for the ADS or ordinary share. The amounts allocated to the taxable year of the sale or other exchange and to any year before we became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the amount allocated to such taxable year. Further, any distribution in respect of ADSs or ordinary shares in excess of 125 percent of the average of the annual distributions on ADSs or ordinary shares received by the United States Holder during the preceding three years or the United States Holder’s holding period, whichever is shorter, would be subject to taxation as described above. Certain elections may be available (including a mark to market election) to United States persons that may mitigate the adverse consequences resulting from PFIC status.

#### *Information Reporting and Backup Withholding*

Payment of dividends or sales proceeds in connection with the ADSs or shares within the United States or through a U.S.-related financial intermediary are generally subject to information reporting and backup withholding unless the U.S. Holder (1) is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact or (2) provides a correct taxpayer identification number on a properly completed Form W-9 or a substitute form and certifies that no loss of exemption from backup withholding has occurred and that such holder is a U.S. person. Any amount withheld under these rules will be creditable against the U.S. Holder’s federal income tax liability, and may entitle the U.S. Holder to a refund, provided that the required information is furnished to the

Internal Revenue Service. A U.S. Holder who does not provide a correct taxpayer identification number may be subject to certain penalties.

#### **F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

#### **G. STATEMENTS BY EXPERTS**

Not applicable.

#### **H. DOCUMENTS ON DISPLAY**

##### **Where You Can Find More Information**

We file Annual Reports on Form 20-F and furnish periodic reports on Form 6-K to the SEC. You may read and copy any of these reports at the SEC's public reference room in Washington, D.C. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from commercial document retrieval services. Some SEC filings of ours are also available at the website maintained by the SEC at "<http://www.sec.gov>".

Our ADSs are listed on the New York Stock Exchange under the symbol "TEF." You may inspect any periodic reports and other information filed with the SEC by us at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

We, as a foreign private issuer, are exempt from the rules under the Exchange Act which prescribe the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act.

We are also subject to the informational requirements of the Spanish securities commission and the Spanish stock exchanges, and we file reports and other information relating to our business, financial condition and other matters with the Spanish securities commission and the Spanish stock exchanges. You may read such reports, statements and other information, including the annual and biannual financial statements, at the public reference facilities maintained in Madrid and Barcelona. Some of our Spanish securities commission filings are also available at the website maintained by the Spanish securities commission at <http://www.cnmv.es>.

#### **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Telefónica Group is exposed to various types of market risk in the normal course of its business, including the impact of changes in interest rates, foreign currency exchange rates and equity investment prices. Telefónica actively manages interest rate risk and foreign currency exchange rate risk, in part with financial derivatives. All of Telefónica's financial derivative transactions are entered into for hedging purposes. However, Telefónica is required to classify some of its exchange rate forward contracts and currency options as held for trading purposes if (1) these financial derivatives are being used to hedge expected foreign income or (2) the hedges are put in place in holding companies (mainly Telefónica, S.A., Telefónica Móviles, S.A. and Telefónica Internacional, S.A.) while the underlying debt is kept in their respective Latin American subsidiaries. Instruments that are classified as held for trading purposes are carried at market prices, and gains or losses arising therefrom are recorded immediately in the income statement as financial revenue or expense, as appropriate.

Telefónica pursues several derivative strategies, including the use of options or swaps in order to hedge either the debt's fair value or cash flows for interest expenses. In some cases, when we determine to swap debt from fixed rates into floating rates (or vice versa) at certain target levels, we sell to financial institutions the right to enter into the swap at some future date. The sale of such options is classified as held for trading purposes. All other financial derivatives held by Telefónica at December 31, 2001 and at December 31, 2000, were classified as hedges under Spanish GAAP. Gains or losses on these instruments are recorded as adjustments to the underlying transactions. In general, Telefónica's counterparties in its financial derivatives transactions are financial institutions.

## **Interest rate risk**

Telefónica uses several derivative strategies, including swaps and options to manage its exposure to interest rate fluctuations. Giving effect to these derivative transactions, at December 31, 2001 approximately 46.5% of Telefónica's long-term debt portfolio bore interest at a fixed rate and at December 31, 2000 approximately 52% of Telefónica's long-term debt portfolio bore interest at a fixed rate. Telefónica's floating rate debt portfolio is principally subject to fluctuations in the London Interbank Offered Rate (particularly for the U.S. dollar LIBOR), the European Interbank Offered Rate (EURIBOR) and the Brazilian Selic, Brazil's prime rate.

## **Exchange rate risk**

The exchange rate risk to which Telefónica is exposed derives principally from (1) its long-term debt portfolio that is denominated in (or swapped into) currencies other than the euro and (2) the fact that Telefónica conducts a substantial amount of business in, and has substantial investments in, countries outside of Spain, principally Latin American countries. Telefónica has incurred foreign currency-denominated debt obligations in order to fund investments outside Spain, primarily in Latin America. Consequently, over 98% of Telefónica's foreign debt obligations at December 31, 2001 and at December 31, 2000 was denominated in U.S. dollars or Latin American currencies. Telefónica hedges its debt-related exchange rate exposure to the extent that it considers necessary and hedges are commercially available. Telefónica from time to time hedges its exchange rate exposure arising from foreign-currency dividend streams, management fees and attributed net income from its principal non-Spanish subsidiaries. Telefónica uses swaps, options and exchange rate forward contracts to manage its exposure to exchange rate fluctuations. Giving effect to these derivative transactions, Telefónica was exposed to foreign currency fluctuations on approximately 49.3% of its long-term debt at December 31, 2001 and on approximately 69% of its long-term debt at December 31, 2000.

## **Equity Price Risk**

We hold investments in equity securities. These securities are subject to risks due to changes in the market values of such securities. Telefónica from time to time uses equity swaps to hedge the risks arising from these investments.

## **Tabular description of market rate sensitive instruments**

The tables below describe the financial instruments bearing interest or exchange rate risk for the companies consolidated in the Telefónica Group.

The tables below have been prepared as follows:

- The debt obligations are ordered according to their final characteristics and taking into account the effect of the associated derivative instruments. They are classified according to the currency in which they are denominated, within the following categories:
  - Euro
  - European currencies other than the euro
  - U.S. dollar
  - Latin American currencies
  - Asian currencies
- Each such group is further divided into:
  - Floating rate interest
  - Fixed rate interest
  - Interest rate bounded with options

- Each column shows the notional amount of each debt obligation maturing in the year indicated at the top of the column through a five-year period. The notional amount outstanding after such five-year period is shown in the next column. The column “Total” sums all of the notional amounts.
- Notional amounts do not include accrued interest, except for zero coupon bonds, which include accrued interest from inception to the date of each table.
- The fair value columns show the value for (1) the underlying debt, (2) the derivatives linked to the underlying debt and (3) the total (the sum of the two previous values).

**SENSITIVITY TO INTEREST RATES AND EXCHANGE RATES OF DEBT OBLIGATIONS AT  
DECEMBER 31, 2001**

	Maturity Dates						Total	Fair Value			
	2002	2003	2004	2005	2006	Subsequent		Underlying Debt	Associated Derivatives	Total	Book Value
	(millions of euro)										
<b>Euro</b>	1,726	856	3,189	3,197	1,441	3,136	13,546	13,696	212	13,908	13,546
Floating Rate.....	363	522	1,478	1,579	393	833	5,169	6,219	(996)	5,223	5,169
Spread Ref Euribor.....	0.63%	0.40%	0.59%	0.41%	0.57%	1.02%	0.59%				
Fixed Rate.....	1,363	334	1,711	1,619	1,047	1,741	7,815	6,915	1,208	8,123	7,815
Interest Rate.....	4.83%	5.36%	4.46%	8.63%	5.17%	5.46%	5.74%				
Other Assets and Liabilities.....	-	-	-	-	-	562	562	562	-	562	562
<b>Other European Currencies..</b>	89	7	326	-	-	-	422	14	421	435	422
<b>Instruments in GBP.....</b>	82	-	326	-	-	-	408	-	421	421	408
Floating Rate.....	82	-	196	-	-	-	277	-	283	283	277
Spread.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	-	-	131	-	-	-	131	-	137	137	131
Interest Rate.....	-	-	6.25%	-	-	-	6.25%				
<b>Instruments in CHF.....</b>	7	7	-	-	-	-	14	14	-	14	14
Fixed Rate.....	7	7	-	-	-	-	14	14	-	14	14
Interest Rate.....	2.18%	2.18%	-	-	-	-	2.18%				
<b>America.....</b>	3,780	1,837	917	1,172	1,761	5,473	14,940	14,192	1,436	15,629	14,940
<b>Instruments in USD.....</b>	1,313	1,172	(345)	1,007	1,621	5,248	10,016	11,427	(568)	10,859	10,016
Floating Rate.....	(3,140)	(453)	1,206	(198)	1,240	1,534	190	1,338	(1,094)	244	190
Spread.....	(0.19)	0.42%	0.38%	3.58%	0.11%	(0.12)	0.54%				
Fixed Rate.....	3,611	407	(1,551)	643	381	3,490	6,982	6,932	436	7,367	6,982
Interest Rate.....	3.26%	4.38%	1.71%	6.81%	8.81%	8.76%	7.05%				
Bounded Rate.....	842	1,218	-	561	-	224	2,845	3,157	90	3,247	2,844
Interest Rate.....	5.20%	5.33%	-	6.20%	-	5.00%	5.44%				
<b>Instruments in CAD.....</b>	0	0	0	0	-	-	0	0	-	0	0
Fixed Rate.....	0	0	0	0	-	-	0	0	-	0	0
Interest Rate.....	1.45%	1.45%	1.45%	1.45%	-	-	1.45%				
<b>Instruments in ARS.....</b>	198	-	113	-	-	-	311	17	177	193	311
Floating Rate.....	217	-	-	-	-	-	217	(19)	177	158	217
Spread.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	(19)	-	113	-	-	-	94	36	-	36	94
Interest Rate.....	3.24%	-	10.38%	-	-	-	11.82%				
<b>Instruments in BRL.....</b>	448	350	822	86	11	40	1,757	1,652	106	1,757	1,757
Floating Rate.....	448	350	822	86	11	40	1,757	1,652	106	1,757	1,757
Spread.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	-	-	-	-	-	-	-	-	-	-	-
Interest Rate.....	-	-	-	-	-	-	-	-	-	-	-
<b>Instruments in CLP.....</b>	62	-	-	-	-	-	62	-	60	60	62
Floating Rate.....	62	-	-	-	-	-	62	-	60	60	62
Interest Rate.....	-	-	-	-	-	-	-	-	-	-	-
<b>Instruments in PEN.....</b>	862	56	-	-	67	15	1,000	617	369	986	1,000
Floating Rate.....	373	-	-	-	67	15	455	81	367	448	455
Spread.....	-	-	-	-	6.57%	-	0.96%				
Fixed Rate.....	489	56	-	-	-	-	545	537	2	538	545
Interest Rate.....	8.43%	10.99%	-	-	-	-	8.69%				
<b>Instruments in UF.....</b>	895	256	321	79	49	170	1,770	455	1,293	1,748	1,770
Floating Rate.....	811	28	114	3	22	-	978	41	890	931	978
Spread.....	1.17%	1.00%	0.76%	0.73	0.94%	-	1.11%				
Fixed Rate.....	84	228	207	76	27	170	792	414	403	817	792
Interest Rate.....	5.17%	6.04%	6.12%	6.19%	6.29%	6.45%	6.08%				
<b>Instruments in COP.....</b>	-	-	-	-	13	-	13	13	-	13	13
Floating Rate.....	-	-	-	-	13	-	13	13	-	13	13
Spread.....	-	-	-	-	0.05%	-	0.05%				
<b>Instruments in GTQ.....</b>	1	3	7	-	-	-	11	11	-	11	11
Fixed Rate.....	1	3	7	-	-	-	11	11	-	11	11
Interest Rate.....	15.00%	14.43%	14.43%	-	-	-	14.50%				
<b>Asia.....</b>	(0)	-	-	-	-	-	(0)	876	(877)	(1)	(0)
<b>Instruments in JPY.....</b>	(0)	-	-	-	-	-	(0)	876	(877)	(1)	(0)
Floating Rate.....	-	-	-	-	-	-	-	258	(259)	(1)	-
Interest Rate.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	(0)	-	-	-	-	-	(0)	618	(618)	(0)	(0)
Interest Rate.....	14.55%	-	-	-	-	-	14.55%				
<b>Africa.....</b>	34	-	-	-	-	-	34	-	35	35	34
<b>Instruments in MAD.....</b>	34	-	-	-	-	-	34	-	35	35	34
Fixed Rate.....	34	-	-	-	-	-	34	-	35	35	34
Interest Rate.....	10.35%	-	-	-	-	-	10.35%				
<b>Total.....</b>	5,629	2,701	4,433	4,369	3,202	8,608	28,942	28,779	1,227	30,005	28,942
<b>Exchange Rate Options.....</b>	1,568	-	-	-	-	-	1,568	-	-	-	-



**SENSITIVITY TO INTEREST RATES AND EXCHANGE RATES OF DEBT OBLIGATIONS AT  
DECEMBER 31, 2000**

	Maturity Dates						Total	Fair Value			
	2001	2002	2003	2004	2005	Subsequent		Underlying Debt	Associated Derivatives	Total	Book Value
	(millions of euro)										
<b>Euro</b>	(651)	169	796	907	2,971	2,928	7,120	12,154	(4,637)	7,516	7,120
Floating Rate.....	(1,513)	(58)	99	525	1,485	1,829	2,368	6,980	(4,618)	2,362	2,368
Spread.....	0.02%	(10.12%)	0.16%	0.28%	0.44%	0.03%	0.61%				
Fixed Rate.....	861	227	697	382	1,486	1,099	4,752	5,174	(19)	5,155	4,752
Interest Rate.....	12.95%	8.21%	5.47%	6.68%	7.79%	5.42%	7.77%				
<b>Other European Currencies.</b>	7	7	7	382	-	-	338	21	328	349	338
<b>Instruments in GBP.....</b>	-	-	-	317	-	-	317	-	328	328	317
Floating Rate.....	-	-	-	190	-	-	190	-	196	196	190
Spread.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	-	-	-	127	-	-	127	-	132	132	127
Interest Rate.....	-	-	-	6.25%	-	-	6.25%	-	-	-	-
<b>Instruments in CHF.....</b>	7	7	7	-	-	-	21	21	-	21	21
Fixed Rate.....	7	7	7	-	-	-	21	21	-	21	21
Interest Rate.....	2.18%	2.18%	2.18%	-	-	-	2.18%	-	-	-	-
<b>America.....</b>	1,304	4,813	2,163	1,623	1,883	6,738	17,895	13,742	5,085	18,828	18,082
<b>Instruments in USD.....</b>	(1,520)	3,699	1,545	772	1,751	6,034	12,281	10,099	3,183	13,277	12,461
Floating Rate.....	2,214	2,753	674	284	516	1,698	8,138	6,435	1,720	8,156	8,142
Spread.....	1.93%	0.21%	0.35%	0.34%	1.18%	0.68%	0.85%				
Fixed Rate.....	(3,734)	946	871	488	1,235	4,124	3,930	3,416	1,467	4,883	4,106
Interest Rate.....	5.92%	6.94%	6.90%	7.90%	7.78%	7.88%	9.27%				
Bounded Rate.....	-	-	-	-	-	212	212	242	(4)	238	212
Less than 3 years.....						212	212				
More than 3 years.....											
<b>Instruments in CAD.....</b>	0	0	0	0	0	-	1	1	-	1	1
Fixed Rate.....	0	0	0	0	0	-	1	1	-	1	1
Interest Rate.....	3.00%	3.00%	3.00%	3.00%	3.00%	-	3.00%	-	-	-	-
<b>Instruments in ARS.....</b>	1,382	-	-	188	-	186	1,756	316	1,412	1,729	1,756
Floating Rate.....	1,437	-	-	-	-	-	1,437	-	1,412	1,412	1,437
Spread.....	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate.....	(55)	-	-	188	-	186	319	316	-	316	319
Interest Rate.....	9.51%	-	-	10.38%	-	11.25%	11.03%				
<b>Instruments in BRL.....</b>	623	63	61	372	77	52	1,248	1,151	79	1,230	1,255
Floating Rate.....	476	63	61	372	77	52	1,101	1,141	(58)	1,083	1,109
Spread.....	100% CDI	100% CDI	100% CDI	100% CDI	100% CDI	100% CDI	100% CDI				
Fixed Rate.....	147	-	-	-	-	-	147	10	137	147	146
Interest Rate.....	10.38%	-	-	-	-	-	10.38%				
<b>Instruments in CLP.....</b>	23	-	-	-	-	-	23	-	26	26	23
Fixed Rate.....	23	-	-	-	-	-	23	-	26	26	23
Interest Rate.....	10.98%	-	-	-	-	-	10.98%				
<b>Instruments in PEN.....</b>	480	21	-	-	-	45	546	180	350	531	546
Floating Rate.....	236	-	-	-	-	45	281	74	196	270	281
Spread.....	0.83%	-	-	-	-	6.96%	1.82%				
Fixed Rate.....	244	21	-	-	-	-	265	106	154	260	265
Interest Rate.....	14.20%	13.81%	-	-	-	-	14.17%				
<b>Instruments in UF.....</b>	275	400	556	291	55	421	1,998	2,000	(6)	1,994	1,998
Floating Rate.....	310	349	509	141	23	-	1,332	1,332	(4)	1,328	1,332
Spread.....	0.85%	0.85%	0.85%	0.85%	0.85%	-	0.85%				
Fixed Rate.....	(34)	51	47	150	32	421	667	668	(2)	667	667
Interest Rate.....	(1.00%)	6.36%	6.38%	6.37%	6.36%	6.36%	6.74%				
<b>Instruments in VEB.....</b>	42	-	-	-	-	-	42	-	41	41	42
Floating Rate.....	42	-	-	-	-	-	42	-	41	41	42
Spread.....	-	-	-	-	-	-	-	-	-	-	-
<b>Asia.....</b>	-	-	-	-	-	-	-	(200)	197	(3)	-
<b>Instruments in JPY.....</b>	-	-	-	-	-	-	-	(200)	197	(3)	-
Fixed Rate.....	-	-	-	-	-	-	-	(200)	197	(3)	-
Interest Rate.....	-	-	-	-	-	-	-				
<b>Africa.....</b>	22	-	-	-	-	-	22	-	22	22	22
<b>Instruments in MAD.....</b>	22	-	-	-	-	-	22	-	22	22	22
Fixed Rate.....	22	-	-	-	-	-	22	-	22	22	22
Interest Rate.....	11.00%	-	-	-	-	-	11.00%				
<b>Total.....</b>	682	4,359	2,966	2,847	4,856	9,666	25,375	25,717	996	26,713	25,562
<b>Exchange Rate Options.....</b>	222	-	-	-	-	-	222	-	-	-	-

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Not applicable.

**ITEM 15. RESERVED**

Not applicable.

**ITEM 16. RESERVED**

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

We have responded to Item 18 in lieu of responding to this Item.

**ITEM 18. FINANCIAL STATEMENTS**

Please see pages F-1 through F-113.

**ITEM 19. EXHIBITS**

*Exhibits*

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
1.1	Amended and Restated Articles of Association.**
1.2	Amended and Restated Articles of Association (English translation). **
4.1	Framework Agreement dated January 12, 2000, by and between Caja de Ahorros y Pensiones de Barcelona and Grupo Telefónica.*
4.2	Framework Agreement dated January 12, 2000, by and between Caja de Ahorros y Pensiones de Barcelona and Grupo Telefónica (English translation).*
4.3	Framework Agreement dated February 11, 2000, by and between Banco Bilbao Vizcaya Argentaria, S.A. and Telefónica, S.A.*
4.4	Framework Agreement dated February 11, 2000, by and between Banco Bilbao Vizcaya Argentaria, S.A. and Telefónica, S.A. (English translation).*
4.5	Amended and Restated Rights Offering Agreement dated May 16, 2000, among Telefónica, S.A., Terra Networks, S.A., and Lycos, Inc.**
4.6	Amended and Restated Agreement and Plan of Reorganization dated September 20, 2000, among Terra Networks, S.A., Lycos, Inc. and Lycos Virginia, Inc.**
4.7	Strategic Alliance Memorandum of Understanding dated May 16, 2000, among Bertelsmann AG,

**Exhibit  
Number**

**Description**

	Telefónica, S.A., Terra Networks, S.A. and Lycos, Inc.**
4.8	Mexican Stock Purchase Agreement among Motorola, Inc., Telefónica, S.A. and Telefónica Móviles, S.A. dated as of October 10, 2000.* *
4.9	Global option plan (TIES).***
4.10	Joint Venture Agreement dated as of January 23, 2001 among Telefónica, S.A., Telefónica Móviles, S.A., Portugal Telecom SGPS S.A. and PT Móveis SGPS, S.A.**†
8.1	List of Subsidiaries.

\* Incorporated by reference to the registration statement of Telefónica, S.A. on Form F-4, registration number 333-11356.

\*\* Incorporated by reference to Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 2000.

\*\*\* Incorporated by reference to the registration statement on Form S-8, registration number 333-13902.

† Confidential material appearing in this document has been omitted and filed separately with the Securities and Exchange Commission in accordance with the Securities Exchange Act of 1934, as amended, and Rule 24b-2 promulgated thereunder. Omitted information has been marked through.

## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

TELEFÓNICA, S.A.

By: /s/ José María Alvarez-Pallete López  
Name: José María Alvarez-Pallete López  
Title: General Manager Corporate  
Finance

TELEFÓNICA, S.A.

By: /s/ Antonio Alonso Ureba  
Name: Antonio Alonso Ureba  
Title: General Secretary and Secretary  
of the Board of Directors

Date: July 1, 2002

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