

## *TRADITIONAL BUSINESS LINES*

The traditional line of business for a telecommunications operator such as **Telefónica** is that of basic telephony, which continues to be of vital importance in the profit and loss accounts. Due to the tariff rebalancing introduced, this business segment continues to more than hold its own in the face of the imminent opening up to competition. This is clearly reflected by those markets already open to competition (data transmission and mobile telephony, for instance), in which **Telefónica** holds a position of leadership. Throughout 1997 a great effort has been made to increase the Company's flexibility, through its market focusing, the reining in of costs, a greater degree of competitiveness, and an enhanced capacity to offer its customers global solutions at the right price and with a heightened degree of efficiency.



### **The Residential Market**

The strategies applied in the Spanish and Latin American markets differ due to the difference in the maturity of these markets. The prime objective in Latin America is that of enhancing market penetration, as this is an area that still offers considerable development opportunities which will enable the expansion of its customer base. In Spain, where almost the whole population is provided service coverage, **Telefónica** focuses on increasing average usage per line, through the introduction of new services and the promoting of second lines.

**Telefónica** is answerable to an overall figure of more than 20 million residential customers, small businesses and business people. Of this figure, more than 12.5 million reside in Spain, where, in 1997, traffic volume grew by around 5.5% to reach 10.1 minutes per line per day. This increase was a result of the introduction of new supplementary services, the 72% growth in the number of calls made from the fixed network to mobile telephones, the significant 360% increase in incoming **InfoVia** traffic, and the tariff cuts introduced.

**The tariff rebalancing  
in our basic telephony business  
allows us to guarantee our success  
in the liberalized marketplace**



The Telefónica Group addresses the needs of more than 20 million residential customers, small businesses and business people

The strategies for Spain

The strategies applied in the market aimed at the **Retail Customer** are founded on the constant study and awareness of the needs of our customers, in order to offer made-to-measure solutions to their requirements. Proof of this is the recently introduced complete customer-care service which further enhances the 24-hour technical assistance provided, at the same time as advising our customers on how to benefit from our services.

One particular feature of this strategy is the new basic service concept of a "new telephone line" which offers additional applications, most of them included in the monthly subscription charge, such as the **Network Answerphone** service which is now used by more than half our customers.

The introduction of these supplementary services, which also include **Call-Waiting** and **Call-Rerouting**, has resulted in 500% growth compared with 1996, with more than 6.5 million customers now taking advantage of some of these services. Throughout 1997, measures were taken to offer a complementary line of services based on the identification of the caller which has opened up a whole new range of possibilities.



Tariff cuts were also introduced in Spain with a view to promoting traffic. Interprovincial call prices went down twice over the year: the first price cut taking place in April which reduced the tariff by an average 5%, only to be followed by another 5% cut in July. International call prices went down an average 8.8% and several basic telephony charges were also reduced, such as change of residence, temporary suspension of service, etc. Regarding second lines, our marketing campaign based on a 43% cut in the subscription charge, resulted in the installation of 315,000 second lines.



Not only was the residential market given additional services and tariff cuts, it was also offered specific packages which further increase the appeal of the basic service. With the suggestions and needs of our customers once again in mind, September witnessed the launching of the **Personal Plans** (provincial, interprovincial and international) which enable greater usage of the telephone service under extremely competitive conditions. These made-to-measure products have been very well received by our customers.

At the beginning of 1998, **Telefónica** launched its “**Clear Plans**” package, which combines a number of products and services related with the new telephone line which includes all the digital services available, along with the new integral maintenance service, etc..., as well as **Discount Plans** for the elderly, young people, families, international calls and housing communities which is just a taste of the things to come throughout the year.

1997 has seen the implantation of the technical developments necessary to introduce the **New Numbering Plan**, which will be launched in Spain on April 4th of this year, and which will increase the number of digits in each telephone number to 9. This will offer the market important development possibilities as it will greatly increase the capacity to assign numbers and in turn heighten the diversity of the services on offer.

Work on the network has been completed by which all the lines can receive **Itemized Billing**, therefore achieving the much strived for objective of increasing the clarity of this information, which has also been improved by the introduction of new applications which permit such things as being able to find out the consumption registered in real time since the previous bill.

### **The new commercial policy**

The area **Retail Clients** has launched a new customer-care programme aimed at offering our customers the highest degree of efficiency possible. Throughout 1997, contact with our customers grew considerably, resulting in a 30% increase in the number of commercial operations carried out.

### **This new programme is based on the following:**

- ♦ The customer-care line 004, which offers direct attention, by telephone, using which the customer can purchase or subscribe to a diverse range of products and services, inquire about these same products and services, place complaints and register line faults, 24-hours a day, 365-days a year. 1997 doubled the number of calls received by this service in 1996.
- ♦ The **Tiendas Telefónica** (Telefonica Shops) are where our customers are made aware of and can try out the whole range of services and products **Telefónica** offers. In 1997, 94 shops were opened and this service will continue to expand in 1998. **Telefónica** services and products are also sold in many of Spain's principal department stores.

**Our made-to-measure solutions  
to our customers' needs make  
for the competitive usage  
of the service**



The complete and personalized  
attention offered to our customers  
is the key to gaining  
their loyalty



- ◆ **Telefónica's Virtual Store**, which can be accessed through **InfoVía** and Internet to make inquiries or subscribe to the services and products offered by **Telefónica**.

- ◆ **Catalogue Sales**, using which the customer, who has previously received our catalogue, can acquire or subscribe to any of the products or services on offer by simply making a free-phone call to the customer-care service, and these will be delivered at no extra charge.

1997 witnessed not only the launching of the **Customer-Care Centres** and **Technical Assistance** service, but also the creation of a new line of specialized after-sale products and services which will appear in the market in the course of 1998 and will allow us to satisfy the specific demands of certain segments of our clientele.

### The Corporate Market

Regarding our corporate clients the commercial strategy is based on the following aspects: the optimizing of the price structure; made-to-measure solutions; single, global and itemized billing; the creation of offers aimed at specific segments; complete and personalized customer attention as a key element in the procuring of their loyalty; and, the defining and promoting of integral services based on the solutions offered by **Telefónica** and its technological partners.

### Corporate Clients

1997 saw the **Ibercom Service** expand within the **Corporate Clients** market, through the launching of new services and marketing. **Telefónica** has greatly improved its range of applications through such new services as **Ibercom Leasing**, **Ibercom Master**, the development of **Ibercom ISDN** or the launching of its **Call Center** for queries. Regarding data communications, the **Data&Voz** service, integrating voice and data, has been further improved, and it is now possible to migrate from the **Ibertex** service to **InfoVía**.

In leased circuits the migration from analogue to digital circuits has been promoted, as has the possibility to migrate to higher speed circuits, improving quality and optimizing costs.

Thanks to the consolidation of our **Integral Customer-Care System (SGIC)**, customers have begun to use **Telefónica's** new information highways. Using **InfoVia** and Intranet, which guarantee confidentiality, our customer can place orders, make inquiries and access information about his business from his own home or workplace.

To inform our customers about all the information systems on offer, we have created a **Corporate Customer Care Centre** which, through the dialling of a single access number provides our customers with information on all the commercial and technical contact points.

### **Small and medium-sized companies (PYMES)**

With the small and medium-sized company in mind, specific programmes have been developed to offer this vital segment of the Spanish economy made-to-measure solutions to their needs. The **PYMES Selection Programme**, which includes the principal members of the PYMES segment, offers personalized attention to our customers; its commercial channel, **Canal Indirecto**, has been strengthened, now offering a network of 150 distributors; the **Consultor** programme has been launched, providing advice free of charge to thousands of small and medium-sized Spanish companies in order to improve their competitiveness through telecommunications services; principal hard and software manufacturers also collaborate with **Telefónica** in order to promote and offer advice on the benefits of using information and communication technology.

Regarding the commercial relations with other network operators, Interconnection Services continued to be developed throughout 1997 as a result of the entrance of new mobile telephony operators and an interconnection agreement was also formed with the second fixed telephony operator.

### **International telephone traffic**

The international traffic carried by **Telefónica** during 1997 reflected significant 20% growth compared with the previous year. This growth comes as a consequence of the economic recovery, which began at the close of 1996, combined with the favourable performance of tourism and the cuts in international tariffs.

Throughout the year, discount packages on international traffic continued to be offered, of which two are particularly outstanding; **Masterbono I and II**, in addition



**Thousands of small and medium-sized companies receive advice and information free of charge to assist in the enhancing of their telecommunications service and increase their competitive edge**

In under a year international  
communications tariffs have been  
cut by 20%

to the packages already on offer: **Masterbono Básico Internacional** and **Masterbono Megavip Internacional**.

Regarding the interprovincial discount packages, the trend has been similar to that of international discounts in line with the relevant regulatory framework, with several proposals having been made to the corresponding regulatory authorities.

Continuing the tariff strategy drawn up the previous year, an average 8.8% reduction was introduced on international tariffs on March 15th, 1997, reflecting a global reduction of 20% in less than a year.

#### **Data transmission**

Data transmission services are provided by **Telefónica Transmisión de Datos**, within a sector that has been open to competition since 1995. This company acts as its customers' technological partner offering made-to-measure solutions to their data communication needs. In 1997 **Telefónica Transmisión de Datos** withdrew from Unisource to become totally integrated in the **Telefónica Group**. From now onwards **Telefónica Servicios Avanzados de Información** and **Telefónica VSAT's** commercial strategies will form part of those of **Telefónica Transmisión de Datos**.

The quality of our customer care has improved considerably since the inauguration of the new **National Control Centre (CNC)**, which is responsible for monitoring the network 24-hours a day. The pace of development and launching of new services has been stepped up, and those services with greatest value-added, those that integrate voice and data (**CINCO, DataVoz**) or network interconnection services such as **LAN (InterLan)**, have now gained customer critical mass.

**Telefónica VSAT** has continued to hold its position of leadership in the corporate communications via satellite market. This type of communications was liberalized at the beginning of 1997. The presence of new operators with licences to transmit via satellite has served to spur **Telefónica VSAT** in its aim to achieve global connection capability and to improve its service quality, as this is the only road to success in this highly competitive market.

## Infrastructures

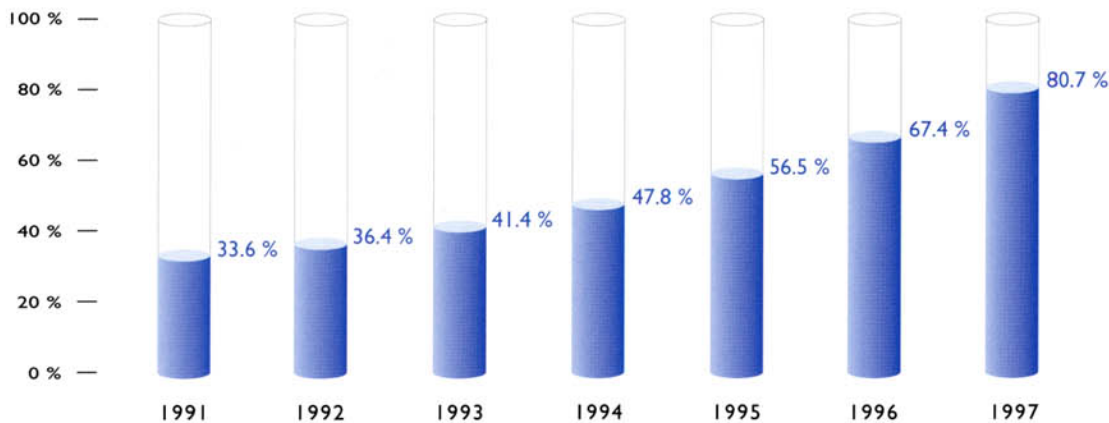
Our infrastructures are undergoing profound changes, on the one hand in order to adapt to the new competitive environment, and on the other, in order to introduce the technical advances necessary to be able to offer new services with the highest degree of quality.

Regarding switching technology, our digital exchanges have been brought up to date to comply with the regulations laid down by the regulatory authorities regarding the **New Numbering Plan** which will introduce 9-digit telephone numbers throughout the whole country and permit the choice of operator.

With regard to the transmission technologies, the first wavelength division multiplexing has been installed which quadruples the carrier capacity of optic fibres, therefore raising the number of telephone channels from 30,000 to 120,000. Proposals are also being considered that would raise this figure to one million telephone channels.

**Latin America will have a fibre optic  
underwater cable network  
with state-of-the-art transmission  
technology**

## Network digitalization



International communications with America have particularly benefited in 1997 from the signing of important international agreements to construct two underwater cable systems, which will begin to operate in the area of the Atlantic Ocean in 1999; these being the **ATLANTIS-2** that will connect Spain and Portugal with Argentina and Brazil, and the **COLUMBUS-3** that will link Spain, Italy and Portugal with the US. These two projects will result in the creation of a ring fibre optic underwater network around the South American continent, provided with state-of-the-art transmission technology and the most advanced maintenance systems, capable of adapting to both traditional and new future developments based on multimedia applications.

1997 witnessed the consolidation of the interconnection structures between **Telefónica de España's** basic telephony network and that of the mobile telephony operators, offering a maximum degree of efficiency and paving the way for the interconnection with Spain's second fixed telephony operator's network.

With an aim to taking maximum advantage of the carrier possibilities offered by such new technologies as ATM and Internet Protocol, at the same time as strengthening **Telefónica's** competitive position in terms of information access services, a new network development model has been designed by **Telefónica**, based on ATM and IP nodes, to provide integrated global and multiservice capabilities.

### The multiservice access networks foresee the introduction of interactive multimedia services on different band widths

It should be underlined that a great effort has been made throughout the year regarding the multiservice access networks, both in terms of technological improvements, and in terms of the designing of network structures, as innumerable new opportunities are opening up as a result of the interactive multimedia services on different band widths. With this in mind, new solutions have been found for the distribution of analog cable TV, along with the necessary elements needed to create a platform for the distribution of digital cable TV and interactive services. Pilot schemes have also been launched to test the possibilities of offering telephony, high-speed data transmission and video-on-demand through the optic fibre networks, along with the testing of advanced solutions for the transmission of high-speed signals (above 2Mbit/s) using the customer's wire loops.

The tests carried out using radio systems should also be mentioned as these fulfill the needs of fixed access, at the same time as offering a greater selection of services and applications.



More than 1,147,000 kilometres of land optic fibre cable has been laid since this technology was first introduced, providing all types of services.

In November the new **National Monitoring and Operating Centre (CNSO)** was inaugurated. This Centre will be responsible for the monitoring, operating and maintenance of all **Telefónica's** networks and services. This same building will also house the main after-sales centres for corporate clients.

Within the systems that will come under the responsibility of the **CNSO**, that of the **Monitoring System for the Signalling Network (SSRS)** will also be included. This system gives information in real time regarding any malfunction in this network, which is commonly known as the **Telefónica** network's "nervous system".

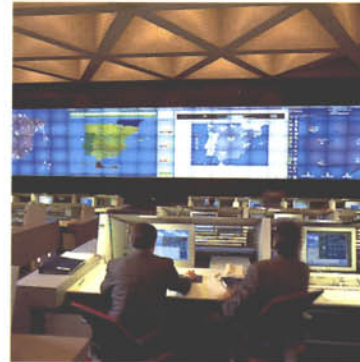
Regarding **Telefónica's** international service, there are four digital exchanges, five centres for satellite communications and 74 earth stations equipped with access to the different satellite systems (Intelsat, Eutelsat, Hispasat, Panamsat etc.); the Company also has 29 underwater cable stations of which 13 are exclusively dedicated to underwater cables, at the same time as participating in 53 underwater cables of which 23 are moored in Spain.

In December the installation of the **ATLAS System** was concluded throughout the whole of the Spanish territory. As a consequence, one single system is capable of providing all kinds of circuits, for both customers and trunks among exchanges, which operates using one central database.

This system centralizes applications and therefore shortens the time needed to provide the service, which naturally strengthens **Telefónica's** competitive edge in terms of leased circuits, which are, at the same time, a vital tool for the the optimizing of the investment in the plant.

Following the policy initiated a few years ago in preparation for the need to compete in new markets, **TEMASA (Telecomunicaciones Marinas)** has continued to invest in tools and equipment such as the submersible **NEREUS**, which is considered to be the most advanced tool of its kind. The acquisition of two more cable-laying ships is also currently underway in order to gain a foothold in the maintenance market covering the South American Pacific, and to increase our competitive edge in the installation marketplace where many possibilities are opening up.

**The new National Monitoring and Operating Centre provides a global views, in real time, of all Telefónica's networks and services**



The R&D strategy  
is market-focused enabling  
us to address the services  
and solutions demanded by today's  
telecommunications

## Research and development

The **Telefónica Group's R&D** strategy is one totally oriented towards the market, so that the **Group** is unfailingly able to offer the necessary telecommunications services and solutions to cover the market's requirements. One example of these services is that of the new version of **InfoVía**, with another being the availability of reliable and sturdy infrastructures that amply cover the demands of both the residential and corporate customer for Internet and on-line services. Yet another example is that of the development of the **Advanced Personal Card** service and also the **One-Stop-Shopping** service for the retail customer.

In 1997 the development of the **Operation and Maintenance Structure** was finalized which was a major contributor to the creation of the **National Monitoring and Operating Centre (CNSO)** and the development of the **Operating System for the Signalling Network** previously mentioned, at the same time as contributing to a new version of the **Traffic Monitoring System**.

Other products have been developed for the **Telefónica Group's** companies, such as the **Customer-Care Centre**, the **Answerphone Service** and the **Centre for the Monitoring** of brief messages belonging to **Telefónica Móviles**, as well as other products for **Telefónica Transmisión de Datos** and **Telefónica Multimedia**.

## Mobile services

1997 has once again been a year of significant growth in the mobile communications marketplace, where **Telefónica** now has over 5 million customers of which 3.2 million derive from the Spanish market and 1.8 from Latin America.

At year-end 1997, **Telefónica Móviles** had 3,187,696 active mobile customers in Spain, of which 2,087,101 subscribe to the **MoviStar** service and 1,100,595 to **MoviLine**. In total these two services have gained the net figure of 842,051 new customers, 36% up on the figure for the previous year, and placing us fourth in the European ranking. Although the most outstanding feature is that **MoviStar** has doubled its customer base, at the same time as doubling its nearest competitor's net customer increase.

The following information should give some idea as to the performance registered by the **Telefónica Móviles Group**:

In 1997 MoviStar doubled  
its customers in Spain as well  
as doubling its nearest competitor's net  
customer increase

TELEFÓNICA MÓVILES GROUP HIGHLIGHTS

	1997	1996	Increase
Operating Revenues (mill. ptas.)	362,938	258,882	40.2 %
Pre-Tax Income (mill. ptas.)	38,982	21,109	84.7 %
Capital Expenditure (mill. ptas.)	100,203	140,997	-28.9 %
Total Assets (mill. ptas.)	400,459	352,744	13.5 %
Carried Calls (mill.)	2,954	1,684	75.4 %
Base Stations	4,968	3,504	41.8 %
Sales Outlets	9,200	6,600	39.4 %
Celular Customers	3,187,696	2,345,645	35.9 %
Mensatel Customers (Paging)	344,689	56,125	514.1 %
RadioRed Customers (Trunking)	17,612	8,906	97.8 %
Basic Telephony with Cellular access	238,626	222,260	7.4 %
Employees	2,377	1,831	29.8 %
Subcontractors	2,274	1,827	24.5 %

Operating revenue has grown by 40.2% to reach Ptas. 363,000 million. Pre-tax income has been even more spectacular having almost doubled the figure for 1996 to total almost Ptas. 39,000 million.

At year-end, the company was responsible for net fixed assets amounting to Ptas. 400,000 million, subsequent to the Ptas. 100,000 million investment made during the course of 1997, placing the accumulated figure invested by **Telefónica** in Spain's mobile service at Ptas. 464,000 million.

The traffic carried by our mobile networks has reached almost 3,000 million calls, reflecting 75% growth compared with 1996.

By and large, these achievements derive from the continuous effort made to satisfy our customers, applying three main principles: **Commitment to Quality, Innovation Capacity and Customer Care.**

**Telefónica Móviles** was the first mobile services operator in Spain to be awarded the AENOR ISO 9001 quality certificate. Since then quality has been a priority, with improvement processes being constantly introduced in all areas and throughout all the Group's companies, as is the case of **MensaTel**, which was awarded the ISO 9002 certificate in 1997.

Quality, innovation and customer care are the keys to our success in mobile telephony



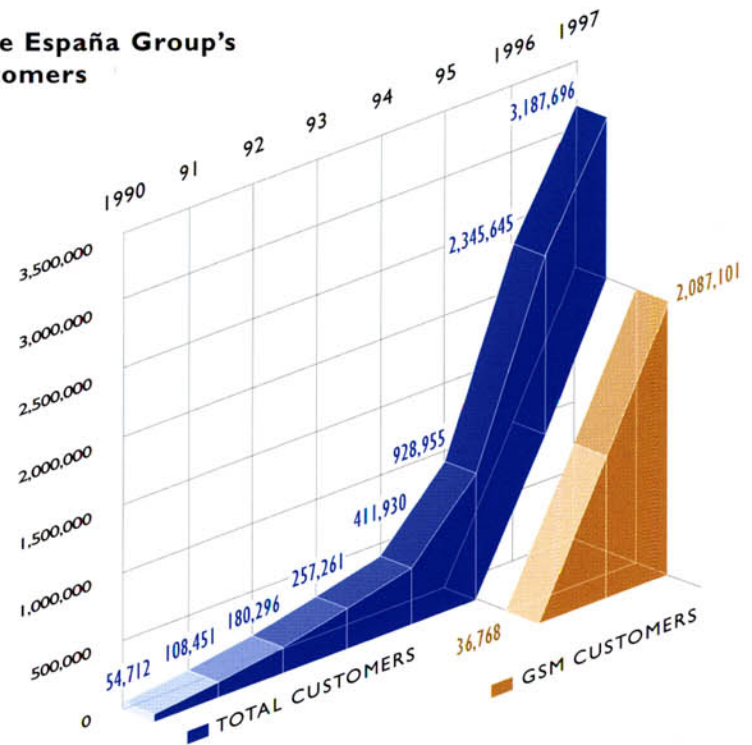
## Telefónica Móviles has the most extensive international roaming for GSM networks

In line with our *Quality Commitment*, and in accordance with the firm belief that our customers measure quality in terms of coverage and the degree of efficiency offered by the network, **Telefónica Móviles** has installed over 1,500 new base stations, raising the total number to 5,000.

Although it is easy to measure the tangible commitments achieved, those that are not so physically obvious should not be forgotten, such as our pioneering of the total coverage of the city of Bilbao's subway system, or the total coverage provided along the whole high-speed (AVE) railway line between Madrid and Seville and also along local train routes around Madrid, as well as improving the coverage inside buildings and underground car parks in major cities.

In terms of international coverage, **Telefónica Móviles** provides the most extensive offer due to its GSM roaming agreements with 106 foreign operators. Its customers can also take advantage of the *Americas Service* which covers 10 countries in the American continent that do not use GSM technology or the *Global Service* that gives

**Telefónica de España Group's cellular customers**



worldwide coverage via satellite or, finally, the **Roaming Service** for **MoviLine** customers that travel abroad.

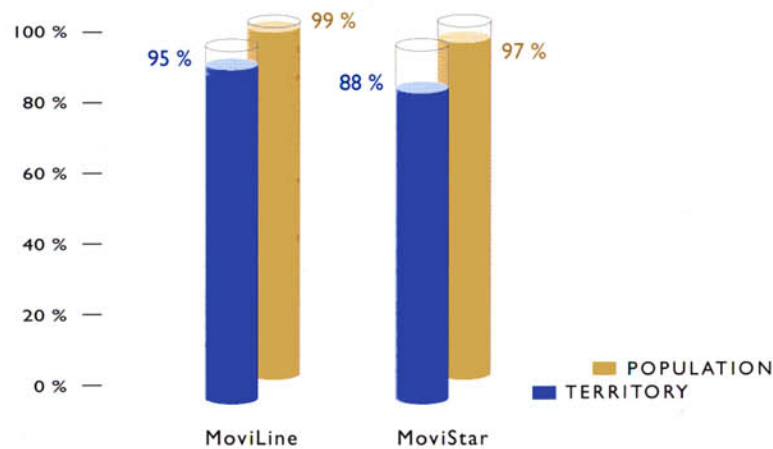
Our **Innovation Capacity** is one of continuous market-focus, which has so far resulted in the launching of almost 100 services and products, of which 39 were presented simultaneously at the state-of-the-art technology fair SIMO 97 held in November, without doubt representing Spain's greatest qualitative leap forward in terms of mobile telephony.

In February the first rechargeable pre-paid telephone card **MoviStar Activa** was launched, to address the clear need for a service that does not require any form of contract or monthly charges. The response to this service has been overwhelming, as by the end of 1997 almost half a million cards were in service. **MensaTel**, the company that operates the radio-paging service, has been the first entity in Spain to offer the **MensaTel Beeper** service which appeals to a high usage segment of the market. MensaTel, who already held the leading position in Spain's radio-paging market, has doubled its market share through the focusing on a new market area, young people. Finally, **RadioRed**, the only provider of **Trunking Services Operating** throughout the whole country, doubled its connections in 1997 thereby raising its market share to over 70%.

**More than 100 new mobile telephony services and products have been developed throughout the year**



**MoviLine and MoviStar coverage at December 1997**





With regard to **Customer Care**, steps have been taken to offer our customers a service that is both personalized and segmented. Our free-phone **Customer-Care service** which is open to our customers 24-hours a day, 365 days of the year, has enhanced its capacity through the opening of a new centre in Barcelona, designed to attend to 50% of all the calls made throughout the country.

**The Telefónica Group manages more than half a million public telephones, of which 300,000 are in Spain**



### **Public Telephony**

The **Telefónica Group** is responsible for half a million public telephones. In Spain alone there are more than 300,000. **CabiTel** is now, without a shadow of a doubt, the leader in Spain's public telephony market. In 1997 over 5,000 new telephones were installed in public thoroughfares, bringing the total figure for this market segment to more than 63,000, all offering modular technology. In Latin America, the plant in service exceeds 175,000 terminals. These figures are complemented by the number of indoor public telephones on private premises which has continued its growth trend. Reference should also be made to the new **Tarjetel** telephone which offers the most advanced solution to telephone communications in hospitals.

Regarding forms of payment, telephones have continued to be adapted to accept the electronic cash-card, over and above the existing facilities for **Telefónica** pre-paid cards and credit cards. The sale of pre-paid cards rose 11.42%, demonstrating the favourable outlook for this form of payment.

### **Advertising and Information**

In the sector dedicated to the production of yellow pages directories and classified advertising, the **Telefónica Group** has published over 30 million copies of **Yellow Pages** and **Directories** in 1997 and is also immersed in the electronic aspect of this market, CD ROM and, above all, Internet.

**Telefónica Publicidad e Información (TPI)** is the company responsible for the development and marketing of directories along with the distribution of information and advertising services in Spain. **TPI** has redesigned its principal product, **Yellow Pages**, gaining, as a result, value added, at the same time as compiling, printing and distributing **Telefónica's** telephone directories. This position confirms the company's leadership

in this sector, with more than 14,400,000 copies of **Yellow Pages** and 6,350,000 of **Directories** published in 1997.

Likewise, over the past year, **TPI** has consolidated its role in the multimedia market, through the launching of **Multimedia Yellow Pages**, the establishing of the subsidiary, **Doubleclick Iberoamérica** responsible for advertising space in Internet, and the agreement signed with Altavista (Internet's principal browser vehicle) in order to offer the same service in Spain.

Not only does **TPI** base its success on the development of its business but also on other business aspects, taking advantage of new technological possibilities, like the development of new products and the international expansion of its operations.



## Telefónica Publicidad e Información is fully immersed in the multimedia environment



