



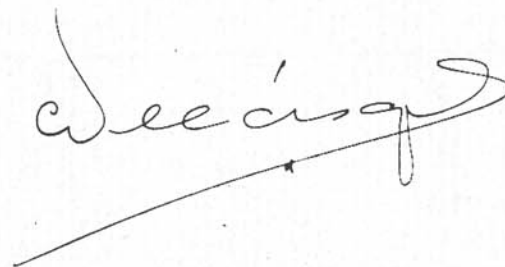
L E T T E R

Dear Shareholder,

The inevitable liberalization process in the telecommunications sector has presented us with major challenges on several fronts. Among these are the modernization and extension of the Network, the improvement of service quality and response to demand both for traditional and new services. Within this context, our company can be proud that it has once again proved its capacity to respond to Spain's needs and demands. It is not my intention here to glibly sing the praises of the company, rather to convey the results of a rigorous and constant assessment of what for us is most important, our clients' satisfaction. Sooner or later, and I trust sooner, our efforts will receive public recognition.

## TO SHAREHOLDERS

In this new competitive environment, and without neglecting our basic responsibility as the provider of a public service, Telefónica has begun to emphasize clients' needs as the principle underpinning its activity. We are now entering a decade which will bring far-reaching changes both in telecommunications themselves and in service provision methods. We must, therefore, adapt our attitudes and working procedures so that our present and future clients regard our company as the best option when choosing a telecommunications services supplier. From now on, Telefónica's continuing progress can only be guaranteed by ensuring a favourable verdict on the part of our customers.



Cándido Velázquez-Gaztelu Ruiz

**Chairman of the Board of Telefónica de España**

1990 saw the consolidation of the major investment drive of the previous year. Capital expenditure in fixed assets and advances for plant reached 703,697 million pesetas, 20.5% more than in 1989. However, if a comparison is made with 1988's investment figures, the annual rate of growth rose to 40.2%. In 1990 Telefónica's capital expenditure programme was again much higher than that of telecommunications operators in neighbouring countries.

## C ONTINUING INVESTMENT DRIVE

Telefónica's importance to the Spanish economy becomes apparent when we consider that this investment accounts for 5.5% of the country's gross capital formation.

This intense activity resulted in a record number of line installations and a considerable improvement in service quality. We were also able to considerably reduce the waiting list and step up plant modernization, and thus widen the range of telecommunication services available to the Spanish public.

1,565,000 lines were installed during 1990, bringing the total number of lines installed at the end of the year to 14,485,150, with 28.4% digitization, compared with 19.6% in 1989.

1990 also saw a fall in the demand for new lines over 1989, and a slowing down of the growth rate of average usage per line.

By the end of the year, telephone service penetration in Spain stood at 31.9 lines per 100 inhabitants as opposed to 300 lines per 100 inhabitants at the end of 1989. The basic telephone network had 12,602,640 local lines in service by the end of 1990, witnessing a growth of 6.8% compared with existing plant at the end of 1989.

During 1990, 1,137,367 demands for telephone lines were met, a 4.9% rise over the year before. The waiting list fell steeply to 379,892 applications at the end of December 1990, a 24.5% fall over the previous year's figure, with the ratio waiting list/line applications reaching an all-time low. During the year Telefónica devoted special attention to extending the telephone service in rural areas, to the benefit of 308,025 rural inhabitants. As a result, by the end of December 1989, 98.5% of Spain's population had access to the telephone service.

By keeping up this intense investment drive Telefónica was able to improve its range of business communications and new services. The number of connections to the Iberpac public data network grew by 15.9%, and the Automatic Mobile Telephone Service, besides increasing subscriber numbers by 83.6%, widened the range of products on offer with the introduction of the 900 Mhz (TMA-900A) waveband mobile system. Telefax recorded a 50% increase in subscriber numbers, while in the Electronic Transfer of Funds service the number of terminals connected rose by 25.8%. The Videoconferencing