



Telefónica: real earnings, real options

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Chief Operating Officer, Telefónica S.A.
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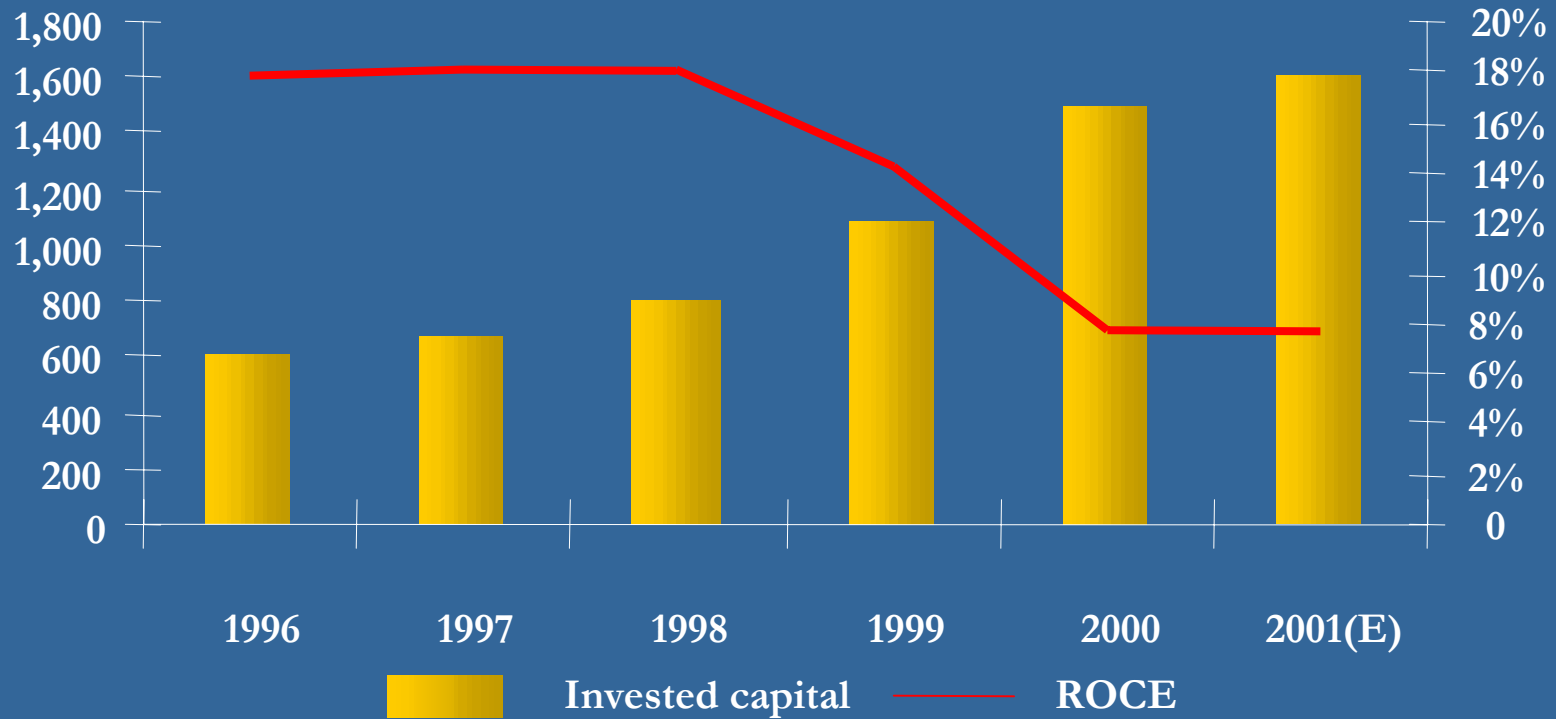
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THEMES FOR TODAY

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

INVESTED CAPITAL vs RETURNS IN TELECOMS

Bn. USD



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

Source: WDR

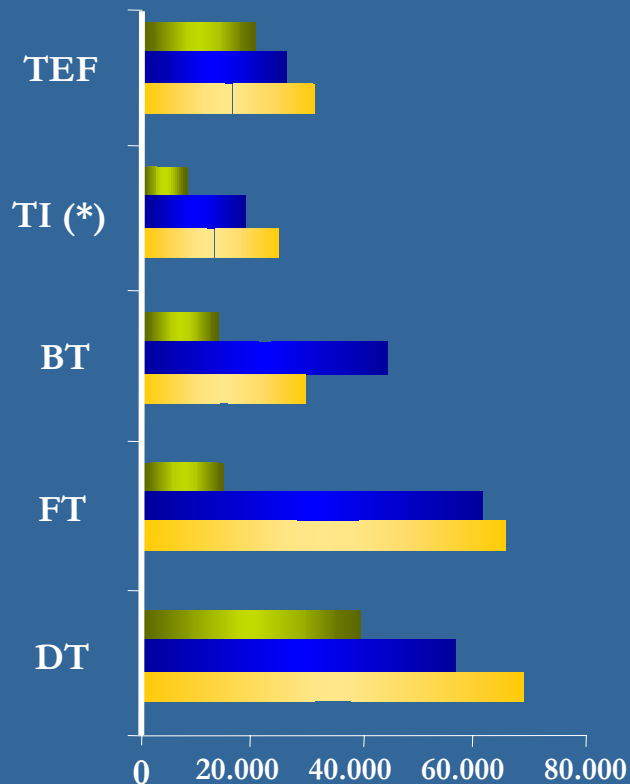
1. A NEW CONTEXT

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INCREASE IN DEBT LEVELS WEAKEN BALANCE SHEET AND ERODE MARKET CAP

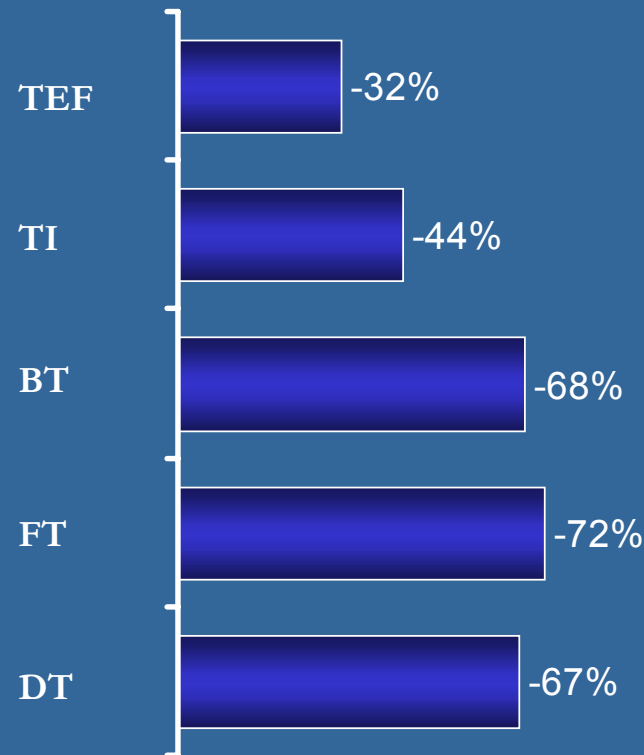
Net Debt

MM €



Change in Market Cap

(Percentage, Dec 99 vs 26 Sep 01)



(*) Excluding Olivetti's debt

1. A NEW CONTEXT

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A NEW CONTEXT

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

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

THEMES FOR TODAY

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

TELEFONICA'S SOLID POSITION

Sound financials

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

Solid fundamentals

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

Strong strategic position

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

TELEFONICA: A DIVERSIFIED GLOBAL PLAYER



10 Telco worldwide by market cap (# 15 in Dec 99)
 # 2 among European incumbents (up from # 5 in Dec 99)



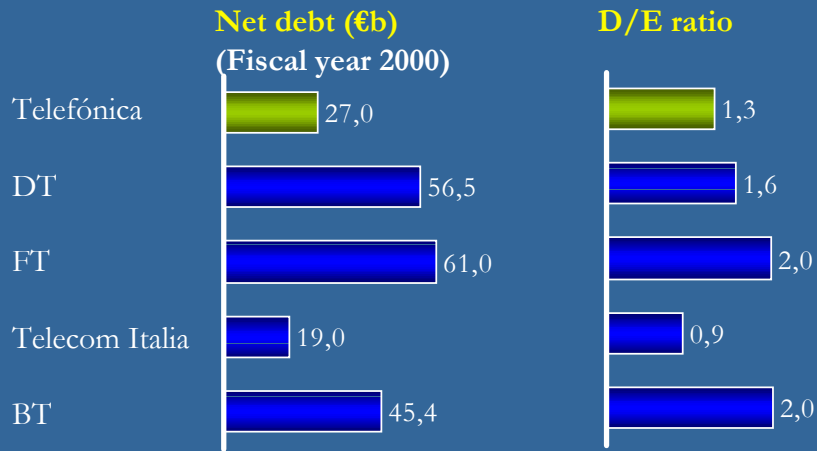
Million	2000	% Change	1H01	% Change
Revenues	28,485.5	24.1	15,302	15.2
EBITDA	11,918.8	9.5	6,356.6	9.2
Reported Net inc.	2,504.8	38.8	1,148.6	16.1
Net inc. - goodwill	3,005.4	50.3	1,631.8	41.6

2. STRUCTURALLY STRONG

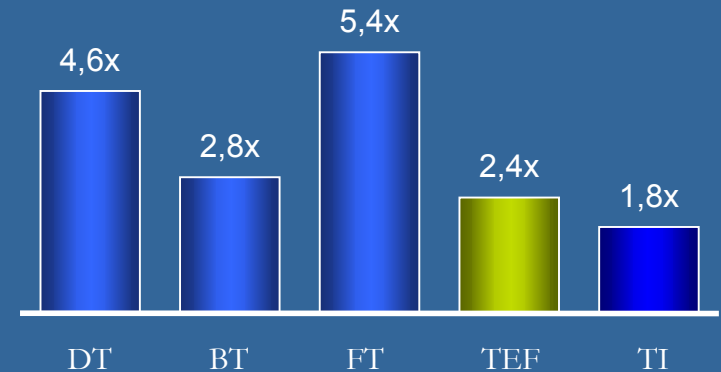


LOWER DEBT LEVELS AND STRONG CASH FLOW GENERATION

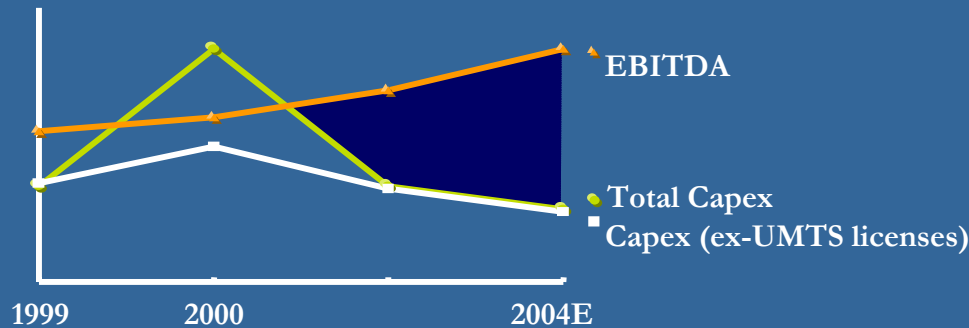
Low debt levels relative to major competitors



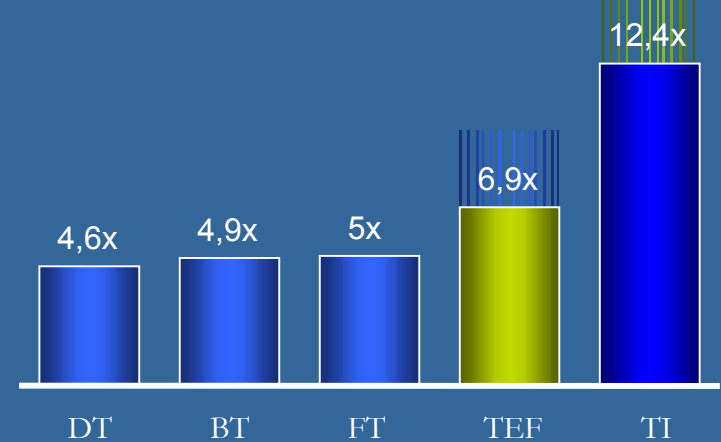
Superior debt cover ratios Net Debt/EBITDA 01E



EBITDA generation in excess of CAPEX required for organic growth



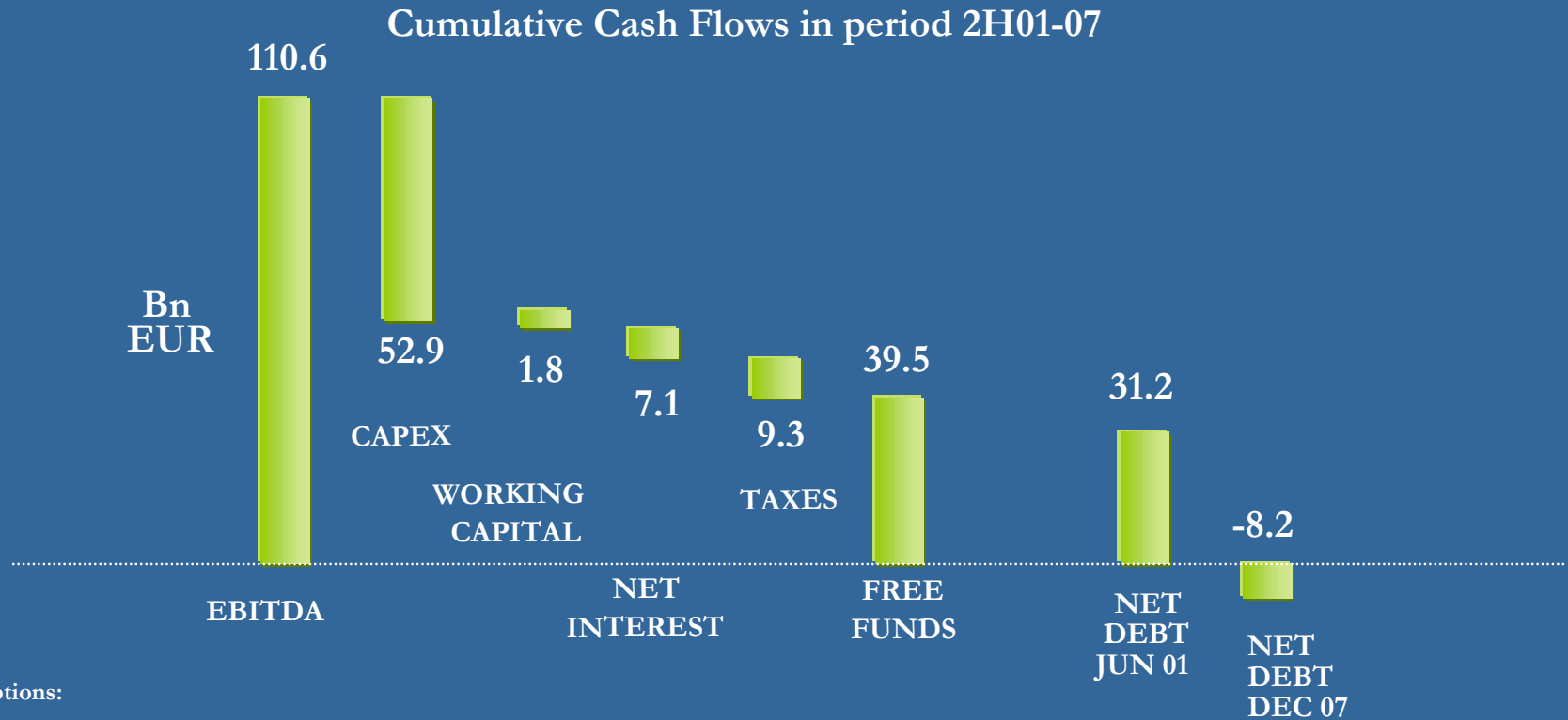
EBITDA 01E /Net Interest Expense 01E



2. STRUCTURALLY STRONG

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



Assumptions:

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

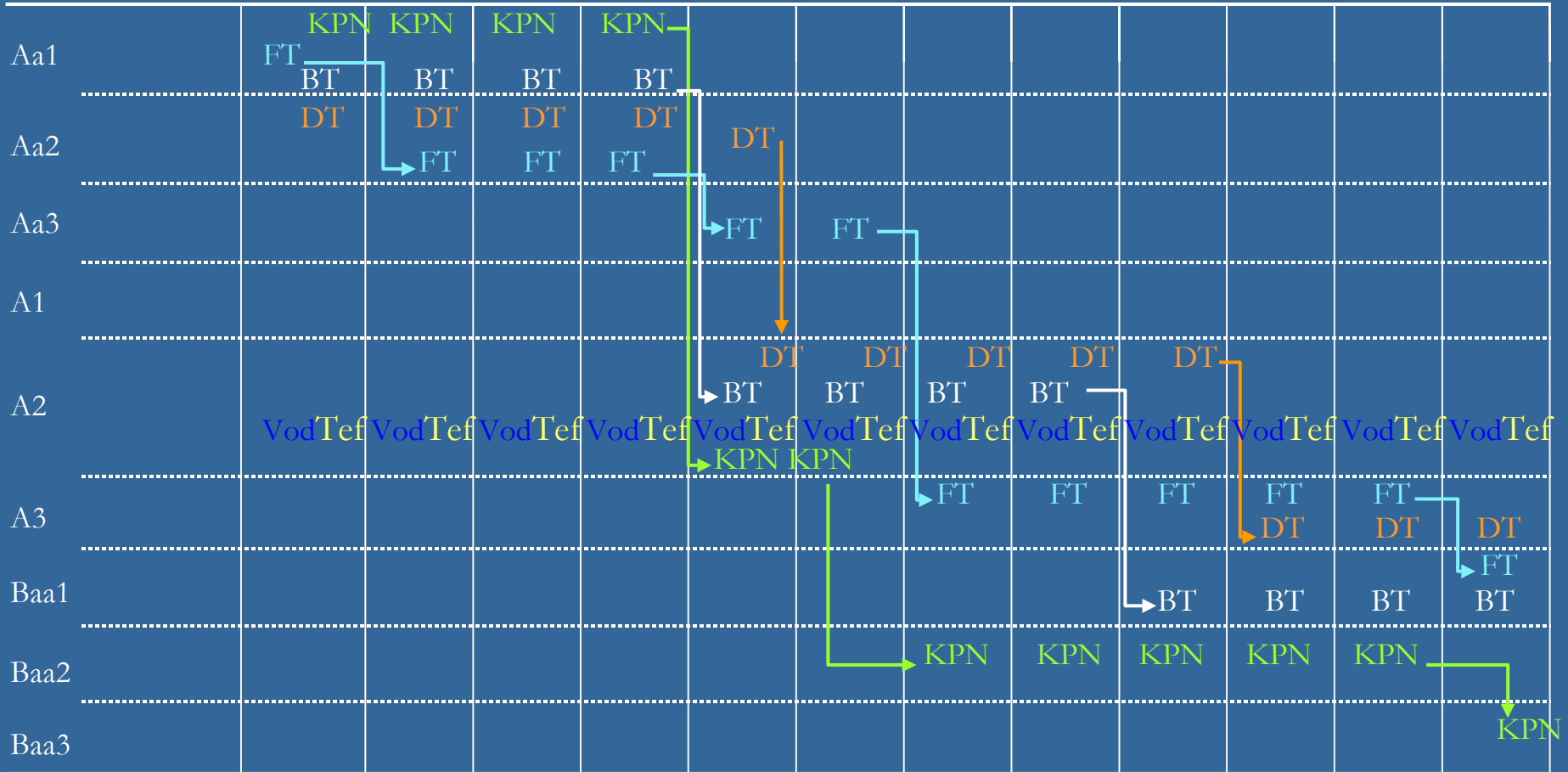
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HIGH CREDIT QUALITY

Evolution of ratings (Moody's)

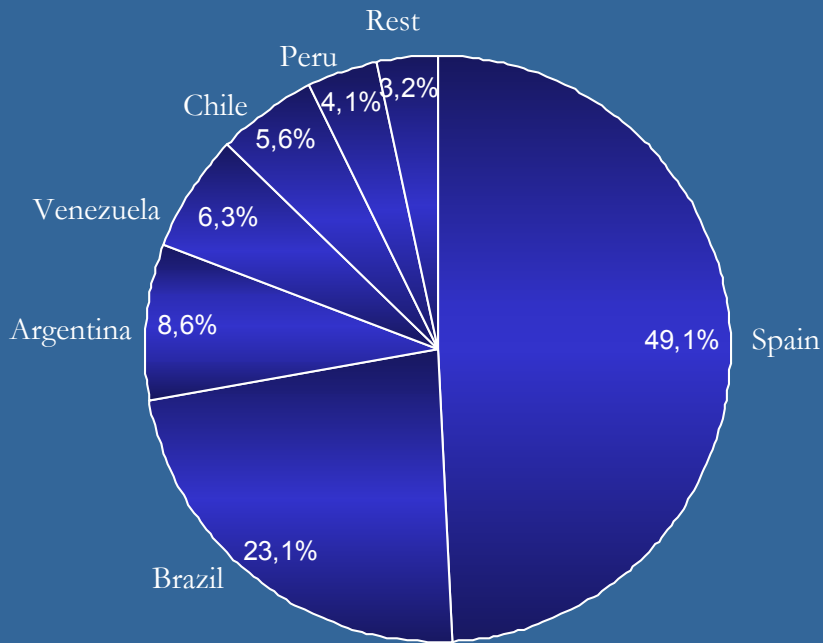
09/99 12/99 03/00 06/00 09/00 12/00 01/01 04/01 05/01 06/01 07/01 08/01 09/01



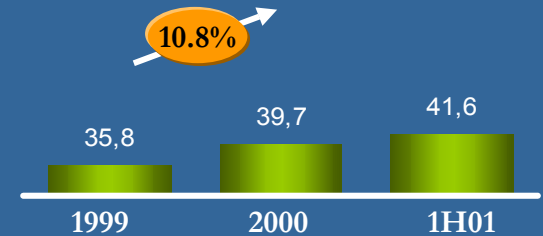
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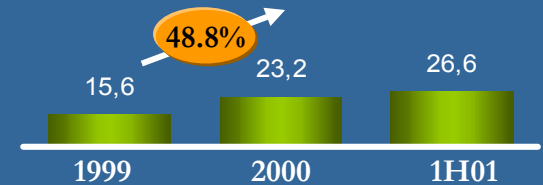
LARGE AND GROWING CUSTOMER BASE



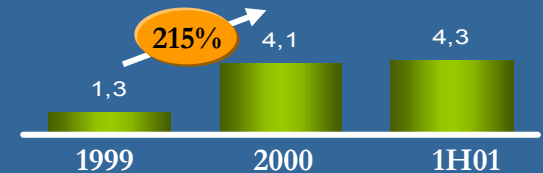
Managed wireline clients (millions)



Managed cellular clients (millions)



Internet access clients (millions)



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

2. STRUCTURALLY STRONG

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STRONG OPERATIONAL PERFORMANCE

Wireline strategy delivering results in Spain

1.- Lead the direct access front through ADSL

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

2.- Lead the Internet Growth

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

3.- Defend voice traffic market share

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

4.-Stabilize regulatory framework

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

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

2. STRUCTURALLY STRONG

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STRONG OPERATIONAL PERFORMANCE

Latam wireline: proven expertise and performance on track

TeleSP (acquisition
in Aug' 98)
3 year management

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

TASA (acquisition in
Nov' 90)
11 year management

• LIS ('000)	1,696	4,450	162%
• Lines per employee	78	504	546%
• Avg. Waiting time (months)	49	0.3	n.m.
• EBITDA (\$US MM)	1,389	3,613 (1)	160%
• EBITDA margin	38%	53%	15 p.p.

(1) Latest FY

(2) Net of interconnection

SKILLED TEAMS WITH UNIQUE TRACK RECORD ON TURN OVERS

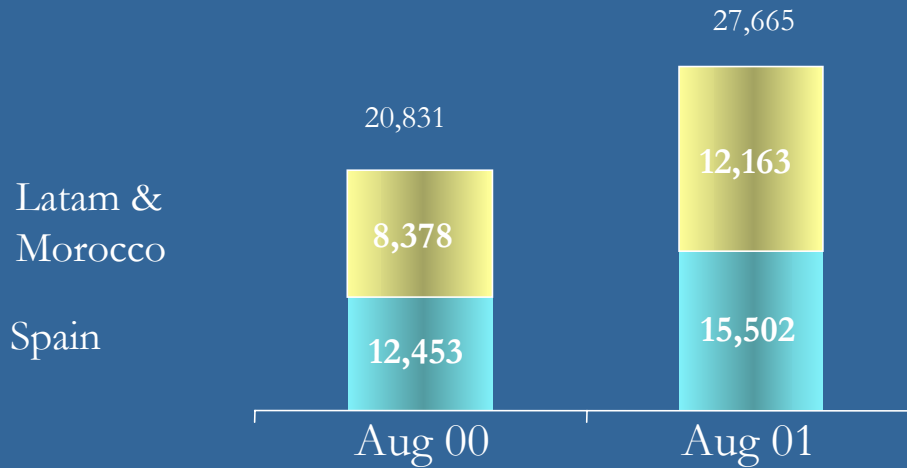
2. STRUCTURALLY STRONG

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STRONG OPERATIONAL PERFORMANCE

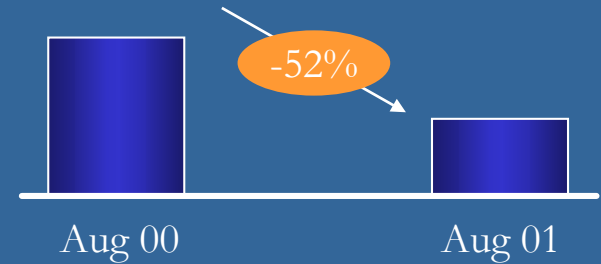
Wireless: significant size, ongoing growth and increasing margin

Managed customers ('000)

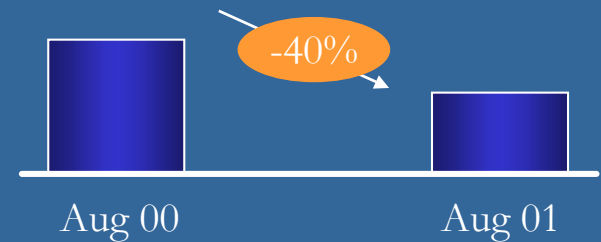


	1H01	%(1H01/1H00)
Operating Revenues	3,933.9	14.2%
EBITDA	1,551.6	32.4%
EBITDA Margin	39.4%	+ 5.4 p.p.

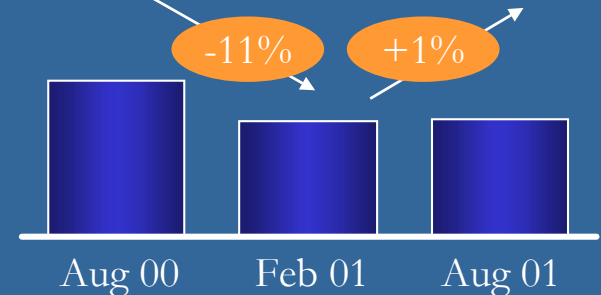
TME Monthly churn



TME SAC (€)



TME ARPU (€)



2. STRUCTURALLY STRONG

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BALANCED BUSINESS PORTFOLIO



Telefonica
Wireline in Spain

Telefonica
Wireline in Latam

Telefonica
Data

Telefonica
Wireline in Spain

Telefonica
Wireline in Latam

Telefonica
Data

emergia

terra lycos

Telefonica
Media

TPI

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

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

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

2. STRUCTURALLY STRONG



OUR STRENGTH: SOLID POSITION AND OPTIONALLITY

- Sound financials
- Solid fundamentals
- Strong strategic position

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

THEMES FOR TODAY

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

TELEFONICA'S PROJECT IN THE NEW INDUSTRY CONTEXT

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



Evolve and reposition business platforms: building our future



Leverage our strong position in the sector restructuring

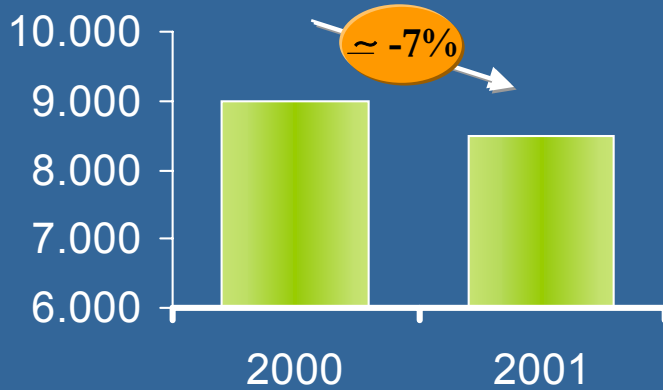
- Operational efficiency
- Capital efficiency
- Transformation towards client
- Organizational alignment/horizontal integration for synergies

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

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

PROACTIVE MANAGEMENT OF INVESTED CAPITAL

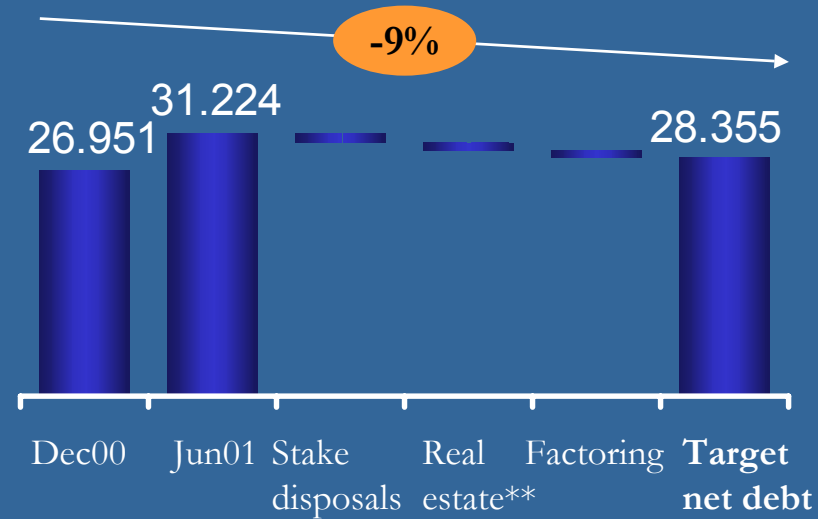
Capex reduction



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

Deleverage our balance sheet

Net debt expected evolution



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

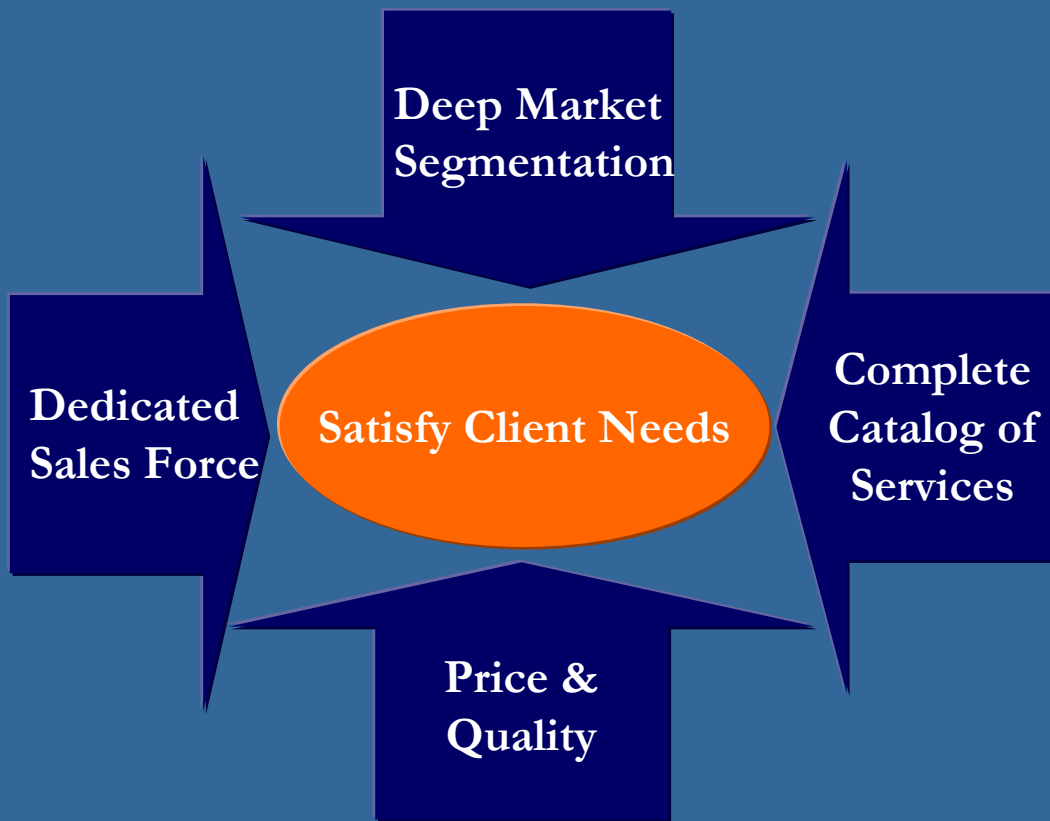
* Excluding intangible assets and LT financial investments

** Funds raised – PV of future rents

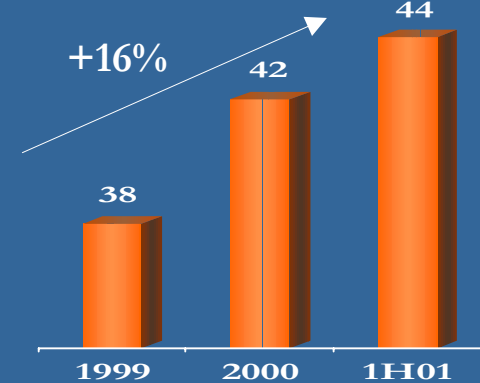
3. REAL EARNINGS, REAL OPTIONS

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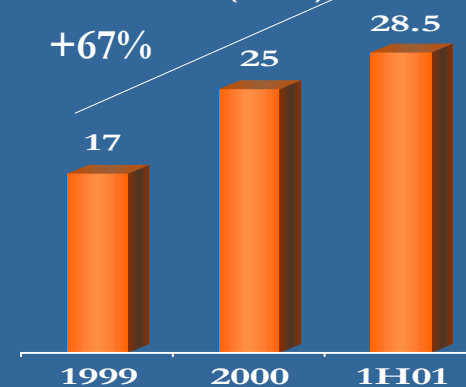
TRANSFORMATION TOWARDS THE CLIENT



Lines in service (MM)



Cellular clients (MM)



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

100 MM clients in 2004

3. REAL EARNINGS, REAL OPTIONS

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BENEFITING FROM AN INTEGRATED STRUCTURE

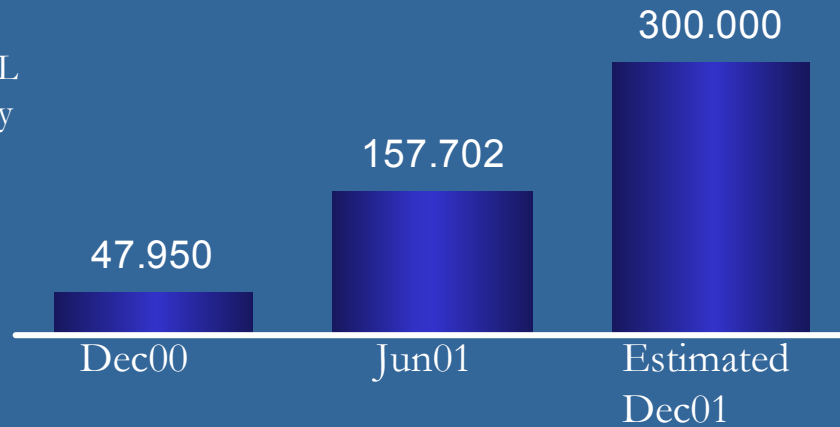
- Achieve functional articulation and horizontal synergies
 - Purchasing
 - IT
 - Efficiency on shared services centers: expected NPV of €960 million
 - Talent
- Cash management and internal financial circuit to reduce finance costs and to lower impact of potential currency devaluations
- Improve “real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

NATURAL STRATEGIC DEVELOPMENT OF CORE BUSINESSES

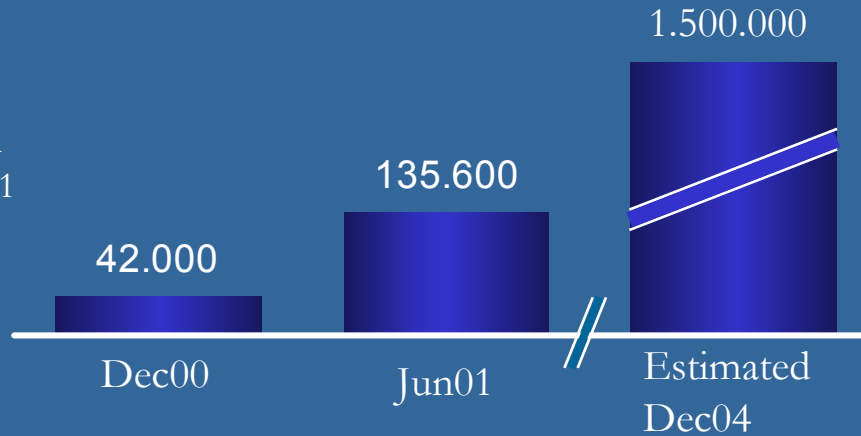
Access: fast deployment of our ADSL commitments



- Up to 1.800 ADSL lines installed daily



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



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

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

3. REAL EARNINGS, REAL OPTIONS



NATURAL STRATEGIC DEVELOPMENT OF CORE BUSINESSES

Brazil 2002

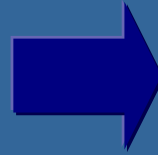
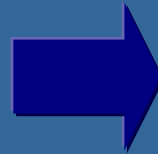
BUSINESS OPPORTUNITIES

Creation of a leading Long Distance Carrier

Developing data & VAS businesses to corporations

Complete Brazilian broadband network

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



COMPETITIVE POSITION

12 Million LIS

Sao Paulo: 40% of DLD+ILD

Telesp: >80% Intra-State mkt. share

Sao Paulo: 80% of top 250 corporations

90% of those serviced by Telesp

Capacity swaps through Emergia
Group bandwidth needs

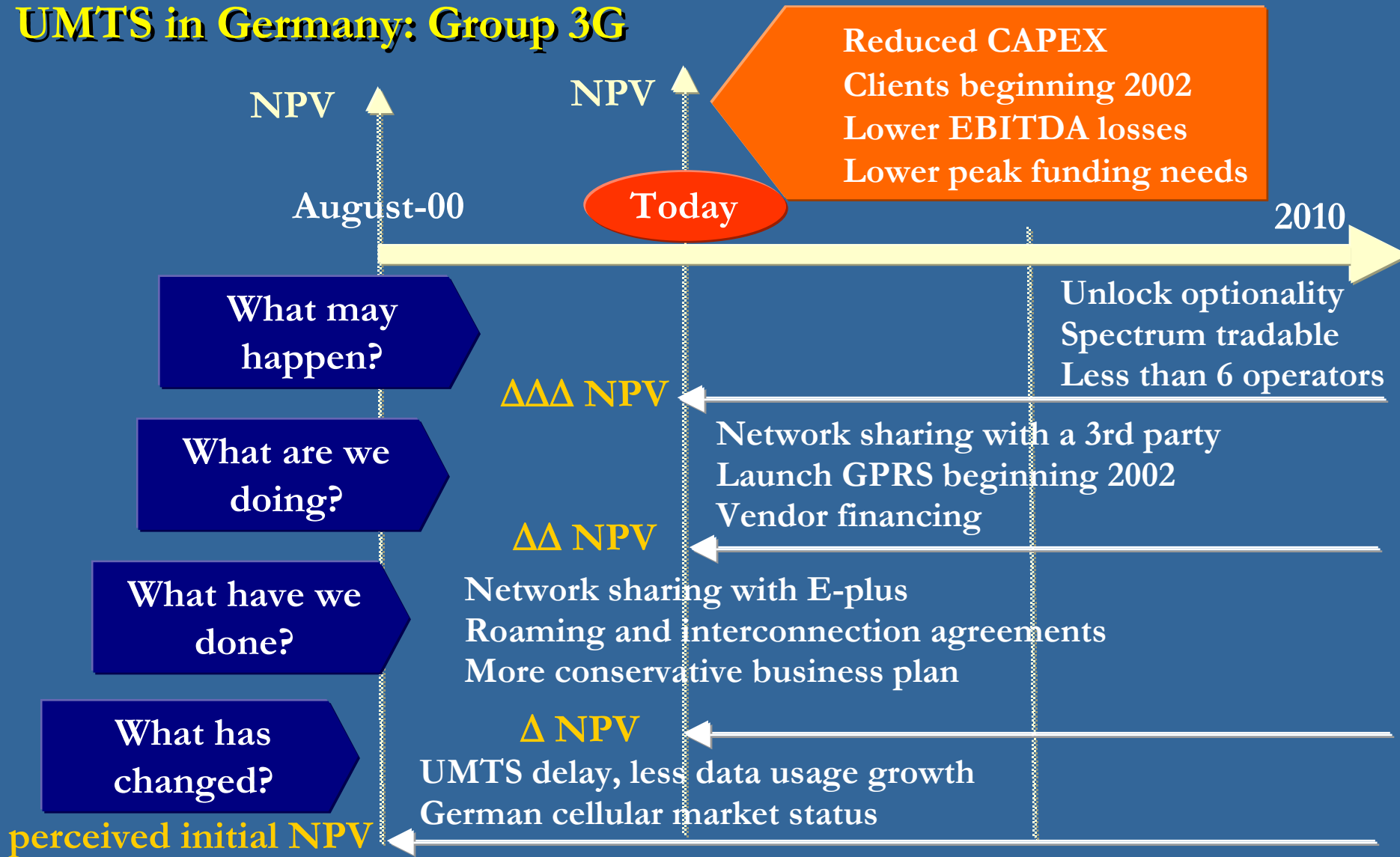
- ✓ Marginal CAPEX
- ✓ EBITDA>0 from year one

3. REAL EARNINGS, REAL OPTIONS

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STRATEGIC REPOSITIONING OF START-UP BUSINESSES

UMTS in Germany: Group 3G



3. REAL EARNINGS, REAL OPTIONS

STRATEGIC REPOSITIONING OF START-UP BUSINESSES

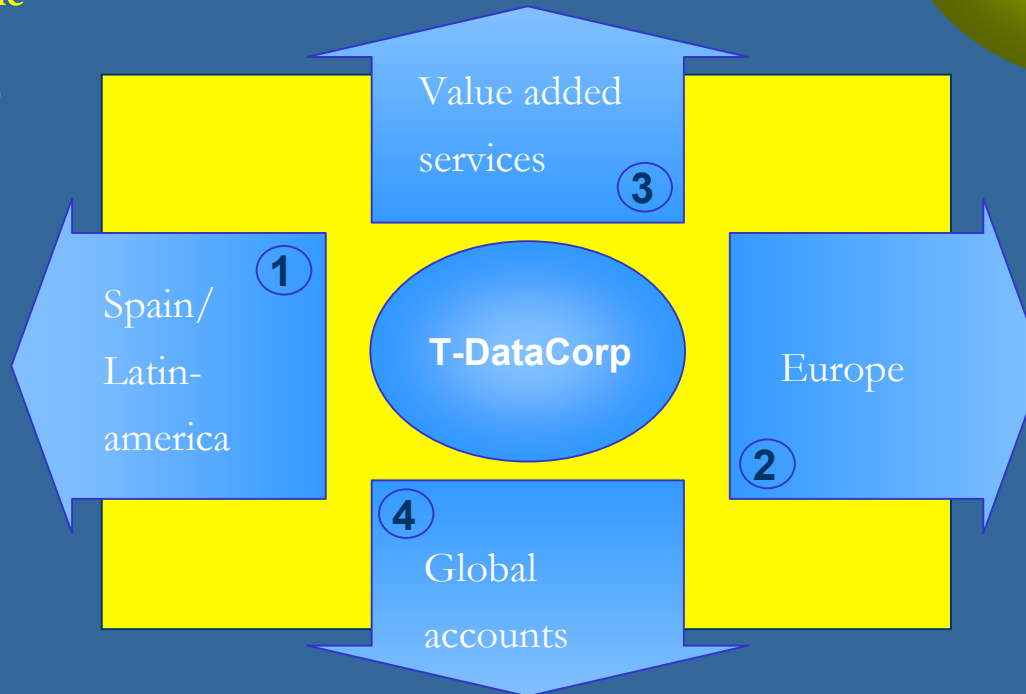
Telefónica Data-Corp

- Hosting
- ASP
- e-consulting

Centralized management of international backbone capacity

Joint effort with fixed line operators

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



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

- Global offer to strategic key accounts

3. REAL EARNINGS, REAL OPTIONS

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MANAGEMENT PRIORITIES GOING FORWARD

Enhance business performance

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

Start-up business repositioning

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

Optimization of invested capital

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

Organization

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

Consolidation

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

BEST PLACED FOR SUCCESS IN ALL SCENARIOS

Best position for
all scenarios

Low growth
scenario

“UMTS take off”
scenario

“ADSL booms”
scenario

“Content killer apps
emerge” scenario

“...” scenario

- Real earning through solid position in core business
- Real options through a balanced portfolio

- Thanks to our strength in the core business we will deliver results in low-growth scenarios

- Thanks to our portfolio of options we will capture value in growth scenarios

IN SUMMARY

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

A clear project going forward

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

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

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