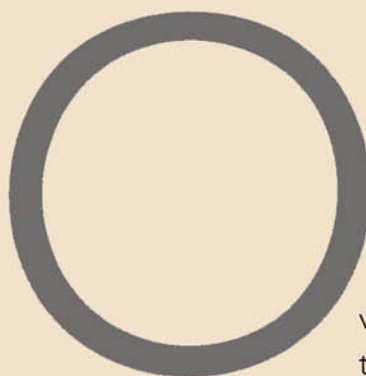


## 1988: a year of inflexion



Overall, in harmony with the positive trends in

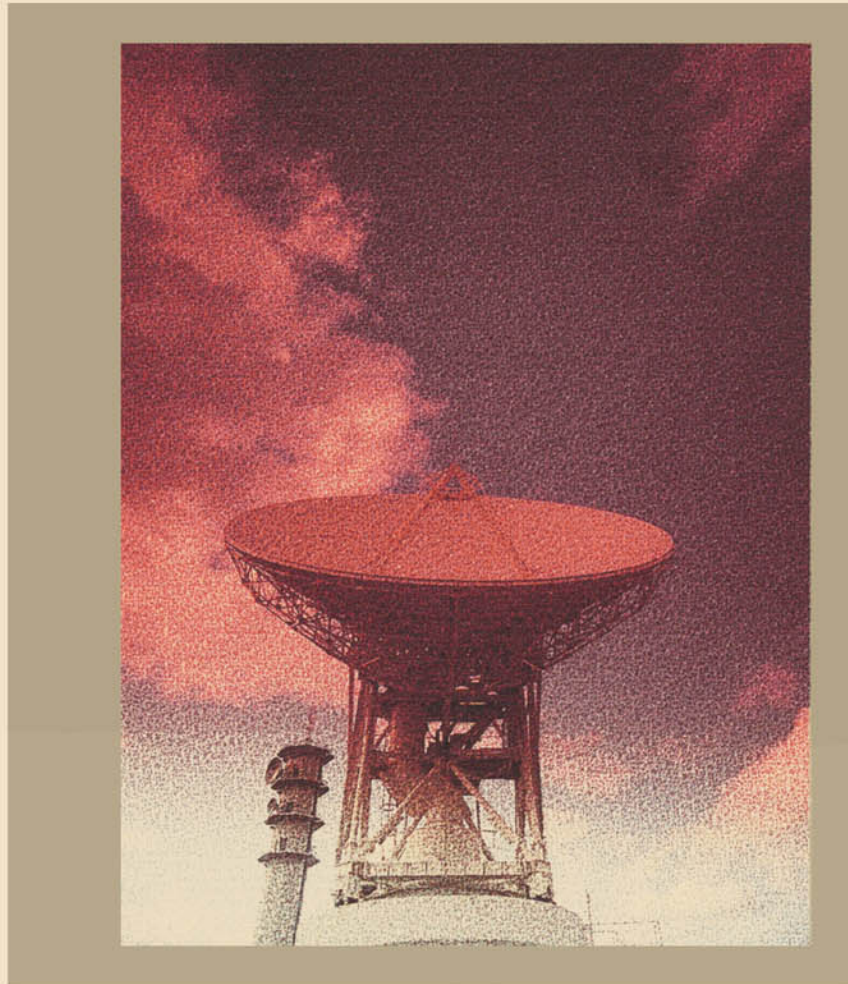
the Spanish economy, 1988 was a year in which Telefónica stepped up its efforts to deal promptly with the domestic demands for telecommunications services. This was reflected in the substantial growth in capital expenditure (both in service expansion and up-dating and in technological enhancements), as well as in the widespread diversification of services supply, the increase in the size and professional expertise of the workforce and in the intense application of the company's resources. As regards provision of services, 1988 witnessed a continuing surge in demand for both conventional and advanced services. Also, from a financial point of view, in a year when service tariffs remained stable, the profits obtained confirm the steady consolidation of Telefónica's sound financial position.

The trends in demand for telecommunications services, especially in the business sector, combined with the healthy prospects for market growth, in a country whose economy is expanding at a faster rate than that of its neighbours, made 1988 the start of a new era for the Company, in response to the current situation within the sector. In this respect, 1988 was a year of inflexion, paving the way towards a new period of capital expenditure, more efficient provision of services, network modernization and deeper penetration of telecommunications throughout Spain. As such, the past year can be considered the start of a new phase during which we aim to narrow the gap separating Spain from other countries in the telecommunications field.

Within this context, it is possible to assess the past financial year. Two of the most notable features were the 19.5% annual rise in demand for lines and the 8.6% increase in average usage per line. In comparative terms, these figures represent exceptionally high levels. In 1988 there were 1,356,364 line applications, that is over 220,000 more than in 1987, when there was also a very high growth in demand of 18%.

Similarly, the 8.6% increase in traffic per line exceeded the figure of 8.2% recorded in 1987.

If we look at the trends over a longer period, we can clearly appreciate the energetic



growth in demand for services during 1988. There were over 582,000 more applications for lines in 1988 than the average for the 1982-1986 period. At the same time, growth in usage per line exceeded by 5.7 points the average 2.9 point increase for 1982-1986.

To deal with this exceptional boost in demand, Telefónica speeded up the pace of line installations, at the same time as taking steps to modernize the network and extend the range of services. Capital expenditure in fixed assets rose by 37.5% over the previous year to reach the figure of 357,815 million pesetas. This enabled us to install 969,998 lines, which represented an increase of 61.4% over 1987. 68.5% of these new lines used digital technology, which will go towards enhancing network capacity to carry advanced telecommunications services.

At the end of the year, the telephone network had 10,971,600 local lines in service, that is 7.2% more than in 1987. 1988 represented the high point in Telefónica automation of the domestic telephone service, with the replacement of the 16,000 manually operated local lines still in service at the start of the year.

On the financial front, 1988 witnessed a continuation of the upward trends set in previous years. Profit before tax was over 84,000 million pesetas and net income rose by 18% over 1987 to 62,845 million pesetas.

Funds generated from operations grew by 13.3% to 304,537 million pesetas. Earnings per share rose by 10% during 1988 to 70.62 pesetas, while gross cash flow per share stood at 342.2 pesetas, showing an increase of 5.7% over 1987.

Finally, the trends in the balance sheet ratios reflected the continuing rationalisation process undertaken by Telefónica during the last few years. Consequently, the 1988 financial profits enable us to confidently embark upon the scheduled capital expenditure programmes in order to meet the growing demand for services and obtain a satisfactory return on the funds invested.