

## Letter to Shareholders

Dear Shareholder,

**D**URING THESE INITIAL MONTHS AS Chairman of Telefónica, I consider myself a privileged participant in the final stages of a long and productive period, during which we served the public under the aegis of the Spanish State. We now open a promising new era, in which Telefónica will continue to guarantee service to Spain and to its customers within a liberalized market and a highly competitive environment.

The Public Offering of the balance of State's participation was highly successful. Telefónica now ranks among the European companies with the largest number of shareholders, with roughly one in every eight Spanish families holding our shares. In this way, we have not only strengthened our shareholder base, but also given many Spaniards a heightened sense of personal commitment to the development of the economy.

Telefónica, Spain's leading multinational company, must be managed with the same high standards set by the largest and most successful corporations worldwide. To this end, our Board of Directors has passed a set of internal rules governing the Board's function. The Board has also welcomed new independent Directors, who do not form part of our management structure, in a measure designed to foster greater transparency, impartiality and professionalism in the Board's dealings, and to guarantee that the interests of all Telefónica shareholders are adequately defended.

I should also point out that the new internal governance rulings provide for the creation of supervisory commissions for Audit and Control, Personnel and Remuneration, and International Strategy functions. In this way, Board Members assume an active role in the management and control of the Company.



When you, the Shareholders, approve the new Board of Directors at the General Shareholders' Meeting, you will be acknowledging the professional credentials and prestige of these new independent Members. They will sit on the Board with Directors representing the majority shareholders and with Telefónica executives who so ably support me in the day-to-day management of the Company.

These measures aim at contributing to increased value for the shareholders in a fully-privatized Telefónica. Value will be generated by increased share price and dividend yield while offering a stable and reliable investment.

We can only reach this goal by offering our customers top-quality service, a commitment to be made by everyone who works at Telefónica.

With a customer base exceeding 23 million, Telefónica holds a position of unrivalled leadership in Spanish-speaking markets. During 1996, Telefónica reported a net profit of 160,282 million pesetas, representing a 20.3 % gain over the previous year. In parallel, our share price showed a positive upward swing and was quoted at 3,365 pesetas on February 18, the day after final privatization of the Company. This figure represented a 370-peseta increase over the price at the close of trading on December 20, date of the Government's formal announcement of the Public Offering.

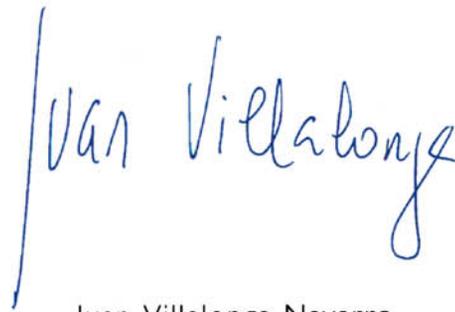
We intend to make Telefónica become increasingly global, competitive, efficient and profitable, thus ensuring enhanced profits for our shareholders.

Our strategic objective, "*Telefónica, a global operator*", sets forth very positively our determination vis-à-vis a newly competitive telecommunications environment. As undisputed leader of Spanish-speaking markets, Telefónica is solidly positioned to face the challenge posed by the progressive liberalization of the telecommunications sector. We view the creation of regulatory authorities as a positive move to ensure a fair and equitable competitive environment which safeguards consumer interests. Our ability to compete has been put

to the test and we are convinced of our ability to meet client needs in a broader marketplace.

This new dynamism is fully compatible with our tradition of public service, a vocation which has strong roots in Telefónica's corporate culture. It takes the form of constant attention to client needs and demands, and our contribution to the economic development and technological advance of our country.

Finally, in this first appearance as Chairman before the General Shareholders Meeting, I do want to extend a warm welcome to all of our shareholders, both those of long-standing and those who are joining to us now for the first time. You may rest assured that together we shall reach the objective of consolidating Telefónica's unrivalled leadership in Spanish-speaking markets , while bringing the Company to the first rank of worldwide telecommunications operators.

A handwritten signature in blue ink that reads "Juan Villalonga Navarro". The signature is written in a cursive style with a large, sweeping initial "J".

Juan Villalonga Navarro  
CHAIRMAN AND CEO OF TELEFÓNICA

