



The culmination of our endeavours

Telefónica's activity throughout 1992 has undoubtedly been determined by its decisive participation in the events which took place in Spain during the year, namely the World Expo in Seville, the Olympic Games in Barcelona and the role of Madrid as European Cultural Capital. However, given the efforts of the past months, both in investment and in the whole-hearted dedication of the workforce, we should make special mention of an exceptional achievement: over 3,500 million people throughout the world were able to watch a live transmission of impeccable quality of the entire Olympic spectacle.



Telefónica Tower on the Montjuïc Olympic Site

This was acknowledged by the major international radio and television operators, who enjoyed the use of the state-of-the-art technology put at their disposal by Telefónica, to transmit simultaneously thousands of images to the furthest corners of the planet, beating all the records registered up to now for an event of this nature.

Telefónica is proud to have been able to offer such a valuable contribution to enhancing the international reputation of our

country, by fulfilling, in this exemplary way, its public service duty. We are also proud to have been able to show off our high technological standards by applying the latest telecommunications resources and techniques, proving once again our capacity to provide Spain with the most advanced services. As we already highlighted in the 1991 Annual Report, Telefónica offered a foretaste of this capacity on the occasion of the Middle East Peace Conference held in Madrid in the autumn of 1991. The Company contributed to the successful staging of this event by providing the



Cartuja | Digital Exchange, EXPO '92

participants and world media with all the necessary circuits, equivalent to 60,000 telephone lines, with less than one week's notice.

Meeting demand

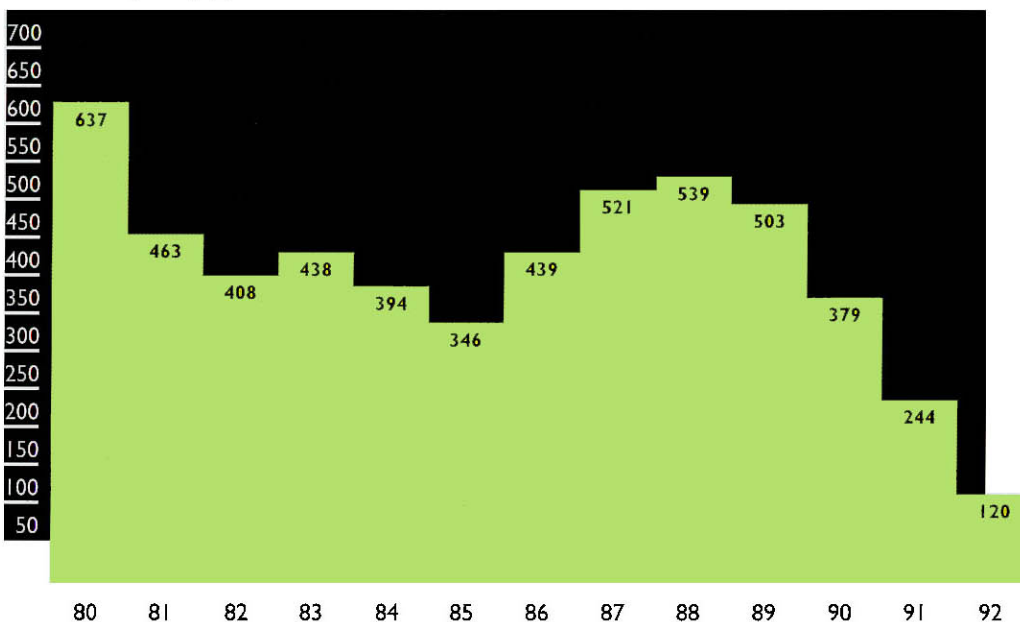
None of these achievements are due to chance or improvisation but are rather the result of a deliberate policy steadily put into practice to furnish Telefónica with the capacity to provide bigger and better

telecommunications services. Sufficient emphasis has been placed on the enhancement of the Basic Telephone Network, a public service for which Telefónica is the sole provider. Between 1989 and 1992 we installed almost 5 million new telephone lines, increasing both supply and network modernization, achieving digitization levels in local exchanges of 36.4%, density levels of 35.3 lines per 100 inhabitants (as opposed to 28.3 in 1988) and of 80 residential lines per 100 households, with a total of 13,792,156 lines in service and 15,475,000 marketable lines installed. Furthermore, whereas in 1988 there was a waiting list of over 500,000, by 1992 year-end the figure was down to only 120,000, of which 46,000 were already being attended to. In 1993 we anticipate being able to meet all requests for new telephone lines in any of the established local zones in less than 20 days.

Once the waiting list has been reduced to practically nothing, it becomes evident that the differences in telephone service density levels between Spain and other advanced European Community countries are to a large degree determined by the basic differences

Waiting list

Thousands of pending applications

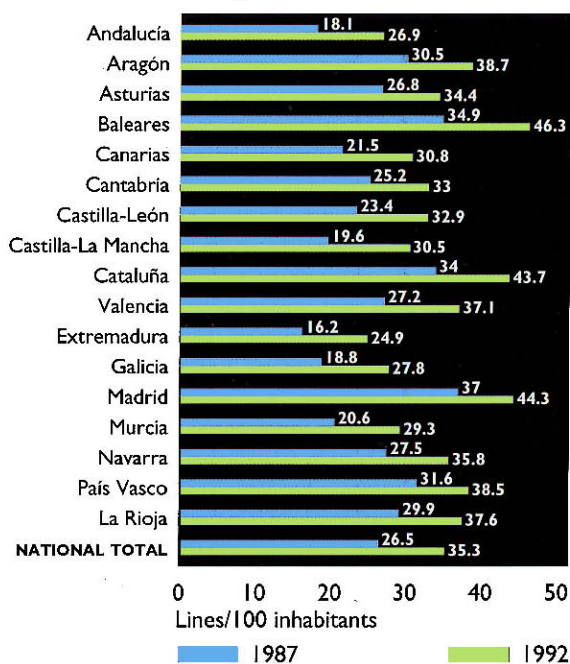


in respective income levels. In fact regions such as the Balearic Islands, Catalonia and Madrid, with density levels of around 45 lines per 100 inhabitants, are within the European average, while areas such as Andalucía, Extremadura, Galicia and Murcia record levels of fewer than 30 lines per 100 inhabitants. This is also partially explained by the differences existing in income levels per inhabitant of the respective Autonomous Regions.

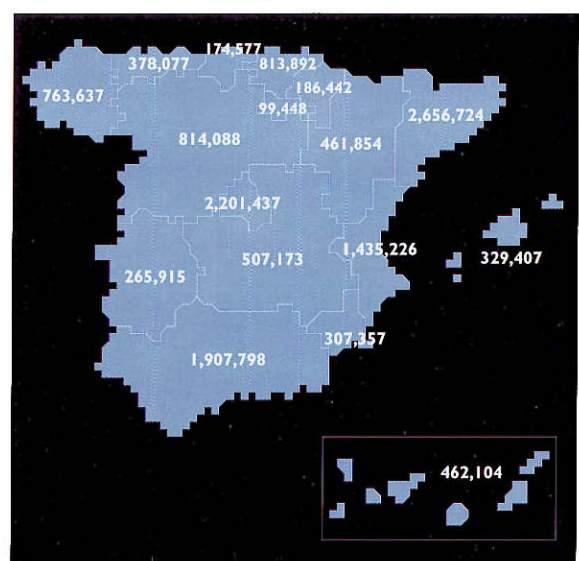
Service extension

We should also highlight the steps undertaken to expand the service to the less developed areas of the country, thereby meeting our obligations, despite the lower profitability of these lines. Density levels recorded in these areas at 1992 year-end represented a growth, compared to four years ago, which was more than proportional to national growth levels. These efforts will continue over the next few years. Already in 1992 we began to introduce radio technology ("cellular access"), installing over 7,000 telephones to

Basic Telephone service density in autonomous regions



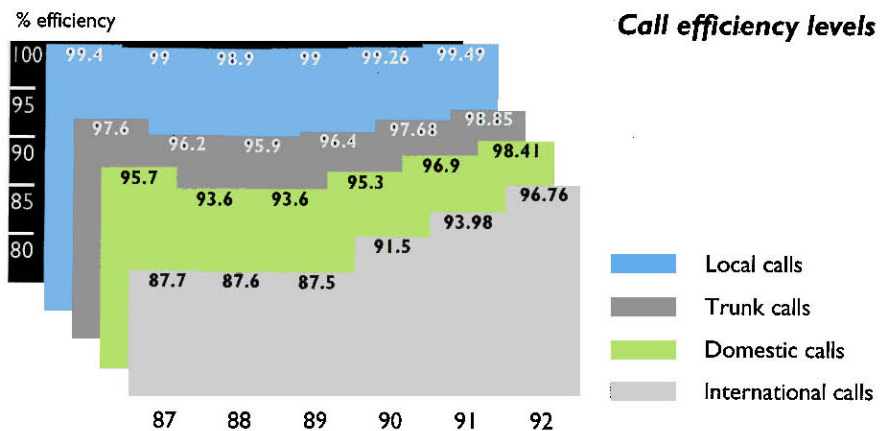
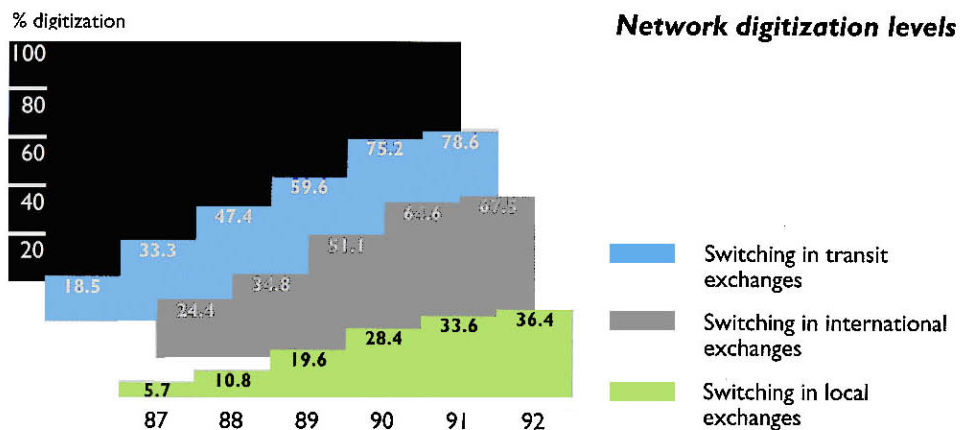
Basic Telephone lines in service per autonomous region at 31.12.92



meet demand in areas of scattered population and low population density. By 1996 we aim to be providing a telephone service under identical conditions to all Spanish citizens regardless of where they reside.

Quality up-grading

There has also been a substantial enhancement of service quality over the last four years. At 1992 year-end the percentage of failed calls due to network performance had fallen to the lowest levels ever recorded, especially in international calls, where figures were well within the target established in the National Telecommunications Plan for the year 1994. Without doubt, the reason for this improvement in network quality, which is now on a par with that of the major world operators, lies firstly in the increased digitization levels, with the



commissioning of new digital exchanges or the modernization of the analog plant, and secondly in the widespread installation of fibre optic systems, the upgrading of signalling systems and the increased efficiency of traffic flow management. In fact the most outstanding improvements were seen in the domestic transit network, which went from extremely low digitization levels to the prospect of total digitization by 1994. Incorporated into the network from 1992 is the new Synchronous Digital Hierarchy equipment and the network is now ready to carry additional increases in traffic and to manage them more efficiently.

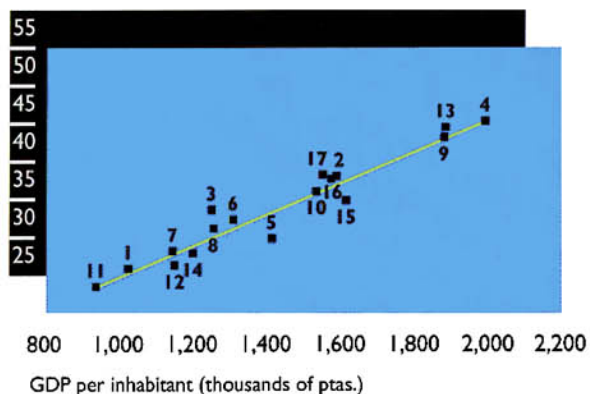
New advanced services

Another of the notable features of the last five years has been the major development in new services. Some of these, such as the packet switching data transmission service (IBERPAC) had already achieved high levels of implantation, while others, such as the advanced voice and data services (IBERCOM) and mobile telephony were still in the early stages. At the time, Telefónica was a pioneer in introducing packet switching into the public network, applying TESYS technology developed in our own research laboratories. The new generations of this equipment and the configuration of a new

Density-GDP per inhabitant 1991

Basic telephone service market

Lines/100 inhabitants



- 1 Andalucía
- 2 Aragón
- 3 Asturias
- 4 Baleares
- 5 Canarias
- 6 Cantabria
- 7 Castilla-La Mancha
- 8 Castilla-León
- 9 Cataluña
- 10 Comunidad Valenciana
- 11 Extremadura
- 12 Galicia
- 13 Madrid
- 14 Murcia
- 15 Navarra
- 16 País Vasco
- 17 La Rioja

advanced network will enable us to meet the challenge presented by the liberalization of the data transmission market. In 1992 the IBERCOM service witnessed important developments. By the end of the year there were around 500,000 extensions installed in the central offices of our major corporate and institutional clients. The advanced features of the service anticipate those due to be incorporated, in the near future, into the Integrated Services Digital Network (ISDN), whose introduction into the Basic Network began last year. In addition, the Automatic Mobile Telephony service reached a figure of 180,000 users. This relatively new service goes from strength to strength and has great potential for future development. Given the limitation of the 450 Mhz radioelectric spectrum, this development has been possible thanks to the implantation in 1990 of a new 900 Mhz. network, with coverage reaching most cities and communication routes. A new addition soon to be introduced is a digital network (GSM) in line with EEC standards. Finally, 1992 witnessed the appearance of the new Intelligent Network services (prefix 90X), which already enjoy a high profile in other developed countries, due to both the type of additional facilities they allow and because they offer the necessary support for the development of a host of liberalized, value added services, distributors of all kinds of information.

Financial performance

Despite the massive investment program, which has enabled Telefónica to simultaneously meet the demand for services, modernize the plant and develop new services, we have also tackled the problem of the staff pension fund. The old "Telefónica Institution Fund", whose medium and long-term solvency was under question, has been replaced by a Pension Fund with the capacity to reasonably meet the needs of our active workforce and of our pensioners through additional payments on top of the Social Security contribution. As

we anticipated, this has led to an increase in the Company's borrowing level, which has, nevertheless, already reached its peak and which it will be possible to reduce in the immediate future. Many other financial ratios, such as the improvement in the ratio of gross sales to total assets, the maintenance of the operating margins, the reduction in the ratio of financial expenses to operating revenue, the improvement in self-financing of capital expenditure (which in 1992 exceeded 95% for the first time in the Company's history) and the increase in cash flow, emphasize the significant enhancement of our financial position. Apart from growth, this healthy position is also evident from improvement in profit quality, with an increase in amortization rates and a reduction in internal

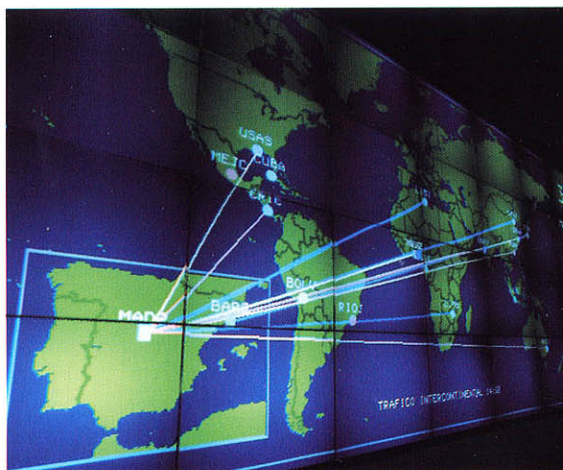
Telefónica Head Office, Madrid



expenditure capitalized in fixed assets. As a result, after many years, we were finally able to increase the shareholder dividend. All these circumstances have logically been duly appreciated by the major international Stock Markets, on all of which Telefónica's shares are listed, reflecting a 50% share revaluation during the last three years.

International projection

One of the determining features of the development of the telecommunications sector is, without doubt, the trend towards increasing liberalization of services, subject to the norms established in the European Community Directives. The liberalization of telecommunications in Spain began at the end of 1987, with the passing of the Telecommunications Act, which was modified in December 1992. This legal instrument, together with the 1991-2002 National Telecommunications Plan and the Contract between Telefónica and the Spanish State, renewed at 1991 year-end, mark out a new, more competitive environment, within which the Company must develop in the immediate future. Apart from terminals and value added services, certain mobile services, such as the radiomessage service and closed group radiotelephony are now also liberalized. Circuit leasing and data transmission services will be liberalized from January 1, 1993 and cellular telephony from 1994. Given the



Dynamic network management guarantees service quality.

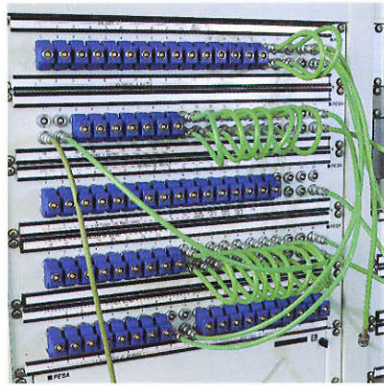


The Iberpac network is among Europe's most advanced

growing trend away from monopolies, telephone services themselves may well be affected. These same trends, commencing with the privatization of state companies or agencies, have also occurred in other countries and Telefónica has taken full advantage of the opportunities which have sprung up for international expansion, especially into the Latin American market. This policy has enhanced our competitive position in the world markets and, in a very short time, turned us into Spain's leading multinational company and the first foreign operator with direct access to the US market.

A company to compete with

The fresh challenges arising from liberalization have also obliged us to restructure our organization and transform a monopolistic corporate culture. The company has evolved towards a new operating framework which is far more focussed on meeting customers needs within a competitive environment. In this respect, the organization has been gradually modified, from a typically functional scheme towards a configuration in well defined areas of business and corporate support. All this, together with the striving to improve management and decision-making processes, have given rise to increased internal efficiency and service quality. Systems such as SIADÉ, which offers computerized back-up to decision-making have been introduced and



developed, along with sophisticated planning assistance models such as MISTELA, which can simulate in real time all the company's activity. Steady progress has also been made both in computer support systems to the different business activities, such as Cost Accounting, which enable us to know more precisely the cost and margins of the different networks and services. An ambitious plan is also underway to renew the company's information systems applying the latest technological platforms. In addition a new Total Quality management system has been introduced aimed at achieving the ambitious targets established in the Company's Strategic Plans and at providing the support for the necessary change in corporate culture.

We can never consider that we have completed these tasks, since, in a dynamic sector like ours, new business opportunities are constantly arising along with new and unexpected threats which need to be warded off. However, Telefónica has proved over the last five years that it is capable of facing the greatest challenges, even under relatively hostile circumstances. In our constant striving for excellency, we hope, in this new liberalized era, to remain true to the Mission we have set ourselves, which is none other than TO BE THE FIRST CHOICE OF PRESENT AND FUTURE CLIENTS AS A TELECOMMUNICATIONS SERVICES SUPPLIER.