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To the Shareholders:

Once again, on writing the introduction to the Annual Report of Telefónica, I should like to set out several general ideas that may serve as a background for analysing the information that follows.

In December of this year, 1985, I will have had the honour of being Chairman of Telefónica for three years. Three years in the life of a Company that held its sixtieth anniversary a few months ago is, obviously, not very long. But I believe that although it has been a short period of time for the Company, it is a good moment to take the opportunity of self-analysis by the new management in front of the Shareholders, and to check the degree of fulfilment of the plans with which the new team reached maximum responsibility in the Company.

I believe that the first idea that should be emphasised is that you, the Shareholder, are participating in one of the key companies in the future of Spain, both in the service and industrial sectors. I consider that Telefónica management in these three years have demonstrated that they understand this role of the Company, of promoting it and reinforcing its presence in Spanish society and in all international forums.

But this general importance of the Company becomes even more relevant on confirming that during this period Telefónica has been recovering from the crisis that affected it - as it affected all companies - and that we are laying the foundations to ensure a better future, on a more solid financial base, with better employment prospects and more brilliant from the technology point of view, providing a more complete service; in a word, more socially and economically profitable, which two parameters a company with a joint public and private shareholding has to apply.

During this time we have implemented new services that will help bring about our idea of making the telephone a key instrument in our fellow citizens' lives over the coming years. We can assure Shareholders that the service is being expanded without forgetting our responsibility towards you. In this balancing act perhaps the greatest problem facing us is expanding the telephone service in the rural environment.

A Royal Decree on this matter has called for the Autonomous Communities, Provincial Councils, etc., to collaborate with Telefónica to enable it to fulfil the function commissioned to it by the State as a public utility with monopoly, without detriment to profitability. We hopefully anticipate that this joint collaboration will allow all Spanish citizens to be close to a telephone within a few years, even should they not have one of their own.

But together with this image of the basic service of Telefónica, we cannot forget our responsibility, be it direct or indirect, towards Spanish technology, towards the creation of companies in the electronics, communications and information technology sectors.

It is obvious that Telefónica cannot have the fundamental vocation of turning itself wholly into an industrial holding company, but even so it is difficult to forget the possibilities that a Company like Telefónica has for the creation of industry and technology, given its important procurement capacity.

At least, this is how we, the present Managers of Telefónica, have understood the situation and I feel that the Shareholders can be proud that their savings are reinforcing Spanish industry.

However, I can understand the worry of some Shareholders who doubt that this effort is being properly remunerated. To avoid any doubt whatsoever, the Management of Telefónica wish to start, as soon as possible, the negotiations required to allow shares in various industrial projects to be distributed among Telefónica Shareholders, in the correct proportions and in the fairest possible way.

Perhaps this whole effort of service and reindustrialization is properly demonstrated by the corporate change of image that we are carrying out. The new Logos, these new colours and symbols of Telefónica are, in my opinion, the clearest way of telling users, Shareholders and society in general that we are trying, to move into the future with verve, while not losing our traditions.

But I must once again insist that this change of image is not only formal, it is also a change of attitudes. Thus, for example, Telefónica Shareholders must know that today they also participate in an ambitious but realistic project for international activities,

that has led us to implement projects in Latin America, China, the United States, Canada, etc.

Undoubtedly, however, in the introduction of the Chairman of Telefónica to the Annual Report, words should give way to numbers.

Consequently, I would ask you to examine our Balance Sheet and Statement of Profit and Loss with great care, in the certainty that you are going to find a telephone utility that, while undoubtedly not perfect, has not stopped improving over this period. The 1984 Balance Sheet is better than in 1983.

I even think that the simplest way of confirming that Shareholders have understood this is the trend of Telefónica shares in the Stock Exchange, which have recovered levels which, while still undervaluing the Company in my belief, are way above the low share prices found by the present Management of the Company when they arrived.

I should very much like you and all of the Shareholders to evaluate the effort made by Telefónica workers and Management to ensure that the savings that you have entrusted to us are properly remunerated, while we render a basic public service to the nation.

Many thanks for the trust that your shareholding in Telefónica signifies; I am sure that we will not disappoint you and that the Annual Report that you now hold in your hands will be the best confirmation of everything that I have been able to say in this open letter.



Luis Solana Madariaga
Chairman of the Board of Directors
of the Compañía Telefónica Nacional
de España.

HIGHLIGHTS

Items	1983	1984	% 84/83
Number of telephones	13,345,332	13,825,459	3.6
Telephones per 100 inhabitants	34.9	35.8	2.6
Lines in service	8,453,707	8,881,727	5.1
Applications pending	296,043	266,979	-9.8
Trunk calls (thousands of units)	2,415,832	2,565,816	6.2
Trunk calls per subscriber	285.7	288.7	1.1
Automatic trunk calls (percent) (STD)	98.3	98.8	0.4
Outgoing international calls (thousands of units)	71,099	78,402	10.3
Automatic international calls (percent) (IDD)	97.0	97.2	0.2
Length of trunk lines (km)	87,011,699	92,346,245	6.1
Number of employees	66,830	66,781	-0.07
Gross investment for the year (millions of pesetas)	159,861	175,417	9.7
Value of telephone equipment and installations (millions of pesetas)	1,979,411	2,258,886	14.1
Share capital (millions of pesetas)	288,374	320,416	11.1
Revenue from services (millions of pesetas)	296,883	349,226	17.6



