

Letter to Shareholders

Dear Shareholder:

A YEAR AGO, WHEN WE TOOK OUR FIRST STEPS AS A totally privatized company, I spoke to you of my absolute faith in the **Company's** future and of our three-way commitment to our shareholders, our customers and to Spanish society in general.

A year has passed, and I take great satisfaction in telling you that we have every reason to be proud of being **Telefónica** shareholders. We form part of a **Company** whose share price has risen 44% over the year, and whose profits have grown 18.6% to reach Ptas 190,063 million. Throughout 1997, we have offered our customers an ever-increasing range of services and, at the same time, we have cut prices, and provided our society with a

telecommunications system that is modern, flexible and reliable.

We took on a three-way commitment and we have fulfilled our promises. We are Spain's leading enterprise in terms of revenue and market capitalization. We have 35.5 million customers in Spain and Latin America, making us the leading telecommunications operator throughout the Spanish-speaking world. We are moving into new geographical markets and, with the support of our international alliances, we are set to play an active role in the reshaping and expansion process that is under way in the communications sector throughout the world.



We want to establish ourselves as the world's fifth-ranked operator in the telecommunications field and therefore, by building on the solid foundations we have already laid, we have begun to move into new lines of business in the audiovisual sector, thus adding a totally new dimension to the relationship with our customers.

Our high levels of investment, coupled with our constant dedication to research and development, have enabled us to consistently offer improved services increasingly tailored to the needs of each of our customers.

We are contributing to the growth in competition and to the economic development of all the countries in which are present, by creating wellbeing for the general public and, through our policy of social support, by playing an active role in socially-oriented projects.

We therefore feel we have reason to be proud of the success and service capability of the company we own, but we must not be lulled by complacency. There are many important challenges ahead of us and our present achievements should spur us on to facing them with determination.

A time of great new opportunity and potential is opening up for the **Telefónica Group**, which will,

in turn, undoubtedly create additional value for our shareholders.

Spain is currently undergoing a transition period which will shortly culminate in the total liberalization of the telecommunications marketplace. **Telefónica** has no misgivings about the advent of competition, because we know how to act in a competitive environment, and we already work with a competitive spirit. We have shown this in Spain, in the field of mobile telecommunications, as well as in those countries where we operate in a totally liberalized market. This challenge brings out the best in us and spurs us on.

We therefore welcome competition with open arms, as we know that it pushes us on to bigger and better things. The only thing we insist on is that the rules of the game be clear, precise and fair for everyone, set by an independent and unbiased regulator.

Beyond Spain's frontiers, we intend to continue taking advantage of the excellent investment and growth opportunities offered by a region in constant expansion such as Latin America. This will enable us to sustain and increase the value created for our shareholders. In order to exploit these opportunities to the full, we will push

forward in the process of integrating the management of all the **Group's** operators.

We can be sure that throughout 1998, **Telefónica** will continue to progress in its aim to consolidate its leadership within and beyond Spain. We will not neglect the three-way commitment I mentioned at the beginning of this letter.

Our main objective is to create shareholder value, which can only be achieved through the expansion and nurturing of our businesses and the constant provision of a service that guarantees our customers the highest quality.

We would therefore like to express our gratitude to our customers, for the trust they have placed in **Telefónica**, and to the tens of thousands of people throughout the world who work for **Telefónica**. Thanks to them, we have become what we now are: a leading company in the telecommunications marketplace.

A handwritten signature in blue ink that reads "Juan Villalonga". The signature is written in a cursive style with a long vertical line extending downwards from the start of the name.

Juan Villalonga

CHAIRMAN OF TELEFÓNICA



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