

Telefónica

Annual Report 1998













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SELECTED DATA					
	1994	1995	1996	1997	1998
<b>Lines in service (thousands)</b>	22,683.0	24,247.3	26,477.1	28,429.9	36,143.3
<b>Basic telephony *</b>	14,685.4	15,095.4	15,412.8	15,854.4	16,288.6
<b>IBERCOM *</b>	622.2	651.3	691.3	715.4	762.5
<b>ISDN *</b>	5.4	28.0	96.0	228.5	504.6
<b>In other countries **</b>	7,370.0	8,472.6	10,277.0	11,631.6	18,587.6
<b>Cellular customers</b>	726,242	1,375,519	3,329,398	5,053,404	10,850,364
<b>MoviLine (analog) *</b>	411,930	892,187	1,307,929	1,100,595	893,192
<b>MoviStar (GSM) *</b>	—	36,768	1,037,716	2,087,101	4,001,072
<b>In other countries ***</b>	314,312	446,564	983,753	1,865,708	5,956,100
<b>Cable TV customers</b>	55,861	774,989	1,149,260	1,551,860	2,087,800
<b>In Spain</b>	—	—	—	—	—
<b>In other countries ****</b>	55,861	774,989	1,149,260	1,551,860	2,087,800
<b>Employees *****</b>	103,938	99,203	92,148	92,151	103,662
<b>Operating Revenue (million pesetas)</b>	1,578,850	1,740,557	2,006,058	2,363,102	2,906,021
<b>Debt ratio (%)</b>	49.8	47.9	44.7	47.3	51.0
<b>Capital investment (million pesetas) *****</b>	810,655	663,851	867,197	1,231,326	2,115,414
<b>Cash flow (million pesetas)</b>	644,750	750,357	811,235	961,435	1,084,114
<b>Net income (million pesetas)</b>	112,608	133,214	160,282	190,063	217,584

\* Figures for Spain.

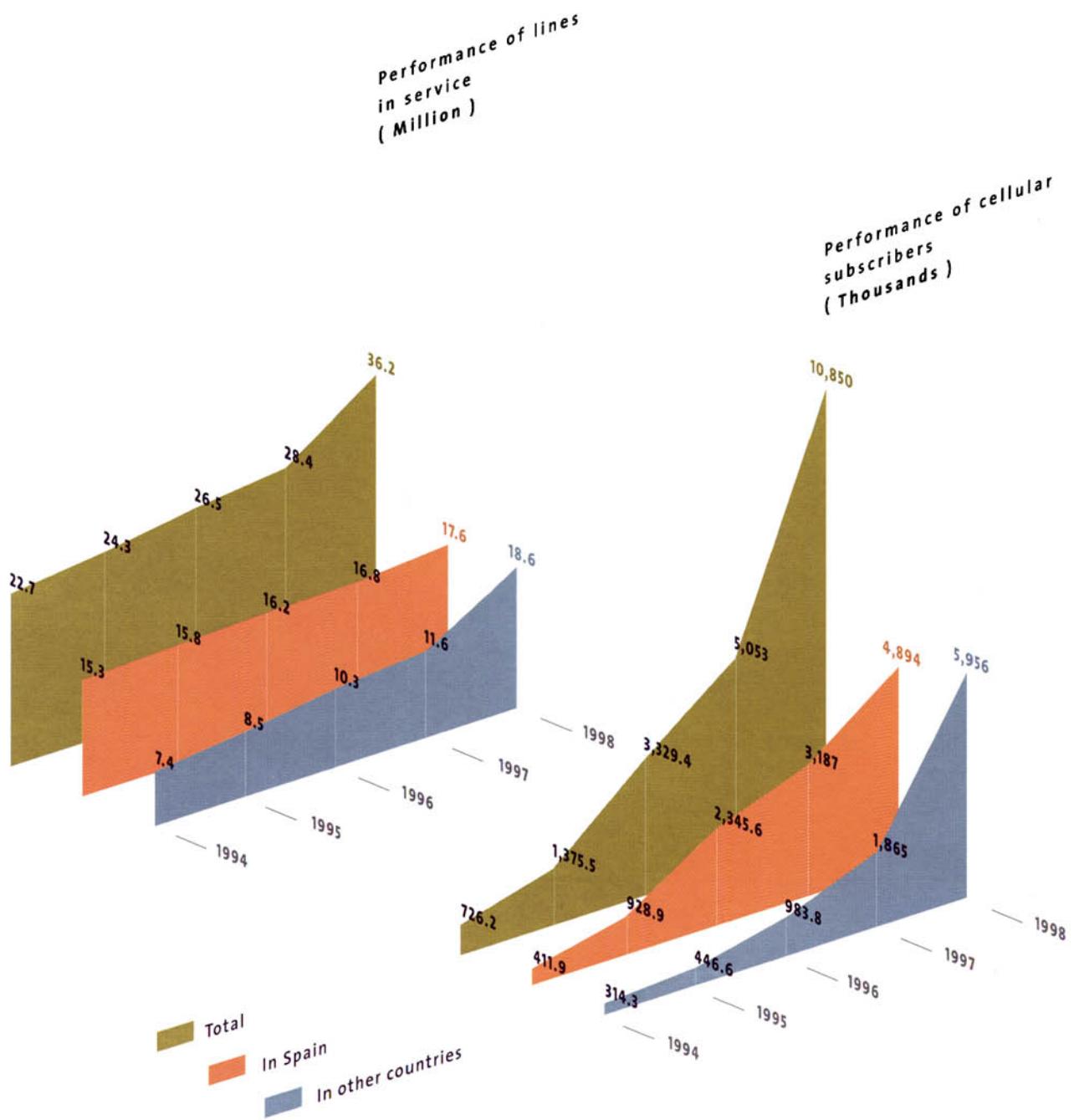
\*\* Lines in service include those of TASA, CTC, Telefónica del Perú, CANTV, CRT and Telesp.

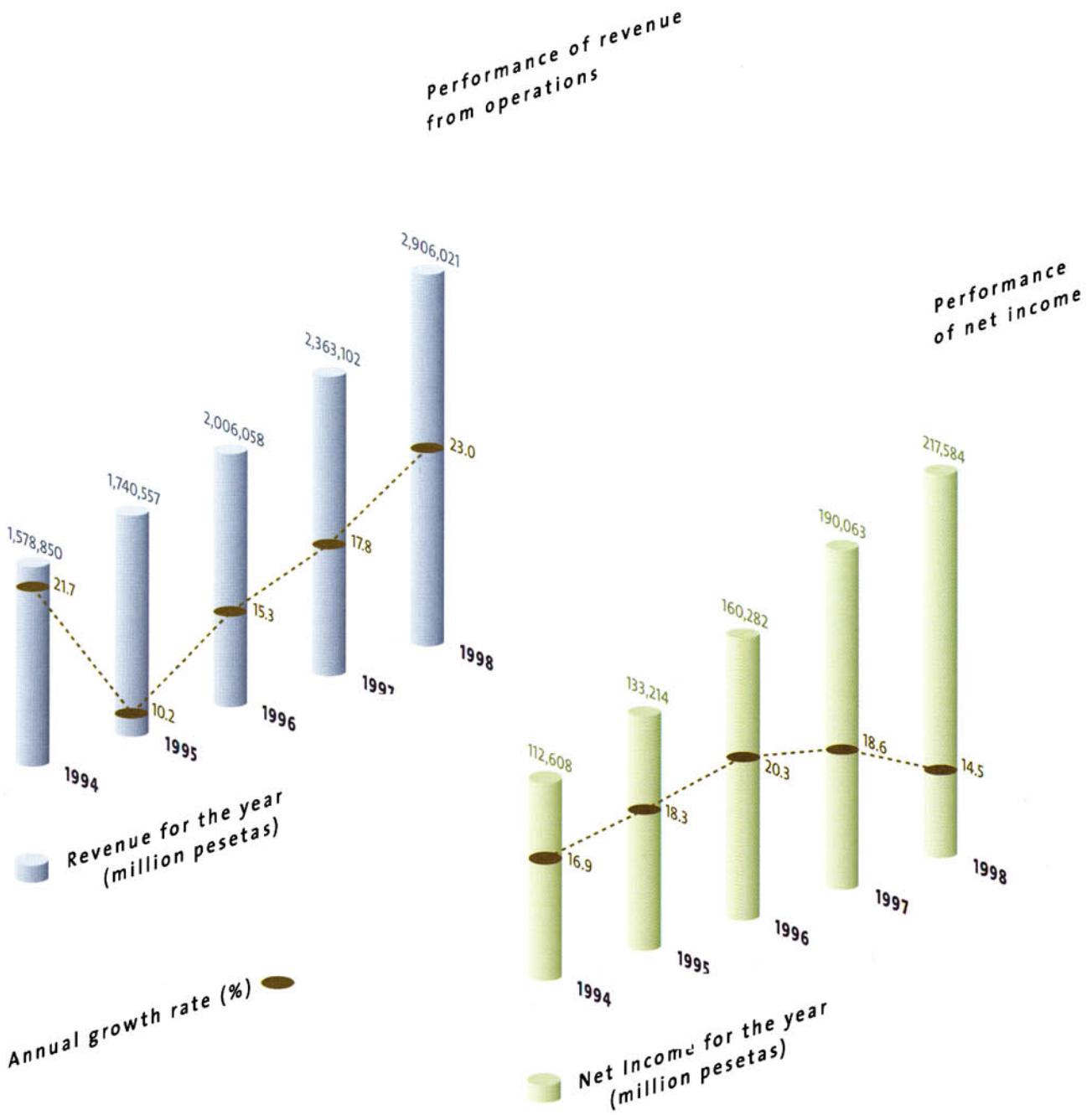
\*\*\* Cellular customers for 1998 include those of TASA, CTC, Telefónica del Perú, CANTV, CRT, Telesp Celular, Telereste and Telefónica de El Salvador.

\*\*\*\* Cable TV customers for 1998 include those of CTC, Telefónica del Perú and Cablevisión Argentina.

\*\*\*\*\* Average number for the year. At year-end 1997 and 1998 the workforce totalled 92,022 and 101,809 employees, respectively.

\*\*\*\*\* Includes tangible, intangible and financial investment.







## Letter to shareholders

Dear shareholder:

**A**S AN OWNER OF **TELEFÓNICA** SHARES, YOU ARE A PARTICIPANT IN ONE OF THE LEADING telecommunications companies of Spain and Latin America, one that has set itself the goal of advancing until it reaches the ranks of the five leading operating companies worldwide. A company that in 1998 went on to manage 49 million customers from a figure of 35 million in 1997, and which has experienced a 14.5% annual growth of net profit following an investment campaign unprecedented in the sector.

In 1998, the value of our company's shares has increased 52 per cent, sustaining a trend of continuously increasing value, which has seen them grow 104 per cent since the conclusion of the privatization process in 1997.

When I addressed you a year ago in these pages, I referred to the progressive liberalization of the telecommunications marketplace, and I expressed the confidence with which we in **Telefónica** were meeting the challenges posed by competition. With 1998 over, we can say that we did well not to fear the opening of the market. In **Telefónica**, we view this process not as a threat, but as a great



opportunity; it is a means to achieve additional growth and enter markets where we had not been present before.

The delay on the part of the Spanish Regulatory Authority in resolving such critical problems as the access deficit, tariff rebalancing and an interconnection pricing policy which sets prices below real costs, has spurred **Telefónica** to improve its efficiency, to diversify its sources of revenue, and to carry out strategic investments in businesses and markets with high growth potential.

The acquisitions made in Brazil have placed **Telefónica** in the position of leading operator

in the largest telecoms market of the region. These investments are part of the company's strategy to maintain as its priority objective the creation of shareholder value. I would like to specifically endorse the company's commitment to leadership in the Spanish- and Portuguese-speaking market; a commitment which will guarantee growth for years to come.

**Telefónica** continues to place a high value on fostering direct links with its customers by offering an increasing number of solutions that bring together telecommunications, Internet and multimedia services.

The company has already become a multinational operator and it therefore needs a single brand for all its services in all geographical and service markets in which it operates. For this reason,

we have adopted the **Telefónica** name as our trademark, in a graphic expression which symbolizes the market changes that have taken place and associates them with the concept of close ties to our customers in all the countries where we operate. Today, one of **Telefónica's** greatest assets is its brand name.

**Telefónica** means growth, and in this context we must place our decision to substitute the distribution of a dividend by a policy of capital increases charged to reserves, a policy which will be continued if the shareholders' meeting approves it.

We started 1998 with a three-fold commitment to our shareholders, our customers and our employees. We now close the year with legitimate pride in having achieved our objectives in a particularly complex environment. We are also aware that success today is no guarantee for the future, and this conviction is enormously stimulating for us.

Ours is undoubtedly the most dynamic sector in the world and one of the most affected by two unstoppable factors of change: the globalization of the economy and the speed with which companies are evolving. We are prepared to operate successfully in this scenario and we have absolute confidence in the future of **Telefónica**.

I would like to close this letter by once again expressing my gratitude to our shareholders, customers and employees. They are the ones who have made it possible for **Telefónica** to become a leading company and a benchmark in the telecommunications market.

A handwritten signature in blue ink, appearing to read "Juan Villalonga".

**Juan Villalonga**  
*Chairman and CEO of Telefónica*



## The year of total liberalization

Since December 1st 1998, **Telefónica** has been operating in the Spanish market in an environment of full competition, some aspects of which are in a more advanced stage of development than what can be found in many other countries regarded as champions of liberalization.

By December 31, 1998, Spain already had some ten data-transmission operators, three nation-wide fixed-line operators, another three mobile-telephone operators, plus a growing number of niche operators, in addition to the operators of the respective regional demarcations established for the provision of services via cable TV lines.

Since then, seven more licences have been granted for the provision of national fixed-line telephone services to operators owning their own networks, along with six of restricted scope and another three for fixed-line telephone operators lacking their own infrastructure. A further twenty licence applications are under study.

The degree to which the Spanish market has been liberalized is comparable to the most advanced countries in the European Union.

The liberalization process, which **Telefónica** has supported for years, has been firmly and expeditiously carried out in Spain.

In short, liberalization and the opening up of markets to competition, which **Telefónica** has supported for years, has been firmly and expeditiously carried out



**Telefónica is established as the Corporate Center, under which are grouped seven affiliate companies as heads of the different business lines.**

**The business lines are set up as independent legal entities, with clear profiles regarding their patrimony and results.**

in Spain. This followed a transition period during which competition effectively existed in all services, although the basic telephone service was limited to a duopoly where the Spanish State held an important shareholding in the second operator.

The accelerated pace of liberalization, its lack of continuity and the systematic application of asymmetrical regulatory criteria have allowed our principal competitors to obtain extraordinarily high operating margins. This has occurred even as critical issues such as the access deficit and its relation to tariff rebalancing, and interconnection tariffs which set prices below real costs, have provoked disputes and appeals brought before the courts.

#### **Corporate restructuring**

In spite of these difficulties, throughout 1998 **Telefónica** has maintained its commitment to leadership both in Spain and in the other markets where it operates. The company is working hard to broaden and diversify its services and, at the same time,

to rationalize its organization for greater flexibility and efficiency.

**The Shareholders' Meeting** held on March 17, 1998 adopted a new management model for the company, in response to the challenges posed by the changes that have taken place in the environment where **Telefónica** operates. These changes have influenced not only the **Group's** size and international scope, but also the liberalization of telecommunications in Spain, the rising prominence of multimedia services, projects and activities, as well as the quantitative aspects of the **Group's Companies** and their growing complexity.

Consequently, a new organizational structure was created in which each business area is set up as an independent legal entity, with clear profiles regarding their patrimony and results.

As a result of the corporate restructuring, **Telefónica, S.A.**, as the parent company, became the corporate center. Under it, the main affiliate companies head the different

business lines, namely: **Telefónica Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A. (Telefónica de España), Telefónica Internacional, Telefónica Móviles, Telefónica Intercontinental, Telefónica Media, Telefónica Interactiva, and Telefónica Data**, each one of which coordinates the different **Group** companies within its respective scope of activity.

#### A symbol for understanding

Over the past few years, **Telefónica** has undergone a process of progressive change that has produced the consolidation of a new **Telefónica**. The **Company** has gone from working basically under a monopoly system on the domestic level, to a company operating in a competitive market with multinational reach. It has been transformed from a telephone company into a communications company; from a public service provider into a provider of diversified services to a broad range of customers.

In 1998, **Telefónica** needed to draw together all of its worldwide

operations under a more international structure, with a view to operating in the same way and with the same brand in all geographic and business markets where the **Company** operates.

**Telefónica** therefore decided, at the end of the past year, to make a change in its corporate image. The name of **Telefónica** was adopted as a single trademark to stand as a symbol of change and, at the same time, to make possible the integration of the different activities and help consolidate a worldwide organization.

The new **Telefónica** brand also seeks to act as a symbol for understanding, underlining the concepts of concern for customers and commitment towards the different countries in which **Telefónica** is present.

**The new corporate identity symbolizes change, enables the integration of activities and helps consolidate a worldwide organization.**

**The **Telefónica** trademark is a symbol for understanding which seeks to emphasize the concepts of commitment and concern for customers.**



## The new IP Network combines Internet technologies with the security features of conventional data networks.



### New companies for data and interactive communications

A pioneer of data transmission services for corporate clients in the 1970s, **Telefónica**, with initiatives such as **Infovía**, continues to lead in the business communications market where the Internet phenomenon is setting the norm for the future.

The possibility of capitalizing on **Telefónica's** experience and maturity in a global scenario represented a magnificent opportunity to create value for the **Group**, and this led to the creation of **Telefónica Data** as the company in charge of the data business on a worldwide level.

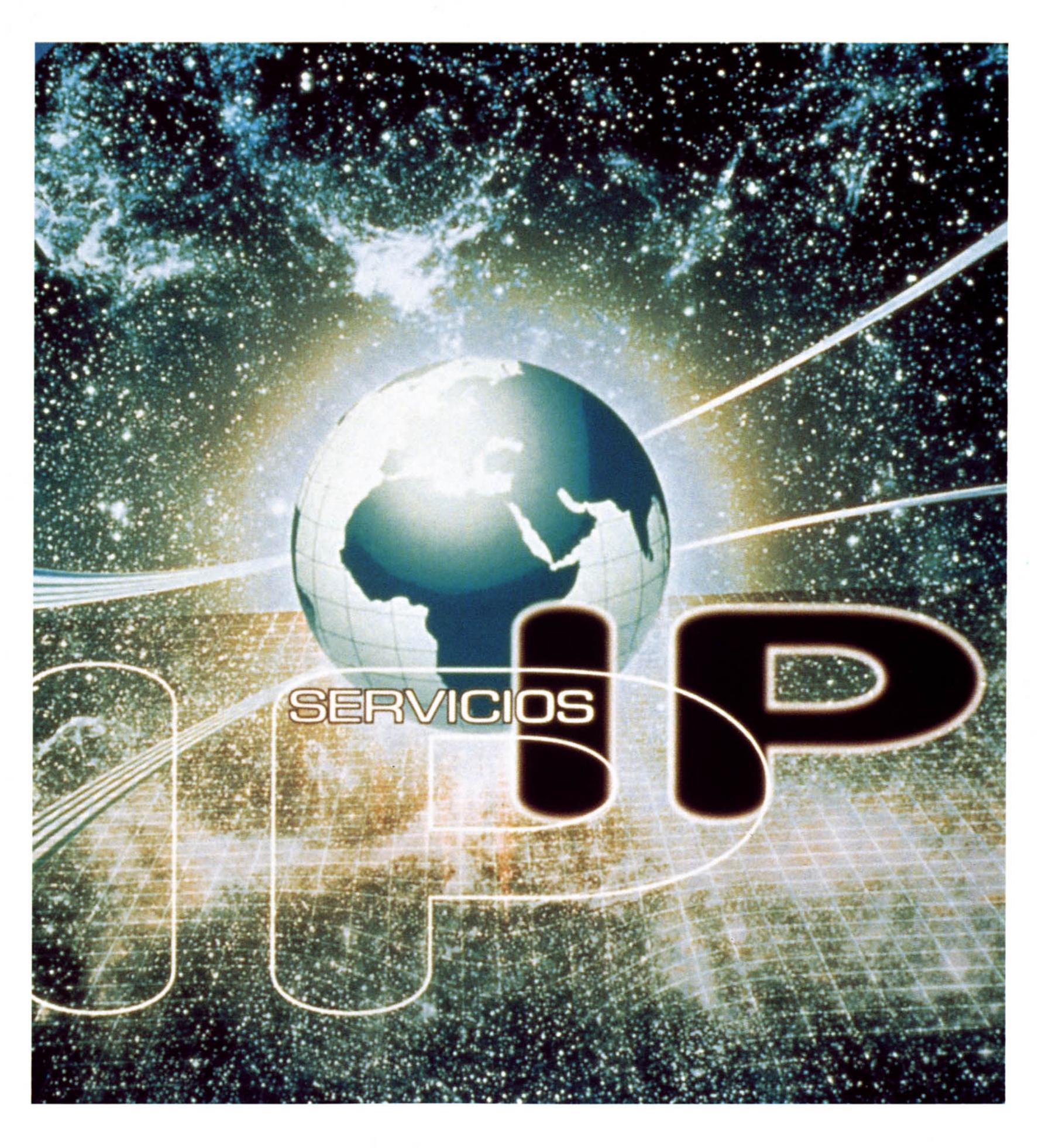
**Telefónica Data** is placing special emphasis on the development and introduction of new services, particularly **Virtual Private Networks** and **Voice over IP (Internet protocol)**.

The growing importance and enormous potential for development of the Internet market and interactive communications

led to the creation, at the end of 1998, of **Telefónica Interactiva**. The new company seeks to take the lead in an emerging market for the management of Internet access, services and content provision, both as a portal and in combination with access services (portal on line), and for participation in businesses relating to advertising, electronic commerce, voice over IP, etc.

**Telefónica Interactiva** aims to become the leading provider of Internet access and content to residential customers in the Spanish- and Portuguese-speaking world.

**Telefónica Interactiva**, with a global vision of the business, and an outlook open to continuous innovation and the development of alliances, will draw together all of the **Group's** initiatives relating to the creation, acquisition, presentation and utilization of content, in order not only to offer interactive services to customers, but also to achieve a multiplier effect that would facilitate a more rapid expansion of those services.



The background of the image is a composite of several elements: a globe centered at the top, a road map of the United States at the bottom, and a grid pattern in the middle. A bright, glowing ring surrounds the globe. A diagonal line of stars runs from the top left towards the bottom right. In the lower right quadrant, there is a large, stylized logo consisting of the word "SERVICIOS" above a lowercase letter "s", and the letters "SP" in a bold, outlined font.

SERVICIOS

SP



## Telefónica in Spain

As mentioned above, **Telefónica** faces a new situation of full competition in Spain following the application of a regulatory framework which leaves many critical points unresolved. This imposes commercial limitations on **Telefónica** that do not apply to **Telefónica's** competitors.



### Telefónica de España

The persistence of asymmetrical regulation which has not corrected either the access deficit or tariff imbalances, has significantly slowed the growth rate for operating revenue in **Telefónica de España**. Its relative weight with respect to total **Group** revenues was reduced by 3.4 percentage points, to 48.6 per cent, down from 52% in the preceding year. Nevertheless, the strong performance of the ISDN, leased-line and data transmission services has compensated for the reduced revenue from the basic telephone service.

Even so, the net profit of **Telefónica de España** totalled Pta. 150.126 billion, an increase of 12.2% over the 1997 results.

On the other hand, the large-scale introduction of new technologies in **Telefónica de España** infrastructure, and the progress made in rationalizing company management, have made it possible for the company not only to offer a wider and more complete range of services, but also to improve productivity, which stands at 313 lines per employee, an increase of 17.4% in annual terms.

In spite of the limitations mentioned earlier, **Telefónica** ended



In spite of the limitations, Telefónica ended 1998 with an estimated market share of 98.5% of total traffic minutes, and of 93.1% in long-distance traffic.

During the year, 80 new products and services have been put on the market.

1998 with an average estimated market share for the year of 98.5% of total traffic minutes, and its average yearly market share of the long-distance traffic (interprovincial and international) was 93.1%.

During the year, Telefónica made determined efforts to improve the quality of its customer-care service, tailored for each customer segment (Corporate Clients, Small and Medium-sized Enterprises, Autonomous Professionals, General Public), by implementing targeted customer care in order to obtain a better knowledge of their needs and service expectations. Significant among these initiatives was the further enhancement of the comprehensive maintenance service scheme provided through the **Centro Nacional de Supervisión y Operación (CNSO)**, allowing the quality of Telefónica's network to rank among the best European practice.

In response to customer demands, 80 new products and services have been put on the market during the past year, with the introduction of new marketing formulas.

New products and services (ISDN, Data Transmission, Intelligent Network Services, Infovia, etc.) showed considerable progress, with sales figures totalling Pta. 118.218 billion, accounting for 7.2% of operating revenue.

#### Residential Market

Residential markets in Spain and Latin America show important differences due to the disparity in their respective maturity levels. Whereas in Latin America the objective is to raise the telephone penetration level and increase attention to new customers, in Spain, where the



service is nearing maturity, with high density levels, the focus is on average consumption per line. Consumption in Spain grew 9.5% in 1998, or an average 11.9 minutes per line and day. This increase was possible thanks to the strong performance of supplementary services, the **Infovia** traffic, which totalled 105 million hours, as well as to reductions in average tariffs, particularly those for provincial, interprovincial and international services.

The concept of a «new telephone line», established in 1997, found expression last year through two new products: **Línea Básica** and **Línea Duplo**, which are prepared to handle supplementary services such as telephone answering service, call waiting, three-way conferencing, call diversion, etc.

The development of the network automatic answering service was particularly impressive, with 7 million customers using the service by end 1998.

The «**Clear Plans**» were also very successful in 1998. These plans offered discounts on provincial,

interprovincial and international calling rates. By the end of 1998, 5 million **Plans** with discount options had been subscribed.

#### BusinessMarket

Telefónica's commercial strategy for this market is based on the introduction of new



By year-end, five million **Clear Plans**, which offer discounts on provincial, interprovincial and international calls, had been subscribed.



**The Innovatel Plan, which facilitates access for SMEs to the new technologies, has 150,000 clients.**

**Infonegocio offers Internet access and presence for small and medium-sized enterprises.**



products and services, as well as on a comprehensive services offering, and the improvement of customer-care systems.

**Telefónica's new Internet Protocol (IP) Network** is one of the new services designed to help businesses improve their competitive advantage. It provides new access services and information exchange capabilities, thanks to a better utilization of the potentialities of Internet technology.

The new IP services represent a new generation that builds upon the attributes of Internet network technologies, coupled with the security features of conventional data networks.

The **Telefónica IP Network** serves two main functions: on the one hand, to carry UNO-IP permanent access services, and the switched access services (**Infovía Plus**); on the other, to carry value-added network services such as **InfoMail**, **InfoHost**, **InfoEDI** and **InfoInternet**.

Within the Large Clients segment, **Ibercom** has continued its positive evolution as a corporate service

that has been enhanced with new marketing formulas such as **Ibercom Clave** and **Ibercom Master**, as well as by new value-added services and new terminals.

The advantages of the IP network have also caused a trend to migrate to it from the conventional X-25 data services.

Special attention has also been given to quality of service and customer care through the launch, among other efforts, of the **Comprehensive Maintenance Plans** for businesses with service level agreements.

Customer care services have been specifically developed for small- and medium-sized enterprises (SMEs), such as the **CENTREX** service, which makes available to our customers all of the features of a modern exchange without the need to install equipment. Moreover, **TSAI**, a Group company, markets the **InfoNegocio** service designed to facilitate Internet access and presence for SMEs.

During 1998, **Telefónica** created the **Innovatel Plan**, designed

to bring new information technologies closer to SMEs. Through this plan, discounts of up to 100% are offered in the acquisition of exchanges and other telephone products and services. The **Innovitel Plan** now has 150,000 subscribers.



#### International Telephone Traffic

**Telefónica** registered strong growth in international traffic in 1998, showing an increase of 15% compared to the previous year. Communications originating in mobile networks showed an even more spectacular growth of 46%.

International calls benefited from the discounts offered through the **Clear Plans** and an average tariff reduction of 12.4%.

#### Cable Telecommunications

In 1998, the Spanish cable map took its final shape, comprising forty-three demarcations in which **Telefónica Cable** is also entitled to operate, although the moratorium imposed

on **Telefónica** by the Regulatory Authority was lengthened in December, from 16 to 24 months.

Nevertheless, **Telefónica** has continued to set up **Local Operating Companies** in the different demarcations, with the participation of partners from the financial, industrial and mass-media sectors on a local and national level.

During the year, **Telefónica Cable** brought into service a platform which brings together digital TV, Internet access and interactive services, using the most advanced technologies available.

**Telefónica Cable** also started trials of digital cable TV transmissions in Barcelona, and carried out trial transmissions of interactive

**Telefónica de España** has shown a substantial advance in productivity, achieving 313 lines per employee, an improvement of 17.4% in annual terms.

**Telefónica** is entitled to operate in all of the cable demarcations, although the moratorium on operation imposed by the regulatory authority was extended to 24 months.

**Telefónica Publicidad e Información, leader in the directories and classified advertising sector, has furthered its development by exploiting new technologies.**



multimedia services to potential customers over broadband networks. Both were groundbreaking events in Spain.

#### **Directories and Classified Advertising**

**Telefónica Publicidad e Información** is the leading company in the Spanish directories and classified advertising sector.

During 1998, the company published 15 million copies of the «**Yellow Pages**» and 11 million copies of the «**White Pages**» telephone directory. These production figures represent an increase of 23% over the previous year. At the same time, the company introduced a new design to add value and increase their usefulness for customers and users.

**Telefónica Publicidad e Información** consolidated its Internet product «**Páginas Amarillas On Line**» and initiated the launch of «**Páginas Habladas**» (talking pages), continuing its development of non-conventional media

and exploiting the possibilities offered by the new technologies.

Consequently, in 1998 revenues rose by 19.6% compared to the preceding year and income before tax increased 4.3%.

**EstraTel** strengthened its position as leader in the telemarketing sector in Spain, in 1998, with a 61% increase in revenues and an 11% rise in profits.

In addition to this quantitative growth, the company also made determined efforts to enter new markets and embark on new value-added activities to improve its competitive position.

In the course of 1998, **EstraTel** carried out investments in material assets amounting to Pta. 2.131 billion, and opened five new operating centers in Madrid, Seville, Valencia and La Coruña, thus enabling the company to support over 4,000, fully computerized, directory assistance stations of its own.

**EstraTel's** constant attention to quality of service earned it an AENOR ISO 9001 quality certificate.

## Public Payphones

**Telefónica Telecommunicaciones Públicas (TTP)** was able to continue holding its number one position in the Spanish public payphone business during 1998, despite the fully competitive environment, through its provision of high-quality services and maintenance of installations equipped with the most advanced technology.

In the past year, **Telefónica** payphones installed on public thoroughfares numbered 67,038 points of communication, up 5.6% from a year earlier, and the number of indoor installations totalled 32,077 terminals.

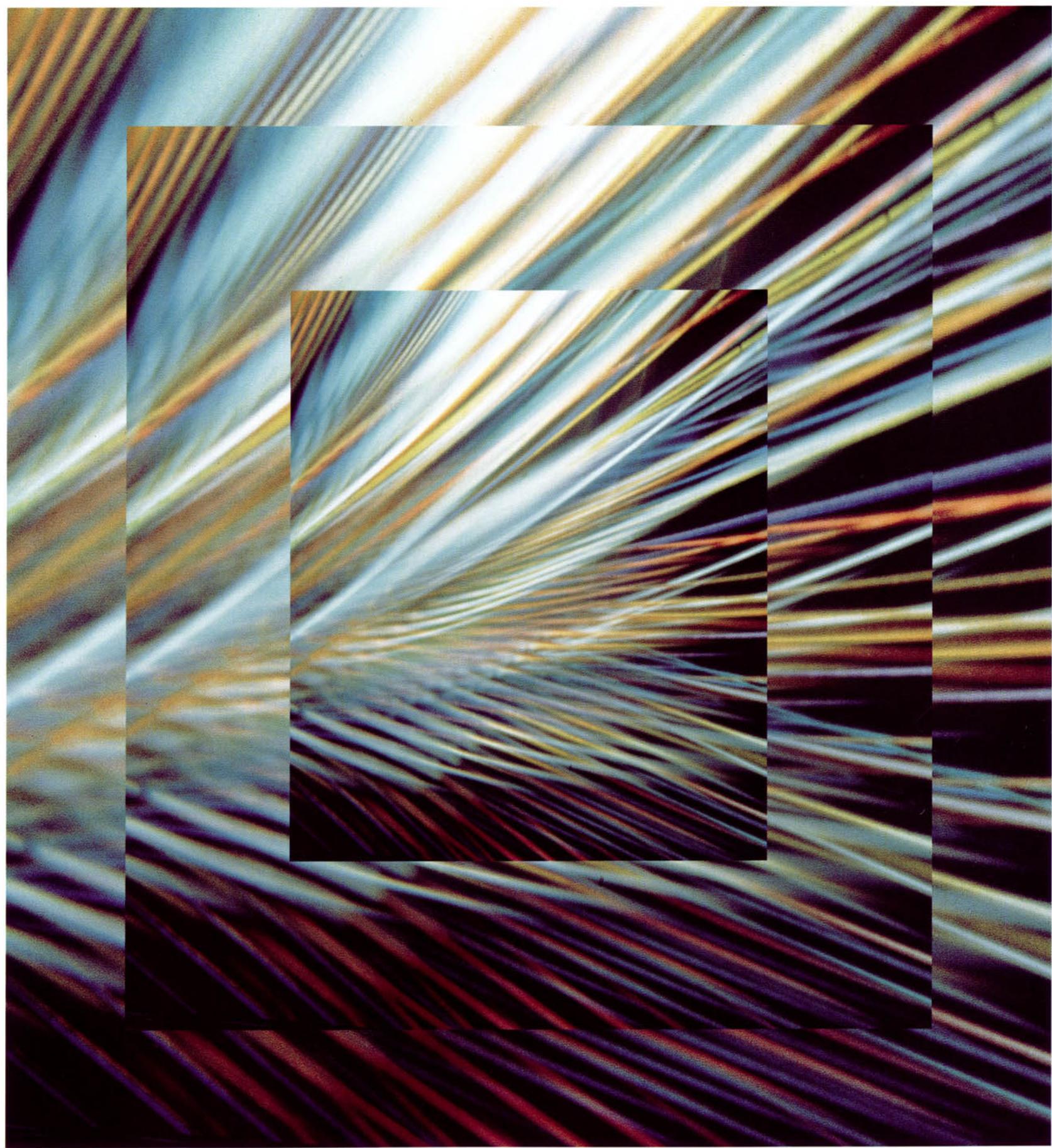
In 1998, the company was awarded the AENOR ISO 9001 quality certificate. This award accredits the company's traditional concern for maintaining the quality of its products and services.

**Telefónica Telecommunicaciones Públicas** reported a very positive performance in 1998. Revenues totalled 50.487 billion pesetas, representing an increase of 14.23% compared to 1997, and income before tax rose to 6.4 billion pesetas; up 44% from 1997.



The number of **Telefónica's** payphones installed on public thoroughfares totalled more than 67,000 points of communication, and more than 32,000 indoor terminals.





## Modernization of the network

During the past financial year, **Telefónica** has continued its efforts to further the development and modernization of its entire network and infrastructure, in the realization that this is an essential requirement for ensuring that customers' demands for modern and diversified services are successfully met.

**Telefónica** plans to deploy optical technologies such as DWDM (dense wavelength division multiplexing), a high-capacity broadband system, as a way to multiply the capacity of the network and, at the same time, reduce unit costs. Initially, these systems will be incorporated into the **Long-Distance Network**.

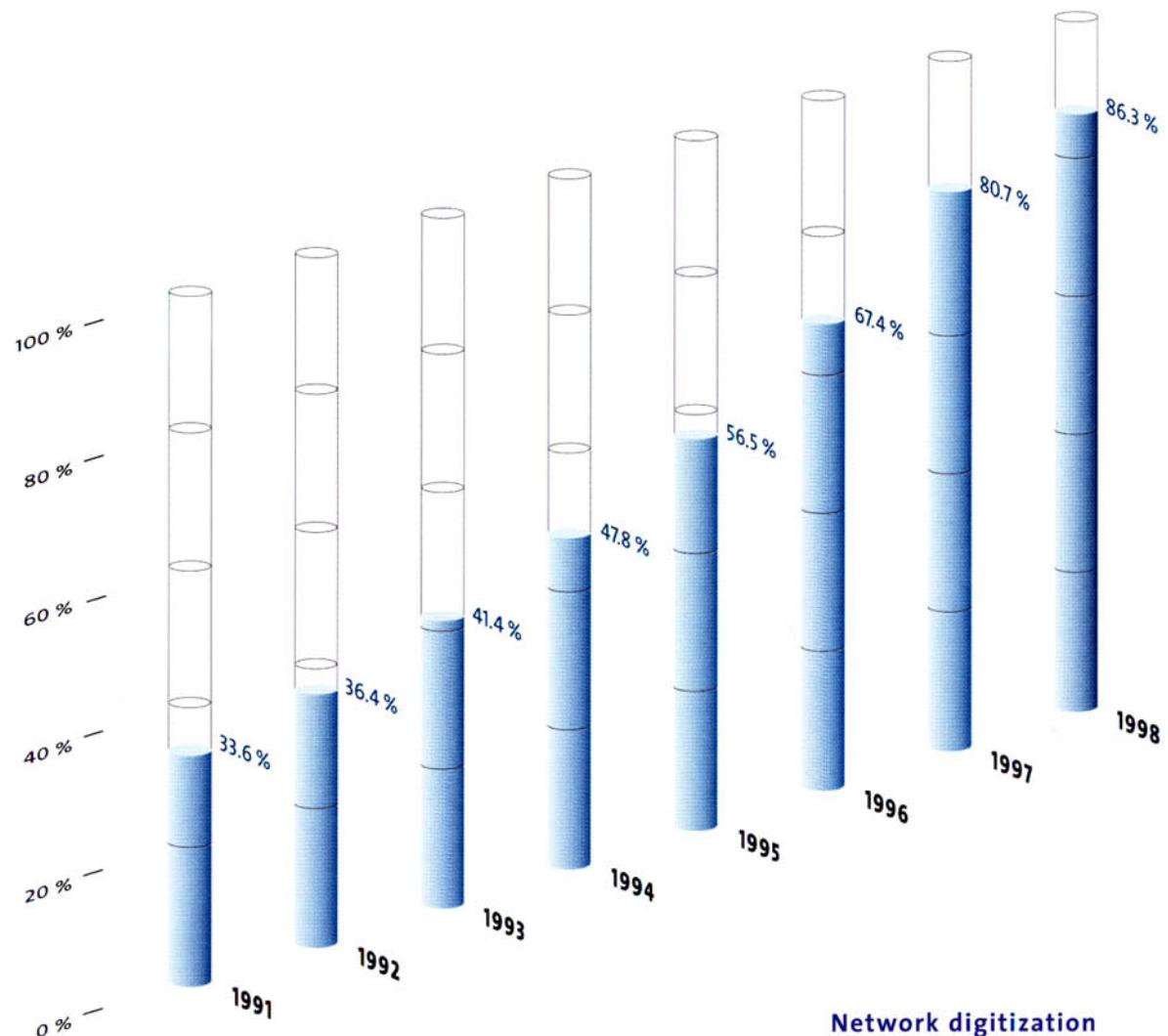
**Telefónica's dedicated Video Network** was extended for studio-quality circuits and an expanded **Ibermic Network** of dedicated circuits was relaunched with improved coverage to support new services such as **Frame Relay** and microcellular connections for mobile telephony.

The fixed network has been modernized with the intensive introduction of optical-fiber technology, with a view to providing a high-quality, efficient, and low-cost infrastructure capable of meeting the telecommunications demands and service availability requirements of end users.

A nine-digit numbering plan came into effect in 1998, and technical changes were introduced in network intelligence to make possible the implementation



During 1998, more than 1,200,000 digital lines were installed in metropolitan areas, bringing the installed plant to 16,776,553 lines.



of number portability and carrier pre-selection in the Access Networks, in compliance with the stipulations set by the Spanish Regulatory Authority.

As a consequence of the new regulatory framework, **Telefónica** has supplied numerous points of interconnection with the networks of competing operators, both for mobile and fixed-line telephone services.

Other important developments in the field of access networks were the design of the network structure for **InfoVía Plus**, and the deployment of the initial «fiber in the loop» (**FITL**) components, as well as of systems capable of efficiently multiplexing both narrowband and broadband traffic. Asymmetrical digital subscriber line (**ADSL**) technology, which allows high speeds and permanent connectivity, was also brought into use.

**Telefónica's International Network** benefitted from important international agreements signed in 1998, for the development of submarine cable systems **MAYA**,



which will improve the connectivity between North and South America; and **TAT 14**, linking Europe and North America. Work has also continued on the deployment of the **Atlantis 2** and **Columbus 3** undersea cables.

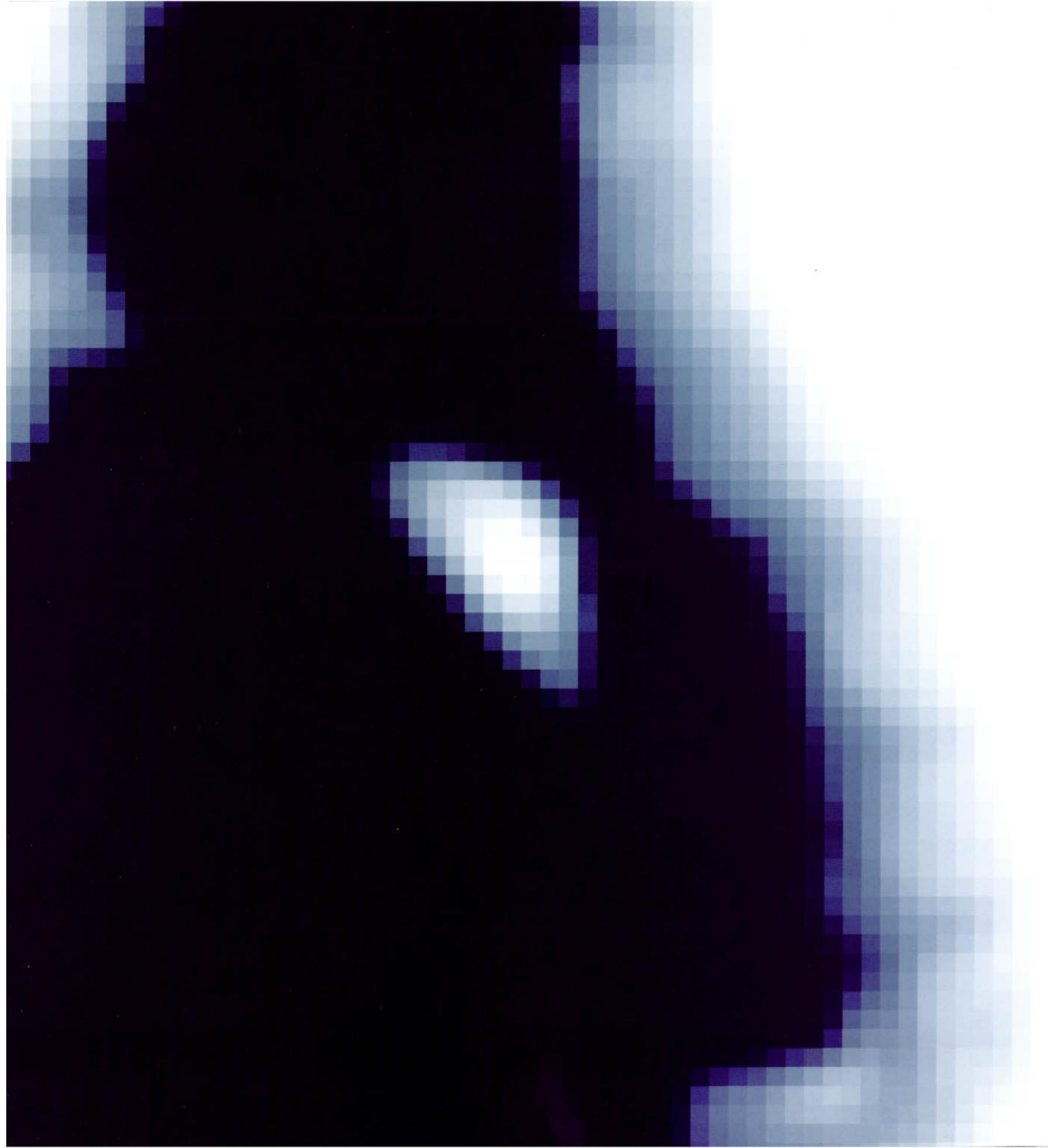
#### Network building

During 1998, 1,222,424 urban digital lines were installed in Spain. Of these, 379,186 meet demand requirements and the remaining 843,238 went to replace analog and digital lines in telephone exchanges. Thus, installed plant totals 16,776,553 lines, 86.25% of which is digitized.

The installation of **ISDN** equipment rose considerably for a total of 285,349 **Basic Access** lines and 9,296 **Primary Access** lines.

The transit network has seen a significant increase in the volume of trunk lines in service, with the incorporation of an additional 32,790 circuits, thus providing complete support for the signalling of the **Integrated Services Digital Network**.

In 1998, agreements were signed for the development of the new **Maya** and **TAT 14** undersea cables.



## Telefónica Móviles outdistances its competitors

The past year was another milestone in the growth of the Spanish cellular market, with an annual gain of 63% and a penetration rate of 17.9%. At the end of the year, **Telefónica Servicios Móviles** had 4,994 mobile telephone customers, representing a 54% improvement over the previous year, with 4,001,072 **MoviStar** customers and 893,192 **MoviLine** customers.

**Telefónica Móviles** saw even greater consolidation of its leadership position in 1998 with a net gain of 1,706,568 customers. This brought the differential with respect to the second mobile operator to over 2,700,000 customers, a 35% increase compared to the previous year. In the case of **MoviStar**, most of the gain in customers - 1,913,971 new connections - came from the prepaid service, which at end 1998 accounted for almost 44% of the total customer base of the **MoviStar** service.

**Telefónica Móviles** ranked among the six largest European cellular operators by volume of customers at the end of 1998.

The creation of one of the most extensive commercial distribution networks in the country has been essential for the growth of the **Telefónica Móviles** customer base. This commercial network has successively incorporated new distribution channels such as newspaper stands, tobacconist's shops, gasoline filling stations, and the like, with the objective of bringing the wide range of products and services on offer ever closer to the customer.

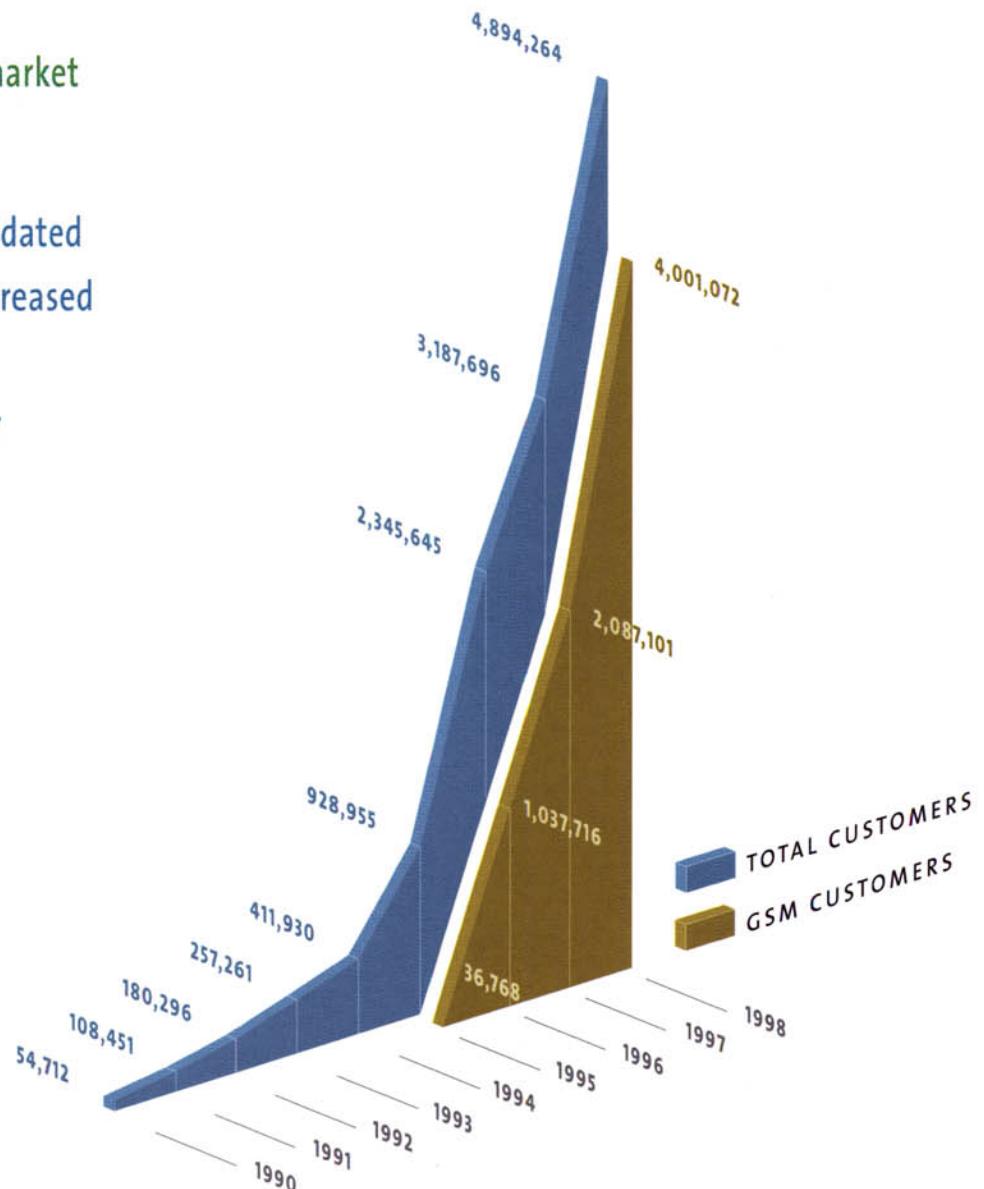
Another outstanding event was the securing of a licence to operate in the 1800 MHz frequency band, which represented an outlay



### Cellular customers of Telefónica Móviles

In 1998, the Spanish cellular market grew 63%.

Telefónica Móviles has consolidated its leadership position and increased the differential with respect to the second mobile operator by 35%.



SELECTED FINANCIAL DATA FOR 1998 (Consolidated figures)			
(Million Pesetas)	1998	1997	Δ %
Operating revenue	468,203	362,938	29.0 %
Income before tax	119,573	38,982	206.7 %
Investments during the year	92,269	100,203	-7.9 %
Accumulated gross investments	560,778	465,749	20.4 %
Added Value	219,820	137,672	59.7 %
 Total Assets	 459,449	 400,459	 14.7 %
Shareholders' funds	169,392	124,047	36.5 %
 Network base stations	 6,927	 4,968	 39.4 %
Mobile Telephony Users	4,894,264	3,187,696	53.5 %
MensaTel Customers	391,574	344,689	13.6 %
RadioRed Customers	24,469	17,612	38.9 %
Basic Telephony with Cellular access	252,028	238,626	5.6 %

of approximately 29 billion pesetas. The system will be deployed in the main capitals where higher levels of traffic are concentrated, thus allowing constant customer growth over the next few years while maintaining the standards of quality upheld by the **MoviStar** service.

The evolution of **Telefónica Móviles** in 1998 is clearly reflected in the table shown above.

Operating revenues increased 29% for a total of Pta. 468 billion. Income before tax rose from Pta. 39 billion a year earlier, to almost Pta. 120 billion, or 25%

of revenue in 1998. Net profit rose by Pta. 80 billion, a threefold increase in net profit compared to 1997, representing 37% of total Group profit.

At the close of 1998, **Telefónica Móviles** managed total net assets amounting to some 460 billion pesetas, following investments during the year totalling over Pta. 92 billion. **Telefónica Móviles** devoted resources totalling approximately Pta. 14.5 billion to research and development activities, in different areas of the business such as **Services**, **Information Systems** and **Network Development**.

**At the end of 1998, Telefónica Móviles had more than a hundred service offerings, developed and conceived to meet the needs of every type of customer.**

**Mensatel, the radiomessaging service, is the undisputed leader, with a market share of 78%.**



Telefónica Móviles has always relied on quality of service as the principal differentiating factor and holds quality certificates for all of its organizational, technological and commercial processes, under the most exacting standards.

In December 1998, and by resolution of the company's **Board of Directors**, a declared dividend was paid out for the first time in the history of the company, in the amount of Pta. 35 billion, which represented 43.6% of the net profit for the financial year and a payment to shareholders' funds amounting to 28.3%.

differentiating competitive factor. Moreover, **Telefónica Móviles** has implemented during 1998 a complex **Environmental Management System** which has received the AENOR Certificate of Environmental Quality ISO-14001.

By end 1998, the **MoviStar** service relied on approximately 7,000 base stations - up 2,000 from the previous year - to ensure adequate coverage throughout the country. It was also the first to provide coverage in the maritime corridors between the eastern coast of Spain and the Balearic Islands, and between the Canary Islands.

#### Quality of Service

One of the factors guaranteeing the quality standards to which the company adheres is the degree of coverage of its service, measured both in terms of population and of territory. Both the **MoviLine** and **MoviStar** services offer its customers nearly total coverage, reaching 99% of the population and 98% of the national territory.

Telefónica Móviles has already been awarded quality certificates for each and every one of its organizational, technological and commercial processes under the most demanding quality standards (standard ISO 9001). This testifies to the company's consistent reliance on quality of service as the principal

In 1998, 30 roaming agreements were reached with other operators, providing customers with coverage in 76 countries through more than 137 operators. Also in 1998, **Telefónica Móviles** signed a roaming agreement for the satellite communications service provided by Iridium, which will provide customers with coverage in almost any point on the earth.

The **Enhanced Full Rate (EFR)** coding mechanism, offering sound quality on a par with that of fixed communication networks

was implemented throughout the **MoviStar** network during 1998.

**Telefónica Móviles** is the first operator to incorporate this technical solution in Spain in its entire network.

#### An attractive offer

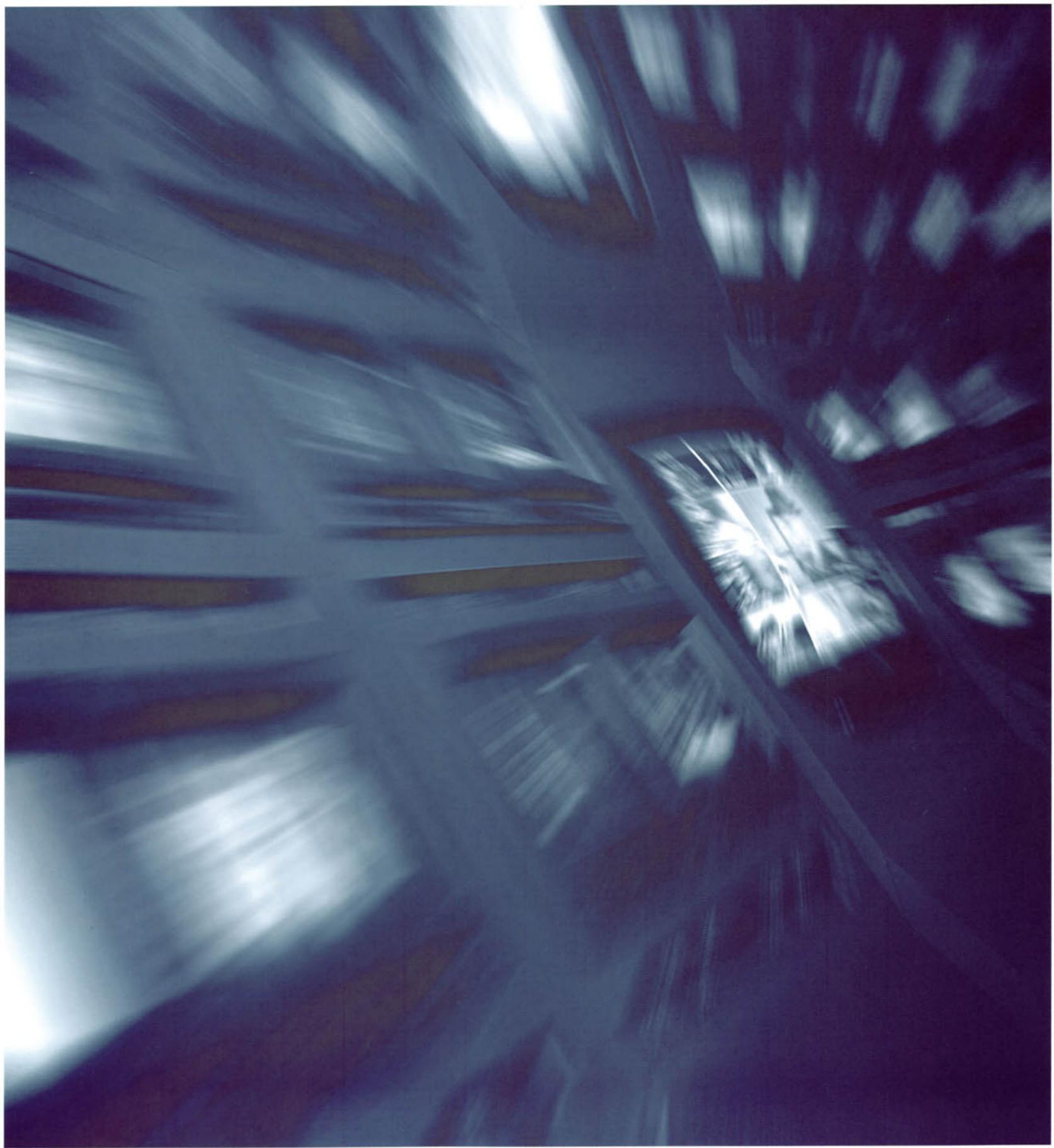
As a result of the company's determined efforts in research and development, **Telefónica Móviles** has asserted its leadership in value-added services. More than one hundred services, developed and conceived to meet the communication needs of its customers, were on offer by the end of 1998. Outstanding among these are services focused on the business market, such as **MoviStar Corporativo 2000**, offered conjointly with **Telefónica**, **MoviStar Enlace Oro** or **MoviStar Gestión**, among others, which make available to this market segment the most advanced technological solutions. Additionally, data communications services such as **MoviStar Telemática** and **MoviStar Datos Express**, have been upgraded to provide higher data transmission speeds via GSM above 25kbit/s,

or to include Internet services, such as **MoviStar Net**.

The offer of prepaid cards to activate mobile telephone service (**MoviStar Activa, Activa 4, Activa Joven, Activa Próxima** and **MoviLine Óptima**), is aimed at the general public. They offer a wide range of pricing plans that fit different consumption patterns. In order to offer greater freedom to its prepaid service customers, in December of 1998, **Telefónica Móviles** introduced the ability to re-program cards for different price plans between cards so that customers can switch to the formula that best suits them.

**MensaTel** finished 1998 as the undisputed leader of the Spanish radio-messaging market, with a market share of nearly 78%. **MensaTel** serves both the professional market segment, which uses the service as a business tool, and the youth-oriented market segment, with the **MensaTel Beeper**. Closed user-group messaging services are provided by **RadioRed**, another **Telefónica** service to finish strongly in 1998, once again leading the market with an estimated 75% market share.





## Consolidation and expansion of audiovisual services.

During 1998, **Telefónica** strengthened its leading position in the audiovisual business by capitalizing on the synergies produced in the different areas of activity in communications media, broadcasting and audiovisual content. These activities are coordinated through **Telefónica Media**, the affiliate company which groups together, among others, subsidiaries and associated companies in the following areas

### Media

#### Antena 3 TV

The outcome of its first year under **Telefónica** management has been excellent: operating revenues increased fourfold, going from Pta. 5.636 billion in 1997 to Pta. 20.892 billion in 1998.

After-tax results logically reflected the improved financial situation in **Antena 3**: from a loss of Pta. 3.648 billion in 1997,

**Antena 3 TV** achieved operating revenues of Pta. 20.892 billion, a fourfold increase.

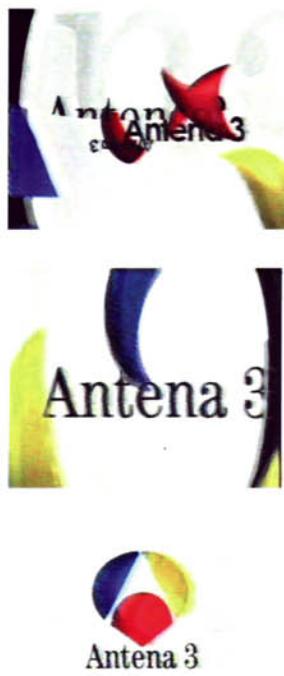
The profit made by **Antena 3** -13.143 billion pesetas - puts the company in the forefront of the audiovisual sector in Europe.

to a net profit of Pta.13.143 billion in 1998.

If 1997 can be considered a year of accounting adjustments and transition towards a new business model for **Antena 3**, 1998 should be remembered for the new managerial style and implementation of organizational changes that were introduced during the period, to which the excellent results obtained can be largely attributed.



**Antena 3 is the absolute leader by audience ratings among middle- and upper-middle-class viewers under 55 years of age, residing in areas with more than 10,000 inhabitants.**



In fulfillment of the objectives set during the past financial year by **Antena 3** three different courses of action were followed:

First, consolidation of its leading position among the private sector Spanish television channels; and particularly, its status as the channel of choice for advertisers. **Antena 3** is the absolute leader by audience ratings, attracting 24.2 % of the middle- to upper-middle-class viewers under the age of 55 residing in areas with more than 10,000 inhabitants - representing over half of the Spanish population.

Secondly, with respect to the management of economic results, a drastic reduction in the cost base of **Antena 3**, to make way for new initiatives and investments. This policy is complemented by an increase

in commercial revenues. **Antena 3** obtained a profit margin of 28.4% in 1998 effectively placing it in the forefront of the European television broadcasting sector.

Lastly, diversification into new areas of activity: theme channels, interactive television and commercial initiatives such as telemarketing, licences and merchandising, advertising events and production, etc. These developments have further diversified the business into different geographical locations and activities, thereby helping **Antena 3** change from a television channel serving the general public, to an audiovisual group with a wide variety of products and services. In short, **Antena 3** now holds its place in the market as a corporation known for its audiovisual content and multi-thematic activities with international scope.

#### Vía Digital

During 1998 **Telefónica** expanded its presence in the audiovisual business by increasing its stake in **Distribuidora de Televisión Digital, S.A. (D.T.S.)** up to 36.95%. DTS markets pay-TV

services under the **Vía Digital** brand.

Although market penetration did not reach the target number of subscribers in 1998, results were nevertheless satisfactory. At 31 December, despite strong competition from the rival Spanish digital platform, **Vía Digital** had billed over 282,000 subscribers.

Customer perception also improved during 1998, with higher levels of viewer brand retention, thanks to better advertising and working guidelines designed to improve service levels and content offerings, such as outstanding films from first-rate producers, both domestic (Lola Films) and foreign (Metro Goldwyn Mayer), musical and sporting events (international boxing and football competition), and retransmission of the world's best bullfighting, among others.

#### Hilo Musical

ST **Hilo** successfully developed its lines of business in 1998. The company's production of digital theme channels with transmission capability via satellite or cable networks,

increased 25% over the previous year. This brings its digital music subject matter up to nearly 90,000 offerings. The company has also developed a specialized music area for its business customers, who can select the type of music needed for a particular business environment. The distribution of this new product will start at the end of next year.

#### Broadcasting

**Telefónica Servicios Audiovisuales (TSA)** is on its way to becoming the leading operator of digital TV broadcasting services in Spain.

In addition, TSA is the principal provider of audiovisual technical services via satellite for Spain and Latin America, as well as in the field of signal processing and satellite up-links.

In the field of TV broadcasting, TSA has launched a new digital platform for Europe called "Europa TV", with five channels. TSA has also expanded the Spanish public television channel for the Americas

to 10 channels, and **Antena 3** started broadcasting in America.

During the year, **TSA** also included production among its activities. Consequently, **TSA** is now the only Spanish provider to offer audiovisual services in any configuration, with the flexibility that such a competitive market demands. **TSA** is also preparing for its entry into digital terrestrial TV broadcasting during 1999.

#### Content

During 1998, the activity in the field of audiovisual content was developed through communications media under **Telefónica Group** management, as well as by companies devoted to production and exercising copyrights, in which **Telefónica Media** has a stake.

Film production has achieved notable success under **Lola Films**, which has strengthened its position as Spain's leading film producer, in terms of both revenue and distribution.



**Vía Digital** had more than 280,000 subscribers.

**Telefónica Servicios Audiovisuales** is the leading operator of digital TV services in Spain.



## Telefónica I+D: Competitiveness, differentiation and foresight

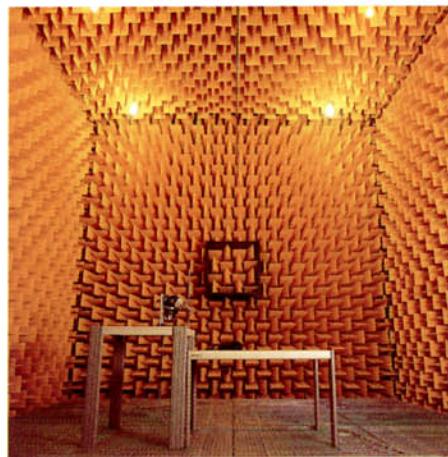
**Telefónica Investigación y Desarrollo**, the Telefónica R&D subsidiary, increased its research and development activity by 35% in 1998, its 10th anniversary year. **Telefónica I+D** has contributed to the competitiveness of the **Group** companies by making available differentiated products in anticipation of market trends.

Among these are the new interactive services, and the platforms for providing them based on **Telefónica's** new **IP Network**, as well as customer care systems, telephone cost-control for customers, and new personal card facilities.

Novel solutions designed to increase market share have also been developed for **Telefónica Móviles**, **Telefónica Data**, **Telefónica Multimedia** and **Vía Digital**.

**Telefónica's** research and development activities have also focused on developing methods to increase

**Telefónica I+D** has increased its research and development activity by 35%.



competitiveness by making the most cost-effective use of infrastructures, such as the new systems for the management of operation and conservation, traffic and interconnection, and operation of the access network.

A wide-angle, low-light photograph of a city at night. The scene is dominated by streaks of light from moving vehicles, creating long, glowing bands across the frame. In the background, a bridge with illuminated towers spans a body of water. The sky is filled with dark, heavy clouds.

Telefónica de Argentina



## Telefónica Internacional, Latin American Leader

Within the framework of the globalization process that is re-defining the telecoms sector throughout the world, **Telefónica Internacional** has maintained its determination to become the leading telecoms operator in Latin America. In 1998, **Telefónica Internacional** strengthened its management role in the companies where it owns a shareholding, with a view to improving its competitive position in the respective countries and tapping new markets with attractive growth potentials.

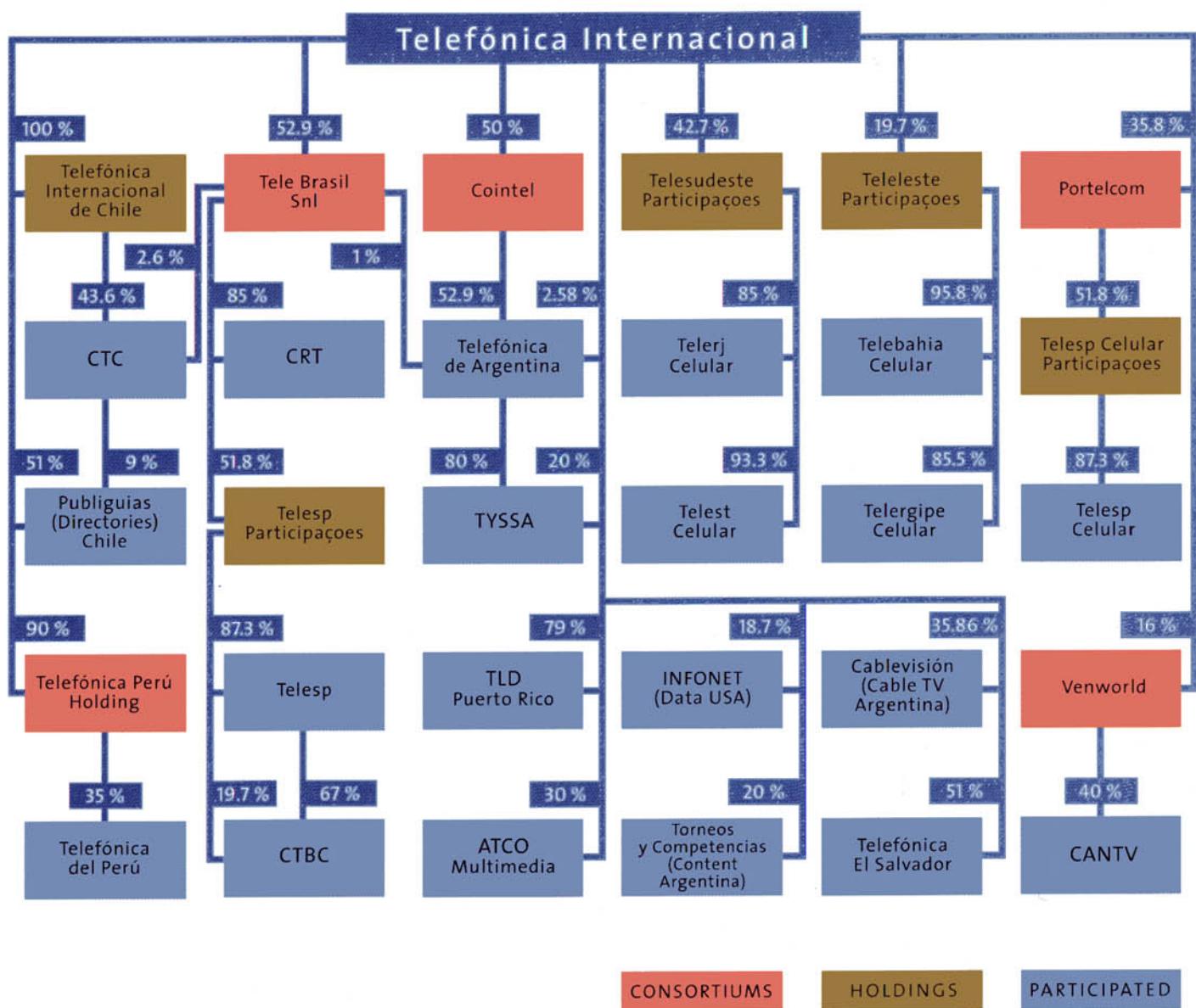
**Telefónica Internacional** made a successful bid for acquiring an important group of businesses in the July 1998 privatization of Brazil's **Telebras** system. As a result, the consortiums led by **Telefónica Internacional** now participate in the management of 4 of the 12 operating companies auctioned by the Brazilian government during the privatization process.

At the conclusion of the privatization process,

**Telefónica's growth strategy consists of participation in the privatization processes of state-run operating companies, and seeking and evaluating new investment opportunities as a second operator of comprehensive services.**

the consortiums led by **Telefónica Internacional** won 51.79 % of the voting shares of **Telesp Participações** (together with Portugal Telecom, Banco Bilbao Vizcaya and Iberdrola); **Tele Sudeste Celular Participações** (together with NTT and Itochu), and **Tele Leste Celular Participações** (together with Iberdrola).





TISA's structure at 12/31/1998

**Telefónica Internacional** also acquired a stake in the Portelcom consortium which was awarded Telesp Celular Participações.

These acquisitions make **Telefónica Internacional** the leading operator in Brazil, the largest communications market of the region, thus consolidating its leadership position in the Latin American communications market overall.

The strategic advantages of the new Brazilian holdings, with their dominant positions in areas characterized by high levels of economic development, and, at the same time, a high growth potential in the telecoms sector, with ready integration and operation possibilities, promise a quick return on the investments undertaken.

Prior to the sale of the **Telebras** holding, **Telefónica Internacional** increased its shareholding in **Companhia Riograndense de Telecomunicações (CRT)** raising its stake to 85.1% of the ordinary shares (31.56% of total equity) on acquiring, in June 1998, the package of shares remaining

in state hands (the initial phase of privatization took place in December 1996).

During 1998, the growth strategy followed by **Telefónica Internacional** combined participation in the privatizations of state-run operating companies, principally in Brazil, while exploring and evaluating new investment opportunities as a second operator of comprehensive communications services, with the objective of capitalizing on the experience and competitive capacity of the **Group** as the basis for expansion.

In this context, **Telefónica Internacional** secured control of **Telefónica El Salvador** (formerly INTEL), the company which won the second licence for the provision of all telecommunications services in El Salvador in competition with the dominant operator CTE. This operation forms part of the project to create **Telefónica Centroamérica**, whose purpose is to serve as a platform for the expansion of TISA in the region. **Telefónica Centroamérica** includes as partner the Mesoamérica Fund, an investment fund formed by Bain



**Telefónica has become the principal operator in Brazil, the largest communications market of the region.**



**TELEFÓNICA INTERNACIONAL GROUP COMPANIES**

<b>Company</b>	<b>Country</b>	<b>Population (Mill.)</b>	<b>Services</b>	<b>Competition</b>
CTC	Chile	14.8	Basic telephony, Long distance, Public payphones, Mobile telephony, Rental and sale of equipment and terminals, Cable TV, Radio-paging and Data transmission.	All telephone services in Chile are liberalized.
TASA	Argentina	16.6	Basic telephony, Long distance, Mobile telephony, Radio-paging, Yellow pages and other Value-added services.	Basic telephony and domestic and international long distance are under a monopoly until Nov.'99 through one of the two existing licences. The remaining services are liberalized.
Telefónica del Perú	Peru	24.6	Basic telephony, Long distance, Mobile telephony, Radio-paging and Cable TV.	Liberalized.
CRT	Brazil	9.52 <sup>(1)</sup>	Basic telephony, Mobile telephony, Leasing of data-transmission lines, Yellow pages, 900 service, Value-added services, Classified advertising.	The services provided in the State of Rio Grande do Sul are not open to competition except mobile telephony.
CANTV	Venezuela	23.2	Basic telephony, Long distance, Public payphones, Mobile telephony, Public telecommunications centers, Private networks, Rural telephony, Data transmission and Directory assistance.	Basic telephony and domestic and international switched long distance services are provided under a monopoly until 2000. The remaining services are liberalized, except mobile telephony which is under a duopoly.
TLD	Puerto Rico	3.8	Long distance.	Liberalized.
Cablevisión	Argentina	35.6	Cable TV.	Liberalized.
T y C	Argentina	35.6	Audiovisual content and Media.	Liberalized.
Infonet	USA	N/A	Data transmission.	Liberalized.
Contactel	Portugal	10	Radio-paging.	Liberalized.
TUPR	Puerto Rico	3.8	Intra-island and international long distance via satellite and radio.	Liberalized.
TYSSA	Argentina	36.1	Telecommunications consultancy.	Liberalized.
Telesp Participações	Brazil (Sao Paulo)	34.1 <sup>(1)</sup>	Local telephony, Intraregional long distance and Data transmission.	Under a monopoly until mirror companies start operations (local and intraregional) and Embratel (intraregional) after July '99. On 1/1/2002 total opening of market to new entrants and current licence holders and mirror companies if they meet objectives early; entry of mirror companies in the remaining regions if they meet their objectives of 31/12/2003; entry of current licence holders in the remaining regions if they meet their objectives of 31/12/2003.
Telesudeste Celular Participações	Brazil (Rio de Janeiro, Espírito Santo)	16.6 <sup>(1)</sup>	Cellular telephony.	Under a duopoly until 1/1/2001 when PCS licences will be auctioned.
Teleste Celular Participações	Brazil (Bahia, Sergipe)	14.5 <sup>(1)</sup>	Cellular telephony.	Under a duopoly until 1/1/2001 when PCS licences will be auctioned.
Telesp Celular Participações	Brazil (Sao Paulo)	34.1 <sup>(1)</sup>	Cellular telephony.	Under a duopoly until 1/1/2001 when PCS licences will be auctioned.
Telefónica El Salvador	El Salvador	6.1	Basic telephony, Long distance, Mobile telephony and Data transmission.	Liberalized.

(1) Population in area of coverage

## Positioning of Telefónica Internacional



Capital of the US and some of the most important Central American business groups.

During the past year, **Telefónica Internacional** has maintained as its priority objective the creation of value for its shareholders by increasing the profitability of its investments, strengthening management from positions of control, and assuming a leadership role in its developing markets.

With this aim, the **Group** operating companies have concentrated their efforts on intensifying the customer focus of their activities, by giving a comprehensive response to their communication needs, as well as on efficiently managing their resources with a view to improving the quality and productivity indicators of the companies.

In the future, **Telefónica Internacional** will combine

the consolidation of the investments made with the aim of maximizing their profitability, with the search for new business opportunities in the region which guarantee company growth in the coming years.

### International Businesses

At end 1998, **Telefónica Internacional** participated

TAMAÑO DEL MERCADO. GRUPO TELEFÓNICA INTERNACIONAL										
Company	Lines in service			Cellular customers			Cable TV customers			DEC-31-97
	DEC-31-98	VAR 98/97	DEC-31-97	DEC-31-98	VAR 98/97	DEC-31-97	DEC-31-98	VAR 98/97	DEC-31-97	
CTC	2,649,786	10.7 %	2,393,707	554,225	151.8 %	220,070	280,570	9.4 %	256,524	
TASA	3,905,353	1.8 %	3,837,125	840,471 <sup>(1)</sup>	10.1 %	763,273	—	—	—	
TELEFÓNICA DEL PERÚ	1,555,746	-5.5 %	1,645,920	504,339	57.8 %	319,706	305,200	21.0 %	252,225	
TELESP + CTBC FIJA	6,407,452									
CRT <sup>(2)</sup>	1,438,600	39.4 %	1,031,806	552,658	53.8 %	359,344				
TELESUDESTE CELULAR <sup>(3)</sup>				772,141	—	—				
TELEESTE CELULAR <sup>(4)</sup>				226,785	—	—				
TELEFÓNICA EL SALVADOR <sup>(6)</sup>				20,052	—	—				
<b>TOTAL UNDER T.I. MANAGEMENT</b>	<b>15,956,940</b>	<b>79.1 %</b>	<b>8,908,558</b>	<b>3,470,671</b>	<b>108.8 %</b>	<b>1,662,393</b>	<b>585,770</b>	<b>15.1 %</b>	<b>508,749</b>	
CANTV	2,615,854	-3.2 %	2,702,609	639,107	70.5 %	374,875				
TELESP CELULAR				1,804,220	—	—				
CABLEVISIÓN <sup>(5)</sup>							1,501,997	44.0 %	1,043,111	
<b>TOTAL</b>	<b>18,572,794</b>	<b>60.0 %</b>	<b>11,611,167</b>	<b>5,913,998</b>	<b>190.3 %</b>	<b>2,037,268</b>	<b>2,087,767</b>	<b>34.5 %</b>	<b>1,551,860</b>	

(1) Cellular customers at 12/31/98 include 612,873 customers of 227,598 customers of TCP.

(2) Cellular customers at 12/31/98 include 542,695 cellular customers + 9,963 customers of Ruralcel.

(3) Includes the cellular customers of Telerj (Rio de Janeiro) and Telest (Espírito Santo).

(4) Includes the cellular customers of Telebahia (Bahia) and Telergipe (Sergipe).

(5) The merger-division process concluded on 7/1/98, therefore the data from Dec. 1998 cannot be compared to Dec. 1997.

(6) Telefónica El Salvador started the Movistar service on 7 Dec. 1998.

in the management of more than 18.5 million lines, which represents an interannual growth of 60%, primarily resulting from its winning control of **Telesp Participações**, which closed 1998 with plant in service exceeding 6.4 million lines. The entry of the company in Brazil has also enabled the Group to significantly enlarge the Group

customer base in cellular communications to over 5.9 million customers at end 1998, a figure three times the number of customers recorded in the preceding year.

Despite the slowdown experienced in the Latin American economies, the revenues of **Telefónica Internacional** grew 7.7%. However,

as a result of the important investments carried out, particularly the acquisitions in the Brazilian market, profits fell by 22.4%, to Pta. 27,266 billion, representing 26.3% of total consolidated revenues.

**Telefónica de Argentina** had nearly 4 million lines in service, representing a penetration rate of 23 lines per 100 inhabitants. This allowed **Telefónica de Argentina** to maintain its position as leading telecommunications company in the region. Since May 1998, the company has a 100% digitized network, capable of supporting the marketing of new value-added services aimed at residential and corporate customers.

**CTC** achieved a net gain of over 250,000 lines during 1998 for a total of 2.6 million lines in service, the only company that provides fixed-line telephone services throughout the country.

In order to strengthen its competitive position in the long-distance market segment, **CTC** acquired 100% of **VTR Larga Distancia** in October 1998. After only two years competing

in this business segment, **CTC's** market share has risen to 40%.

In Peru, **Telefónica del Perú** closed the year with more than 1.5 million lines, achieving 90% digitization of the network.

**CRT** recorded 39% growth of its plant in service during 1998, closing the year with more than 1.4 million lines. In only two years under **Telefónica Internacional** management, the plant in service of **CRT** has maintained an annual average growth of 36%, with an increase in the degree of digitization of 20 percentage points, bringing it to 71%.

In mobile telephony, **Telefónica de Argentina** closed the year with over 800,000 customers, distributed between its two affiliates, **Miniphone**, with operations in Buenos Aires, and **TCP**, whose area of coverage is located mainly in the southern part of the country. In Chile, **CTC** ended the year with nearly 555,000 customers through its affiliate Startel, registering an interannual growth of 152%, the result of the aggressive marketing policies applied and

**During the year, Telefónica consolidated its position in all of the countries where it operates, gaining a notable enlargement of its customer base in the different service segments.**





of the gradual reduction in service prices.

**Telefónica del Perú** enlarged its customer base 1.5 times in 1998, to more than 500,000 customers, thus continuing its leading position with a 66% market share.

The competitive capacity of the **Telefónica Group** was evident last year following the successful marketing push of the cellular service in El Salvador, when **Telefónica El Salvador** attracted over 20,000 customers in only 20 days of operation (capturing a 22% market share).

During 1998, the commitment of the **Telefónica Group** to give the cellular operations greater autonomy, to facilitate their expansion and development, involved structuring the cellular holdings in Perú and Brasil (**CRT**) as independent affiliates, in line with the cellular operators in Chile and Argentina.

In the public payphone service, **Telefónica de Argentina** had a total of 72,286 lines, representing

an annual growth of 25%. Likewise, **Telefónica del Perú** closed 1998 with 47,040 lines (23% more than in 1997), **CTC** with 13,619 (an interannual increase of 11%), **CRT** with 36,345 lines (25% interannual growth) and **Telesp Participações** with nearly 162,000 public payphones.

In the telephone directory business, the **Chilean Company Publiguías**, in which **Telefónica Internacional** holds a 51% equity stake, and **CTC** with 9%, has achieved a 54% penetration of the market, with over 3 million copies published. In Argentina, **Telinver**, publisher of **Páginas Doradas**, closed 1998 with a 13% growth in advertising sales, thanks to product improvements and more effective marketing processes. During the year, the companies have continued to further the development of multimedia-based products (CD-Rom), with the aim of encouraging new lines of business and fresh sources of revenue.

The operations of **Telefónica Internacional** in the region's cable TV business have consolidated

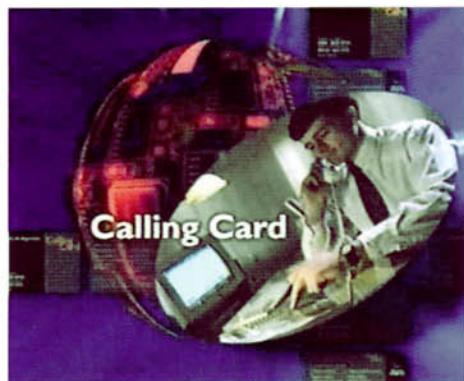


its position in the respective local markets, managing a combined total of over 2 million customers. In Argentina, **Cablevisión** had a total of 1.5 million customers at the end of the year, representing an annual growth rate of 44%, while in Chile and Peru, **Metropolis-Intercom** and **Cable Mágico** attained 280,000 and 305,000 customers (an interannual growth of 9% and 21%) respectively. In addition, **CTC**'s shareholding in **Metropolis-Intercom** rose to 40% in 1998 (up 10%).

Lastly, in the field of «on-line» service provision and access to the Internet network, **Advance Telecomunicaciones** is the leading Internet service provider in Argentina, with a market share of 43%. Since May 1998, **Advance Telecomunicaciones** was set up as an affiliate 100% controlled by **TASA** following

The successful bid to control **Telefónica El Salvador** comes within the Group's expansion plans in Central America.

At year-end, **Telefónica** participated in the management of 18.5 million lines in Latin America, with an annual growth of 60%.



the transfer of shares held by **TISA** and **CEI** to **Telefónica de Argentina**.

**Telefónica InterContinental, together with local partners, plans to develop telecoms ventures in Turkey.**

**Telefónica InterContinental is also participating in the international bidding for the second GSM licence in Morocco**

**The acquisition of European Telecom of Austria marks a new approach to developing business through alternative operators.**

### **Business opportunities in Europe and the Mediterranean**

The priority objectives of **Telefónica InterContinental** are focused on the development of business opportunities in Europe and the Mediterranean area, basically through the identification of projects with high potential for growth, strategic value and profitability.

Adhering to **Group** strategy, projects are undertaken together with local and financial partners. Such is the case of Turkey, where an accord has been reached with three of the principal industrial, financial and media groups of the country (Sabanci, Dogus and Dogan) to jointly develop telecommunications businesses through the third cellular licence (**DCS 1800**) and the privatization of **Turk Telecom**.

Similarly, **Telefónica InterContinental** is competing, in Morocco, in the international bidding for the second GSM licence, in partnership with Portugal Telecom and local banking institution Banque Marocaine de Commerce Exterieur.

In like manner, and within its strategy of consolidation as a European-based operator, **Telefónica InterContinental** acquired in February 1999 the alternative Austrian operator **European Telecom**, one of the main players in the Austrian telecoms sector. This operation will enable the **Telefónica Group** to initiate an innovative project for development of the telecoms business in third countries through alternative operators with important commercial potential. This approach could lead to further actions in other attractive markets in eastern and western Europe.

In Italy, and in parallel with other possible metropolitan projects, **Telefónica InterContinental** will jointly develop with its partner MCI WorldCom its penetration strategy in the large and medium-sized companies market.



100% Pure Baby Wool



100% Baby Wool

Woolmark  
Certified

100% Baby Wool

100% Baby Wool  
Woolmark  
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## Advanced Purchasing Systems

As part of the permanent process for reducing costs, improving competitiveness and generating value for the **Group**, in 1998 the **Advanced Purchasing System (APS)** was implemented, aimed at obtaining maximum quality, cost-effectiveness and service in all purchasing requirements.

The most outstanding characteristics of this new management system are globalization and coordination through joint purchasing and the establishment of common policies and strategies, transparency in the processes and decision-taking, speeding up bureaucratic procedures and more fluid communication between the technical and purchasing areas.

Application of **APS** started last year in the largest companies operating in Spain and since the end of the year it is being adopted by American operators. In 1998, this management system has achieved important cost reductions, with savings of 15% on purchase volumes of 500 billion pesetas. This approach will no doubt be consolidated in 1999 when purchases to the value of 2 trillion pesetas are foreseen.

### Real-estate activity

The application of new management models during the year has made it possible to rationalize services, optimize patrimony and reduce expenses by approximately Pta. 3 billion.

In this context, **Telefónica's «Communications City» project** aims to provide the **Group** with a new office complex whereby the use of rental property will be substituted by property ownership, providing annual savings of Pta. 3.8 billion

In December, within the overall framework of company reorganization of the **Telefónica Group, Inmobiliaria Telefónica**

was set up with assets of 62 buildings and a book value of Pta. 224.542 billion. The process of incorporating assets will continue in 1999, defining a market position, while maintaining the focus on providing a real estate service for the **Telefónica Group**.

## The Millennium and Euro corporate projects

During 1998, and in the context of the **Millennium**, decisive progress has been made in adapting the systems installations and other facilities to ensure correct functioning of the computer systems in the year 2000. In the first quarter of 1999, all elements will have been adapted and tested, and throughout the year comprehensive trial runs of business processes will be carried out. A **Contingencies Plan** has also been prepared.

Additionally, the **Euro Project** embraces the combined actions necessary to adjust operations to the new monetary unit, adapting

to the needs of our customers and shareholders.

Since October 1998, telephone billing information in euros has been offered through **Telefónica's Virtual Shop** and through the **Consumer Information Service**, as well as through the «on line» billing service.

## European Regional Programs

In the past year, **Telefónica** has maintained its participation in the European programs backed by the Structural Funds (Feder and FSE) aimed at correcting imbalances through actions in the field of communications, applications, training and technological research and development.

In this regard, **Telefónica** has taken steps to modernize infrastructures, promote advanced services and develop new applications and solutions that could contribute to furthering the information society in underprivileged regions.

## Telefónica, leader in solidarity

**Telefónica** is carrying out an enormous technological, financial and business effort to face the new challenges posed today by telecommunications and the information society, because it intends to be in the group at the head of the sector worldwide.

But **Telefónica** is also a business group committed to the development of the countries and societies where it is present as an operating company, and it also wants to be a leader in solidarity and social commitment, developing social applications from the technologies in order to respond in solidarity with the needs of today's society.

Therefore, **Telefónica** has set up **Foundations** in Argentina, Brasil, Chile, Spain and Peru as instruments capable of channeling its social action in those countries and thus promote the human side of technology.

Education and promotion of equality of opportunity, improvement of the quality of life of the underprivileged, community development and art and culture are the basic fields of activity of these institutions, to which important economic and management resources are allocated.





**Consolidated Annual Accounts  
and Management Report  
for fiscal years 1998 and 1997  
along with the Auditor's Report  
of the Telefónica Group**

# ARTHUR ANDERSEN

Raimundo Fdez. Villaverde, 65  
28003 Madrid

Translation of a report and consolidated financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 25).

In the event of a discrepancy, the Spanish-language version prevails.

## AUDITORS' REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

To the Stockholders of Telefónica, S.A.:

1. We have audited the consolidated financial statements of Telefónica, S.A. and Companies composing the Telefónica Group (see composition in Exhibit I), which consist of the consolidated balance sheets as of December 31, 1998 and 1997, and the related consolidated statements of income and notes to consolidated financial statements for the years then ended. The preparation of these consolidated financial statements is the responsibility of the Controlling Company's directors. Our responsibility is to express an opinion on the consolidated financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the consolidated financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made.
2. As explained in Note 2, the Board of Directors of Telefónica, S.A. prepared the consolidated financial statements for 1998 and 1997 in pesetas, the currency in which entries are made in the Controlling Company's books of account. In addition, comparative information in euros is presented in the consolidated balance sheet and consolidated statement of income for 1998 and 1997, pesetas being translated to euros at the exchange rate set on December 31 by the Council of the European Union for application from January 1, 1999 (Ptas. 166.386/euro). This information cannot be considered to form an integral part of the audited consolidated financial statements.
3. To tackle the new challenges facing the telecommunications industry at short and medium term, in 1998 management of the Telefónica Group took various strategic decisions relating to its sizing and organization policy, evaluated the cost of these decisions and recorded, with a charge to extraordinary expenses, the provisions it considered necessary, basically for the voluntary "preretirements" and early retirements expected to take place in 1999 and 2000 amounting to Ptas. 459,500 million (see Notes 4-1 and 20). Since acceptances of this plan by employees and employers commenced in 1999 (see Note 23), this provision must be considered excessive.

Arthur Andersen y Cía., S. Com.  
Reg. Merc. Madrid, Tomo 3190, Libro 0, Folio 1,  
Sec. 8, Hoja M-54414, Inscript. 1.<sup>a</sup>

Inscrita en el Registro Oficial de Auditores de  
Cuentas (ROAC)  
Inscrita en el Registro de Economistas Auditores (REA)

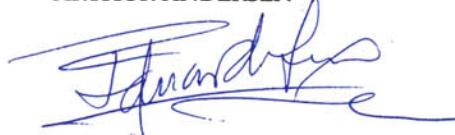
Domicilio Social:  
Raimundo Fdez. Villaverde, 65. 28003 Madrid  
Código de Identificación Fiscal D-79104469

Also, a credit for the same amount as the recorded provision was made to extraordinary revenues, with charges of Ptas. 298,675 million and Ptas. 160,825 million to unrestricted reserves and prepaid taxes (see Notes 4-l, 11-c and 20). Although under Spanish corporate law unrestricted reserves can be released subject to prior resolution of the Stockholders' Meeting, under Spanish accounting regulations, reserves cannot be reversed to income for the year.

To adjust the aforementioned accounting entries, unrestricted reserves should be increased by Ptas. 298,675 million, provisions and prepaid taxes should be reduced by Ptas. 459,500 million and Ptas. 160,825 million, respectively, and extraordinary revenues and expenses for 1998 should be reduced by Ptas. 459,500 million.

4. In our opinion, except for the effect of the matter described in paragraph 3 above, which only affects 1998, the consolidated financial statements referred to above present, in all material respects, a true and fair view of the net worth and financial position of Telefónica, S.A. and Companies composing the Telefónica Group as of December 31, 1998 and 1997, and of the results of their operations and of the funds obtained and applied by them in the years then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with generally accepted accounting principles and standards applied on a consistent basis.
5. The accompanying consolidated management report for 1998 contains the explanations which the directors of Telefónica, S.A. consider appropriate about the Telefónica Group's situation, the evolution of its business and other matters, but is not an integral part of the consolidated financial statements. We have checked that the accounting information in the management report is consistent with that contained in the consolidated financial statements for 1998. Our work as auditors was confined to checking the consolidated management report with the aforementioned scope, and did not include a review of any information other than that drawn from the accounting records of the consolidated companies.

ARTHUR ANDERSEN



Eduardo Sanz Hernández

February 25, 1999

**TELEFÓNICA GROUP**  
**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1998 AND 1997**

	Consolidated Group Millions of Pesetas		Consolidated Group Millions of Euros Note 2-e	
	1998	1997	1998	1997
<b>ASSETS</b>				
A) DUE FROM STOCKHOLDERS FOR UNCALLED CAPITAL	513	446	3,1	2,7
B) FIXED AND OTHER NONCURRENT ASSETS	6,654,338	4,987,098	39,993,5	29,973,3
I. Start-up expenses	16,285	2,337	97,9	14,0
II. Intangible assets (Note 6)	1,100,180	356,109	6,612,2	2,140,3
Research and development expenses	142,309	120,582	855,3	724,7
Administrative concessions	929,692	229,776	5,587,6	1,381,0
Rights on leased assets	17,376	16,336	104,4	98,2
Other intangible assets	186,602	118,797	1,121,5	714,0
Accumulated amortization	(175,799)	(129,382)	(1,056,6)	(777,6)
III. Property and equipment (Note 7)	4,629,131	4,148,113	27,821,7	24,930,9
Land and structures	839,245	717,016	5,044,0	4,309,4
Technical installations and machinery	161,816	159,392	972,5	958,0
Telephone installations	6,937,564	6,035,655	41,695,6	36,275,0
Furniture	329,509	256,411	1,980,4	1,541,1
Construction in progress	395,465	396,465	2,376,8	2,382,8
Advances on property and equipment	1,982	2,288	11,9	13,8
Installation materials	40,457	38,977	243,2	234,3
Accumulated depreciation	(4,076,907)	(3,458,091)	(24,502,7)	(20,783,5)
IV. Long-term financial investments (Note 8)	908,742	480,539	5,461,7	2,888,1
Holdings in associated companies	345,614	201,390	2,077,2	1,210,4
Other holdings	78,998	92,642	474,8	556,8
Other loans	172,042	96,834	1,034,0	582,0
Long-term deposits and guarantees	13,321	1,754	80,1	10,5
Receivable from public authorities (Note 18)	302,869	92,763	1,820,3	557,5
Provisions	(4,102)	(4,844)	(24,7)	(29,1)
C) GOODWILL IN CONSOLIDATION (Note 5)	399,623	284,364	2,401,8	1,709,1
D) DEFERRED CHARGES (Note 9)	138,376	135,103	831,7	812,0
E) CURRENT ASSETS	1,053,274	817,750	6,330,3	4,914,8
I. Inventories	49,172	37,691	295,6	226,6
Inventories	46,438	40,149	279,1	241,3
Advances	4,968	144	29,9	0,9
Provisions	(2,234)	(2,602)	(13,4)	(15,6)
II. Accounts receivable	876,687	629,230	5,269,0	3,781,8
Customer receivables (Note 10)	664,573	479,916	3,994,2	2,884,4
Receivable from associated companies	10,082	4,391	60,6	26,4
Sundry accounts receivable	135,553	113,138	814,7	680,0
Employee receivables	12,065	12,612	72,5	75,8
Receivable from public authorities (Note 18)	186,709	87,188	1,122,1	524,0
Allowance for bad debts (Note 10)	(125,907)	(61,355)	(756,7)	(368,8)
Allowances for sundry accounts receivable	(6,388)	(6,660)	(38,4)	(40,0)
III. Short-term financial investments	60,400	126,093	363,0	757,8
Loans to group and associated companies	8,131	0	48,9	0,0
Short-term investment securities	44,283	85,331	266,1	512,8
Other loans	8,109	40,770	48,7	245,0
Provisions	(123)	(8)	(0,7)	0,0
IV. Short-term treasury stock (Note 11)	4,863	369	29,2	2,2
V. Cash	23,795	10,432	143,0	62,7
VI. Accrual accounts	38,357	13,935	230,5	83,8
<b>TOTAL ASSETS (A+B+C+D+E)</b>	<b>8,246,124</b>	<b>6,224,761</b>	<b>49,560,2</b>	<b>37,411,6</b>

The accompanying Notes I to 25 and Exhibits I to VI are an integral part of these consolidated balance sheets.

**TELEFÓNICA GROUP**  
**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1998 AND 1997**

	Consolidated Group Millions of Pesetas		Consolidated Group Millions of Euros Note 2-e	
	1998	1997	1998	1997
<b>STOCKHOLDERS' EQUITY AND LIABILITIES</b>				
<b>A) STOCKHOLDERS' EQUITY (Note 11)</b>	<b>2,246,214</b>	<b>1,991,374</b>	<b>13,500,0</b>	<b>11,968,4</b>
I. Capital stock	512,439	469,735	3,079,8	2,823,2
II. Additional paid-in capital	427,398	43,067	2,568,7	258,8
III. Revaluation reserve	569,717	868,392	3,424,1	5,219,1
IV. Other controlling company reserves	323,159	269,863	1,942,2	1,621,9
Unrestricted reserves	229,126	175,779	1,377,1	1,056,5
Restricted reserves	93,947	93,947	564,6	564,6
Prior years' income	86	137	0,5	0,8
V. Reserves at companies consolidated by the global integration method	104,012	97,347	625,1	585,1
VI. Reserves at companies consolidated by the equity method	29,212	29,230	175,6	175,7
VII. Translation differences in consolidation	62,693	61,256	376,8	368,2
VIII. Income for the year	217,584	190,063	1,307,7	1,142,3
Income of the parent company and subsidiaries	297,936	254,147	1,790,6	1,527,5
Income of associated companies	12,199	9,958	73,3	59,8
Income attributed to minority interests (Note 12)	(92,551)	(74,042)	(556,2)	(445,0)
IX. Interim dividend paid during the year	0	(37,579)	0,0	(225,9)
<b>B) MINORITY INTERESTS (Note 12)</b>	<b>589,927</b>	<b>394,097</b>	<b>3,545,5</b>	<b>2,368,6</b>
<b>C) DEFERRED REVENUES (Note 13)</b>	<b>121,357</b>	<b>112,471</b>	<b>729,4</b>	<b>676,0</b>
<b>D) PROVISIONS FOR CONTINGENCIES AND EXPENSES (Note 14)</b>	<b>992,312</b>	<b>388,896</b>	<b>5,963,9</b>	<b>2,337,3</b>
<b>E) LONG-TERM DEBT</b>	<b>2,278,729</b>	<b>1,916,627</b>	<b>13,695,3</b>	<b>11,519,1</b>
I. Debentures, bonds and other negotiable instruments (Note 15)	928,959	714,923	5,583,1	4,296,7
Nonconvertible debentures and bonds	836,443	611,472	5,027,1	3,675,0
Convertible debentures and bonds	92,516	103,149	556,0	619,9
Other marketable debt securities	0	302	0,0	1,8
II. Payable to credit entities (Note 16)	1,168,880	942,728	7,025,1	5,665,9
III. Other accounts payable	62,547	174,505	375,9	1,048,8
Other accounts payable (Notes 2-d and 4-l)	60,369	174,505	362,8	1,048,8
Notes payable	2,178	0	13,1	0,0
IV. Accrued taxes payable (Note 18)	117,424	83,444	705,7	501,5
V. Uncalled capital payments payable (Note 8)	919	1,027	5,5	6,2
Associated companies	800	452	4,8	2,7
Other companies	119	575	0,7	3,5
<b>F) CURRENT LIABILITIES</b>	<b>2,017,585</b>	<b>1,421,296</b>	<b>12,125,9</b>	<b>8,542,2</b>
I. Debentures, bonds and other marketable debt securities (Note 15)	234,686	284,018	1,410,5	1,707,0
Debentures	155,155	192,201	932,5	1,155,2
Other negotiable instruments	56,848	77,274	341,7	464,4
Interest on debentures and other securities	22,683	14,543	136,3	87,4
II. Payable to credit entities	884,630	336,525	5,316,7	2,022,6
Loans and other accounts payable (Note 16)	845,179	322,515	5,079,6	1,938,4
Interest payable	39,451	14,010	237,1	84,2
III. Payable to associated companies	17,333	15,080	104,2	90,6
IV. Trade accounts payable	387,463	351,357	2,328,7	2,111,7
Advances received on orders	2,418	2,961	14,5	17,8
Payables for purchases and services	380,307	344,832	2,285,7	2,072,5
Notes payable	4,738	3,564	28,5	21,4
V. Other nontrade payables	448,850	382,872	2,697,6	2,301,1
Accrued taxes payable (Note 18)	174,007	91,407	1,045,8	549,4
Other nontrade payables (Note 19)	274,843	291,465	1,651,8	1,751,7
VI. Accrual accounts	44,623	51,444	268,2	309,2
<b>TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES (A+B+C+D+E+F)</b>	<b>8,246,124</b>	<b>6,224,761</b>	<b>49,560,2</b>	<b>37,411,6</b>

The accompanying Notes I to 25 and Exhibits I to VI are an integral part of these consolidated balance sheets.

**TELEFÓNICA GROUP**  
**CONSOLIDATED STATEMENTS OF INCOME AS OF DECEMBER 31, 1998 AND 1997**

DEBIT	Consolidated Group Millions of Pesetas		Consolidated Group Millions of Euros Note 2-e	
	1998	1997	1998	1997
A) EXPENSES				
Reduction in inventories	1.740	758	10,5	4,6
Supplies	366.673	334.068	2.203,7	2.007,8
Purchases	228.954	195.132	1.376,0	1.172,8
Work performed by other companies	137.719	138.936	827,7	835,0
Personnel expenses (Note 20)	650.171	570.895	3.907,6	3.431,1
Period depreciation and amortization	725.434	602.657	4.359,9	3.622,1
Property and equipment (Note 7)	673.531	565.472	4.048,0	3.398,6
Intangible assets (Note 6)	47.061	35.575	282,8	213,8
Deferred charges	4.842	1.610	29,1	9,7
Variation in operating provisions	106.105	35.757	637,7	214,9
Variation in provision for inventories	(312)	1.150	(1,9)	6,9
Variation in allowance for bad debts	102.963	22.711	618,8	136,5
Variation in other operating provisions	3.454	11.896	20,8	71,5
Other operating expenses	394.498	321.521	2.370,9	1.932,4
Outside services	322.159	260.760	1.936,2	1.567,2
Taxes other than income tax	48.125	38.763	289,2	233,0
Other operating expenses	24.214	21.998	145,5	132,2
I. OPERATING INCOME	815.278	660.454	4.900,0	3.969,3
Interest on payables to associated companies	165	0	1,0	0,0
Other interest on accounts payable and similar expenses (Note 20)	241.035	189.967	1.448,6	1.141,7
Amortization of deferred interest expenses	4.776	3.754	28,7	22,6
Variation in financial investment provisions	16.868	6.464	101,4	38,8
Exchange losses (Note 20)	22.580	21.066	135,7	126,6
II. FINANCIAL INCOME	—	—	—	—
Share in losses of companies carried by the equity method	17.928	10.968	107,7	65,9
Amortization of goodwill in consolidation (Note 5)	21.135	33.312	127,0	200,2
III. INCOME FROM ORDINARY ACTIVITIES	576.706	449.367	3.466,2	2.700,6
Variation in control portfolio provisions	(724)	213	(4,4)	1,3
Losses on fixed assets	26.267	27.513	157,9	165,4
Losses on disposals of consolidated companies (Note 8)	49	68	0,3	0,4
Extraordinary expenses and losses (Note 20)	663.380	135.593	3.987,0	814,9
IV. EXTRAORDINARY INCOME	—	—	—	—
V. INCOME BEFORE TAXES	402.010	337.641	2.416,3	2.029,1
Corporate income tax (Note 18)	40.074	36.554	240,8	219,7
Foreign taxes (Note 18)	51.801	36.982	311,3	222,3
VI. CONSOLIDATED INCOME FOR THE YEAR	310.135	264.105	1.864,2	1.587,1
Income attributed to minority interests (Note 12)	92.783	74.282	557,6	446,4
VII. INCOME FOR THE YEAR	217.584	190.063	1.307,7	1.142,3

The accompanying Notes I to 25 and Exhibits I to VI are an integral part of these consolidated statements of income

**TELEFÓNICA GROUP**  
**CONSOLIDATED STATEMENTS OF INCOME AS OF DECEMBER 31, 1998 AND 1997**

	Consolidated Group Millions of Pesetas	Consolidated Group Millions of Euros Note 2-e	1998	1997
	1998	1998	1997	1997
<b>CREDIT</b>				
B) REVENUES				
Net sales and services (Note 20)	2.906.021	17.465,5	2.363.102	14.202,5
Variation in work-in-process	10.192	61,3	3.779	22,7
Capitalized expenses of in-house work on fixed assets	124.310	747,1	117.932	708,8
Other operating revenues	19.376	116,4	41.297	248,2
Sundry and other current operating revenues	14.746	88,6	36.795	221,1
Subsidies (Note 13)	978	5,9	1.639	9,9
Overprovision for contingencies and expenses	3.652	17,2	2.863	21,9
<b>I. OPERATING LOSS</b>	—	—	—	—
Income from shareholdings	1.845	11,1	1.769	10,6
Associated companies	14	0,1	23	0,1
Other companies	1.831	10,5	1.746	11,0
Revenues from other securities and loans	38.115	141,8	23.604	229,1
Associated companies	1.161	4,1	687	7,0
Other companies	36.954	137,7	22.917	222,1
Exchange gains	15.828	49,0	8.145	95,1
<b>II. FINANCIAL LOSS</b>	229.636	1.128,3	187.733	1.380,1
Equity in income of companies carried by the equity method	30.127	125,7	20.926	181,0
<b>III. LOSS ON ORDINARY ACTIVITIES</b>	—	—	—	—
Gains on fixed asset disposals	2.310	4,3	709	13,9
Gains on disposals of holdings in consolidated companies (Note 8)	23.897	164,5	27.371	143,6
Capital subsidies	12.088	67,8	11.285	72,7
Extraordinary revenues (Note 20)	475.981	74,0	12.296	2.860,8
<b>IV. EXTRAORDINARY LOSS</b>	174.696	671,5	111.726	1.049,9
<b>V. LOSS BEFORE TAXES</b>	—	—	—	—
<b>VI. CONSOLIDATED LOSS FOR THE YEAR</b>	—	—	—	—
Loss attributed to minority interests (Note 12)	232	1,4	240	1,4
<b>VII. LOSS FOR THE YEAR</b>	0	0,0	0	0,0

The accompanying Notes I to 25 and Exhibits I to VI are an integral part of these consolidated statements of income



Translation of reports and consolidated financial statements originally issued in Spanish  
and prepared in accordance with generally accepted accounting principles  
in Spain (see Note 25). In the event of a discrepancy,  
the Spanish-language version prevails.

**TELEFÓNICA, S.A.  
AND COMPANIES COMPOSING THE TELEFÓNICA GROUP**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR YEARS ENDED  
DECEMBER 31, 1998 AND 1997**

**I. INTRODUCTION AND GENERAL INFORMATION**

**Group companies**

Telefónica, S.A. and its subsidiaries and investees make up an integrated group of companies ("the Telefónica Group") operating mainly in the telecommunications, media and entertainment industries.

The parent company of this Group is Telefónica, S.A. ("Telefónica"), a corporation that was formed for an indefinite period of time on April 19, 1924. Its registered office is at Gran Vía 28, Madrid (Spain).

Exhibit I to these notes to consolidated financial statements lists the dependent, associated and investee companies in which Telefónica has direct or indirect holdings and their lines of business, net worth and earnings at year-end and the contribution to consolidated Group reserves.

**Corporate structure of the Group**

The Company's basic corporate purpose, per Article 4 of its bylaws, is the provision of all manner of public and private telecommunications services, and all manner of ancillary or supplementary telecommunications services or the services derived therefrom. All the activities that constitute the corporate purpose may be performed either in Spain or abroad and may be carried on either wholly or partially by the Company, or through shareholdings or participations in other companies or legal entities with an identical or similar corporate purpose.

On March 17, 1998, the Stockholders' Meeting approved a new organizational structure for the Telefónica Group for the performance of the activities that make up its corporate purpose and that of the various companies composing its corporate Group. Under the new organizational structure, Telefónica (previously known as "Telefónica de España, S.A.") will have the position of parent company and head of the corporate Group and will pursue its corporate purpose through various directly controlled subsidiaries, which were identified and structured during the months of 1998 that followed the Stockholders' Meeting.

At the end of 1998, the main dependent companies through which Telefónica pursues its corporate purpose and manages its basic lines of business were: Telefónica Móviles (which is responsible for the management and operation of mobile services in Spain, especially mobile telephones), Telefónica Internacional (mainly responsible for making and managing investments in the telecommunications industry in America), Telefónica Intercontinental (which makes and manages investments in the telecommunications industry outside Spain and America), Telefónica Media (which operates in the media and entertainment industries), Telefónica Data (whose principal activity is the provision of integral data transmission services for companies), and Telefónica Comunicaciones Interactivas (which provides Internet access and related services and interactive services in general).

At the end of 1998, the most significant and relevant part of the restructuring of the Telefónica Group had been completed, with the subsidiarization of the basic Spanish domestic telecommunications business (especially fixed line telephony) through the transfer to another wholly-owned subsidiary, "Telefónica, Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A." –a sole shareholder company-, of the personnel and assets and liabilities assigned to operations in this business area.

**Framework for the provision of telecommunications services in Spain**

The process of deregulation of the telecommunications industry in Spain, which started in 1987, was marked by two milestones up to 1997: a) the deregulation of Data Transmission Services (Royal Decree 804/1993 enacting the Regulations on Technical Matters

and on Provision of the Value Added Telecommunications Service of Supply of Packet or Circuit Data Switching) and b) the opening to competition of automatic mobile telephony services.

Despite this, the most important milestone in the telecommunications deregulation process has, without doubt, been the opening to competition of the market in fixed line public telephony, first in a restricted way with the appearance of a second global operator (Retevisión) and some cable operators who obtained licenses to perform this service within their geographical areas (Law 12/1997 on the Deregulation of the Telecommunications Industry), and then completely on December 1, 1998, after the passing of the General Telecommunications Law and its implementing regulations.

The basis of the legal regime for the telecommunications industry in Spain is now the General Telecommunications Law 11/1998 (LGT), which establishes, amongst other things, fundamental principles relating to the following:

- Telecommunications are regarded as services in the general interest that are provided under a system of competition, there being a public service only in relation to those services and obligations that are enumerated by the Law.
- The performance of the different services and the establishment and operation of networks remain part of a system of General Authorizations and Individual Licenses.
  - An Individual License is required to establish or operate public telecommunications networks, to provide public telephone services, and, when necessary, to use the radio wave public domain. In all other cases a General Authorization is required.
  - Conditions of access and interconnection to public networks, their interoperability, and the assignment and management of numbering resources.
  - Definition of public service obligations, especially those relating to the Universal Telecommunications Service. The creation of the National Universal Telecommunications Service Fund as a mechanism to finance the public service, and the obligation to contribute to the Fund.
  - Criteria to define the dominant operator in each of the different areas. The specific obligations that this operator must fulfil, in terms of the publication of an Interconnection Reference Offer, the determination of interconnection prices based on the principles of transparency and cost orientation, and the provision of the universal service.  
Telefónica, as the initially dominant operator, must guarantee the provision of the universal service until the year 2005.
  - Application of levies and fees, management of the radiowave public domain, and inspection and sanction powers.

Within the new framework, the current regulatory system is one of full competition in all the services provided by Telefónica, only restricted in some cases regarding the number of licenses because of the lack of resources to support these services.

The provision of telecommunications services by Telefónica, especially the telephone service, is governed by the State License Contract signed in 1991. However, Telefónica has requested the transformation of this Contract into licenses and authorizations within the new legal framework (LGT and its implementing regulations). Telefónica is now waiting for this request to be processed and resolved.

The main telecommunications services that the Telefónica Group currently provides or can provide are as follows:

- Fixed line public telephone service, the provision of which is subject, under the LGT, to the obtainment of an individual license, issuable in unlimited numbers, which can either cover the whole of Spain or be restricted to smaller areas. This license also permits circuit-rental services, which are considered by the LGT to be obligatory telecommunications services. The holder of this license is Telefónica Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A. To date 11 national and 5 provincial licenses have been granted.
- Servicio de Telefonía Móvil Automática is subject under the LGT to an individual license, and the number of these licenses is expected to be limited. To date only one license has been granted, in addition to those already issued to Telefónica Servicios Móviles and Airtel Móvil. This license is specifically for the provision of DCS-1800 personal communication services, which the current operators can also provide. Additionally, Telefónica provides this same service on a monopoly basis with analog technology, which must be discontinued by January 1, 2007.
- Provision of the packet- and circuit-switched data transmission service, which under the LGT requires a General Authorization, and an Individual License when the corresponding network is also operated. At present 11 licenses have been granted for this service, and they need to be converted as stipulated. One of these licenses is granted to Telefónica Transmisión de Datos.
- Information Access Service originally operated by Telefónica under the "Infovía" name, currently "Infovía Plus" which under the LGT requires general authorization, of which Telefónica Sociedad Operadora de Servicios de Telecomunicaciones en España will have to become the holder when appropriate.
- Cable Telecommunications Services, which Telefónica has the right to provide as part of the basic telephone service in each area in which it is requested. Competition in each of these areas is limited to one operator, and Telefónica cannot commence its operations until 24 months have elapsed from the date of the award to the competing operator, or, if there is no award of a license to another operator after the tender process, Telefónica may commence its operations immediately.

The license award process has been completed in the 43 areas of Spain, although in 6 cases no tenders were submitted.

- Sound radio and television services, in competition with a limited number of participants, not addressed in the LGT. The Telefónica Group has a presence in this market via Antena 3 de Televisión, S.A. and DTS Distribuidora de Televisión Digital, S.A. (Via Digital).
- Voice telephony in closed user groups, which requires a Type A general authorization.
- Satellite telecommunications services, which need a general authorization, and an individual license when the corresponding network is also being operated.
- Services relating to safety of human life at sea and public maritime correspondence, which Telefónica is required to provide for a period of four years from the entry into force of the LGT.

**Rate system-**

The License Contract entered into with the State in 1991 established a system of regulated rates and prices aimed at guaranteeing the overall financial balance of the concession while safeguarding the principle of universal service. To that end, prior to the passing of the LGT, basic telephone rates were approved by the Government at the proposal of the Ministry of Development, and subject to a report by the Telecommunications Market Commission since its creation.

The rates for the remaining services, which have already been deregulated, such as data transfer and mobile telephony, may be freely established, the only obligation being to notify the Administration of them. The only exception to this case has been that of mobile analog telephony (Movilne), since it is a monopoly with rates set by the Administration.

The new LGT established the general principle that the operators are free to determine their rates. However, the Fourth Transitory Provision of the LGT stipulates that the Government's Standing Committee on Economic Affairs, at the proposal of the Ministry of Development and subject to a report by the Telecommunications Market Commission, may temporarily establish fixed maximum and/or minimum rates or the methods to be used to set them, based on the actual cost of providing the service and on the level of supply by operators in the market for the various services.

The LGT also recognizes the existence of an imbalance in the rates applicable at the date of its publication and the need to redress the balance, as well as the possibility of compensating the dominant operator for the shortfall in access that may be caused by this situation.

In application of the above, the Ministerial Order of July 31, 1998, on rebalancing the rates for the services provided by Telefónica set the rates for its services and approved a discount system for the principal rates. Another Ministerial Order published on the same date established a range of maximum and minimum rates for the analog mobile telephony service.

Telefónica considers that the aforementioned rate imbalance was not offset by the rates set in the Ministerial Order, so it regards this to be the first step in a rate adjustment process in an open market; also, the Company has submitted an estimate of the shortfall in access that it has suffered, and continues to call for the completion of the rate rebalance process so that its competitiveness is not impaired.

Also, in the new framework of competition in the basic telephone service, the interconnection rates, as well as the established requirements for the granting of licenses, are becoming the determining factors in the short-term development of the system. In this connection, the rates in force from December 1, 1998, were set by the Ministry when it approved the Interconnection Reference Offer on October 29, 1998, although Telefónica has appealed against that approval.

**Tax Regime.**

Telefónica and those Group companies that meet the necessary requirements file consolidated corporate income tax returns.

Pursuant to a Ministerial Order of December 27, 1989, issued by the Directorate-General of Taxation, Telefónica was authorized to file consolidated corporate income tax returns for 1990, 1991 and 1992. This authorization was extended to 1993, 1994 and 1995 by a Ministerial Order of July 21, 1993. Subsequently the Stockholders' Meetings on March 29, 1996 and March 17, 1998, decided that the Company and its corporate Group would continue to file tax returns for 1996, 1997 and 1998, and 1999, 2000 and 2001, respectively, under the aforementioned special consolidated tax regime.

**2. BASIS OF PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS**

**a) True and fair view-**

The accompanying consolidated financial statements of the Telefónica Group were prepared from the accounting records of Telefónica, S.A. and from those of each of the companies which compose the Telefónica Group. The respective individual financial statements were prepared by each company's directors in accordance with the accounting principles and standards regulated in Spain by the Commercial Code as implemented by the Spanish National Chart of Accounts and in the applicable regulations in the different countries in which the companies composing the Consolidated Group are located, and are presented in accordance with the regulations for the preparation of consolidated financial statements, as approved by Royal Decree 1815/1991. Accordingly, these consolidated financial statements give a true and fair view of the net worth, financial position, results and funds obtained and applied in 1998 and 1997.

The Telefónica Group's consolidated financial statements as of December 31, 1998, were prepared by Telefónica's directors only in Spanish pesetas, so the accompanying data in euros are only included for information purposes (see Note 2-e), and will be submitted for approval by the Stockholders' Meeting. It is considered that they will be approved without any changes. The 1997 consolidated financial statements of the Telefónica Group were approved by the Stockholders' Meeting of the Company on March 17, 1998.

The figures in these consolidated financial statements, and the management report, are expressed in millions of Spanish pesetas unless otherwise stated.

**b) Consolidation principles-**

The companies over which effective control is exercised by virtue of ownership of a majority of the voting rights in their representation and decision-making bodies were consolidated by the global integration method; those in which there is significant influence but not ownership of a majority of the voting rights or joint management with third parties are carried by the equity method. Significant influence is deemed to exist if the ownership interest exceeds 20% in the case of unlisted companies or 3% in the case of listed companies.

Telesp Participações, S.A., Tele Leste Celular Participações, S.A., TeleSudeste Celular Participações, S.A., Telesp Celular Participações, S.A. and C.R.T., in which the Group has 12.1%, 7.32%, 15.9% and 16.7% holdings, respectively, purchased in August 1998, were carried in 1998 by the equity method pursuant, inter alia, to article 11 of Royal Decree 1815 which lays down rules for the drawing up of consolidated financial statements.

The amounts of the main balance sheet aggregates in the financial statements of the companies mentioned above as of December 31, 1998, are as follows:

Direct and Indirect Participation in Capital Stock	Telesp Participações 12,1%	Tele Leste Celular Participações 7,32%	TeleSudeste Celular Participações 15,9%	(*) Telesp Celular Participações 6,9%	C.R.T. 16,7
Fixed assets	1,547,137	40,675	118,129	251,635	368,892
Current assets	181,176	10,647	32,989	33,638	36,578
Non-Financial Liabilities	(267,364)	(13,169)	(32,758)	(41,392)	(98,717)
Financial Liabilities	(110,828)	(10,761)	(4,108)	(88,285)	(101,956)
Cash	97,602	1,944	9,945	32,210	11,178
<b>Net worth</b>	<b>1,447,723</b>	<b>29,336</b>	<b>124,197</b>	<b>187,806</b>	<b>215,975</b>
Shareholders' equity	1,001,606	25,630	105,583	138,801	215,975
Minority Interests	446,117	3,706	18,614	49,005	—

(\*) As of September, 1998

All material accounts and transactions between the consolidated companies were eliminated in consolidation. In the case of Group's companies whose accounting and valuation methods differed from those of Telefónica, adjustments were made in consolidation so as to present the consolidated financial statements on a uniform basis. The margins included in the invoices issued by dependent companies to Telefónica for capitalizable assets or services are eliminated at the time of the transaction, and this income is recognized as the related installations are depreciated.

The consolidated statement of income includes the revenues and expenses of the companies that are no longer in the Group up to the date when the holding was sold or the company was liquidated, and those of the new companies in the Group from the date when the holding was acquired or the company was formed up to year-end.

The equity of the minority interests in the net worth and results of the consolidated dependent companies consolidated by the global integration method is recorded under the "Minority Interests" and "Income Attributed to Minority Interests" captions (see Note 12).

In accordance with standard practice in Spain, the accompanying consolidated financial statements do not include the tax effect, if any, of transferring the reserves of the consolidated dependent companies and holdings carried by the equity method to the controlling company's accounts, since it is considered that such reserves will be used to finance their operations and that those that may be distributed will not give rise to a material additional tax cost.

**c) Comparative information-**

In 1998, Telefónica de Argentina, S.A., in which Cointel has a 58.04% holding, and Cointel itself, were consolidated by the global integration method, as a result of the increase to more than 50% of Telefónica Internacional, S.A.'s holding in Cointel in 1997 and of the agreements reached with shareholders. Had this consolidation method been applied in the 1997 financial statements, the effect would have been as follows:

## BALANCE SHEET

ASSETS		STOCKHOLDERS' EQUITY AND LIABILITIES	
Fixed and other noncurrent assets	671,975	Minority interests	336,584
Start-up expenses	830	Provisions for contingencies	29,585
Intangible assets	1,870	Long-term debt	270,797
Tangible fixed assets	707,566	Current liabilities	278,701
Long-term financial investments	(38,291)		
Deferred charges	4,701		
Current assets	238,991		
Variation in assets	915,667	Variation in stockholders' equity and liabilities	915,667
STATEMENT OF INCOME			
DEBIT		CREDIT	
Operating expenses	235,039	Operating revenues	363,860
Financial expenses	28,172	Financial revenues	5,731
Minority interests	45,340	Income of Companies carried by equity method	(8,090)
Extraordinary and other income	21,878		
Tax on earnings	31,072		
Variation in Expenses	361,501	Variation in Revenues	361,501

In 1998 the accounting rule for goodwill in consolidation was changed to extend the maximum period of amortization from 10 years to 20 without modifying amortization recorded in previous years. Amortization recorded in 1997 was based on a maximum period of 10 years. Under the new legislation, goodwill in consolidation is amortized on a straight-line basis over a maximum period of 20 years, which is the estimated period in which the goodwill will contribute to Group earnings (see detail of amortization in 1998 and 1997 in Exhibit III).

### d) Changes in the consolidated Group-

All the changes in the consolidated Group are described in Exhibit II.

The main changes in the consolidated Group in 1998 and 1997 were as follows:

#### 1998

- In July 1998, the Brazilian government privatized Telecomunicações Brasileiras, S.A. (Telebrás), which had previously been divided into 12 holding companies (1 for long-distance telephony, 3 for fixed line telephony and 8 for cellular telephony), in a sale through public auction of 51.79% of the capital stock with voting rights, equivalent to 19.26% of the total capital stock of each of these companies. Telefónica Internacional, submitted successful bids, through dependent companies or consortia, for the following companies:
  - Telesp Participações, S.A.: A holding company that controls Telesp, S.A. and CTBC (Compañía Telefónica de Borde do Campo), fixed line telephone operators in São Paulo state. The holding was acquired through Tele Brasil Sul Participações, S.A., a holding company in which Telefónica Internacional, S.A. has a 52.93% holding at an acquisition cost of Ptas. 473,286 million.
  - Tele Sudeste Celular Participações, S.A.: A holding company that controls the cellular telephone operators in Río de Janeiro and Espírito Santo states (Telerj Celular, S.A. and Telest Celular, S.A., respectively). The holding is owned by a consortium in which Telefónica Internacional, S.A. has an 82.5% stake at an acquisition cost of Ptas. 164,293 million.
  - Tele Leste Celular Participações, S.A.: A holding company that controls the cellular telephony operators in Bahía (Telebahía Celular, S.A.) and Sergipe (Telergipe Celular, S.A.) states. The consortium formed by Telefónica Internacional with a 38% holding and Iberdrola with the remaining 62%, won the auction, at a cost to the Group of Ptas. 21,130 million.
  - Telesp Celular Participações, S.A.: A holding company that controls the cellular telephony operator in São Paulo state (Telesp Celular, S.A.). Portelcom, the consortium in which Telefónica Internacional has a 35.8% stake, obtained the holding that was being offered, at a cost to the Group of Ptas. 166,848 million.

All these companies are carried by the equity method.

- As a result of the successful bid that Telefónica Do Brasil Holding, S.A. made for the additional 50.12% of common stock of the Brazilian company Companhia Riograndense de Telecomunicações, S.A. (CRT), Telefónica Internacional Group's new indirect holding in CRT increased from 10.3% to 16.7%, with an acquisition cost of Ptas. 64,945 million.
- In March Telefónica Medios de Comunicación, S.A. subscribed all the shares issued by Recoletos Compañía Editorial, S.A. in a capital increase of Ptas. 122 million with additional paid-in capital of Ptas 22,003 million. Telefónica Medios de Comunicación

is wholly owned by Telefónica, and has a 20% holding in Recoletos Compañía Editorial, S.A. The company is carried by the equity method.

- In April, the Telefónica Internacional Group sold the 25% holding that it possessed in the Argentinian company Multicanal, S.A. As a result of this sale, the Group recorded extraordinary income of Ptas. 17,718 million, which is recorded under the "Gains on Disposals of Holdings in Consolidated Companies" caption in the accompanying statement of income. In 1997, this company was carried by the equity method.
- In January, Telefónica Internacional, S.A. acquired an additional 3.33% of the Argentinian company Torneos y Competencias, S.A. reaching a 20% controlling stake. The company, which was not included in the consolidated group in 1997, is currently carried by the equity method.
- Cablevisión, S.A., an Argentinian company 33.28% owned by Telefónica Internacional, S.A. that was acquired in 1997 and included that year at cost, was carried by the equity method in 1998. In December Telefónica Internacional, S.A. acquired an additional holding of 2.58% making a total holding of 35.86%.
- In April Telefónica Medios de Comunicación, S.A. (TMC) acquired the remaining 51% of the capital stock of Gestora de Medios Audiovisuales de Fútbol, S.L. (GMAF), at a cost of Ptas. 6,356 million. This company was carried by the equity method but is now consolidated by the global integration method.
- In October Compañía de Telecomunicaciones de Chile, S.A. acquired 99.99% of the capital stock of VTR Larga Distancia, S.A. from V.T.R., S.A. for US\$ 50 million, equivalent to Ptas. 7,130 million.

#### 1997

- In November Telefónica acquired from SEPPA 23.78% of its shares in Telefónica Internacional, S.A. for Ptas. 127,000 million. As a result of this acquisition, the Telefónica Group's percentage of ownership in Telefónica Internacional, S.A.'s dependent companies increased by the same proportion. The outstanding amount payable (Ptas. 88,000 million) was recorded under the "Other Nontrade Payables" caption (see Note 19).
- Telefónica sold 25% of its shares of Unisource, N. V. to Telia AB, PTT and Telecom BV and Swisscom. This purchase and sale transaction was carried out for a total price of FI 465 million (Ptas. 34,921 million).
- Telefónica acquired all the shares of Telefónica Transmisión de Datos, S.A. (TTD) and Telefónica VSAT, S.A. (VSAT), for FI 455 million and FI 10 million, respectively. TTD and VSAT are consolidated by the global integration method.
- In addition, the Group increased its holding in Cointel from 33.16% to 50%, involving a disbursement of Ptas. 80,423 million.
- In December 1997 CTC acquired the remaining 45% of Startel, S.A., bringing its holding to 100%. The purchase price was US\$ 425 million (Ptas. 64,473 million), and this amount was included under the "Other Long-Term Debt" caption in the accompanying 1997 balance sheet.
- In August Telefónica Multimedia, S.A. acquired 25% of the capital stock of Antena 3 de Televisión, S.A. for Ptas. 26,004 million. The company is carried by the equity method.
- In July Telefónica Multimedia, S.A. acquired 49% of the capital stock of Gestora de Medios Audiovisuales de Fútbol, S.L. for Ptas. 18,545 million. This holding was subsequently sold to Telefónica Medios de Comunicación, S.A., a company wholly owned by the Group. The company is carried by the equity method.
- In January Telefónica participated in the incorporation of DTS Distribuidora de Televisión Digital, S.A., subscribing 35% of its capital stock for Ptas. 3,500 million. In May, the aforementioned company was sold to Telefónica Multimedia, S.A. In November DTS increased its capital and T. Multimedia subscribed its corresponding share of capital stock for Ptas. 5,250 million. The company is carried by the equity method.
- From January 1, 1998, CRT, a company which was acquired in December 1996, became a member of the consolidated Group, having been carried at cost at 1997 year-end. The Group's ownership interest in the aforementioned company amounts to 10.3% of its total common and preferred shares of capital stock, through the various holdings owned by Group companies in the consortium which was awarded 35% of the company's common voting stock.
- In October, Telefónica acquired 3.5% of the capital stock of Portugal Telecom, S.A., for Ptas. 41,212 million. The company is carried by the equity method.

#### e) Information in euros (unaudited)

The amounts included in the accompanying consolidated balance sheets and statements of income have been converted to euros for information purposes at the irreversible exchange rate of Ptas. 166.386 per euro set by the Commission of the EU as of December 31, 1998, and do not form part of the consolidated financial statements for the years ended December 31, 1998 and 1997.

#### 3. DISTRIBUTION OF THE INCOME OF THE CONTROLLING COMPANY

The proposed distribution of 1998 income that the Board of Directors will submit for approval by the Stockholders' Meeting is as follows:

BASIS OF DISTRIBUTION	Millions of Pesetas
1998 net income	150,127
Prior year's retained earnings	86
Total amount to be distributed	150,213
<b>DISTRIBUTION TO:</b>	
Legal reserve	8,541
Voluntary reserve	141,672
<b>Total amount distributed</b>	<b>150,213</b>

#### 4. VALUATION STANDARDS

The main valuation standards used in the preparation of these 1998 and 1997 consolidated financial statements are as follows:

##### a) Goodwill in consolidation-

The accompanying 1998 and 1997 consolidated balance sheets include goodwill, net of amortization, arising from the positive difference in consolidation between the amounts paid to acquire the shares of the dependent companies consolidated or carried by the equity method and their underlying book values at the acquisition date.

In 1998, the Group amortized existing goodwill over 20 years except in those cases where it was considered that would cease to contribute to obtaining income at the Group (see Exhibit III). In 1997 goodwill was amortized over 10 years pursuant to legislation in force at that time (see Note 2-c).

##### b) Translation methods (year-end exchange rate method)-

The financial statements of the Group companies abroad were translated to pesetas at the exchange rates ruling at year-end, except for:

1. Capital stock and reserves, which were translated at historical exchange rates.
2. Income statements, which were translated at the average exchange rate for the year.

The exchange difference arising from application of these procedures is included under the "Stockholders' Equity - Translation Differences in Consolidation" caption in the accompanying consolidated balance sheets, net of the portion of said difference relating to minority interests, which is recorded under the "Minority Interests" caption on the liability side of the accompanying consolidated balance sheets.

The companies using accounting methods that include inflation adjustments apply the accounting standards in force in their respective countries, which consist of valuing monetary assets and liabilities at face value and adjusting the historical cost of nonmonetary assets by the inflation from the date of inclusion of the asset in the company's balance sheet to year-end. The effect of the year's inflation on the monetary assets and liabilities is included in the statement of income for the year in the "Exchange Losses" or "Exchange Gains" caption. The amounts thus adjusted are converted to US dollars at the rate pertaining at year-end and the later conversion to pesetas is made by the translation method at year-end described in paragraphs 1 and 2 above.

##### c) Start-up expenses-

Start-up expenses, which comprise incorporation and capital increase expenses, are recorded at cost and are amortized on a straight-line basis over five years.

##### d) Intangible assets-

This caption in the accompanying consolidated balance sheets includes the following items:

###### Research and development expenses

These relate to the costs incurred in developing new products to be marketed or used for the Group's own network, which are amortized by the straight-line method over five years. Costs incurred in projects which are not viable for the future are expensed currently.

###### Rights on leased assets

The rights under financial lease contracts are recorded at the cost of the related assets, and the total debt for lease payments plus the amount of the purchase option are recorded as a liability. The difference between the two amounts, which represents the interest expenses on the transaction, is recorded as a deferred expense and is allocated to income each year by the interest method. The existing contracts, which relate to computer hardware, are amortized by the straight-line method over five years, which coincides with the years of useful life of the hardware.

#### *Software licenses*

Software licenses are recorded at cost and are amortized by the straight-line method over three years.

#### *Administrative Concessions*

This caption includes the following items:

The administrative concession granted by the Peruvian Government to CPT and Entel Perú at the time of acquisition of these two companies by Telefónica Internacional. This concession will be amortized over 20 years (the concession period) and on the basis of the number of lines installed, since this is the variable that determines the obtaining of revenues allocable to the concession.

The licenses to operate fixed line and mobile telephone services in the companies acquired via the privatization of the Telebras system, assigned as an addition to the asset's carrying value at the time of acquisition. The licenses will be amortized over 27 years (the concession period) and on the basis of the number of lines installed, since this is the variable that determines the obtaining of revenues allocable to the concessions.

The DCS 1800 license that includes the amount paid to the different Spanish authorities and the amount destined to pay for the costs of the deregulation of the radio spectrum that is necessary for the implementation and development of the license. The licenses will be amortized over 25 years (the concession period) and on the basis of the estimated capacity for the generation of revenues in each period.

#### *Other intangible assets*

This caption includes other intangible assets; the main items relate to the costs incurred in acquiring capacity and rights of way in other operators' cables, mainly submarine cables. These rights are amortized on a straight-line basis over 25 years.

### **e) Property and equipment-**

Property and equipment is carried at cost revalued pursuant to the applicable enabling legislation from 1946 to 1996, including Royal Decree-Law 7/1996 (see Note 7). If the regulations applicable in each country so require, the property and equipment is valued at cost or appraisal value adjusted by inflation.

Cost includes external costs plus internal costs comprising materials used, direct labor used in installation work and the allocable portion of the indirect costs required for the related investment. The latter two items are recorded as revenue under the "Capitalized Expenses of In-House Work on Fixed Assets" caption.

The costs of expansion, modernization or improvements leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of the assets are capitalized.

Upkeep and maintenance expenses are expensed currently.

The companies depreciate their property and equipment by the straight-line method at annual rates based on the years of estimated useful life, calculated in accordance with technical studies conducted by Telefónica and the Group companies, reviewed periodically based on technological advances and the rate of dismantling, as follows:

	<b>Years of Estimated Useful Life</b>
Buildings	30 – 50
Technical installations and machinery	10 – 20
Switching equipment	7 – 17
Transmission equipment	5 – 14
Local and domestic long-distance networks	7 – 25
Subscriber equipment and other installations	4 – 8
Furniture, office equipment and other	4 – 15

The increases in value resulting from the revaluations are depreciated over the years of residual useful life of the revalued assets.

### **f) Long- and short-term financial investments-**

Shareholdings which were not consolidated were recorded in the consolidated balance sheet at the lower of cost or market.

The market value was determined as follows:

1. Listed securities:

The market value was taken to be the lower of average market price in the last quarter or market price at year-end.

2. Unlisted securities:

At cost, net, if appropriate, of the required provisions for diminution in value.

Unrealized losses (cost higher than market or underlying book value at year-end) are recorded in the "Provision for Financial Investments" account.

**g) Deferred charges-**

This caption in the accompanying consolidated balance sheets includes the following items:

*Supplementary pension payments to retired employees (shortfall)-*

These relate to the shortfall in the provisions recorded for the commitments made by Telefónica to retired employees as of June 30, 1992. Since then, the shortfall has been allocated to income over 15 years by the straight-line method, in accordance with the communication obtained from the Accounting and Audit Institute dated March 1, 1993. On November 1, 1997, an external fund had been set up for these commitments (see Notes 4-l and 14).

*Debt arrangement expenses-*

These relate to long-term debt arrangement expenses and paid-in surpluses on debentures and bonds and are amortized by the interest method on the basis of the principal amounts outstanding.

*Interest on promissory notes-*

This relates to the difference between the par value and the effective issue value of the promissory notes issued at over one year. This interest is charged to income by the interest method.

*Interest on financial lease contracts-*

This relates to the interest expenses on financial lease contracts, which are charged to income by the interest method (see Note 4-d).

**h) Inventories-**

Warehouse materials for installation in capital expenditure projects and consumables and replacement parts are valued at the lower of weighted average cost, monetarily adjusted in the countries whose legislation so requires, or market.

Obsolete, defective or slow-moving inventories have been reduced to realizable value. The provisions for depreciation of inventories are recorded on the basis of age and turnover.

**i) Treasury stock-**

Treasury stock is valued at the lower of cost, comprising the total amount paid or to be paid for acquisition, or market. Market value is the lower of average market price in the last quarter of the year or year-end market price, which does not differ significantly from the underlying book value per share. The Company has recorded the related restricted reserve as required by article 79.3 of the Corporations Law (see Note 11).

**j) Capital subsidies-**

Capital subsidies are valued at the amount granted and are allocated to income on a straight-line basis over a maximum period of ten years, which does not differ materially from the estimated useful life of the subsidized assets.

The main subsidies obtained were granted as follows:

Grantor	Reason for granting
Official agencies, autonomous community governments and provincial and municipal authorities	Extension of supply to rural areas
European Union	Promotion and development of telecommunication activities
European Union (ERDF Program)	Infrastructure for depressed areas

Most of the aforementioned subsidies were granted to the parent company and all the subsidy grant requirements are being met in all cases (see Note 13).

**k) Foreign currency transactions-**

Fixed-income securities and receivables and payables denominated in foreign currencies are translated to pesetas at the exchange rates ruling at the transaction date, and are adjusted at year-end to the exchange rates then prevailing.

Exchange differences arising on adjustment of foreign currency accounts payable and receivable to year-end exchange rates are classified by currency and due date, and for this purpose currencies which, although different, are officially convertible are grouped together.

The positive net differences in each group of currencies are recorded under the "Deferred Revenues" caption on the liability side of the consolidated balance sheet, unless exchange losses in a given group have been charged to income in prior years, in which case the net positive differences are credited to period income up to the limit of the negative net differences charged to income in prior years.

The positive differences deferred in prior years are credited to income in the year in which the related accounts receivable and payable fall due or are repaid early, or as negative exchange differences for the same or a higher amount are recognized in each homogeneous group.

Exchange gains or losses arising from specific financing of foreign currency investments in investee companies to hedge the exchange rate risk in these investments have been recorded under the "Translation Differences in Consolidation" caption in the consolidated balance sheet.

These transactions are deemed to be hedging transactions since they meet certain requirements, most notably that the foreign currency in which the financing is denominated is the same as or match the functional currency of the investment and of the flows generated by it, and that anticipated flows of dividends and management fees match the loan repayments.

#### I) Pension and similar commitments-

##### *Inclusion in the general social security system*

Through December 31, 1991, Telefónica de España, S.A. personnel benefited from a social welfare system provided by Institución Telefónica de Previsión (ITP). A Ministry of Labor and Social Security Order dated December 30, 1991, provided for serving and retired employees of ITP to be included in the general social security system. Since January 1, 1992, Telefónica and its employees have been contributing to and receiving benefits from the general social security system.

The methods used to record and calculate the commitments arising from the aforementioned event are as follows:

A) Cost of including pensioners in the social security system-

A resolution issued by the Directorate-General of Planning and Economic Organization of the Social Security System on May 25, 1992, stipulated that the cost of including ITP pensioners in the social security system would amount to Ptas. 130,683 million. ITP had to pay this amount to the social security authorities as follows:

— An initial payment of Ptas. 75,000 million.

— The remaining Ptas. 55,683 million will be paid in constant annual installments over a period of ten years, with a two -year grace period, with interest at 8%.

Since ITP does not have sufficient resources to meet the payments, Telefónica, which is vicariously liable, has been contributing the necessary funds to the social security authorities to make the payments. As of December 31, 1996, the outstanding debt amounted to Ptas. 38,688 million, for which Telefónica has recorded the related provisions under the "Provisions for Contingencies and Expenses" caption (see Note 14). On November 21, 1997, I.T.P. was finally liquidated. Accordingly, a resolution issued by the Ministry of Labor's Directorate-General of Social Security on November 24, 1997, stipulated that Telefónica is directly liable to the social security authorities for the outstanding debt plus the related interest. On November 28, 1997, Telefónica paid early this debt (Ptas. 38,688 million) plus the interest incurred through that date (Ptas. 2,815 million),and these amounts were recorded under the "Extraordinary Expenses" caption (see Note 20). Also in 1997 Ptas. 7,301 million were recorded under "Deferred Revenues" (see Note 18) due to the accrual for accounting purposes of the tax credit taken.

B) As a result of the inclusion of serving employees in the social security system, Telefónica must make additional contributions to the social security system until the year 2016, based on the serving employees' effective contribution bases at every given moment. These contributions consist of the payment of an additional 2.2% over the regulatory base salary, and the related amounts are recorded under the "Personnel Expenses" caption. Ptas. 5,608 million and Ptas. 5,715 million were recorded in this connection in 1998 and 1997, respectively.

##### *Supplementary pension plan for serving employees as of June 30, 1992 and for those hired since that date*

Telefónica has a collective labor agreement with its employees. The main features of the agreement are as follows:

— A pension plan pursuant to Pension Plans and Funds Law 8/1987.

— Defined contribution of 6.87% of the participating employees' regulatory base salary. For employees who joined Telefónica after June 30, 1992, the contribution is 4.51% of the regulatory base salary.

— The obligatory contribution of the participants will be a minimum of 2.2% of his/her regulatory base salary.

— Individual and financial capitalization systems.

The plan came into effect on July 1, 1992. The past service benefits recognized for employees availing themselves of the plan amounted to Ptas. 228,489 million, including projected extraordinary contributions for employees who joined the Company in the period between the entry into force of Law 8/1987 and July 1, 1992, the date of commencement of the Plan.

The amount of Ptas. 121,350 million that had been collected internally until July 1, 1992, together with corresponding interest of Ptas. 33,107 million calculated at an annual rate of 6.7%, had been fully transferred by July 1998 to the pension fund set up for that purpose, which is managed by Fonditel, Entidad Gestora de Pensiones, S.A., a company 81% owned by the Telefónica Group and consolidated by the global integration method.

The resulting shortfall (Ptas. 107,139 million) must be contributed to the pension plan within 28 years (the estimated remaining life

for serving employees on the date the plan came into force) in increasing monthly installments payable in advance at an annual interest rate of 6%. In accordance with the communication from the Spanish Accounting and Audit Institute (ICAC) dated March 1, 1993, the Company records provisions for the shortfall over that same 28-year period pursuant to a systematic plan, increasing the amounts each year by a factor of 1.042 through the year 2002 after which the recorded annual expense will coincide with the payments which are made.

The provision for 1998 was Ptas. 5,082 million (Ptas. 4,876 million in 1997). The resulting cumulative difference (Ptas. 15,346 million as of December 31, 1998) between the provisions recorded (with a charge to income in 1998 and prior years) and the contributions made to the pension plan, is recorded in the "Provisions for Contingencies and Expenses - Provisions for Rebalancing Plan" account (see Note 14).

The transfers made to the pension fund and the present value of future commitments are shown below:

	Transfer plan			
	Principal			
	Initial Funds to Be Transferred	Shortfall to Be Transferred	Total	Interest
Through December 31, 1996	58,407	11,747	70,154	53,945
Transferred in 1997	14,670	1,919	16,589	8,994
Transferred in 1998	48,273	2,352	50,625	6,748
<b>Total transferred as of December 31, 1998</b>	<b>121,350</b>	<b>16,018</b>	<b>137,368</b>	<b>69,687</b>
<b>Future commitments</b>	<b>—</b>	<b>91,121</b>	<b>91,121</b>	<b>—</b>
<b>Total</b>	<b>121,350</b>	<b>107,139</b>	<b>228,489</b>	<b>69,687</b>

Of the future commitments shown above, Ptas. 15,346 million have been recognized in income, as mentioned above. Consequently, Ptas. 75,775 million have yet to be recognized in future years' income and provisions for this amount will be recorded with a credit to provisions (see Note 11).

68,172 employees had joined the Plan as of December 31, 1998 (67,618 at the same date in 1997). Vested retirement, disability and death benefits had accrued to a total of 6,727 participants in 1998 (5,583 in 1997).

#### *Supplementary pension payments to employees who retired before June 30, 1992*

On July 8, 1992, Telefónica reached an agreement with its employees whereby it recognized supplementary pension payments for employees who were retired as of June 30, 1992, equal to the difference between the pension payable by the social security system and that which would be paid to them by ITP. Once the aforementioned supplementary pension payments have been quantified, they become fixed, lifelong and nonrevaluable. 60% of the payments are transferable to the spouse recognized as such as of June 30, 1992, and to underage children.

In accordance with an actuarial study conducted by Telefónica, applying GRM-F80 tables and an assumed interest rate of 8%, as of June 30, 1992, the discounted present value of the commitments amounted to Ptas. 132,025 million, and this amount was recorded under the "Provisions for Contingencies and Expenses" caption. Through that date, the Company had recorded provisions totaling Ptas. 14,356 million in this connection. The resulting underprovision (Ptas. 117,669 million) was recorded under the "Deferred Charges" caption and has been allocated to income since that date by the straight-line method over 15 years, the estimated remaining life of the retired employees (1992-2007). As of December 31, 1998, the amount yet to be charged to income was Ptas. 87,102 million (Ptas. 98,161 million in 1997) (see Note 9).

The increase in the present discounted value of these commitments due to the financial adjustment thereof is recorded as an expense under the "Other Interest on Accounts Payable and Similar Expenses" caption (see Note 20).

In addition, in 1996 the assumed interest rate decreased from 8% to 6.5%, leading to an increase of Ptas. 10,597 million in the provision. In 1997 the Company, as a result of application of the new GRM/F-80-2 tables, adjusted the value of the necessary provision by Ptas. 10,048 million. Also, the assumed interest rate decreased from 6.5% to 6.3%, leading to an increase of Ptas. 1,841 million in the provision. The balancing entry of these adjustments was recorded in "Deferred Charges" which, in accordance with the method described above, will be recognized in income over 8.5 years using the straight line method (see Note 9).

The amounts charged to income were as follows:

	Millions of Pesetas	
	1998	1997
Annual amortization	10,247	9,370
Financial adjustment	6,188	7,296
<b>Total</b>	<b>16,435</b>	<b>16,666</b>

Under Private Insurance Law 30/1995, on November 1, 1997, these commitments were externalized to the Group company, Seguros de Vida y Pensiones Antares, S.A. and payments of Ptas. 17,068 million were made in 1998 (Ptas. 28,846 million in 1997). This company has also placed various structured deposits with finance entities with maturities up to 2027 to eliminate the risk that the payments to be made might be affected by future interest rate fluctuations. The amounts to be externalized as of December 31, 1998 and 1997 were Ptas. 89,241 million and Ptas. 100,933 million, respectively (Note 14).

#### *Group life insurance*

Serving employees who did not join the pension plan continue to be entitled to receive survivorship benefits at the age of 65. The Company has recorded an internal allowance to cover these commitments, based on the actuarial studies conducted internally, applying the adjusted GRM/F-80-2 mortality table and an assumed interest rate of 4%. As of December 31, 1998 and 1997, this allowance amounted to Ptas. 14,543 million and Ptas. 13,376 million, respectively, and was recorded under the "Provisions for Contingencies and Expenses" caption (see Note 14).

An external fund must be created for this commitment pursuant to Private Insurance Law 30/1995, within the time limits established in Tax, Administrative and Social Order Measures Law 50/1998 of January 1, 2001.

#### *Other commitments to personnel*

In 1998 Telefónica entered into a three-year Loyalty-Building Plan with 100 of the Group's most important executives, whereby Telefónica undertakes to pay them, on February 25, 2000, certain amounts calculated on the basis of the market price of Telefónica's shares during the life of the Plan, provided that the executive has previously acquired a certain number of shares of the Company, the precise figure depending on the level of his or her responsibility.

In order to meet the payments that may arise under this plan, the Company arranged with two finance entities the purchase of options on Telefónica shares that would fully cover such payments. The cost of these options will be deferred over three years until the Plan matures. Ptas. 969 million were recorded in this connection in 1998 (Ptas. 700 million in 1997) with a charge to the "Extraordinary Expenses and Losses" caption.

In addition, in January 1998 the Board of Directors of Telefónica Internacional, S.A. resolved to grant to a group of executives options to purchase a total of 77,985 shares of Telefónica Internacional, S.A. (0.65% of its capital stock). This option may be exercised in a staggered manner over a period of three years, starting in 1998, at the same price at which they were acquired by Telefónica Internacional, S.A. from Telefónica, S.A. This price is the same as that paid by Telefónica, S.A. to SEPPA on November 7, 1998 (see Note 2-d). Telefónica guarantees to repurchase these shares at each maturity date at the market price.

#### *Provisions for voluntary preretirements and early retirements*

With the object of adapting itself to the competitive environment, Telefónica has initiated voluntary "preretirement", early retirement and technology renewal plans in recent years (the technology renewal plans involve the dismantling of analog plants to replace them with digital facilities, to fulfil a commitment to the Government, amongst others, to digitalize 85% of lines in place by the year 2002).

The Company has been charging costs generated by this action to the operating account of the services covered by the license, since the bearing of these costs formed part of the ordinary business of the Company. These costs must be borne because the license contract requires the Company to maintain cost discipline and efficient management of productive resources. The recovery of these costs is covered by the rate system regulated in the contract itself. Under the conditions of exclusive provision of the telephone service during those years, the rate system enabled the overall financial balance of the license provided for in the contract to be maintained in spite of the internal imbalance of that rate system.

In 1997 and 1998 the voluntary "preretirement" and early retirement plans provided for the 1997/1998 Collective Labor Agreement were put into practice. The terms of the Agreement provide for "preretirement" of employees above 55 years of age and/or subsequent early retirement of employees above 60 years of age, all at the employee's request and subject to acceptance by the company and to certain financial conditions. In addition, only in 1998, employees over the age of 53 could opt for "preretirement" on similar terms.

The number of employees who availed themselves of these plans in 1998 and obtained the required approval of the Company was 5,741 (2,873 in 1997). Telefónica systematically records, with a charge to income, the amounts required to ensure that the allowance for "preretirements" and early retirement has been recorded in full by the time the employee is terminated. The allowance recorded in this respect amounts to Ptas. 187,739 million (Ptas. 124,613 million in 1997), and represents the present value of the estimated obligations in this respect discounted at 4%. The annual provision totaled Ptas. 125,891 million in 1998 (Ptas. 90,166 million in 1997) (see Note 14).

As shown above, during those periods in which the Company operated as a monopoly the aforementioned costs were recovered within the framework of the rate system approved by the Government to meet the obligation to guarantee the overall financial balance regulated in the license contract. However, at the beginning of the year the monopoly was broken when Retevisión started to provide services, leading to full competition in the industry on December 1, 1998, five years before the deadline set by the European Commission for the Spanish Government. This opening to competition was brought about by the Government, without having previously established the mechanisms necessary to eliminate the shortfall caused to Telefónica by the application of the current rates set for access and for metropolitan telephone calls, or stipulating compensation for the costs arising as a result of the introduction of competition.

In this context, as a consequence of the hurried deregulation of the industry, and having requested on various occasions that the Government find a favorable solution to these problems, Telefónica was obliged to further adapt its cost structure to the new environment, taking certain strategic decisions in relation to its policy on the size and organization of the Company. For this purpose, it decided to implement an extraordinary preretirement and early retirement plan that, as has been announced, will affect approximately 13,967 employees over the next two years. The aim of the plan is to take maximum advantage of the digitalization undertaken in recent years by exploiting the inherent productivity improvements made possible by it.

The basic characteristics of this plan are as follows: voluntary preretirement for employees 52 years of age or above, and voluntary severance and transfers to subsidiaries with indemnity.

Given this situation, the Company deemed it appropriate to record on the balance sheet the need to deal with these costs through a provision as of December 31, 1998, of Ptas. 459,500 million with a charge to "Extraordinary Expenses" (see Note 11-e). Additionally, a credit has been recorded to "Extraordinary Revenues" for that amount with charges of Ptas. 298,675 million to unrestricted reserves and of Ptas. 160,825 million to prepaid taxes.

This procedure has meant not following the accounting principle that states that expenses in each year should be effectively incurred and recognized in the income statement. This procedure has been followed because it was considered that not making the provision and simultaneous charge to unrestricted reserves for the same amount, would not have allowed a true and fair view of the Company's net worth, financial position and results to be given.

The Company considers that in this way it fulfils the accounting principle of prudence in valuation and the matching principle:

- Our approach complies with the principle of prudence in valuation because it informs of and reflects for accounting purposes as of December 31, 1998, through a reduction in equity, the Company's need to meet significant costs at short term as a consequence of the need to adapt to the new, fully competitive framework, although they were not incurred due to any contractual obligations. Thus, the effect on net worth is the same as if the provision had been made against period expenses without the offsetting extraordinary revenue, since, in that case, the period loss would have reduced equity by an identical amount.
- Our approach complies with the matching principle because the Company does not know the amount, mechanism and time frame of recovery of these costs to which it is entitled and will collect in the future. In consequence, if the Company decided to record the costs in the period when they were incurred, regardless of when it could record the related offset, which would require a knowledge of its amount and its timing, the Company would not be fulfilling the matching principle.

This approach has already been used in situations with similar characteristics in other industries, such as banking or electricity, and it is considered to comply with the objective of giving as fair a view as possible of the net worth and financial situation of the companies.

Should the Company have continued to follow the method used in previous years –i.e. charge the costs to income for the period at the time the contractual obligations were incurred- and given that the preretirement plan will be signed with the employees in 1999 and 2000, the effect on the 1998 and subsequent financial statements would have been as follows:

- I. If the method used in the financial statements submitted for approval is completely disregarded:
  - a) Unrestricted reserves, and consequently, net worth per books as of December 31, 1998, would increase by Ptas. 298,675 million, and the balance-sheet provisions and prepaid tax accounts would decrease by Ptas. 459,500 million and Ptas. 160,825 million, respectively.
  - b) Net income for 1998 would not change as both extraordinary revenue and expenses would decrease by Ptas. 459,500 million.
  - c) The effect on future years' financial statements would depend on the economic and accounting mechanisms that were finally used to eliminate the access shortfall and enable recovery of the costs caused by the change to free competition and also on the number of requests for preretirement, and their specific characteristics that were finally approved in 1999 and 2000. In any case the compensation received or the overprovision, if any, will be recognized by a method that is consistent with the accounting criteria established above.
- II. If the provision were maintained, but no charge were made to unrestricted reserves for the same amount:
  - a) Net worth per books as of December 31, 1998, would be identical to that in the financial statements submitted for approval.
  - b) 1998 net income would decrease by Ptas. 298,675 million, which would mean a loss for the year of Ptas. 81,091 million.
  - c) In the future years' financial statements, the overprovision, if any, or the indemnities received, would be recognized as revenue in the period in which they became known or arose.

**m) Technical provisions-**

This caption relates mainly to mathematical provisions, which represent the amount by which the present value of life insurance, pension and reinsurance commitments exceed the net premiums to be paid by the policyholders to Seguros de Vida y Pensiones Antares, S.A. and Casiopea Re. These provisions are credited when the commitments covered are paid.

**n) Accounts payable**

Accounts payable are recorded at redemption value, except for zero-coupon debenture and bond issuances made through December 31, 1995, which are recorded in the balance sheet at issue value plus earned interest (see Note 15).

**o) Derivatives**

Transactions aimed at eliminating or significantly reducing exchange, interest rate or market risks on balance sheet positions or on other transactions are treated as hedging transactions. Gains or losses arising over the life of these derivatives are taken to the income statement using the same recognition method as that used for gains or losses on the asset and main transaction hedged by the derivatives (see Note 17).

Transactions carried out to obtain returns rather than to hedge risks are not treated as hedge transactions. In transactions of this kind, the differences in market price are recorded for accounting purposes when the transactions are canceled or finally settled. However, if potential losses are anticipated at year-end, the related provision is recorded with a charge to the statement of income.

**p) Corporate income tax and other taxes**

These captions in the consolidated statements of income include all the debits and credits arising from Spanish corporate income tax and similar taxes applicable to the Group companies abroad, including those relating to period expenses and those arising from adjustments to amounts recorded in prior years.

The expense for corporate income tax of each year is calculated on the basis of book income before taxes, increased or decreased, as appropriate, by the permanent differences from taxable income, defined as those arising between taxable income and book income before taxes that do not reverse in subsequent periods.

Tax relief and tax credits, excluding tax withholdings and prepayments, are deducted from the corporate income tax charge in the year in which they are definitively taken, except in the case of investment tax credits earned from 1996, which, at the time when they are taken, are deferred over the average life of the assets which gave rise to the tax credits. The difference between the expense incurred and the tax paid is due to the above-mentioned deferral and to revenue and expense recognition timing differences giving rise to prepaid and deferred taxes, provided that they have a certain reversal period (see Note 18).

**q) Recognition of revenues and expenses**

Revenues and expenses are recognized on an accrual basis, i.e. when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises.

The revenues from telephony and other services are recognized on an accrual basis. These services are generally billed every two months. Uninvoiced revenues from the beginning of the billing cycle to the end of each month are estimated or recorded as soon as they are known. The differences between the estimated revenues and those subsequently invoiced are not material and are recorded in the following period. In accordance with the accounting principle of prudence, only realized income is recorded at year-end, whereas foreseeable contingencies and losses, including possible losses, are recorded as soon as they become known (see Note 20).

## 5. GOODWILL IN CONSOLIDATION

The variations in the "Goodwill in Consolidation" caption and in the related accumulated amortization in 1997 and 1998 were as follows:

	Millions of Pesetas
<b>Balance at 12/31/96</b>	<b>49,798</b>
Additions	232,149
Amortization	(33,312)
Net retirements	(8,451)
Net transfers	42,813
Translation differences	1,367
<b>Balance at 12/31/97</b>	<b>284,364</b>
Additions	93,564
Amortization	(21,135)
Net retirements	(5,166)
Net transfers	53,889
Translation differences	(5,893)
<b>Balance at 12/31/98</b>	<b>399,623</b>

The transfers in 1998 relate mainly to the inclusion in the consolidated Group of Cablevisión and Torneos y Competencias, which were carried at cost in 1997.

The goodwill arising on the acquisition of companies by the U.S. operators is recorded in the local currency and is affected by exchange rate fluctuations, and the resulting differences are shown in the "Translation Differences" account.

The transfers in 1997 relate to the inclusion in the consolidated Group of CRT, which was carried at cost in 1997.

Per the estimates and projections available to the directors, the projected income attributable to the Group that will be earned by the companies at which goodwill has arisen is at least equal to the unamortized balance of the related goodwill over the relevant periods.

The detail of the balance of goodwill at each company, the related accumulated amortization and the variations therein is shown in Exhibit III.

## 6. INTANGIBLE ASSETS

The detail of the balances of the intangible asset accounts and of the variations therein in 1997 and 1998 is as follows:

	Millions of Pesetas					
	Research and Development Expenses	Leased Assets	Software Licenses and Development	Administrative Concessions	Other Intangible Assets	Total
<b>Balance at 12/31/96</b>	<b>104,047</b>	<b>15,425</b>	<b>73,466</b>	<b>229,321</b>	<b>10,549</b>	<b>432,808</b>
Additions	19,683	2,192	27,997	329	842	51,043
Retirements	—	—	(553)	(5)	(232)	(790)
Transfers	(3,241)	(1,798)	201	—	4,662	(175)
Inclusion of companies	—	—	241	—	846	1,087
Translation differences	93	517	—	358	840	1,808
Exclusion of companies	—	—	—	(228)	(62)	(290)
<b>Balance at 12/31/97</b>	<b>120,582</b>	<b>16,336</b>	<b>101,352</b>	<b>229,776</b>	<b>17,445</b>	<b>485,491</b>
Additions	21,928	1,879	42,958	710,254	2,037	779,056
Retirements	—	(52)	(2,602)	(17,183)	(442)	(20,279)
Transfers	(61)	(1,789)	4,952	6,645	1,291	11,038
Inclusion of companies	—	1,684	—	522	20,796	23,002
Translation differences	(94)	(682)	—	(322)	(776)	(1,874)
Exclusion of companies	(46)	—	(400)	—	(9)	(455)
<b>Balance at 12/31/98</b>	<b>142,309</b>	<b>17,376</b>	<b>146,260</b>	<b>929,692</b>	<b>40,342</b>	<b>1,275,979</b>

The variations in the related accumulated amortization were as follows:

	Millions of Pesetas					
	Research and Development Expenses	Leased Assets	Software Licenses and Development	Administrative Concessions	Other Intangible Assets	Total
<b>Balance at 12/31/96</b>	<b>41,227</b>	<b>3,766</b>	<b>33,192</b>	<b>15,804</b>	<b>994</b>	<b>94,983</b>
Additions	12,772	1,670	11,644	8,184	1,305	35,575
Retirements	—	—	(136)	(1)	(166)	(303)
Transfers	(1,191)	(1,634)	(17)	(590)	1,620	(1,812)
Inclusion of companies	—	—	66	—	423	489
Translation differences	65	91	—	94	374	624
Exclusion of companies	—	—	—	(171)	(3)	(174)
<b>Balance at 12/31/97</b>	<b>52,873</b>	<b>3,893</b>	<b>44,749</b>	<b>23,320</b>	<b>4,547</b>	<b>129,382</b>
Additions	13,553	1,692	13,592	13,181	5,043	47,061
Retirements	—	(52)	(2,532)	(131)	(431)	(3,146)
Transfers	6	(730)	(65)	2	124	(663)
Inclusion of companies	—	551	—	112	3,442	4,105
Translation differences	(77)	(85)	—	(136)	(484)	(782)
Exclusion of companies	(46)	—	(90)	—	(22)	(158)
<b>Balance at 12/31/98</b>	<b>66,309</b>	<b>5,269</b>	<b>55,654</b>	<b>36,348</b>	<b>12,219</b>	<b>175,799</b>
<b>1997 intangible assets, net</b>	<b>67,709</b>	<b>12,443</b>	<b>56,603</b>	<b>206,456</b>	<b>12,898</b>	<b>356,109</b>
<b>1998 intangible assets, net</b>	<b>76,000</b>	<b>12,107</b>	<b>90,606</b>	<b>893,344</b>	<b>28,123</b>	<b>1,100,180</b>

The additions to "Administrative Concessions" in 1998 relate mainly to the acquisition of the DCS 1800 license in Spain for Ptas. 28,814 million, and to the various licenses required to provide fixed and mobile telephony services relating to the companies acquired in the spin-off of the Telebrás system for Ptas. 680,472 million, respectively, the detail being as follows:

	Millions of Pesetas
Telesp Celular Participações, S.A.	156,935
Telesudeste Celular Participações, S.A.	144,243
Tele Leste Celular Participações, S.A.	18,827
Telesp Participações, S.A.	360,467
<b>Total</b>	<b>680,472</b>

Per the projections available to the directors as of December 31, 1998, relating to future operations and the income that will be obtained from the administrative concessions held by these companies, such income is at least equal to the unamortized balance of the related administrative concessions.

The retirements in 1998 arose basically as a result of the sale of the holding in Tele Sudeste Participações, S.A. for Ptas. 16,175 million.

In 1998 the "Inclusion of Companies" caption reflects the effect arising from the consolidation by the global integration method of Telefónica Argentina, S.A., Venturini España, S.A., Gestión de Medios Audiovisuales de Fútbol, S.L. (GMAF) and Compañía de Inversiones en Telecomunicaciones, S.A. (Cointel), which had been carried by the equity method in 1997.

The "Exclusion of Companies" account includes in 1997 the accumulated balances as of December 31 of Telefónica de Romania. In 1998 it includes the accumulated balances as December 31, 1997, of Telefónica Gestión de Sistemas, S.A. (T.G.S.), Telefónica Sistemas de Ingeniería de Productos, Seguridad, S.A. (T.S.I.P-S) and Rem Infográfica, S.A.

## 7. PROPERTY AND EQUIPMENT

The detail of the balances of property and equipment, the related accumulated depreciation and the variations therein in 1998 is as follows:

	Balance at 12/31/97	Additions	Retirements	Millions of Pesetas				Balance at 12/31/98
				Inclusion of Companies	Exclusion of Companies	Translation Differences	Transfers	
<b>Cost:</b>								
Land and structures	717,016	3,767	(4,115)	109,791	—	(15,146)	27,932	839,245
Technical installations and machinery	159,392	3,187	(6,456)	1,964	(5)	(2,745)	6,479	161,816
Telephone installations, networks and equipment	6,035,655	62,227	(314,189)	720,494	(2)	(150,510)	583,889	6,937,564
Furniture, tools and other	256,411	28,951	(12,504)	40,657	(329)	(8,689)	25,012	329,509
<b>Total property and equipment in service</b>	<b>7,168,474</b>	<b>98,132</b>	<b>(337,264)</b>	<b>872,906</b>	<b>(336)</b>	<b>(177,090)</b>	<b>643,312</b>	<b>8,268,134</b>
Net variation in construction in progress	396,465	520,906	(639)	148,785	(1)	(33,518)	(636,533)	395,465
Advances to fixed asset suppliers	2,288	(1,344)	(609)	1,899	—	(251)	(1)	1,982
Installation materials in warehouses	38,977	16,415	(7,056)	11,129	—	(2,585)	(16,423)	40,457
<b>Property and equipment, gross</b>	<b>7,606,204</b>	<b>634,109</b>	<b>(345,568)</b>	<b>1,034,719</b>	<b>(337)</b>	<b>(213,444)</b>	<b>(9,645)</b>	<b>8,706,038</b>
<b>Accumulated depreciation:</b>								
Structures	170,748	21,283	(591)	15,291	—	(3,920)	(208)	202,603
Technical installations and machinery	85,297	12,772	(5,773)	1,419	(3)	(1,324)	(328)	92,060
Telephone installations, networks and equipment	3,039,324	602,693	(276,152)	265,128	—	(57,204)	337	3,574,126
Furniture, tools and other	161,236	36,783	(18,331)	33,599	(128)	(6,785)	808	207,182
<b>Total accumulated depreciation</b>	<b>3,456,605</b>	<b>673,531</b>	<b>(300,847)</b>	<b>315,437</b>	<b>(131)</b>	<b>(69,233)</b>	<b>609</b>	<b>4,075,971</b>
Provisions for diminution in value	1,486	366	(916)	—	—	—	—	936
<b>Property and equipment, net</b>	<b>4,148,113</b>	<b>(39,788)</b>	<b>(45,637)</b>	<b>719,282</b>	<b>(206)</b>	<b>(144,211)</b>	<b>(10,254)</b>	<b>4,629,131</b>

The detail of the balances of property and equipment, the related accumulated depreciation and the variations therein in 1997 is as follows:

	Millions of Pesetas							
	Balance at 12/31/96	Additions	Retirements	Inclusion of Companies	Exclusion of Companies	Translation Differences	Transfers	Balance at 12/31/97
<b>Cost:</b>								
Land and structures	656,279	490	(2,556)	8	(18)	11,583	51,230	717,016
Technical installations and machinery	130,487	6,506	(6,347)	408	(45)	2,769	25,614	159,392
Telephone installations, networks and equipment	5,598,023	73,065	(288,417)	48,371	(3,277)	148,274	459,616	6,035,655
Furniture, tools and other	237,582	14,449	(4,319)	1,148	(182)	9,337	(1,604)	256,411
<b>Total property and equipment in service</b>	<b>6,622,371</b>	<b>94,510</b>	<b>(301,639)</b>	<b>49,935</b>	<b>(3,522)</b>	<b>171,963</b>	<b>534,856</b>	<b>7,168,474</b>
Net variation in construction in progress	327,861	552,946	(89)	6,852	—	22,325	(513,430)	396,465
Advances to fixed asset suppliers	23,640	(6,766)	(19)	—	—	2,222	(16,789)	2,288
Installation materials in warehouses	50,804	(6,734)	(165)	—	(41)	2,351	(7,238)	38,977
<b>Property and equipment, gross</b>	<b>7,024,676</b>	<b>633,956</b>	<b>(301,912)</b>	<b>56,787</b>	<b>(3,563)</b>	<b>198,861</b>	<b>(2,601)</b>	<b>7,606,204</b>
<b>Accumulated depreciation:</b>								
Structures	148,177	20,043	(993)	1	(2)	3,482	40	170,748
Technical installations and machinery	71,599	11,124	(5,641)	160	(22)	1,137	6,940	85,297
Telephone installations, networks and equipment	2,682,757	517,165	(252,011)	34,951	(695)	58,707	(1,550)	3,039,324
Furniture, tools and other	148,273	15,654	(3,348)	314	(77)	5,064	(4,644)	161,236
<b>Total accumulated depreciation</b>	<b>3,050,806</b>	<b>563,986</b>	<b>(261,993)</b>	<b>35,426</b>	<b>(796)</b>	<b>68,390</b>	<b>786</b>	<b>3,456,605</b>
<b>Provisions for diminution in value</b>	—	1,486	—	—	—	—	—	1,486
<b>Property and equipment, net</b>	<b>3,973,870</b>	<b>68,484</b>	<b>(39,919)</b>	<b>21,361</b>	<b>(2,767)</b>	<b>130,471</b>	<b>(3,387)</b>	<b>4,148,113</b>

The installation materials in warehouses are recorded net of provisions, which amounted to Ptas. 4,229 million as of December 31, 1998 (Ptas. 4,126 million in 1997). The provisions for diminution in value of installation materials in warehouses recorded in 1998 amounted to Ptas. 2,386 million (Ptas. 888 million in 1997). The "Retirements" relate mainly to the dismantling of telephony plant (see Note 20).

The "Inclusion of Companies" account in 1997 includes the variations in property and equipment as a result of inclusion in the Group of Telefónica Transmisión de Datos (TTD), Telefónica VSAT and Hispaservices. In 1998 it reflects the effect of consolidating Telefónica Argentina, S.A., Venturini España, S.A., Venturini, S.A. and Compañía de Inversiones en Telecomunicaciones, S.A. (Cointel), which were carried by the equity method in 1997.

The effect of consolidation of Telefónica de Argentina, S.A. on the cost and accumulated depreciation of property and equipment amounted to Ptas. 1,018,434 million and Ptas. 310,873 million, respectively.

The "Exclusion of Companies" account in 1997 includes the accumulated balances as of December 31, 1996, of Telefónica Romanía. In 1998 this account includes the accumulated balances as of December 31, 1997, of Telefónica Gestión de Sistemas, S.A. (T.G.S.), Telefónica Sistema Ingeniería de Productos, Seguridad, S.A. (TSIP-S) and Rem Infográfica, S.A.

The "Exchange Differences" column includes both the effect of the variation in exchange rates on the beginning balances and the monetary adjustment applied by certain companies to their balances to adjust for inflation, in accordance with the accounting practices in their respective countries. The effect of exchange rates on the period variations is included under the appropriate column for each variation.

As of December 31, 1998 and 1997, the following items had been fully depreciated:

	Millions of Pesetas	
	12/31/98	12/31/97
Buildings	10,430	8,525
Technical installations and machinery	21,027	30,176
Switching equipment	213,623	355,287
Transmission equipment	100,216	125,264
Local and long-distance networks	341,374	224,613
Subscriber equipment and other installations	252,617	166,953
Furniture, office equipment and other	152,242	107,256
<b>Total</b>	<b>1,091,529</b>	<b>1,018,074</b>

Telefónica, S.A.'s fixed assets used to provide services currently regulated by license cannot be mortgaged without government authorization.

The Telefónica Group companies have taken out insurance policies to cover the possible risks affecting its property and equipment used in operations, except for the franchise existing in policies in force for local and long-distance networks and subscriber equipment.

On December 31, 1996, Telefónica, S.A. revalued its property and equipment pursuant to Royal Decree-Law 7/1996. The Company had previously revalued its accounts pursuant to the enabling legislation specifically applicable to Telefónica, S.A.

The net increase in value resulting from these revaluations will be depreciated over the tax periods in the remaining useful lives of the revalued assets. The 1996 revaluation increased the 1998 and 1997 depreciation charges by Ptas. 30,374 million and Ptas. 38,608 million, respectively.

The detail of the property and equipment owned by Group companies consolidated by the global integration method located abroad is as follows:

	Millions of Pesetas	
	12/31/98	12/31/97
Cost	2,565,751	1,512,435
Accumulated depreciation	(882,358)	(511,793)
<b>Total</b>	<b>1,683,393</b>	<b>1,000,642</b>

## 8. LONG-TERM FINANCIAL INVESTMENTS

A) The detail of the balances of and variations in long-term financial investments in 1998 and 1997, of the related provision for diminution in value, and of the capital payments outstanding is as follows:

### I. Variations in long-term financial investments:

	Millions of Pesetas							
	Balance at 12/31/96	Additions	Transfers	Balance at 12/31/97	Additions	Transfers and Retirements	Consol.	Balance at 12/31/98
Holdings in associated companies (Exhibit I)	116,317	195,061	(41,600)	(68,388)	201,390	275,588	(7,160)	(124,204)
Other holdings (Exhibit I)	128,540	70,433	(4,299)	(102,032)	92,642	57,920	(3,252)	(68,312)
Other loans	31,374	53,243	(10,679)	22,896	96,834	114,564	(42,277)	2,921
Long-term guarantees and deposits	1,369	548	(162)	(1)	1,754	11,878	(345)	34
Tax receivables	70,007	41,471	(18,650)	(65)	92,763	209,329	(8,122)	8,899
<b>Total</b>	<b>347,607</b>	<b>360,756</b>	<b>(75,390)</b>	<b>(147,590)</b>	<b>485,383</b>	<b>669,279</b>	<b>(61,156)</b>	<b>(180,662)</b>
								<b>912,844</b>

The additions to and retirements from the "Holdings in Associated Companies" and "Other Holdings" accounts reflect the investment amounts detailed in the variations in the consolidated Group in 1998 and 1997 described in Exhibit II.

The transfers in 1998 from "Other Holdings" were made mainly to goodwill in consolidation as a result of carrying the holdings in Cablevisión and Torneos y Competencias, which were carried at cost in 1997, by the equity method in 1998 (see Exhibit III). The transfers from "Holdings in Associated Companies" arose mainly as a result of consolidating TASA and COINTEL by the global integration method in 1998.

The transfers from "Other Holdings" in 1997 arose as a result of carrying the holding in CRT, which was carried at cost in 1996, by the equity method in 1997.

The "Other Loans" caption includes the investment of the mathematical provisions of the Group's insurance companies, mainly in government debentures, government debt securities and long-term deposits, which mature through 2027 and provide average returns of 7.06%. In addition, the "Short-Term Financial Investment - Short-Term Investment Securities" caption in the consolidated balance sheet includes Ptas. 37,154 million (Ptas. 43,432 million in 1997) of "Technical Reserves" recorded to cover commitments (see Note 14).

The "Tax Receivables" caption includes the long-term prepaid taxes which are grouped together under the "Long-Term Financial Investments" caption on the asset side of the consolidated balance sheet, in accordance with a Spanish Accounting and Audit Institute (ICAC) Resolution on Valuation Standard 16 of the Spanish National Chart of Accounts (see Note 18). The additions in 1998 relate basically to the provision for "preretirement".

2. Variations in the provision for diminution in value of long-term financial investments:

Provisions	Millions of Pesetas								
	Balance at 12/31/96	Additions	Retirements and Consol.	Transfers	Balance at 12/31/97	Additions	Retirements and Consol.	Transfers	Balance at 12/31/98
Other holdings	4,729	133	(490)	472	4,844	146	(35)	(853)	4,102
<b>Total financial investments</b>	<b>342,878</b>	<b>360,623</b>	<b>(74,900)</b>	<b>(148,062)</b>	<b>480,539</b>	<b>669,133</b>	<b>(61,121)</b>	<b>(179,809)</b>	<b>908,742</b>

3. Variations in capital payments outstanding:

	Millions of Pesetas								
	Balance at 12/31/96	Additions	Retirements and Consol.	Transfers	Balance at 12/31/97	Additions	Retirements and Consol.	Transfers	Balance at 12/31/98
Group companies	—	918	—	(918)	—	—	—	—	0
Associated companies	243	378	(169)	—	452	572	(224)	—	800
Other companies	2,508	523	(2,457)	1	575	12	—	(468)	119
<b>Total</b>	<b>2,751</b>	<b>1,819</b>	<b>(2,626)</b>	<b>(917)</b>	<b>1,027</b>	<b>584</b>	<b>(224)</b>	<b>(468)</b>	<b>919</b>
<b>Total long-term financial investments, net</b>	<b>340,127</b>	<b>358,804</b>	<b>(72,274)</b>	<b>(147,145)</b>	<b>479,512</b>	<b>668,549</b>	<b>(60,897)</b>	<b>(179,341)</b>	<b>907,823</b>

B) In 1998 the Telefónica Group sold its holdings in various companies with the following results:

	Percentage of Capital Stock Sold	Millions of Pesetas	
		Book Value	Gain/ (Loss)
Dependent and associated companies:			
Rem Infográfica, S.A.	57.48%	400	(47)
Advance Telecommunicaciones, S.A.	50.00%	1,856	19
Indra SSI, S.A.	36.56%	2,121	2,862
Telefónica Cable Extremadura, S.A.	34.00%	34	(2)
Compañía Celular de Colombia, S.A. (Cocelco)	30.83%	4,779	1,977
Multicanal, S.A.	25.00%	23,157	17,718
Telefónica Cable Catalunya, S.A.	20.00%	20	12
Telefónica Cable Madrid, S.A.	10.00%	5	4
Telefónica Cable Castilla y León, S.A.	10.00%	100	2
Companhia Brasil Sul Participações, S.A.	20.07%	48,591	978
Telesudeste Celular Participações, S.A.	2.02%	1,140	245
Other	—	—	80
<b>Total</b>		<b>82,203</b>	<b>23,848</b>

In 1997 the Telefónica Group sold its holdings in various companies with the following results:

	Percentage of Capital Stock Sold	Book Value	Millions of Pesetas	Gain/ (Loss)
Dependent and associated companies:				
Sintelar, S.A.	25.00%	114	(43)	
Sintelperú, S.A.	25.00%	122	(25)	
Telefónica Cable Andalucía, S.A.	27.00%	23	3	
Telefónica Cable Castilla y León, S.A.	24.00%	21	2	
Telefónica Cable Madrid, S.A.	34.00%	26	9	
Telefónica Cable Navarra, S.A.	31.00%	26	5	
Telefónica de Argentina, S.A.	1.08%	4,789	6,494	
Telefónica Rumanía, S.A.	60.00%	1,850	197	
Unisource, N.V.	25.00%	34,907	20,556	
Other	—	730	105	
<b>Total</b>		<b>42,608</b>	<b>27,303</b>	
Investees:				
I-CO Global Communications (Holdings) Limited	1.69%	2,987	122	
<b>Total</b>		<b>2,987</b>	<b>122</b>	

C) The listed Group companies are as follows:

Telefónica, S.A.  
 Amper, S.A.  
 Compañía de Telecomunicaciones de Chile, S.A.  
 Telefónica de Argentina, S.A.  
 Telefónica del Perú, S.A.  
 Compañía Anónima Nacional de Teléfonos de Venezuela, C.A.  
 Portugal Telecom, S.A.  
 Telesp Participações, S.A. (\*)  
 Telesp Celular Participações, S.A. (\*)  
 Tele Leste Celular Participações, S.A. (\*)  
 Telesudeste Celular Participações, S.A. (\*)  
 Companhia Riograndense de Telecomunicações, S.A.

(\*) The shares of BOVESPA owned by these companies were admitted for listing on September 21, 1998, in blocks of 1,000 shares, and were issued as ADRs on the New York Stock Exchange on November 21, 1998.

## 9. DEFERRED CHARGES

The breakdown of the balance of this caption and the amortization schedule are as follows:

	Millions of Pesetas							
	Maturity					Balance at 12/31/98	Balance at 12/31/97	
	1999	2000	2001	2002	2003			
Pension supplements (shortfall) (Note 4-l)	10,247	10,247	10,247	10,247	10,247	35,867	87,102	98,161
Debt arrangement expenses	6,507	5,031	3,793	2,377	894	3,297	21,999	23,654
Interest on long-term promissory notes	2,740	1,550	183	—	—	—	4,473	8,214
Interest on lease transactions	62	48	9	—	—	—	119	277
Other deferred charges	10,825	9,152	2,358	115	115	2,118	24,683	4,797
<b>Total</b>	<b>30,481</b>	<b>26,028</b>	<b>16,590</b>	<b>12,739</b>	<b>11,256</b>	<b>41,282</b>	<b>138,376</b>	<b>135,103</b>

The variations in the balances of the "Pension Supplements (Shortfall)" caption were as follows:

	Millions of Pesetas
Balance at 12/31/96	95,642
Amortization (Note 4-l)	(9,370)
Updating of new GRM/80-2 tables (Note 4-l)	10,048
Change of assumed interest rate (Note 4-l)	1,841
Balance at 12/31/97	98,161
Amortization (Note 4-l)	(10,247)
Discounting to present value of costs (Note 14)	(812)
<b>Balance at 12/31/98</b>	<b>87,102</b>

## 10. CUSTOMER RECEIVABLES

The detail of the balances of this caption as of December 31, 1998 and 1997, is as follows:

	Millions of Pesetas	
	Balance at 12/31/98	Balance at 12/31/97
Services billed:		
Customers billed	219,763	141,546
Doubtful customer receivables	124,641	61,063
Other	15,502	9,518
	<b>359,906</b>	<b>212,127</b>
Unbilled services	304,667	267,789
	<b>664,573</b>	<b>479,916</b>
Allowance for bad debts	(125,907)	(61,355)
<b>Total</b>	<b>538,666</b>	<b>418,561</b>

The "Unbilled Services" account includes the connection, subscription and metered service charges not yet billed by Telefónica and the other Group operators. This amount arises because these companies' subscriber billing schedules do not coincide with year-end (see Note 4-q).

The balance of the public-sector customer accounts receivable in the countries in which the Group operates amounted to Ptas. 52,373 million (Ptas. 37,821 million in 1997) (at Telefónica, S.A. it amounted to Ptas. 39,617 million in 1998 and Ptas. 34,093 million in 1997).

In 1998 provisions amounting to Ptas. 53,200 million (Ptas. 16,448 million in 1997) were released and Ptas. 106,417 million (Ptas. 34,607 million in 1997) were recorded.

As a result of the worsened economic situation in South America caused by the natural disasters in 1998, Telefónica del Perú, S.A. made an extraordinary write-off of customer receivables of a certain age, the effect of which on the "Doubtful Customer Receivables"

and "Allowance for Bad Debts" accounts are shown in the table below. In 1997 Telefónica de Argentina, S.A. was carried by the equity method in the accompanying consolidated financial statements and, accordingly, it did not contribute any amount in that year.

	Millions of Pesetas	
	Balance at 12/31/98	Balance at 12/31/97
Telefónica de Argentina	25,107	—
Telefónica del Perú	41,304	11,231
<b>Total</b>	<b>66,411</b>	<b>11,231</b>

## II. STOCKHOLDERS' EQUITY

The detail of the balances of and variations in equity accounts in 1998 and 1997 is as follows:

	Millions of Pesetas							
	Balance at 12/31/96	Distribution of 1996 Income	Other Variations	Balance at 12/31/97	Distribution of 1997 Income	Other Variations	Capital Increase	Balance at 12/31/98
Capital stock	469,735	—	—	469,735	—	—	42,704	512,439
Additional paid-in capital	43,067	—	—	43,067	—	—	384,331	427,398
Revaluation reserve	868,392	—	—	868,392	—	(298,675)	—	569,717
Restricted reserves	86,071	7,876	—	93,947	—	—	—	93,947
Unrestricted reserves	157,061	18,718	(369)	175,410	53,347	(4,494)	—	224,263
Reserve for treasury stock	—	—	369	369	—	4,494	—	4,863
Consolidation reserve	75,935	50,051	591	126,577	40,942	(34,295)	—	133,224
Retained earnings	112	25	—	137	(51)	—	—	86
Consolidation translation differences	35,986	—	25,270	61,256	—	1,437	—	62,693
Income for the year	160,282	(160,282)	190,063	190,063	(190,063)	217,584	—	217,584
Interim dividend	(32,881)	32,881	(37,579)	(37,579)	37,579	—	—	—
<b>Total</b>	<b>1,863,760</b>	<b>(50,731)</b>	<b>178,345</b>	<b>1,991,374</b>	<b>(58,246)</b>	<b>(113,949)</b>	<b>427,035</b>	<b>2,246,214</b>

### a) Capital stock

As of December 31, 1998, Telefónica's capital stock consisted of 1,024,877,900 fully subscribed and paid bearer shares of Ptas. 500 par value each, all recorded by the book-entry system of trading and listed on the four Spanish stock exchanges and on the Frankfurt, London, Paris, Tokyo and New York stock exchanges. According to the information available in the public registers of the Spanish National securities Market Commission, as of December 31, 1998, significant holdings in its capital stock were owned by Banco Bilbao Vizcaya, S.A. (4.673%), Grupo Corporación Bancaria de España, S.A. (ARGENTARIA, 5.02%), Caja de Ahorros y Pensiones de Barcelona (5.01%) and Portugal Telecom, S.A. (1%). The State Property Agency owned 0.28% of its capital stock, through Sociedad Estatal de Participaciones Patrimoniales (SEPPA) (0.18%) and Sociedad Estatal de Patrimonio II, S. A. (0.1%).

Pursuant to Royal Decree 8/1997, the prior administrative authorization regime applies to Telefónica, S.A. and Telefónica Móviles, S.A. Accordingly, certain corporate resolutions and other agreements which may give entitlement to the direct or indirect acquisition, including through fiduciary or interposed third parties, of shares of Telefónica, S.A. or Telefónica Móviles, S.A. representing at least 10% of capital stock are subject to such authorization. The administrative authorization regime will be in force for ten years from February 18, 1997.

On April 21, 1995, the Stockholders' Meeting authorized the Board of Directors to increase capital, at one or several times, up to a maximum of Ptas. 704,603 million within a maximum period of five years and without requiring further notice or resolution.

In May 1998 85,406,438 new shares were issued at 1000% of their par value, giving rise to new funds amounting to Ptas. 427,032 million (Ptas. 42,703 million relating to capital stock and Ptas. 384,329 million to additional paid-in capital).

Also, in May 1998 642 new shares were issued as a result of the conversion of 20 debentures from the July 1997 issue, pursuant to a resolution of the Board of Directors dated May 27, 1998. The shares were issued at 968.5% of their par value, giving rise to a capital increase of Ptas. 1 million and to an addition of Ptas. 2 million to the additional paid-in capital balance.

On March 17, 1998, the Stockholders' Meeting authorized the derivative acquisition of treasury stock, for a consideration, by the Board of Directors up to the limits and within the terms and conditions established by the Stockholders' Meeting, within a maximum period of 18 months from that date, up to a maximum number equal to 5% of capital stock.

As of December 31, 1998 and 1997, the Group held the following shares of the parent company earmarked for sale:

Transaction Date	Number of Shares	Book Value per Share	Amount
Shares in portfolio at 12/31/97	100,000	Ptas. 3,689	369
Shares in portfolio at 12/31/98	775,650	Ptas. 6,310	4,768
Shares relating to the capital increase in progress (Note 23)	15,113	Ptas. 6,310	95
<b>Total</b>			<b>4,863</b>

The Company set up the requisite reserve for treasury stock amounting to Ptas. 4,863 million.

**b) Legal reserve**

Under the revised Corporations Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of capital stock. The legal reserve can be used to increase capital provided that the remaining reserve balance does not fall below 10% of the increased capital stock amount. Otherwise, until the legal reserve exceeds 20% of capital stock, it can only be used to offset losses, provided that sufficient other reserves are not available for this purpose.

**c) Revaluation reserves**

The balance of the "Revaluation Reserves" caption arose as a result of revaluations made from 1946 to 1987, and of the revaluation pursuant to Royal Decree-Law 7/1996.

As of December 31, 1998 and 1997, the balances of the revaluation reserve amounted to Ptas. 569,717 million and Ptas. 868,392 million, respectively, as follows:

	Millions of Pesetas
Revaluations from 1946 to 1987	745,203
Revaluation reserve Royal Decree-Law 7/1996	225,852
<b>Amounts used:</b>	
Capital increases from 1977 to 1986	(74,487)
Transfer to provisions in 1982	(18,829)
Single tax on revaluation, Royal Decree-Law 7/1996	(6,776)
Other variations from 1981 to 1986	(2,571)
<b>Balance at 12/31/97</b>	<b>868,392</b>
Amount used in 1998 (Note 4-l)	(298,675)
<b>Balance at 12/31/98</b>	<b>569,717</b>

From the date on which the tax authorities have reviewed and approved the balance of the "Revaluation Reserve Royal Decree-Law 7/1996" account (or the three-year period for review has expired), the aforementioned balance can be used, free of tax, to offset recorded losses which might arise in the future, and to increase capital stock. From January 1, 2007 (ten years from the date of the balance sheet reflecting the revaluations), the balance of this account can be taken to unrestricted reserves, provided that the monetary surplus has been realized. The surplus is deemed to be realized in respect of the portion relating to the depreciation recorded for accounting purposes or when the revalued assets have been transferred or retired from the accounting records.

The balance of the reserve for revaluations made in the period from 1946 to 1987 is unrestricted. On June 24, 1998, the Special Stockholders' Meeting resolved to declare Ptas. 22,000 million of this reserve restricted to cover the amount of the capital increases consisting of the delivery, free of charge for the stockholders, of a stock dividend of one share for every 50 outstanding shares. The first capital increase was completed on January 30, 1999 (see Note 23).

As a result of the labor force reduction plan for 1999/2000 described in Note 4-l, the Company recorded provisions amounting to Ptas. 459,500 million with a charge to extraordinary expenses (see Note 20). In addition, a credit for the same amount was recorded to extraordinary revenues with charges to revaluation reserves and prepaid taxes of Ptas. 298,675 million and Ptas. 160,825 million, respectively.

**d) Consolidation reserve**

The detail of the consolidation reserve and of the variations therein in 1998 and 1997 is as follows:

	Millions of Pesetas			
	Balance at 12/31/97	Increase	Decrease	Balance at 12/31/98
<b>1998</b>				
Companies consolidated by the global integration method	97,347	38,560	(31,895)	104,012
Companies carried by the equity method	29,230	7,832	(7,850)	29,212
<b>Total</b>	<b>126,577</b>	<b>46,392</b>	<b>(39,745)</b>	<b>133,224</b>

The variations shown in the foregoing table relate mainly to 1997 retained earnings, which gave rise to a net increase of Ptas. 40,942 million, and to the effect of the purchase, for subsequent retirement, of shares of Telefónica de Argentina, S.A. and Telefónica del Perú, S.A. for an amount exceeding their underlying book value, which reduced the reserve for companies consolidated by the global integration method by Ptas. 18,240 million and Ptas. 16,055 million, respectively.

	Millions of Pesetas			
	Balance at 12/31/96	Increase	Decrease	Balance at 12/31/97
<b>1997</b>				
Companies consolidated by the global integration method	58,342	41,160	(2,155)	97,347
Companies carried by the equity method	17,593	12,180	(543)	29,230
<b>Total</b>	<b>75,935</b>	<b>53,340</b>	<b>(2,698)</b>	<b>126,577</b>

The detail of the contribution made by the Group companies to the consolidation reserves is shown in Exhibit I.

**e) Consolidation translation differences**

The translation differences relate mainly to the effect of exchange rate fluctuations on the net assets of the companies located abroad (see Note 4-b) and the effect of the adjustment for inflation on the assets contributed by the companies at which this accounting practice is applied. These effects gave rise to a decrease of Ptas. 45,088 million in 1998 and an increase of Ptas. 62,839 million in 1997.

This account also includes exchange differences resulting from specific foreign-currency financing transactions relating to investments in investee companies and which hedge the exchange risk on these investments. The balance of this account increased by Ptas. 45,418 million as of December 31, 1998, as a result of the revaluation of Ptas. 1,048,704 million of loans assigned to these investments. In 1997 this account decreased by Ptas. 27,798 million as a result of the revaluation of loans amounting to Ptas. 425,903 million.

## 12. MINORITY INTERESTS

This caption relates to the share of minority stockholders in the equity and income/loss for the year of the Group companies consolidated by the global integration method. The variations in 1997 and 1998 in the balances of this caption in the consolidated balance sheets is as follows:

	Millions of Pesetas
	Amount
<b>Balance at 12/31/96</b>	<b>374,693</b>
Capital contribution and inclusion of companies	723
Income for the year	74,042
Variation in translation differences	61,061
Other variations	(87,287)
Capital reduction and exclusion of companies	(1,281)
Dividend paid	(27,854)
<b>Balance at 12/31/97</b>	<b>394,097</b>
Capital contribution and inclusion of companies	370,528
Income for the year	92,551
Variation in translation differences	(52,226)
Other variations	(4,177)
Capital reduction and exclusion of companies	(163,695)
Dividend paid	(47,151)
<b>Balance at 12/31/98</b>	<b>589,927</b>

The detail of the balances and of the variations relating to the main Group companies is shown in Exhibit IV.

## 13. DEFERRED REVENUES

The detail of the balances of and variations in this caption in the accompanying consolidated balance sheets is as follows:

	Millions of Pesetas				
	Capital Subsidies	Exchange Gains	Deferred Taxes (Note 18)	Nonrefundable Third-Party Contributions and Other	Total
<b>Balance at 12/31/96</b>	<b>73,834</b>	<b>2,989</b>	<b>17,027</b>	<b>8,368</b>	<b>102,218</b>
Additions	9,071	271	15,433	15,310	40,085
Transfers	—	—	—	—	—
Allocation to income	(11,285)	(2,989)	(1,938)	(13,620)	(29,832)
<b>Balance at 12/31/97</b>	<b>71,620</b>	<b>271</b>	<b>30,522</b>	<b>10,058</b>	<b>112,471</b>
Additions	8,397	5,211	12,334	16,219	42,161
Transfers	(36)	—	—	(3,016)	(3,052)
Allocation to income	(12,088)	(1,559)	(5,160)	(11,416)	(30,223)
<b>Balance at 12/31/98</b>	<b>67,893</b>	<b>3,923</b>	<b>37,696</b>	<b>11,845</b>	<b>121,357</b>

The "Nonrefundable Third-Party Contributions" caption includes amounts received by Telefónica for use of the underwater cable systems in which Telefónica has an interest as owner or co-owner.

### **Capital subsidies**

The detail of the capital subsidies not yet allocated to income is as follows:

Grantor	Millions of Pesetas	
	12/31/98	12/31/97
Official agencies, autonomous community governments, provincial and municipal governments and other	25,012	29,264
EU—		
STAR Programme	8,766	11,495
ERDF Programme	4,972	6,032
IRTA Programme	1,355	1,677
ERDF 94/95 Operating Programme	24,393	19,571
Other	3,395	3,581
	<b>67,893</b>	<b>71,620</b>

### **14. PROVISIONS FOR CONTINGENCIES AND EXPENSES**

The detail of the balances of and variations in provisions for contingencies and expenses is as follows:

	Millions of Pesetas								
	Balance at 12/31/96	Provisions	Amounts Used	Other	Balance at 12/31/97	Provisions	Amounts Used	Other	Balance at 12/31/98
Provision for cost of integrating retired employees in the social security system (Note 4-l)	38,688	—	(38,688)	—	—	—	—	—	—
Provision for Rebalancing Plan (Note 4-i)	9,121	4,876	(1,525)	—	12,472	5,082	(2,208)	—	15,346
Provision for supplementary pension payments to retired employees (Notes 4-l and 9)	122,035	7,296	(40,287)	11,889	100,933	6,188	(17,068)	(812)	89,241
Group insurance (Note 4-l)	13,219	1,368	(1,211)	—	13,376	1,240	(73)	—	14,543
Provision for voluntary "preretirement" and early retirement (Note 4-l)	86,784	90,166	(52,337)	—	124,613	585,391	(62,765)	—	647,239
Technical reserves (Note 4-m)	48,438	58,967	—	—	107,405	28,920	—	—	136,325
Provision for claims	377	—	(119)	(258)	—	—	—	—	—
Other provisions	17,953	17,110	(7,962)	2,996	30,097	44,890	(11,793)	26,424	89,618
<b>Total</b>	<b>336,615</b>	<b>179,783</b>	<b>(142,129)</b>	<b>14,627</b>	<b>388,896</b>	<b>671,711</b>	<b>(93,907)</b>	<b>25,612</b>	<b>992,312</b>

Most of the provisions are explained in Note 4. The "Technical Reserves" account includes the provisions recorded by the Group companies engaging in the insurance business. The amounts of these provisions are invested in assets recorded under the "Short-Term Financial Investments" and "Long-Term Financial Investments" captions.

## 15. DEBENTURES, BONDS AND OTHER NEGOTIABLE INSTRUMENTS

The variations in 1998 and 1997 in the debentures, bonds and other negotiable instruments were as follows:

	Group Companies Excluding Foreign Operators				Foreign Operators			
	Nonconvertible Peseta	Nonconvertible Foreign Currency	Convertible Foreign Currency	Promissory Notes	Subtotal	Nonconvertible Foreign Currency	Convertible Foreign Currency	Total Group
<b>Balance at 12/31/96</b>	<b>613,878</b>	—	—	70,668	<b>684,546</b>	87,318	14,948	<b>786,812</b>
New issues	—	88,245	99,402	159,871	<b>347,518</b>	19,320	—	<b>366,838</b>
Redemptions, conversions and exchanges	(52,365)	—	—	(152,963)	<b>(205,328)</b>	(19,401)	(12,195)	<b>(236,924)</b>
Revaluations and other variations	51,083	—	(982)	—	<b>50,101</b>	15,595	1,976	<b>67,672</b>
Transfers	—	—	—	—	<b>0</b>	—	—	<b>0</b>
<b>Balance at 12/31/97</b>	<b>612,596</b>	<b>88,245</b>	<b>98,420</b>	<b>77,576</b>	<b>876,837</b>	<b>102,832</b>	<b>4,729</b>	<b>984,398</b>
New issues	70,000	—	—	85,098	<b>155,098</b>	145,931	—	<b>301,029</b>
Redemptions, conversions and exchanges	(187,060)	—	(3)	(104,624)	<b>(291,687)</b>	(15,895)	(4,445)	<b>(312,027)</b>
Inclusion of companies	—	—	—	—	—	151,702	—	<b>151,702</b>
Revaluations and other variations	46,623	(4,465)	(5,901)	(1,673)	<b>34,584</b>	(18,911)	(284)	<b>15,389</b>
Transfers	—	—	—	471	<b>471</b>	—	—	<b>471</b>
<b>Balance at 12/31/98</b>	<b>542,159</b>	<b>83,780</b>	<b>92,516</b>	<b>56,848</b>	<b>775,303</b>	<b>365,659</b>	<b>0</b>	<b>1,140,962</b>
Maturity:								
Long term	396,535	83,780	92,516	—	<b>572,831</b>	356,128	—	<b>928,959</b>
Short term	145,624	—	—	56,848	<b>202,472</b>	9,531	—	<b>212,003</b>
Unmatured accrued interest	7,702	4,831	669	—	<b>13,202</b>	9,481	—	<b>22,683</b>

The balance of the "Inclusion of Companies" account relates to the effect of the consolidation in 1998 of Telefónica Argentina, S.A., which had been carried by the equity method in 1997.

The detail of the debentures and bonds outstanding as of December 31, 1998, and of the main features thereof is shown in Exhibit V.

The zero-coupon debentures and bonds issued through December 31, 1995, are recorded in the consolidated balance sheet at their issue value plus the related accrued interest.

In March 1998 Telefónica, S.A. issued nonconvertible debentures amounting to Ptas. 70,000 million, bearing average annual nominal interest of 4.8414% and maturing in 2008.

In May and August 1998 Telefónica Argentina made a placement of two issues, under an overall marketable debenture program with a limit of US\$ 1,000 million, amounting to Ptas. 400 million each. For the first issue there was an early redemption of US\$ 31.5 million. The first issue bears annual interest at 9.125% and matures at ten years; the second issue bears interest tied to Libor plus 1.125%, 1.375% and 1.625% in each of the three years up to its maturity.

In July 1997 convertible debentures were issued amounting to US\$ 600 million.

The features of the issue were as follows:

- Issue of 600,000 debentures of par value US\$ 1,000 each.
- Interest rate: 2.125%.
- Possibility of conversion during the life of the issue at a ratio of 31.43467 shares per debenture. Following the capital increase resolved by the Board of Directors on March 25, 1998 (one new share for every eleven old shares, giving rise to the issuance of 85,406,430 new shares for an effective price of Ptas. 5,000 per share), the conversion ratio was set at 32.11968 shares per debenture.
- Possibility of early redemption by Telefónica from 07/15/2000.
- Final redemption on 07/15/2002 at 108.02%.

To cover possible conversions, the Board of Directors has been authorized to carry out the appropriate capital increases (see Note 11-a).

In October and December 1997 two medium-term notes issues were made for Esc 15,000 million (maturing in 2004) and US\$ 500 million (maturing in 2003), respectively.

#### **Corporate promissory notes**

There are two corporate promissory note issue programs at Telefónica, as follows:

Millions of Pesetas

Outstanding Balance Limit	Addressed to:	Pesetas	Method of Sale
		Face Value	
75,000	Public	500,000 pesetas 100 million	Monthly auctions
75,000	Companies and institutions	500 million (minimum)	Specific transactions

#### **16. PAYABLE TO CREDIT ENTITIES**

The detail of accounts payable to credit entities is as follows:

	Millions of Pesetas								
	Group Companies Excluding Foreign Operators			Foreign Operators			Total		
	Balance at 12/31/98			Balance at 12/31/98			Balance at 12/31/98		
	Short Term	Long Term	Total	Short Term	Long Term	Total	Short Term	Long Term	Total
Corporate promissory notes	21,637	13,904	35,541	—	—	—	21,637	13,904	35,541
Loans and credits	288,216	415,588	703,804	—	—	—	288,216	415,588	703,804
Foreign currency loans	297,427	406,206	703,633	237,899	333,182	571,081	535,326	739,388	1,274,714
<b>Total</b>	<b>607,280</b>	<b>835,698</b>	<b>1,442,978</b>	<b>237,899</b>	<b>333,182</b>	<b>571,081</b>	<b>845,179</b>	<b>1,168,880</b>	<b>2,014,059</b>

	Millions of Pesetas								
	Group Companies Excluding Foreign Operators			Foreign Operators			Total		
	Balance at 12/31/97			Balance at 12/31/97			Balance at 12/31/97		
	Short Term	Long Term	Total	Short Term	Long Term	Total	Short Term	Long Term	Total
Corporate promissory notes	1,314	35,541	36,855	—	—	0	1,314	35,541	36,855
Loans and credits	54,697	291,477	346,174	—	—	0	54,697	291,477	346,174
Foreign currency loans	122,904	457,835	580,739	143,600	157,875	301,475	266,504	615,710	882,214
<b>Total</b>	<b>178,915</b>	<b>784,853</b>	<b>963,768</b>	<b>143,600</b>	<b>157,875</b>	<b>301,475</b>	<b>322,515</b>	<b>942,728</b>	<b>1,265,243</b>

In 1998, as a result of the acquisitions made in Brazil following the award to the Telefónica Internacional Group of the various holding companies arising from the privatization of the Telebrás System, Telefónica Internacional, S.A. recorded a debt for 60% of the deferred payment to the Brazilian government for the acquisitions made through subsidiaries or consortiums formed for this purpose.

The amount payable plus the interest accrued from the date of award totals 4,056 million Brazilian reales. The debt incurs fixed interest at 12% plus inflation (GPI-DI), the principal and interest are payable in equal portions on August 4, 1999 and 2000, and the possibility of early payment is provided for. If early payment is made on or before the first payment date, the interest rate will be reduced to 9% plus inflation (GPI-DI).

On October 2, 1998, Telefónica Internacional, S.A. acquired from Banco Nacional de Desarrollo Social (BNDES), a customized private bond issue amounting to US\$ 2,347 million with the following features:

**Put option:** the bonds may be redeemed by the purchaser at any time, provided that the principal and interest accrued through the date of early redemption are used to repay the debt to BNDES that arose from the privatization of the Telebrás System.

**Netting or Set-Off:** in the event of default by the issuer, the aforementioned debt may be repaid through delivery of the bonds.

**Security:** the pledge of the shares acquired in the privatization shall be replaced, in the related proportion, by the bonds issued by BNDES.

**Interest:** the annual interest, net of the withholdings collectible together with the bond principal payments, is 11.875%.

**Maturity:** Payment shall be made in two equal installments on August 4, 1999 and 2000.

The debt to BNDES is shown net of the bonds subscribed with this bank because they are indivisible, and one cannot be repaid/redeemed without the other. On January 27, 1999, the bonds were redeemed early and the debt repaid early, and the difference was settled as described in Note 23.

As of December 31, 1998, the balance relating to the loan was Ptas. 478,702 million, and that relating to the bonds was Ptas. 335,696 million. The difference between the two amounts, Ptas. 143,006 million is recorded in equal amounts under the "Long-Term Debt - Payable to Credit Entities" and "Current Liabilities – Payable to Credit Entities" captions in the accompanying consolidated financial statements on the basis of their maturity. The "Current Liabilities – Payable to Credit Entities" caption also includes Ptas. 14,016 million relating to the unmatured accrued interest (Ptas. 24,090 million) on the debt, net of the interest earned on the bonds (Ptas. 10,074 million).

As of December 31, 1998, the payables were scheduled to mature as follows:

Millions of Pesetas						
<b>Scheduled Maturities</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Subsequent Years</b>
<b>Group Companies Excluding Foreign Operators</b>						<b>Total</b>
Corporate promissory notes	21,637	1,618	12,286	—	—	—
Loans and credits	288,216	52,807	49,060	39,200	31,794	242,727
Foreign currency loans	297,427	133,087	59,471	23,911	30,486	159,251
<b>Total</b>	<b>607,280</b>	<b>187,512</b>	<b>120,817</b>	<b>63,111</b>	<b>62,280</b>	<b>401,978</b>
						<b>1,442,978</b>

Millions of Pesetas						
<b>Scheduled Maturities</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Subsequent Years</b>
<b>Foreign Operators</b>						<b>Total</b>
CTC loans	68,507	25,152	47,850	46,156	46,156	261
Telefónica del Perú loans	76,699	2,269	45,051	2,932	2,931	20,049
TASA/COINTEL loans	90,868	31,614	22,905	12,132	14,074	11,971
Loans to other operators	1,825	1,050	195	210	197	27
<b>Total</b>	<b>237,899</b>	<b>60,085</b>	<b>116,001</b>	<b>61,430</b>	<b>63,358</b>	<b>32,308</b>
						<b>571,081</b>

Millions of Pesetas						
<b>Scheduled Maturities</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>Subsequent Years</b>
<b>Total</b>						<b>Total</b>
Corporate promissory notes	21,637	1,618	12,286	—	—	—
Loans and credits	288,216	52,807	49,060	39,200	31,794	242,727
Foreign currency loans	535,326	193,172	175,472	85,341	93,844	191,559
<b>Total</b>	<b>845,179</b>	<b>247,597</b>	<b>236,818</b>	<b>124,541</b>	<b>125,638</b>	<b>434,286</b>
						<b>2,014,059</b>

## **Loans and credits**

The peseta loans and credits include the amount used in pesetas of a multicurrency loan originally granted in ECUs by the European Investment Bank for Ptas. 10,838 million and other multicurrency loans swapped for peseta loans totaling Ptas. 137,746 million.

### **Foreign currency loans**

The detail of the foreign-currency loans as of December 31, 1998 and 1997, is as follows:

#### **Outstanding Balance (in Millions)**

Currency	Foreign Currency		Pesetas	
	12/31/98	12/31/97	12/31/98	12/31/97
USD	3,588	2,662	511,683	403,885
Brazilian reales	1,212	—	143,006	—
ECU	413	466	68,645	78,133
FRF	1,196	1,367	30,346	34,620
JPY	17,871	17,000	22,413	19,922
NLG	165	197	12,524	14,785
DEM	123	144	10,490	12,191
Lire	120,000	120,000	10,322	10,358
CHF	53	64	5,528	6,688
Other currencies	—	—	80	157
Swaps	—	—	(111,404)	—
<b>Group companies excluding foreign operators</b>			<b>703,633</b>	<b>580,739</b>
USD	1,224	—	174,527	—
Argentine pesos	47	—	6,635	—
ECU	14	—	2,393	—
DEM	0.1	—	9	—
<b>TASA/COINTEL</b>			<b>183,564</b>	<b>0</b>
USD	958	707	136,605	107,254
UF	21	16	96,244	75,469
FRF	0.2	—	6	—
DEM	8	8	636	635
Chilean pesos	1,959	26,268	591	9,067
<b>CTC CHILE</b>			<b>234,082</b>	<b>192,425</b>
USD	1,017	517	144,983	78,440
N. Sol	79	1,309	3,566	26,176
FRF	7	—	181	—
NLG	13	14	985	1,027
BEF	52	48	216	196
<b>TELEFÓNICA PERU</b>			<b>149,931</b>	<b>105,839</b>
USD	7	9	1,045	1,296
Chilean pesos	8,151	5,548	2,459	1,915
<b>Other companies</b>			<b>3,504</b>	<b>3,211</b>
<b>Foreign operators</b>			<b>571,081</b>	<b>301,475</b>
<b>TOTAL GROUP</b>			<b>1,274,714</b>	<b>882,214</b>

#### Credit available

The loans and credits accounts reflect only the amounts drawn against the credit facilities, and there is no penalty or cost for the portion not drawn down. The undrawn credit facility funds available were as follows:

	Millions of Pesetas	
	Balance at 12/31/98	Balance at 12/31/97
Credit available at long term	95,696	147,946
Other credit facilities (floating facilities)	79,000	50,531
Credit available at short term	105,105	154,220
<b>Total</b>	<b>279,801</b>	<b>352,697</b>

#### 17 DERIVATIVES

In 1998 the Group continued to use derivatives both to limit interest rate and exchange risks on unhedged positions and to adapt its debt structure to market conditions.

As of December 31, 1998, the total outstanding volume of hedging transactions to limit on-balance sheet interest rate and exchange risks was Ptas. 1,858,778 million (Ptas. 793,422 million as of December 31, 1997), of which Ptas. 771,364 million related to interest rate risk, Ptas. 1,080,848 million to exchange risk and Ptas. 6,566 million to share-price risk (see Exhibit VI).

The most significant transactions carried out in 1998 by Telefónica, S.A. included most notably the hedging of bonds aimed at the retail market and borrowings in non-euro zone foreign currencies.

In 1998 management of the debt and derivatives portfolio gave rise to a result of zero (income of Ptas. 1,674 million in 1997).

#### 18 TAX MATTERS

Since 1990 Telefónica has filed consolidated tax returns with certain Group companies. 53 companies formed the tax consolidation group in 1998, including most notably, in terms of sales, Telefónica, S.A., Telefónica Internacional, S.A., which joined the tax consolidation group in 1998, Telefónica Móviles, S.A., Cabinas Telefónicas, S.A., Telefónica Publicidad e Información, S.A. and Telefónica Transmisión de Datos, S.A.

##### Prepaid and deferred taxes

The detail as of December 31, 1998 and 1997, of the Telefónica Group's prepaid and deferred taxes, and of the variations therein in the years then ended, is as follows:

	Millions of Pesetas				
	Prepaid Taxes		Deferred Taxes		
	Short Term	Long Term	Short Term	Long Term	Intercompany Long Term
<b>Balance at December 31, 1996</b>	<b>5,477</b>	<b>70,007</b>	—	<b>72,725</b>	<b>11,018</b>
Reversal	(5,902)	(18,650)	—	(5,591)	(1,865)
Arising in the year	4,982	41,471	—	3,233	1,484
Net international variations	—	—	—	13,790	—
Inclusion/Exclusion of companies and other	731	(65)	—	(14,732)	3,382
<b>Balance at December 31, 1997</b>	<b>5,288</b>	<b>92,763</b>	—	<b>69,425</b>	<b>14,019</b>
Reversal	(597)	(8,122)	—	(5,310)	(232)
Arising in the year (Note 8)	2,734	209,329	—	30,558	3,425
Net international variations	—	8,504	—	6,084	—
Inclusion/Exclusion of companies and other	(398)	395	117	(115)	(430)
<b>Balance at December 31, 1998</b>	<b>7,027</b>	<b>302,869</b>	<b>117</b>	<b>100,642</b>	<b>16,782</b>

The deferred intercompany taxes relate to the differences arising from the elimination of unrealized gains and losses on intercompany transactions, plus the accumulated differences between the net tax payable reported in the Telefónica Group's consolidated corporate income tax return and the sum of the tax charges per the individual corporate tax returns of the Telefónica Group companies.

#### **Accrued taxes payable and tax receivables**

The detail of the "Accrued Taxes Payable" and "Tax Receivables" captions as of December 31, 1998 and 1997, is as follows:

	Millions of Pesetas	
	Balance at 12/31/98	Balance at 12/31/97
<b>Accrued taxes payable:</b>		
Personal income tax withholdings	11,051	10,781
VAT and Canary Islands general indirect tax	18,954	5,054
Withholdings from income from movable capital and other	1,468	1,586
Corporate income tax	44,659	39,467
Local taxes	340	1,342
Accrued social security taxes	27,027	25,124
Foreign taxes	70,508	8,053
<b>Total</b>	<b>174,007</b>	<b>91,407</b>
<b>Tax receivables:</b>		
Corporate income tax prepayments—		
Withholdings at source from income from movable capital	2,068	2,046
Prepayments on consolidated income tax returns	73,068	48,503
Prepayments on individual income tax returns	1,452	163
Foreign withholding tax	8,776	8,776
Corporate income tax refundable	16,089	—
Taxes, surcharges and other payments recoverable	114	393
Prepaid taxes	7,027	5,288
VAT and Canary Islands general indirect tax	21,292	15,482
VAT deductible	104	41
Foreign taxes	56,719	6,496
<b>Total</b>	<b>186,709</b>	<b>87,188</b>

#### **Reconciliation of the income per books to the taxable income**

The reconciliation of income per books to taxable income for corporate income tax purposes for 1998 and 1997 is as follows:

	Millions of Pesetas	
	1998	1997
Income before taxes	402,010	337,641
Permanent differences	(612,689)	(175,869)
Timing differences:		
Arising in the year	512,849	88,790
Arising in prior years	(10,108)	(36,831)
<b>Taxable income</b>	<b>292,062</b>	<b>213,731</b>

The adjustments for permanent differences relate mainly to the release of allowances for voluntary "preretirement" and early retirement (Ptas. 459,500 million in 1998), with a credit to income.

The variations in timing differences in 1998 were as follows:

	Millions of Pesetas	
	Increase	Decrease
Voluntary retirement	544,059	—
Provisions for supplementary pension payments to retire employees	2,950	—
Pension allowance	2,874	—
Allowance for bad debts	10,693	—
Unrealized gains on transactions involving fixed assets	3,383	—
Loyalty bonuses and other	7,924	—
Fixed asset provisions	1,155	—
Intercompany transactions	—	9,786
Accelerated depreciation	1,593	31,652
Reinvestment of extraordinary income	—	22,118
Other	3,804	2,030
<b>Timing differences arising in the year</b>	<b>578,435</b>	<b>65,586</b>
Reversal of accelerated depreciation taken in prior years	15,230	346
Provision for diminution in value of securities portfolio in prior years	—	86
Exchange differences	—	6,854
Reversal of allowance for bad debts	—	9,683
Reversal of provision for contingencies and expenses	—	3,281
Intercompany transactions	664	5
Other	—	5,747
<b>Timing differences arising in prior years</b>	<b>15,894</b>	<b>26,002</b>

#### **Calculation of corporate income tax expense and net corporate income tax payable**

The detail of the corporate income tax expense and the net corporate income tax payable in 1998 and 1997 is as follows:

	Millions of Pesetas	
	1998	1997
Income per books	402,010	337,641
Permanent differences	(612,689)	(175,869)
Timing differences	502,741	51,959
<b>Taxable income</b>	<b>292,062</b>	<b>213,731</b>
Gross tax payable	102,222	74,806
Tax credits and relief	(57,567)	(35,339)
<b>Corporate income tax payable</b>	<b>44,655</b>	<b>39,467</b>
Tax effect of extraordinary provision for "preretirement" and early retirement	(160,825)	—
Other timing differences and deferred revenues	(4,581)	(2,913)
Tax effect of extraordinary provision for "preretirement" and early retirement	160,825	—
Spanish corporate income tax expense	40,074	36,554
Accrued foreign taxes and other	51,801	36,982
<b>Total corporate income tax</b>	<b>91,875</b>	<b>73,536</b>

The tax credits and relief taken in 1998 and 1997 totaled Ptas. 57,567 million and Ptas. 35,339 million, respectively. The main tax credits taken by the Group are as follows: Ptas. 12,275 million of international double taxation tax credits; Ptas. 3,562 million of tax credits for research and development activities; and Ptas. 6,123 million of export tax credits, since the Group made investments in foreign companies in Brazil (see Notes 2-d and 6) which qualify for the tax credits provided for in Article 34 of the Corporate Income Tax Law because the investments exceed 25% of the capital stock of the foreign companies and are directly related to export activities, since a portion of the price paid includes the expected flow of funds derived from goods and services export contracts between the operators in Brazil and the Telefónica Group (see Note 20).

Also, Ptas. 30,258 million of investment tax credits earned in prior years were also taken. In view of the ceilings on investment tax credits, as of December 31, 1998, after deducting the tax credits taken in 1998, the Telefónica tax group had Ptas. 23,378 million of unused prior years' tax credits, as follows:

Amount	Millions of Pesetas			
	1995	1996	1997	Total
	1,902	14,632	6,844	23,378

The years open for review by the tax inspection authorities for the main applicable taxes vary from one consolidated company to another, although they are generally all years since 1993. No additional material liabilities are expected to arise for the Group in the event of a tax inspection.

#### **Accrual of investment tax credit and permanent differences**

The effect of this accrual on the corporate income tax expense (see Note 4-q) is as follows:

	Accrual of Corporate Income Tax Expense (Note 13)
<b>Balance at December 31, 1996</b>	<b>17,027</b>
Reversal	(1,938)
Arising in the year	15,433
<b>Balance at December 31, 1997</b>	<b>30,522</b>
Reversal	(5,160)
Arising in the year	12,334
<b>Balance at December 31, 1998</b>	<b>37,696</b>

#### **19. OTHER NONTRADE PAYABLES**

The detail of the balances of this caption in the consolidated balance sheets as of December 31, 1998 and 1997, is as follows:

	Millions of Pesetas	
	Balance at 12/31/98	Balance at 12/31/97
Accrued expenses payable	135,721	50,833
Dividends payable	6,983	45,531
Provision for extra-payroll	24,472	29,423
Exchange of telephone service with other operators	13,681	15,146
Guarantees and deposits	7,786	10,308
Provision for third-party liability	—	11,590
Other accounts payable (see Note 2-d)	86,200	128,634
<b>Total</b>	<b>274,843</b>	<b>291,465</b>

## 20. REVENUES AND EXPENSES

### Sales and services

The detail, by business line, of net sales and services is as follows:

	Millions of Pesetas	
	1998	1997
Basic telephony—		
Basic telephone service	1,005,981	1,007,844
Rental of circuits	112,938	98,133
Ibercom	62,563	62,858
Digital exchanges, intelligent network, ISDN and other	119,529	86,583
Terminals	64,143	73,456
Directories	13,381	12,050
	<b>1,378,535</b>	<b>1,340,924</b>
International communications	129,622	134,659
Public telephony	70,579	68,193
Data transmission	60,278	54,513
Other revenues	13,375	6,812
<b>Total revenues of Telefónica</b>	<b>1,652,389</b>	<b>1,605,101</b>
Telefónica Telecomunicaciones Públicas	49,961	43,788
Telefónica Internacional Group	893,073	443,131
Telefónica Servicios Móviles Group	468,202	362,993
Telefónica Publicidad e Información Group	65,396	47,476
Telefónica Transmisión de Datos	70,704	—
Other subsidiaries	196,458	198,210
<b>Group revenues before intercompany sales</b>	<b>3,396,183</b>	<b>2,700,699</b>
Intercompany sales	(490,162)	(337,597)
<b>Total revenues from Group operations</b>	<b>2,906,021</b>	<b>2,363,102</b>

### Personnel expenses

The detail of personnel expenses is as follows:

	Millions of Pesetas	
	1998	1997
Compensation	482,042	424,320
Provisions to the pension allowance and other commitments to employees	22,897	23,155
Employee welfare expenses and other	145,232	123,420
	<b>650,171</b>	<b>570,895</b>

### Number of employees

	1998		1997	
	Average	Year-End	Average	Year-End
Telefónica	60,379	58,127	65,663	64,109
TS.M.	2,491	2,743	1,929	2,239
Telefónica Internacional	28,018	27,802	16,157	15,523
T.T.P.	697	696	660	647
T. Publicidad e Información	1,141	1,117	1,141	1,130
T.T.D.	378	413	323	355
Estratel	6,414	6,877	3,198	4,390
Other	4,144	4,034	3,080	3,629
<b>Total</b>	<b>103,662</b>	<b>101,809</b>	<b>92,151</b>	<b>92,022</b>

The figures in the foregoing table relate to companies consolidated by the global integration method.

### Other interest on accounts payable and similar expenses

The detail of the "Other Interest on Accounts Payable and Similar Expenses" caption is as follows:

	Millions of Pesetas	
	12/31/98	12/31/97
Debentures, bonds and other negotiable instruments	82,278	101,509
Loans and credits	40,582	25,756
Foreign currency loans	91,182	53,249
Promissory notes with credit entities	2,742	3,388
Other	24,251	6,065
	<b>241,035</b>	<b>189,967</b>

### Exchange losses

The detail of exchange losses charged to income is as follows:

	Millions of Pesetas	
	12/31/98	12/31/97
Repayment of loans	—	10,000
Losses deferred pursuant to Ministerial Order dated March 12, 1993	—	8,590
Operating transactions	6,898	2,476
Translation losses (Note 4-b)	15,682	—
	<b>22,580</b>	<b>21,066</b>

#### **Extraordinary revenues**

The detail of extraordinary revenues is as follows:

	Millions of Pesetas	12/31/98	12/31/97
Prior years' revenues		1,728	2,935
Indemnity payments for breach of contract		2,866	829
Consortium for compensation of insurance		1,287	281
Gain on sale of shares		119	319
Share in EURESCOM		117	763
Reversal of sundry provisions		3,660	—
Recovery of revenue on intercompany transactions		—	2,221
Collections from third parties		619	617
Allowances for "preretirement" and early retirement released (Notes 4-I and 11-c)		459,500	—
Other		6,085	4,331
	<b>475,981</b>	<b>12,296</b>	

#### **Extraordinary expenses**

	Millions of Pesetas	12/31/98	12/31/97
Supplementary pension payments to retire employees (Note 4-I)		16,435	9,370
Court-ordered indemnity payments		—	1,111
<b>Provisions recorded:</b>			
Provision for expenses		13,312	—
Cost of inclusion of retired employees in social security system (Note 4-I)		—	2,815
<b>"Preretirement" and early retirement:</b>			
Period provision (Note 4-I)		125,891	90,166
Extraordinary provision (Note 4-I)		459,500	—
Other		20,281	8,598
Compensation for transfers		43	802
Subsidies and voluntary donations		570	844
Early repayment of loans (Note 16)		—	7,124
Airtel Móvil indemnity (Royal Decree 1252/97)		12,033	2,967
Corporate liquidations and other		369	—
Directory overprinting		1,363	—
Write-down of goodwill		5,048	—
Other extraordinary expenses		8,535	11,796
	<b>663,380</b>	<b>135,593</b>	

Under Royal Decree-Law 1252/1997, Telefónica was obliged to reduce by Ptas. 15,000 million the interconnection charges to Airtel Móvil, S.A., thus concluding the dispute between the Spanish government and the European Commission regarding the contributions made by Airtel Móvil for the award of the license to provide GSM services. In addition to other measures adopted by the Spanish government, said decision was completed with the signature by Telefónica and Airtel of a commercial agreement which is satisfactory to the interests of both companies. Charges are made to expenses for the year as the interconnection revenues arise. Ptas. 2,967 million were recorded under the "Extraordinary Expenses" caption in 1997 in this connection, and the remaining Ptas. 12,033 million were charged to income in 1998.

#### **Losses on fixed assets**

This caption includes Ptas. 20,582 million in 1998 and Ptas. 24,069 million in 1997 recorded as a result of the dismantling of Telefónica's plant for network digitalization (see Note 7).

#### **Management contract with Telefónica de Argentina, S.A.**

In November 1990 Telefónica and Telefónica Argentina entered into a management contract expiring in 2003 regulating the counseling services rendered by Telefónica and the price thereof. The revenues received in this connection, net of the payments for third-party counseling, amounted to Ptas. 6,205 million in 1998 and Ptas. 9,219 million in 1997. These revenues were eliminated in consolidation.

#### **Other technical services and management transfer contracts**

On May 16, 1994, Telefónica del Perú entered into a technical know-how and management transfer contract with Telefónica Internacional for a five-year term, automatically renewable for additional five-year terms, up to a maximum of 20 years, coinciding with the initial term of the assignment contract. The revenues received in this connection amounted to Ptas. 16,755 million in 1998 (Ptas. 21,991 million in 1997). These revenues were eliminated in consolidation.

In December 1996, following the privatization of CRT, the consortium which was awarded a holding in Compañía Riograndense de Telecomunicações (CRT), in which Telefónica Internacional has a 73% holding, signed an agreement whereby it receives 1% of CRT's net revenues on the basis of compliance with certain network service quality requirements defined in the agreement. The agreement has a five-year term, renewable for a further five years, and is subsequently renewable for consecutive two-year periods.

In 1998 and 1997 this agreement generated Ptas. 1,284 million and Ptas. 1,023 million of revenues allocable to the Group before taxes and withholdings, and these amounts were recorded under the "Sundry and Other Current Operating Revenues" caption.

In 1998 the Brazilian telecommunications regulator (ANATEL) and the relevant Stockholders' Meetings approved the management contracts that the Group will have with Telesp Participações, S.A., Tele Sudeste Participações, S.A. and Tele Leste Participações, S.A. These contracts have an initial term of five years and are all renewable. Telefónica Internacional will receive an annual fee equal to a percentage ranging from 1% to 2% of the aforementioned companies' net revenues. As of December 31, 1998, the Group received Ptas. 2,252 million of revenues under these contracts.

### **21. DIRECTORS' REMUNERATION AND OTHER BENEFITS**

In 1998 and 1997 the compensation paid to the Board members for salaries, per diems and attendance fees amounted to Ptas. 1,057 million and Ptas. 783 million, respectively.

The pension commitments to directors with executive functions arise solely from their status as employees and amounted to Ptas. 2 million in each year. There are no pension commitments to the rest of the Board members.

### **22. OTHER INFORMATION**

#### **a) Sundry commitments and rights**

	Millions of Pesetas	
	1998	1997
Financial transaction guarantees	5,912	12,342
Guarantees provided for employees	—	209
Other	1,707	2,333

No loss is expected in connection with these commitments.

Also, Telefónica has provided guarantees to Banco Santander, S.A. and Banco Central Hispanoamericano, S.A., by means of an agreement dated August 7, 1997, to ensure the liquidity and value of the investment made by them in Antena 3 de Televisión, S.A., including interest at Mibor during the period up to exercise of the option, less the dividends received in said period. This guarantee is applicable from the second year of the investment in strict compliance with current legislation.

#### **b) Put option on Telefónica Perú Holding**

On November 3, 1997, Telefónica Internacional arranged a put option with the current stockholders of Telefónica Perú Holding, S.A. on this company, whereby it undertook, at the request of these stockholders, to acquire their ownership interests in this company. The exercise price of the option is the value of the shares of Telefónica del Perú, S.A. owned by these stockholders per the market price of the shares on the New York stock exchange. The option may be exercised on either September 14, 2001, or March 14, 2005.

#### **c) Put option on CRT shares**

Telefónica Internacional entered into a put option contract with RBS, a Brazilian partner in the consortium to which the shares of CRT were awarded. Under this contract, Telefónica Internacional undertakes to buy 69,393,817 shares of Tele Brasil Sul, S.A. (TBS), which owns the holding in CRT. This option will be exercisable on December 27, 2001, depending on whether or not RBS has fulfilled certain financial obligations. The price will be the initial acquisition price of the shares. If a loss arises as a result of the difference

between the option exercise price and the market price of the shares at the time of sale, RBS must compensate Telefónica Internacional by means of shares of the consortium (or of such company as may replace it) owned by RBS. If, on the contrary, a capital gain should arise, it would be for RBS.

RBS also holds a call option on the shares of TBS owned by Telefónica Internacional that would enable it to reach a 30% holding in TBS. The option may be exercised through January 12, 2000. Until the date of the possible exercise of the option, the voting rights on these shares will be held by RBS. If the option is not exercised on the stipulated date, the aforementioned voting rights will automatically be assigned to Telefónica Internacional. The price of the above-mentioned option will be the initial acquisition price, capitalized at three-year LIBOR plus 40 basis points. The incorporation of the subsidiary Celular CRT, S.A. was approved on June 25, 1998, and the assets and liabilities relating to the aforementioned business were transferred to this company. This transaction was carried out in the light of the requirement that fixed telephony and cellular telephony operators be different companies and, accordingly, the option was changed to enable RBS to acquire up to 30% of the two aforementioned companies.

**d) Purchase and sale agreement for shares of Telefónica Centroamérica, S.L.**

On November 19, 1998, Telefónica Internacional entered into various agreements with Mesotel de Costa Rica, S.A. (Mesotel) for put and call options on the shares owned by the latter in Telefónica de Centroamérica, S.L. (Telca). Under these agreements, Mesotel has an option exercisable from August 13, 2003, through February 12, 2005, whereby it can sell to Telefónica Internacional all (49% of capital stock) or a portion of the Telca shares that it owns. Telefónica Internacional has a call option on all the Telca shares owned by Mesotel, which it can exercise from February 13, 2005, through August 12, 2006. The exercise price of the two options will be determined, in the event that they are exercised, by an investment bank, which will calculate the market value of the shares.

**e) Call option on Cablevisión, S.A.**

Telefónica Internacional has granted an option to Tele Communications Inc. (TCI) whereby the latter may sell, and Telefónica Internacional would be obliged to buy, together with the other stockholders, all or certain of the shares that it owns in Cablevisión, S.A. in proportion to its percentage of ownership. This option may be exercised at any time from September 30, 1998, through September 30, 1999, for a price established by an investment bank. This option had not been exercised as of December 31, 1998.

There is also a reciprocal option whereby any of the parties may oblige the others to purchase or sell the company's shares. This option may be exercised at any time through September 30, 1998. The share price will be determined by the stockholder that exercises the option, and the other parties may choose whether to purchase or sell the shares at that price.

Also, TCI has entered into a management contract with Cablevisión, S.A. expiring on September 19, 2002. On expiration, if the contract is not renewed, TCI may sell its shares in this company to the other stockholders for the price set by an investment bank.

**f) Call option on Atlántida Comunicaciones, S.A. (ATCO)**

Telefónica Internacional has granted an option to Syrup Trading, S.A., a stockholder of Atlántida Comunicaciones, S.A. (ATCO), whereby the latter may sell all or certain of its shares to the other stockholders in proportion to their percentage of ownership. This option, which would be rendered null and void if the company's shares were admitted to listing, can be exercised in the period between the 30th and the 60th month after March 26, 1998.

**g) Put and call option on Torneos y Competencias, S.A.**

The Torneos y Competencias, S.A. stockholders' agreement entered into by Telefónica Internacional and the other stockholders provides that, if a proposal is submitted for the admission to listing of the company's shares and such proposal is rejected, the party that opposed listing must either purchase the shares of the party submitting the proposal or sell its own shares. This option may not be exercised prior to September 30, 2000.

**h) Put option on Tele Brasil Holding**

Telefónica Internacional has granted a put option to Banco Bilbao Vizcaya whereby the latter may sell, and Telefónica Internacional is obliged to purchase, the 172,332,410 Tele Brasil Holding, S.A. shares owned by Banco Bilbao Vizcaya for US\$ 148.9 million. This amount would be increased by the interest accrued thereon at an annual rate of Libor divided by two, from August 4, 1998, through August 4, 2000, the date on which the option may be exercised. Similarly, any amount received by Banco Bilbao Vizcaya from Tele Brasil Holding in the form of dividends, reserve distributions, capital reductions or any other similar item payable to stockholders would be deducted from the aforementioned amount, which would be increased in turn by the accrued interest on such payments at an annual rate of Libor divided by two, from the date on which such payments are made through the date on which the option may be exercised.

**i) Agreements with Iberdrola**

On July 27, 1998, Telefónica Internacional and Iberdrola Investimentos entered into an agreement to regulate their relations within the consortium that the two parties had set up for the investment in Tele Leste Celular Participações, S.A. Under this agreement, Iberdrola offered Telefónica Internacional the option of acquiring 12% of the shares owned by it, provided that this were permitted under Brazilian legislation.

### i) "Year 2000 issue"

This issue is of particular importance to the telecommunications industry, since there is a significant software component in telecommunications networks, and both the management and operation thereof could be affected.

In 1997 Telefónica, aware of the scope and magnitude of this problem, initiated a corporate project known as "Millennium" to address and solve the problems and incidents that the arrival of the Year 2000 may have with respect to the activities, items, processes and systems involved in managing the business.

The project addresses all the possible facets of the effects of this issue and encompasses technological and systems aspects, processes, products and services, organizational areas and functions and legal and risk hedging aspects. In this regard, it caters for the measures required to:

- Assess the possible impacts on all areas of the business.
- Draw up the action plans required in each case in order to minimize the impacts identified.
- Carry out all the conversions, replacements and corrective measures required to neutralize the problem in all the affected areas.
- Conduct tests, on both an individual and an overall basis, on all items, processes and systems.
- Start-up all the new items tested.
- And, lastly, prepare contingency and emergency plans so as to be able to react in the event of any unforeseen failures that might arise as a result of dependence on third parties.

The costs incurred through December 31, 1998, in resolving the problems associated with the "Year 2000 issue" amount to Ptas. 8,374 million, and the costs to be incurred in 1999 in this connection are expected to amount to approximately Ptas. 13,747 million, and no material additional costs are foreseen.

The action plans will be completed in the first half of 1999, and the last six months of the year will be used for final testing. However, from a global standpoint, the Telefónica Group acknowledges its dependence on other organizations and companies to solve this problem (suppliers, interconnection with other telecommunications operators, etc.) and, accordingly, it is cooperating closely with them in order to identify and implement the appropriate solutions in each case. Based on the foregoing, management of the Telefónica Group does not expect the "Year 2000 issue" to give rise to any significant problems in connection with management and ordinary operations.

## 23. SUBSEQUENT EVENTS

On January 8, 1999, Telefónica del Perú obtained a three-year loan of Ptas. 450 million on the international markets.

On January 14, 1999, Telefónica and Lucent Technologies entered into a strategic cooperation agreement to establish a framework for product development, services and joint analysis of markets. Also, Telefónica sold to Lucent 50% of the Amper shares owned by it for Ptas. 6,800 million. This transaction involved 12.2% of Amper's capital stock and gave rise to a gain of approximately Ptas. 2,877 million.

On January 8, 1999, the Telefónica Group arranged a loan of US\$ 280 million with the European Investment Bank (EIB), with final maturity in 2008. The loan is repayable in six annual installments, with a grace period of four years, and bears floating interest.

On January 8, 1999, Compañía de Telecomunicaciones de Chile (CTC) carried out a seven-year bond placement in the U.S.A. for US\$ 200 million, with interest at 8.375%.

Antena 3 Televisión and ONCE entered into an agreement of intent for the acquisition of all the shares of Uniprex owned by the Onda Cero radio network. The company hitherto owned by ONCE has 102 radio stations and maintains association agreements with a further 84. The cost of the transaction will not be fixed until the purchasing company has evaluated, by means of an audit, the financial position of Onda Cero.

On January 27, 1999, the Board of Directors of Telefónica resolved to redenominate the Company's capital stock and, consequently, the par value of the shares into which it is divided, in euros, pursuant to Article 21 of Law 46/1998 on the introduction of the euro.

Accordingly, the capital stock of Telefónica amounts to 3,079,820,117.08 euros, and consists of 1,024,877,900 shares with a par value of 3.005060 euros each. It was also resolved to denominate in euros the stock dividend issue with a charge to unrestricted reserves agreed on by the Stockholders' Meeting on June 24, 1998, in the proportion of one new share for every 50 outstanding shares. Implementation of this resolution gave rise to a capital increase of 61,596,402.34 euros, represented by 20,497,558 new shares. The deadline for the assignment of the new shares free of charge was January 30, 1999, and the related public deed of capital increase was executed on February 10, 1999.

In January 1999 the Brazilian government eliminated the exchange rate bands existing through that date and set a limit on the annual fluctuation in the price of the Brazilian real with respect to the U.S. dollar. Once the aforementioned bands had been eliminated, the Brazilian real started to float freely, and fell by around 65% with respect to the exchange rate prevailing at December 31, 1998. In the light of the new economic scenario derived from the depreciation in the price of the Brazilian real in January 1999, the Company reassessed the recoverability of the book value of the investments owned by it in Brazil. This reassessment disclosed the need to

write down in 1999 the book value of the investments by Ptas. 119,374 million. This, together with the reduction in book value recorded in 1998, represented a decrease of 15.2% with respect to the total acquisition cost of these investments, and was triggered by the impact of the possible delay in the emergence of the expected demand growth and the foreseeable reductions in rates in real terms over the coming years. The Company will recognize this write-down in 1999.

In addition, as described in Note 16, as of December 31, 1998, the Company had an account payable to BNDES amounting to 4,056 million Brazilian reales. This debt was repaid on January 27, 1999. The depreciation of the Brazilian real gave rise to a reduction of Ptas. 165,391 million in the amount paid in this connection with respect to the book value of the debt as of December 31, 1998. Telefónica Internacional will use part of this difference to cover the aforementioned write-down. The remainder will be used to increase the measures taken to protect and write down the holdings of Telefónica Internacional in Latin America that might be affected by the impact of the depreciation of the Brazilian real in the other countries in the area, if the economic circumstances so advise.

In February 1999, Telefónica acquired, thorough its wholly-owned subsidiary Telefónica Media, 17.09% of the capital stock of Antena 3 de Televisión, S.A., pursuant to an authorization granted to this end under a resolution of the Spanish General Secretariat of Communications on January 27, 1999. Following this acquisition, Telefónica Media now has a holding of 40.49% in the capital stock of Antena 3 de Televisión.

In February 1999 Telefónica acquired, through Telefónica Intercontinental, S.A., all the shares of the Austrian telecommunications company European Telecom International GmbH for approximately Ptas. 4,800 million.

As described in Note 4-I, the Company announced in 1998 the possibility of undertaking in 1999 and 2000 a new "preretirement" and early retirement plan for 13,967 employees, for which it recorded a provision of Ptas. 459,500 million as of December 31, 1998. After analyzing the applications received, at the beginning of 1999 the Company decided to formally accept, on a case-by-case basis, those which did not pose any problems to its current operating management. 6,016 agreements had been entered into with employees through February 15, 1999. The discounted present value of the related cost, net of the corresponding prepaid tax, totals Ptas. 131,323 million.

A group of finance entities led by Banco Central Hispano, Citibank, N.A. and Commerzbank Aktiengesellschaft have granted Telefónica a syndicated loan of 1,200 million euros. This loan is repayable at five and seven years and bears floating interest tied to Euribor.

The Board of Directors of DTS Distribuidora de Televisión Digital, S.A. resolved to increase capital at par by Ptas. 40,477.5 million. This resolution was ratified by the Stockholders' Meeting on February 22, 1999. The subscription period is one month from the date of ratification.

During current year 1999, the Puerto Rican Telecommunications Authority has notified the Group the execution at the exercise option over 19% at the capital stock of TLD, by which the Group has the obligation of buying such stock. At the date of the issuance of these financial statements neither the purchase of the stock nor the payment had been formalized.

#### 24. CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

<b>Application of Funds</b>	<b>1998</b>	<b>1997</b>	<b>Source of Funds</b>	<b>1998</b>	<b>1997</b>
— Funds applied in operations	—	—	— Funds from operations	1,306,425	1,147,863
— Start-up and debt arrangement expenses	41,581	9,740	— Stockholder contributions		
— Fixed asset additions			a) Capital increase	42,704	—
a) Intangible assets	98,584	51,043	b) Additional paid-in capital	384,331	—
b) Property and equipment	636,495	634,845	c) Minority interests	33,723	723
c) Long-term financial investments	1,380,335	545,438	— Deferred revenues	24,616	24,381
— Prepaid taxes	(495)	—	— Long-term deferred taxes	3,722	3,550
— Dividends	105,397	116,164	— Long-term debt	652,441	518,725
— Repayment or transfer of long-term debt	525,343	424,531	— Fixed asset disposals		
— Provisions	93,907	142,129	a) Intangible assets	—	—
— Other funds applied	209	2,144	b) Property and equipment	27,463	13,108
— Decrease in working capital due to disposal of shareholdings	—	563	c) Long-term financial investments	93,176	87,670
— Decrease in working capital due to acquisition of shareholdings	64,405	—	— Increase in working capital due to disposal of shareholdings	2,354	—
— Variation in working capital due to translation differences	(14,040)	(2,379)	— Increase in working capital due to inclusion of subsidiaries	—	9,702
<b>Total funds applied</b>	<b>2,931,721</b>	<b>1,924,218</b>	<b>TOTAL FUNDS OBTAINED</b>	<b>2,570,955</b>	<b>1,805,722</b>
<b>Funds obtained in excess of funds applied (INCREASE IN WORKING CAPITAL)</b>	<b>—</b>	<b>—</b>	<b>Funds applied in excess of funds obtained (DECREASE IN WORKING CAPITAL)</b>	<b>360,766</b>	<b>118,496</b>
	<b>2,931,721</b>	<b>1,924,218</b>		<b>2,931,721</b>	<b>1,924,218</b>

#### VARIATIONS IN WORKING CAPITAL

<b>INCREASE IN WORKING CAPITAL</b>	<b>1998</b>	<b>1997</b>	<b>DECREASE IN WORKING CAPITAL</b>	<b>1998</b>	<b>1997</b>
— Due from stockholders for capital calls	—	—	— Due from stockholders for capital calls	—	—
— Inventories	11,481	3,857	— Inventories	—	—
— Accounts receivable	247,457	121,456	— Accounts receivable	—	—
— Accounts payable	—	—	— Accounts payable	603,111	308,441
— Short-term financial investments	—	90,250	— Short-term financial investments	65,693	—
— Cash	17,857	—	— Cash	—	1,845
— Accrual accounts	31,243	—	— Accrual accounts	—	23,773
<b>TOTAL</b>	<b>308,038</b>	<b>215,563</b>	<b>TOTAL</b>	<b>668,804</b>	<b>334,059</b>
<b>VARIATION IN WORKING CAPITAL</b>	<b>360,766</b>	<b>118,496</b>	<b>VARIATION IN WORKING CAPITAL</b>	<b>—</b>	<b>—</b>
	<b>668,804</b>	<b>334,059</b>		<b>668,804</b>	<b>334,059</b>

The reconciliation of the balances in the consolidated statements of income to the funds obtained from operations is as follows:

	Millions of Pesetas	
	12/31/98	12/31/97
Income	217,584	190,063
Income attributed to minority interests	92,551	74,042
Loss attributed to associated companies	(12,199)	(9,958)
	297,936	254,147
<b>Add:</b>		
Dividends at companies carried by the equity method	4,806	29,465
Depreciation and amortization	725,434	602,657
Provision for property and equipment	(550)	—
Amortization of debt arrangement expenses	4,776	3,754
Amortization of goodwill in consolidation	21,135	33,312
Write-down of goodwill	5,048	—
Provision for diminution in value of financial investments	(724)	213
Exchange differences	(7,387)	4,166
Undepreciated plant dismantled	30,027	38,100
Provision for inventory adjustment	2,386	888
Period provisions	636,603	120,696
Provisions to technical reserves of insurance companies	28,921	59,087
Deferred interest	50,818	55,656
Additional paid-in capital and reimbursement	2,225	1,366
Deferred taxes and other	851	—
Property and equipment and intangible assets	6,234	3,444
Financial provision and supplementary pension payments to retired employees	16,520	9,370
Loss on disposal of consolidated companies	49	68
<b>Less:</b>		
Gain on disposal of long-term financial investments	119	122
Gain on disposal of property and equipment	11,636	14,740
Capital subsidies	12,088	11,285
Nonrefundable third-party contributions	11,416	13,504
Long-term deferred and prepaid taxes	—	1,402
Gain on disposal of consolidated companies	23,897	27,371
Provision for commitments to employees	459,500	—
Other	27	102
<b>Funds from operations</b>	<b>1,306,425</b>	<b>1,147,863</b>

## 25. EXPLANATION ADDED FOR TRANSLATION TO ENGLISH

These consolidated financial statements are presented on the basis of accounting principles generally accepted in Spain. Certain accounting practices applied by the Group that conform with generally accepted accounting principles in Spain may not conform with generally accepted accounting principles in other countries.

## EXHIBIT I

### CONTRIBUTION OF THE GROUP COMPANIES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The contribution of the Group companies to consolidated reserves and translation differences as of December 31, 1998 and 1997, was as follows:

Companies	Millions of Pesetas			
	December 31, 1998		December 31, 1997	
	To Reserves	To Translation Differences	To Reserves	To Translation Differences
Fonditel	1,275	—	687	—
G. Casiopea	2,380	6	1,495	2
G. Comet	(885)	—	(882)	—
G. Servicio Teledistribución Hilo	—	—	248	—
G. Telefónica Internacional	82,221	62,687	88,516	61,255
G. Telefónica Media	(7,152)	—	(1,122)	—
G. Telefónica Medios Comunicación	(926)	—	—	—
G. Telefónica Publicidad e Informac.	9,903	—	6,943	—
G. Telefónica Servicios Móviles	45,681	—	17,855	—
G. Telefónica Sistemas	2,864	—	2,956	(1)
G. Telefónica Soluciones Sectoriales	(204)	—	—	—
Playa de Madrid	114	—	96	—
Taetel	1,535	—	1,466	—
Telefónica Europe B.V.	14	—	—	—
Telefónica Telecomunicaciones Públicas	5,897	—	5,051	—
Telfisa	52	—	(42)	—
Telyco	(105)	—	(685)	—
Temasa	5,274	—	4,676	—
Tidsa	3,221	—	2,974	—
Urbana Ibérica	95	—	94	—
Telefónica de España and associated companies	1,333,848	—	1,213,735	—
<b>Total Telefónica Group</b>	<b>1,485,102</b>	<b>62,693</b>	<b>1,344,061</b>	<b>61,256</b>
Intercompany fixed asset transactions	(31,604)	—	(36,162)	—
<b>Total contribution</b>	<b>1,453,498</b>	<b>62,693</b>	<b>1,307,899</b>	<b>61,256</b>

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Telefónica Telecomunicaciones Públicas, S.A. (*) (**) (1) <i>Installation of public telephones Plaza de las Bertrán, 7 - 28020 Madrid</i>	100,00%		100,00%	200	5.897	(3.000)	4.171	200	G. I.	—
Casiopea Reaseguradora, S.A. (3) <i>Reinsurance 73, Rue du Fort Neipperg - L-2230 Luxemburg</i>	100,00%		100,00%	498	152	—	—	498	G. I.	—
Pléyade Peninsular Correduría de Seguros del Grupo Telefónica, S.A. (3) <i>Distribution, promotion or preparation of insurance contracts, operating as a broker Avda. General Perón, 38 Master II - 17 P. 28020 Madrid</i>	16,67%	83,33%	100,00%	60	213	—	192	60	G. I.	—
Seguros de Vida y Pensiones Antares, S.A. (3) <i>Life insurance and pensions Avda. General Perón, 38 - 28020 Madrid</i>	21,33%	78,67%	100,00%	1.500	1.835	—	1.050	1.960	G. I.	—
Fonditel Entidad Gestora de Fondos de Pensiones, S.A. (3) <i>Pension fund management Pedro Teixeira nº 8 - 3º P. - 28020 Madrid</i>		3,78%								
Compañía Española de Tecnología, S.A. (COMET) (*) (**) (3) <i>Promotion of business initiatives and holding of securities Villanueva, 2 duplicado planta 1º Oficina 23 - 28001 Madrid</i>	100,00%		100,00%	1.049	(251)	—	(127)	1.682	G. I.	—
Satel, S.A. (8) 85,00% <i>Comandante Zorita, 4 - 28020 Madrid</i>		85,00%	85,00%	125	N/D		N/D	81	L.	81
Cleon, S.A. (3) <i>Property development Villanueva, 2 duplicado planta 1º Oficina 23 - 28001 Madrid</i>		50,00%	50,00%	1.370	(51)	—	(5)	685	G. I.	—
Barcelona Tecnología, S.A. <i>Venture capital company c/60 - 25º,27º Sector A Polígono Industrial Zona Franca 08040 Barcelona</i>		4,21%	4,21%	238	24		14	10	L.	10
Fonditel Entidad Gestora de Fondos de Pensiones, S.A. (3) <i>Pension fund management Pedro Teixeira nº 8 - 3º P. - 28020 Madrid</i>	77,22%	3,78%	81,00%	2.612	1.574	—	927	2.115	G. I.	—
Playa de Madrid, S.A. (*) (**) (12) <i>Distribution of all manner of goods, operation of sporting and hospitality facilities Doctor Fleming, 3 - 1º P. - 28036 Madrid</i>	100,00%		100,00%	40	128	—	(122)	54	G. I.	—
Taetel, S.L. (*) (**) (3) <i>Acquisition, holding and disposal of shares and holdings in other companies Beatriz de Bobadilla, 3 - 28040 Madrid</i>	100,00%		100,00%	4.700	1.535	(130)	180	4.700	G. I.	—
Telecomunicaciones Marinas, S.A. (TEMASA) (*) (**) (12) <i>Drilling, laying and repair of underwater cables Silva, 1 - Pl. 3º - 28013 Madrid</i>	100,00%		100,00%	1.376	5.274	—	2.031	1.326	G. I.	—
Telefonía y Finanzas, S.A. (TELFISA) (*) (**) (3) <i>Integrated cash management, counseling and financial support for Group companies General Perón, 38 - Master II Pta. 15 - 28020 Madrid</i>	100,00%		100,00%	500	387	—	67	2.099	G. I.	—
Telefónica Intercontinental, S.A. (1) (**) <i>Holding company Gran Vía, 28 - 28013 Madrid</i>	100,00%		100,00%	250	—	—	(118)	250	G. I.	—
Iberadvance, S.A. (PORTUGAL) <i>Management of holdings in companies, mainly in the telecommunications industry Avd. Alvaro Pani, 2 - Lisboa</i>		50,00%	50,00%	10 MESC	—	—	—	4	L.	4
Telefónica Sdad. Operadora de Servicios de Telecomunicaciones en España, S.A. (**) <i>Telecommunication services in Spain Gran Vía, 28 - 28013 Madrid</i>	100,00%		100,00%	10	—	—	—	10	L.	10
Telefónica Internet, S.A. (**) <i>Internet access services Gran Vía, 28 - 28013 Madrid</i>	100,00%		100,00%	10	—	—	—	10	L.	10
Telefónica Investigación y Desarrollo, S.A. (TIDSA) (*) (**) (3) <i>Telecommunications research activities and projects. Emilio Vargas 6 - 28043 Madrid</i>	100,00%		100,00%	1.000	3.240	(616)	1.012	1.000	G. I.	—
Telefónica North America, INC (3) <i>Financial intermediation 1209 Orange Street, 19.801 Wilmington/New Castle County Delaware (U.S.A.)</i>	100,00%		100,00%	1	—	—	—	1	G. I.	—
Teleinformática y Comunicaciones, S.A. (TELYCO) (*) (**) (3) <i>Promotion, marketing and distribution of telephone and telematic equipment and services Plaza Descubridor Diego de Ordás, 3 - Pta. 4º - 28003 Madrid</i>	100,00%		100,00%	460	1.577	—	1.204	2.075	G. I.	—

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Telefónica Europe, B.V. (1) <i>Attracting funds in capital markets.</i> Aert van Nesstraat 45, 4º Rotterdam - 3012 CA - Holland	100.00%		100.00%	8	15	—	169	8	G. I.	—
Inmobiliaria Telefónica, S.L. (**) <i>Purchase, sale and lease of real estate</i> Gran Vía, 28 - 28013 Madrid	100.00%		100.00%	1.670	15.541	—	2	17.211	G. I.	—
Telefónica Procesos y Tecnología de Información, S.A. (**) <i>Services related to information technology</i> José Abascal, 4 - 28003 Madrid	100.00%		100.00%	10	—	—	—	10	G. I.	—
Urbana Ibérica, S.A. (3) (**) <i>Debt collection and management of the cash generated by the sale of land and buildings</i> General Perón, 38 - Master II Pta. 15 - 28020 Madrid	100.00%		100.00%	264	(40)	—	(1)	14	G. I.	—
Telefónica Servicios y Contenidos por la Red, S.A. (Teleline) (*) (**) (12) <i>Leisure and entertainment services</i> Julian Camarillo, 6, 2º P. - 28037 Madrid	100.00%		100.00%	920	(54)	—	(369)	767	G. I.	—
Ifigenia Plus, S.L. <i>Culture and education software</i> Almogro, 12 -		10.00%	10.00%	16	N/D		N/D	—	I.	—
Telefónica Comunicaciones Interactivas, S.A. (**) <i>Operation of telecommunication services</i> Gran Vía, 28 - 28013 Madrid	100.00%		100.00%	10	—	—	—	10	I.	10
Telefónica Data, S.A. (**) <i>Provisional operation of telecommunication services</i> Gran Vía, 28 - 28013 Madrid	100.00%		100.00%	10	—	—	—	10	I.	10
Telefónica Media, S.A. (*) (**) (1) <i>Organization and operation of activities and businesses relating to multimedia services</i> Jorge Manrique, 12 - 28006 Madrid	100.00%		100.00%	20.000	(6.427)	—	(6.245)	20.000	G. I.	—
Telefónica Servicios Audiovisuales, S.A. (*) (**) (1) <i>Audiovisual telecommunication services of all kinds</i> Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (Pozuelo de Alarcón) - 28223 Madrid	100.00%		100.00%	1.000	916	—	697	1.393	G. I.	—
Telefónica Cable, S.A. (**) (1) <i>Cable telecommunication services</i> Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (Pozuelo de Alarcón) - 28223 Madrid	100.00%		100.00%	3.000	(265)	—	(369)	3.000	G. I.	—
Telefónica Cable Madrid, S.A. (1) <i>Cable television systems and value-added services</i> Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (Pozuelo de Alarcón) - 28223 Madrid	56.00%	56.00%	100	(35)	—	(12)	45	G. I.	—	
Telefónica Cable Catalunya, S.A. (1) <i>Cable television systems and value-added services</i> Avda. Icaria, 136 - 08005 Barcelona	80.00%	80.00%	100	(20)	—	(50)	80	G. I.	—	
Telefónica Cable Cantabria, S.A. (**) <i>Cable television systems and value-added services</i> La Milagrosa, 2 - 39001 Santander	100.00%		100.00%	100	(37)	—	(8)	75	G. I.	—
Telefónica Cable Menorca, S.A. (**) <i>Cable television systems and value-added services</i> Santiago Ramón y Cajal, 13 - Mahón (Menorca)	100.00%		100.00%	100	(16)	—	16	94	G. I.	—
Telefónica Cable Asturias, S.A. (**) <i>Cable television systems and value-added services</i> Gral. Elorza, 17 - 33001 Oviedo	100.00%		100.00%	100	4	—	2	101	G. I.	—
Telefónica Cable Euskadi, S.A. (**) <i>Cable television systems and value-added services</i> Gregorio de la Revilla, 27 - 48010 Bilbao	100.00%		100.00%	100	(34)	—	(7)	78	G. I.	—
Sociedad General de Cablevisión Cádiz, S.A. (**) <i>Cable television systems and value-added services</i> Santa María Soledad, 6 - 11006 Cádiz	100.00%		100.00%	100	(19)	—	19	93	G. I.	—
Telefónica Cable Extremadura, S.A. (1) <i>Cable television systems and value-added services</i> Plaza de la Soledad, 2 - 06001 Badajoz	66.00%	66.00%	100	4	—	3	67	G. I.	—	
Telefónica Cable Galicia, S.A. (**) <i>Cable television systems and value-added services</i> Ronda de Ourense, 1-3 - A Coruña	100.00%		100.00%	100	4	—	3	101	G. I.	—
Telefónica Cable Aragón, S.A. (**) <i>Cable television systems and value-added services</i> Vía Universitaria, 10 - Zaragoza	100.00%		100.00%	100	(27)	—	26	83	G. I.	—

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Sociedad General de Cablevisión Málaga, S.A. (**) Cable television systems and value-added services Híero, 2 - 29007 Málaga	100,00%	100,00%	100	4	—	—	3	101	G. I.	—
Telefónica Cable Murcia, S.A. (**) Cable television systems and value-added services San Antón, 4 - 30005 Murcia	100,00%	100,00%	100	(21)	—	—	(7)	89	G. I.	—
Telefónica Cable Navarra, S.A. (1) Cable television systems and value-added services Monasterio de lo Oliva, 9 - 31011 Pamplona	69,00%	69,00%	100	(27)	—	—	(11)	58	G. I.	—
Telefónica Cable La Rioja, S.A. (**) Cable television systems and value-added services San Millán, 3 - 26004 Logroño	100,00%	100,00%	100	(9)	—	—	(7)	101	G. I.	—
Telefónica Cable Andalucía, S.A. (1) Cable television systems and value-added services Grahan Bell, 5 - 41010 Sevilla	73,00%	73,00%	1,000	(23)	—	—	(35)	720	G. I.	—
Telefónica Cable Valencia, S.A. (**) Cable television systems and value-added services San Vicente, 148 - 46007 Valencia	100,00%	100,00%	100	(18)	—	—	(23)	92	G. I.	—
Telefónica Cable Castilla la Mancha, S.A. (**) Cable television systems and value-added services Cuesta de Carlos V, 5 - Toledo	100,00%	100,00%	100	(8)	—	—	10	101	G. I.	—
Telefónica Cable Baleares, S.A. (**) Cable television systems and value-added services Federico García Lorca, 2 - 07014 Palma de Mallorca	100,00%	100,00%	100	(25)	—	—	(7)	85	G. I.	—
Telefónica Cable Castilla y León, S.A. (1) Cable television systems and value-added services Avda. Reyes Católicos, 38 - 09005 Burgos	51,00%	51,00%	1,000	(11)	—	—	(23)	512	G. I.	—
Sociedad General de Cablevisión Canarias, S.A. (1) Cable television systems and value-added services Alcalde Mandado Tejera, 8 - 38007 Santa Cruz de Tenerife	51,00%	51,00%	215	(54)	—	—	(24)	96	G. I.	—
Servicios de Teledistribución, S.A. (S.T. HILO) (*) (**) (12) Supply of services in the teledistribution industry Luchana, 23 - 28010 Madrid	100,00%	100,00%	210	524	—	—	141	297	G. I.	—
Producciones Multitemáticas, S.A. (**) (12) Production, distribution, sale and purchase and operation of television and movie productions. Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (Pozuelo de Alarcón) - 28223 Madrid.	100,00%	100,00%	2,000	(338)	—	—	(51)	2,000	G. I.	—
Rem Infográfica, S.A. (1) Production of 3D objects, promotion and marketing of computer products and services Plaza de Santa Bárbara, 10 - 1º Dcha. - 28004 Madrid	42,52%	42,52%	25	423	—	(222)	170	P. L.	95	
Lola Films, S.A. (1) Movie production Doctor Gimena, 12 - Barcelona	33,33%	33,33%	1,050	219	—	155	600	P. L.	475	
Antena 3 de televisión, S.A. (1) Management of public and satellite T.V. service. Avda. Isla Graciosa, s/n - San Sebastián de los Reyes - 28700 Madrid	23,40%	23,40%	27,778	(1,086)	—	13,143	24,653	P. L.	9,683	
DTS Distribuidora de Televisión Digital, S.A. (5) Digital satellite T.V. services Rafael Calvo, 18, Pta. 3º - 28010 Madrid	36,95%	36,95%	22,500	18,757	—	(21,273)	21,005	P. L.	7,384	
Audiovisual Realtime BIT, S.A. (ARTBIT) Production of synthetic images Polígono Industrial de Inca Solar en intersección de las vías C y D Mallorca 07300 Inca	12,50%	12,50%	200	(118)	—	—	25	P. L.	(4)	
Telefónica Publicidad e Información, S.A. (*) (**) (2) Publishing of directories and advertising for all types of media Avda. de Manoteras, 12 - 28050 MADRID	100,00%	100,00%	502	8,591	(4,709)	7,141	996	G. I.	—	
Estrategias Telefónicas, S.A. (ESTRATEL) (*) (**) (12) Services, promotion, marketing and market surveys relating to direct marketing Santiago de Compostela, 94 - 5º - 28035 Madrid	100,00%	100,00%	230	1,413	(1,005)	1,475	411	G. I.	—	
Tempotel, Empresa de Trabajo Temporal, S.A. (*) (**) (12) Temporary employment agency Hermani, 64 - 28020 Madrid	100,00%	100,00%	10	(7)	—	32	10	G. I.	—	
Gestión de Servicios de Emergencia y Atención al Ciudadano, S.A. (12) Information and communication systems for emergency situations Paseo Marítimo, 38 A - 1º E - 07014 Palma de Mallorca	51,00%	51,00%	100	—	—	(36)	51	G. I.	—	

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Book Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Doubledclick Iberoamérica, S.L. (**) (2) Advertising in Internet Avda. de Monteros, 12 - 28050 MADRID	90.00%	90.00%	149	(5)	—	(47)	134	G. L.	—	—
TMP Worldwide España, S.A. (2) Marketing and advertising of major customers in yellow pages Príncipe de Vergara, 112 - 4º Pta. - 28002 Madrid	95.00%	95.00%	45	(1)	—	6	43	G. L.	—	—
Venturini España, S.A. (2) Printing, graphic arts and direct marketing Avda. Industria, 17 Tres Cantos - 28760 Madrid	100.00%	100.00%	500	88	—	(103)	545	G. L.	—	—
Venturini, S.A. (2) Direct marketing Via Augusta, 117, 2º 1º - 08006 Barcelona	100.00%	100.00%	30	4	—	—	34	G. L.	—	—
Rotakom - Vesa Direct	50.00%	50.00%	17	—	—	—	8	L.	8	—
Venturini North Direct marketing Place Saint Lambert, 14 - 1200 Brussels (Belgium)	10.00%	10.00%	4 M.F.B.	—	—	—	2	L.	2	—
Euredit, S.A. Publication of European yearbooks Avda. Friedland, 9 - 75008 París (France)	5.00%	5.00%	3 t.F.F.	6 t.F.F.	—	3 t.F.F.	13	L.	13	—
Telefónica Internacional, S.A. (**) (1) (9) Investment in the telecommunications industry abroad Jorge Manrique, 12 - 28006 Madrid	98.75%	1.25%	100.00%	119.009	225.447	—	27.266	217.713	G. L.	—
Telefónica Panamericana - MCI, B.V. (HOLLAND) (1) Holding company	50.00%	50.00%	1.413	15	—	—	802	L.	802	—
Cablevisión, S.A. (ARGENTINA) (11) Cable television	35.86%	35.86%	23.368	45.213	—	(8.426)	57.682	P. I.	21.709	—
Atlántida Comunicaciones, S.A. (ARGENTINA) Multimedia industry Tucumán, 1 Pto.20 Buenos Aires	30.00%	30.00%	N/D	N/D	—	N/D	17.637	L.	17.637	—
Torneos y Competencias, S.A. (ARGENTINA) (3) Football content and rights	20.00%	20.00%	165	24.115	—	(1.494)	11.755	P. I.	4.571	—
Tele Leste Celular Participações, S.A. (Bahía Celular) (BRAZIL) (1) Telebahía Celular, S.A. (1) Telerglobe Celular, S.A. (1)	7.32%	7.32%	12.176	19.006	—	4.264	21.129	P. I.	2.206	—
Telesuldeste Celular Participações, S.A. (Rio Celular) (BRAZIL) (1) Telcel Celular, S.A. (1) Telest Celular, S.A. (1)	89.30%	65.4%	22.034	187	—	4.039	N/A	P. I.	N/A	—
Telefónica El Salvador Holding (EL SALVADOR) Intel El Salvador	51.00%	51.00%	5.847	—	—	—	3.768	L.	3.768	—
Beleggingsmaatschappij Koningsvijver I, B.V. (HOLLAND)	50.00%	50.00%	N/D	N/D	—	N/D	13	G. L.	—	—
Tele Brasil Sul Participações, S.A. (BRAZIL) (1) Holding company	52.93%	52.93%	261.985	860	—	22	N/A	P. I.	N/A	—
Telesp Participações, S.A. (1) C.T.B.C. (1) Telesp S.A. (1)	22.92%	12.13%	452.411	638.452	—	99.173	473.242	P. I.	102.330	—
Companhia Riograndense de Telecomunicações (BRAZIL) (1) Telecommunications operator Avda. Borges de Medeiros nº 512, 15 andar Porto Alegre - Rio Grande do Sul 90020-022 Brasil	67.52%	8.19%	57.062	76.818	—	7.124	N/A	P. I.	N/A	—
Interteléfonica do Brasil Holding, Ltd. (BRAZIL) Portelcom (BRAZIL)	35.80%	35.80%	N/D	N/D	—	N/D	166.848	P. I.	10.689	—
Telesp Celular Participações, S.A. (Río Celular) Telesp Celular, S.A.	19.27%	6.90%	N/D	N/D	—	N/D	—	P. I.	—	—
Telefónica Centroamérica (SPAIN)	71.40%	4.93%	N/D	N/D	—	N/D	—	L.	—	—
Telefónica Finance Limited (ISLE OF MAN) (1) Finance	100.00%	100.00%	1	5.999	—	—	—	G. L.	—	—
Telefónica del Perú Holding, S.A. (PERU) (1) Holding company	90.00%	90.00%	285.525	8	(5.954)	6.230	249.701	G. L.	—	—
Telefónica del Perú, S.A. (PERU) (14) Operator of local, long distance and international services in Peru Avda. Arequipa, 1155 Santa Beatriz - Lima	38.89%	35.00%	146.139	160.979	—	29.861	—	G. L.	—	—
Otras Participaciones	N/A	N/A	N/A	N/A	—	N/A	40.892	L.	40.892	—

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Value	Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group								
Telefónica International Holding B.V. (HOLLAND) (1) Holding company	100,00%	100,00%	90.156	48.892			20.792	69.410	G. I.	—	
Telefónica Chile Holding B.V. (HOLLAND) (1) Holding company	100,00%	100,00%	4.615	7.446			(1)	29.322	G. I.	—	
Telefónica de Chile, S.A. (CHILE) (4) Holding company	100,00%	100,00%	10.596	153.162			19.824	12.108	G. I.	—	
Compañía de Telecomunicaciones de Chile, S.A. (C.T.C.), (CHILE) (4) Telecommunications operator in Chile. Avenida Providencia, 111 piso 29 Santiago de Chile	43,64%	43,64%	194.888	169.228	(9.604)		41.145	171.848	G. I.	—	
Other holdings	N/A	N/A	N/A	N/A			N/A	—	P. L.	1.631	
Other holdings	N/A	N/A	N/A	N/A			N/A	144	I.	144	
Impresora y Comercial Publiguías, S.A. (CHILE) (4) Publishing and sole of advertising. White and yellow pages Avda. de Santa María, 792 Santiago de Chile	54,93%	54,93%	804	1.582			1.861	2.123	G. I.	—	
Compañía de Inver. en Telecomunicaciones, S.A.(COINTEL) (ARGENTINA) (11) Holding company	50,00%	50,00%	75.673	80.041			39.874	136.767	G. I.	—	
Tucumán, 1 P-18 Buenos Aires											
Telefónica de Argentina, S.A. (ARGENTINA) (11) Telecommunications operator in southern Argentina Presidente Perón, 949 - piso 7 - 1038 Buenos Aires	58,04%	29,02%	305.301	75.909	—		76.333	124.146	G. I.	—	
Other holdings	N/A	N/A	N/A	N/A			N/A	N/A	P. L.	45.803	
Other holdings	N/A	N/A	N/A	N/A			N/A	590	I.	590	
Telefónica Venezuela Holding B.V. (HOLLAND) (1) Holding company	100,00%	100,00%	3	(30.15)			(842)	11.209	G. I.	—	
Verworld Telecom, C.A. (VENEZUELA) (13) Holding company	16,00%	16,00%	N/D	N/D			N/D	43.015	P. L.	—	
Cía. Andinima N. de Teléfonos de Venezuela, C.A.(CANTV) (VENEZUELA) (13) Telecommunications operator Avenida Libertador, Centro Nacional de Telecomunicaciones, Piso 1 - 1226 Caracas	40,00%	6,40%	664.197	—	(30.858)		37.898	N/D	P. L.	38.232	
TYSSA, Telecommunicaciones y Sistemas, S.A. (ARGENTINA) Telecommunications systems consulting Presidente Perón, 949 P-14 - 1038 Buenos Aires	100,00%	100,00%	N/D	N/D			N/D	109	I.	109	
Telefónica Larga Distancia de Puerto Rico, INC. (PUERTO RICO) (1) Telecommunications operator Calle 1, Edificio nº 8. Metro Office Park. Sector de Buchanan. Guayanabo - Puerto Rico	79,00%	79,00%	15.914	(1.200)			111	16.138	G. I.	—	
Contactel (PORTUGAL) Telecommunications operator (Radiopaging) Rua Luciano Cordeiro 116 - 1050 Lisbon	15,00%	15,00%	285.214	(335.193)			N/D	561	I.	561	
Telecomunicaciones Ultramarinas de Puerto Rico (PUERTO RICO) Telecommunications operator	14,90%	14,90%	—	1.823			N/D	3.280	I.	3.280	
Infonet Services Corporation (USA) (5) Telecommunications operator 2100 East. Grand Avenue. El Segundo, California 90245 - 1022 USA	18,74%	18,74%	N/D	N/D			N/D	5.001	I.	5.001	
Geostar Corporation, INC (USA) Other holdings	N/D N/A	N/D N/A	N/D	N/D			N/D	607	I.	607	
Telefónica Sistemas de Portugal, S.A. (PORTUGAL) Telur, S.A. (RUSSIAN FEDERATION) Manufacture of telecommunications equipment	12,50% 5,00%	15,74%	N/D	N/D			N/D	66	I.	66	
T.S. Telefónica Sistemas, S.A. (*) (**), (3) Telecommunications systems, network and infrastructure engineering Sor Ángela de la Cruz, 3 - Pl. 9º - 28020 Madrid	100,00%	100,00%	1.403	3.434	—		(453)	2.366	G. I.	—	
Telefónica Sistemas de Información Geográfica, S.A. (TSIG) (*) (**), (3) Computer advisory services and digital cartography Rosario Pino, 5 - 10º P. - 28046 Madrid	100,00%	100,00%	215	136	—		14	230	G. I.	—	
Telefónica Sistemas Ingeniería de Productos, S.A. (TSIP) (*) (**), (3) Public communications network infrastructure Torrelaguna, 79 - 2º P. - 28043 Madrid	100,00%	100,00%	150	151	—		280	150	G. I.	—	
T.S. Telefónica Sistemas de Portugal, S.A. (PORTUGAL) (2) Communications systems equipment engineering Praça de Albalade, 6 - 2º A-I - 1700 Lisbon	87,50%	99,99%	51	(56)	—		(25)	50	G. I.	—	
Telefónica Transmisión de Datos, S.A. (**) (1) Data transmission Beatriz de Bobadilla, 18 - 28040 Madrid	100,00%	100,00%	6.533	1.843	—		3.925	34.170	G. I.	—	

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Telefónica VSAT, S.A. (**) (1) Satellite telecommunications services. Avda. Europa, 4. Edificio Bruselas. Parque empresarial de La Moraleja - 28109 Alcobendas	100.00%	100.00%		262	274	—	81	751	G. I.	—
Telefónica Servicios Avanzados de Información, S.A. (TSAI) (*) (**) (1) Value-added services supporting voice, data, text and images for public and private sector systems Julian Camarillo, 6 - 28037 Madrid	100.00%	100.00%		310	572	—	71	922	G. I.	—
Telefónica Servicios Móviles, S.A. (*) (**) (1) Management and marketing of automatic mobile telephony Plaza de la Independencia, 6 - Pta. 5 - 28001 MADRID	100.00%		100.00%	68.100	55.693	(35.000)	80.348	78.460	G. I.	—
Radiored I, S.A. (*) (**) (1) Group company management support. Trunking (Parent Company) Manuel Tovar, 43 - 2º - 28034 Madrid	100.00%		100.00%	1.500	(181)	—	(30)	2.750	G. I.	—
Radiored Catalunya, S.A. (*) (**) (1) Trunking Manuel Tovar, 43 - 28034 Madrid	91.00%		91.00%	200	(38)	—	23	273	G. I.	—
Compañía Gestora del Servicio Mensatel, S.A. (1) Management and marketing of the mensatel radiopaging service Manuel Tovar, 35 - 3º - 28034 Madrid	90.00%		90.00%	1.417	449	—	(708)	1.972	G. I.	—
Telefónica Medios de Comunicación, S.A. (**) (1) Holding of shares of companies in the media industry Gran Vía, 28 - 28013 Madrid	100.00%		100.00%	26.300	(1.303)	—	(6.815)	26.300	G. I.	—
Gestora de Medio Audiovisuales de Fútbol, S.L. (1) Football rights Rafael Calvo, 18 - 20010 Madrid	100.00%		100.00%	20.000	(1.307)	—	(7.719)	25.154	G. I.	—
Audiovisual Sport, S.L. (3) Holder of football rights O'Donnell, 12 - Madrid	40.00%		40.00%	16.200	(2.247)	—	(8.340)	6.480	P. I.	2.245
Recoletos Compañía Editorial, S.A. (2) Publisher Pº de Recoletos, 14 - 7º - 28001 Madrid	20.00%		20.00%	609	33.283	(2.438)	4.363	23.182	P. I.	7.163
Agencia EFE, S.A. Obtaining and distribution of news throughout the world Espronceda, 32 - 28003 Madrid	0.06%		0.06%	4.161	(1.275)	—	(3.178)	2	I.	2
Telefónica Soluciones Sectoriales, S.A. (**) (12) Advisory services for communications and information technologies companies Av. Burgos, 17 - 10º - 28036 Madrid	100.00%		100.00%	1.600	(55)	—	(543)	1.600	G. I.	—
Telefónica Ingeniería de Comunicaciones, S.A. (**) (3) Network management and marketing Goya, 4 - 28001 Madrid	100.00%		100.00%	500	(46)	—	(177)	450	G. I.	—
Portel Servicios Telemáticos, S.A. (1) Systems engineering and telecommunications in port areas Avda. de Partenón, 10 Campo de las Naciones - 28042 Madrid	49.00%		49.00%	500	(54)	—	5	224	P. I.	221
Caser MVS Virtual insurance market research Plaza de la Lealtad, 4 - 28014 Madrid	49.00%		49.00%	580	—	—	(72)	284	P. I.	249
Bitel Baleares Innovación Telemática, S.A. (6) Provision of services and systems engineering in the information technology and communications fields Paseo Marítimo, 38 A - 07005 Palma de Mallorca	44.00%		44.00%	416	(82)	—	(20)	130	P. I.	138
Gestión del Conocimiento Consulting and installation of Virtual Campuses for teaching Avda. Tibidabo, 39	40.00%		40.00%	10	—	—	13	4	P. I.	9
Incitel Provision of multimedia services Cebrián, 3 - 35003 Las Palmas de Gran Canaria	40.00%		40.00%	50	—	—	(5)	20	P. I.	18
Agencia de Certificación Electrónica, S.A. Development of "Electronic notary" business through SET technology San Angel de la Cruz, 3 - 28020 Madrid	40.00%		40.00%	250	(31)	—	(196)	97	P. I.	9
Buildnet (2) other On-line and other information services for the construction industry via own telecommunications system Edificio Triada, Avda. de Burgos, 17 Torre A, 10º - 28036 Madrid	33.50%		33.50%	52	—	—	(155)	11	P. I.	—
QSL Télessistance Pabellón nº 11 Isla de la Cartuja - Sevilla	33.33%		33.33%	60	(17)	—	(20)	20	P. I.	8

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

DEPENDENT COMPANIES AND THEIR HOLDINGS	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Book Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Tecnología e Ingeniería de Sist. y Servicios Avanzados de Telec., S.A. (TISSAT) (7) Systems engineering and marketing of advanced services Correos, 1 - 46002 Valencia	30,77%	30,77%	130	(15)		—	29	P. L.	70	
ZZJ Mundovisión Canal Satélite (satellite TV platform) Dótils, 14 - Polígono La Palmera - 41700 Dos Hermanas - Sevilla	25,00%	25,00%	20	289		(64)	150	P. L.	61	
Madrid 112, S.A. (6) Emergency services and citizen advice in the Autonomous Community of Madrid Carretera de La Coruña, Km. 22 - Las Rozas - Madrid	24,50%	24,50%	1,000	(157)		—	226	P. I.	207	
Fitex Software research and development Carlos Colleja, 37 - 10001 Cáceres	24,50%	24,50%	25				6	P. I.	6	
Ciudad Interactiva Publication of digital contents Plaza del Marqués de Salamanca nº 3 y 4 Pta.3º - 28006 Madrid	20,00%	20,00%	300				60	P. I.	60	
Andalucía Comercio Electrónico Telematic network services Pº de la Habana, 14 - Sevilla	20,00%	20,00%	100				20	P. I.	20	
SEMCIA Emergency telephone number in the Autonomous Community of Cantabria Casimiro Sainz, 4 - Santander	20,00%	20,00%	100				20	L.	20	
ATENET Teaching via computer systems C/ Jorge Juan, 32	16,00%	16,00%	125				20	L.	20	
Audiovisual Realtime BIT, S.A. (ARTBIT) Production of synthetic images Polígono Industrial de Inca. Solar en intersección de los viales C y D Mallorca 07300 Inca	17,50%	17,50%	200	(118)			35	P. I.	35	
Caseritel Virtual insurance marketing Plaza de la Lealtad, 4 - 28014 Madrid	15,00%	15,00%	500			1	75	L.	75	

(\*) Companies filing consolidated corporate income tax returns in 1997.

(\*\*) Companies filing consolidated corporate income tax returns in 1998.

**DETAIL OF DEPENDENT, ASSOCIATED AND INVESTEE COMPANIES AS OF DECEMBER 31, 1998 (continued)**

<b>ASSOCIATED COMPANIES</b>	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Telefactoring Establecimiento Financiero de Crédito, S.A. (1) <i>Loans and credits for consumer, mortgage and commercial transactions Pedro Teixeira, 8 - 28020 Madrid</i>	50.00%		50.00%	850	101		37	440	P. I.	494
Utilitel Comunicaciones, S.A. (2) <i>Value-added services and teleassistance Serrano, 41 - 28001 Madrid</i>	50.00%		50.00%	1.800	(40)		(72)	893	P. I.	829
Torre de Collserola, S.A. (2) <i>Operation of a telecommunications tower and technical assistance and advisory services. Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona</i>	42.00%		42.00%	2.000	41		15	845	P. I.	864
Sistemas Técnicos de Loterías del Estado, S.A. (2) <i>Operation of a gaming terminal system for Organismo Nacional de Loterías y Apuestas del Estado Manuel Tovar, 9 - 28034 Madrid</i>	31.75%		31.75%	2.000	3.680		1.435	635	P. I.	2.259
Hispasat, S.A. (3) <i>Operation of a satellite telecommunications system Gobelas, 41-45 - 28023 Madrid</i>	22.74%		22.74%	18.312	(3.694)		3.905	6.021	P. I.	4.212
Sofres Audiencia de Medios, S.A. (2) <i>Market surveys and audience measurement Plaza Carlos Trias Bertrán, 7 - 28020 Madrid</i>	25.00%		25.00%	210	936		335	435	P. I.	371
Amper, S.A. (6) (9) <i>Development, manufacture and repair of telecommunications systems and equipment Torrelaguna, 75 - 28027 Madrid</i>	24.41%		24.41%	4.186	9.804		1.731	7.869	P. I.	3.837
Portugal Telecom, S.A. (PORTUGAL) (1) <i>Telecommunications operator Fontes Pereira de Melo, 40 - 1089 Lisbon</i>	3.50%		3.50%	190.000 M.ESC	164.316 M.ESC		61.095 M.ESC	41.212	P. I.	13.019
<b>INVESTEES</b>	Ownership			Capital Stock	Reserves	Interim Dividend	Income (Loss)	Gross Book Value	Consolidation Method	Value in Consolidation (10)
	Direct	Indirect	Telefónica Group							
Promoció de Ciutat Vella, S.A. <i>Urban improvements in the Ciutat Vella of Barcelona Rambles, 77 - 08002 Barcelona</i>	3.57%		3.57%	2.800	N/D		N/D	100	I.	100
Catalana D'Iniciatives, C.R., S.A. <i>Promotion of nonfinance entities Passeig de Gracia, 2 - 2<sup>B</sup> - 08007 Barcelona.</i>	3.61%		3.61%	5.000	N/D		N/D	240	I.	240
I-CO Global Communications (HOLDINGS) Limited	0.49%		0.49%	N/D	N/D		N/D	1.002	I.	1.002
Other holdings	N/A	N/A	N/A	N/A	N/A		N/A	3.871	I.	3.871
<b>TOTAL VALUE IN CONSOLIDATION OF DEPENDENT COMPANIES (Note 8)</b>										<b>345.614</b>
<b>TOTAL VALUE IN CONSOLIDATION OF INVESTEES (Note 8)</b>										<b>78.998</b>

(1) Company audited by Arthur Andersen.

(2) Company audited by Price & Cooper.

(3) Company audited by K.P.M.G. Peat Marwick.

(4) Company audited by Langton Clarke (Arthur Andersen Group). (11) Company audited by Pistrelli, Diaz & Asociados

(5) Company audited by Deloitte & Touche.

(6) Company audited by Ernst & Young.

(7) Company audited by Coopers & Lybrand.

(8) Companies in liquidation.

(9) Consolidated figures.

(10) This figure refers to the contribution to the Telefónica

Group and not to the sub-groups to which the contributing companies belong.

(11) Company audited by Pistrelli, Diaz & Asociados

(Arthur Andersen Group).

(12) Company audited by B.D.O.

(13) Company audited by Piernavieja, Porta, Cachafeiro & Asociados

(Arthur Andersen Group).

(14) Company audited by Medina, Zalzívar & Asociados

(Arthur Andersen Group).

G. I. Companies consolidated by the global integration method.

P. I. Companies consolidated by the proportional integration method.

E. Companies carried by the equity method.

I. Investees.

N/D Information not available.

N/A Not applicable.

Figures in foreign currencies: M=millions and t= thousands.

Provisional figures for associated companies and investees.

## **EXHIBIT II**

- The changes in the consolidated Group in 1998 and 1997 were as follows:

### **1998**

In July 1998, the Brazilian government privatized Telecomunicações Brasileiras, S.A. (Telebrás), which had previously been divided into 12 holding companies (1 for long-distance telephony, 3 for fixed line telephony and 8 for cellular telephony), in a sale through public auction of 50.10% of the capital stock with voting rights and to 19.26% of the dividend rights of each of these companies.

Telefónica Internacional, submitted the successful bids through dependent companies or consortia, for the following companies:

- Telesp Participações, S.A.: A holding company that controls Telesp, S.A. and CTBC (Compañía Telefónica de Borde do Campo), fixed line telephone operators in the State of São Paulo. The holding was acquired through Tele Brasil Sul Participações, S.A., a holding company in which Telefónica Internacional, S.A. has a 52.9% holding, at an acquisition cost of Ptas. 473,286 million. The other stockholders in Tele Brasil Sul Participações, S.A. are Portugal Telecom (23%), Iberdrola (7%), Banco Bilbao Vizcaya (7%), CTC (2.6%), Telefónica de Argentina (1.2%) and Rede Brasil Sul (6.3%). The volume of lines in service managed by Telesp Participações' subsidiaries at the time of acquisition was 6.04 million and the Company had a facility for 6.45 million lines as of December 31, 1998. The Company's market penetration index in its area of operations is 17.8%.
- Tele Sudeste Celular Participações, S.A.: A holding company that controls the cellular telephone operators in the States of Río de Janeiro and Espírito Santo (Telerj Celular, S.A. and Telest Celular, S.A., respectively). The holding is owned by a consortium in which Telefónica Internacional, S.A. has an 82.5% stake at an acquisition cost of Ptas. 164,293 million. Iberdrola (7%), NTT Docomo (7%) and Itochu (3.5%) are the other consortium members. The volume of cellular customers managed at December 31, 1998, was 635,000.
- Tele Leste Celular Participações, S.A.: A holding company that controls the cellular telephony operators in the States of Bahía (Telebahía Celular, S.A.) and Sergipe (Telergipe Celular, S.A.). The consortium formed by Telefónica Internacional with a 38% holding and Iberdrola with the remaining 62%, won the auction, at a cost to the Group of Ptas. 21,130 million. This company had approximately 238,000 cellular customers at December 31, 1998.
- Telesp Celular Participações, S.A.: A holding company that controls the cellular telephony operator in the State of São Paulo (Telesp Celular, S.A.). Portelcom, the consortium formed with Portugal Telecom in which Telefónica Internacional has a 35.8% holding, won the holding that was being offered, at a cost to the Group of Ptas. 166,848 million.

All these companies are carried by the equity method.

In May the Argentinian company Telefónica de Argentina S.A. (TASA) recorded a capital reduction of US\$ 757 million, through the purchase of stocks owned by employees. With this reduction, the company holding its stocks, Compañía de Inversiones en Telecomunicaciones, S.A. (COINTEL) increased its holding in TASA from 51% to 56.154%. Both companies are now consolidated by the global integration method.

During this same period COINTEL settled its debt with PRIDES which could have been settled with TASA class B stocks. Part of the debt was paid in cash, so the Group reconsolidated those shares that were not used to make the settlement. Initially this percentage was 1.70% but it was later fixed at 1.8775%, and COINTEL consolidated this latter percentage.

As a result of the successful bid that Telefónica Do Brasil Holding, S.A. made for the additional 50.12% of ordinary stock of Companhia Riograndense de Telecomunicações, S.A. (CRT) of Brazil, the Telefónica Internacional Group's new indirect holding in CRT increased from 10.3% to 16.7%, with an acquisition cost of Ptas. 64,945 million. Telefónica do Brasil was then transformed into the Tele Brasil Sul consortium. CRT managed 1.3 million fixed lines and 464,000 cellular customers as of December 31, 1998.

In March Telefónica Medios de Comunicación, S.A. subscribed the full amount of the stocks issued by Recoletos Compañía Editorial, S.A. in a capital increase of Ptas. 122 million with additional paid-in capital of Ptas 23,003 million. As a result of this transaction Telefónica Medios de Comunicación, S.A. holds 20% of Recoletos Compañía Editorial, S.A. The company is carried by the equity method.

In November Telefónica, S.A. incorporated Inmobiliaria Telefónica, S.L. with initial capital stock of Ptas. 501,000. In December the capital stock was increased to Ptas. 1,670 million with a paid-in surplus of Ptas. 15,541 million, fully subscribed and paid through a monetary payment of Ptas. 30 million and a nonmonetary contribution of real estate worth Ptas. 17,181 million. The company is consolidated by the global integration method.

Telefónica Internacional, S.A. acquired 30% of Holding Atlántida de Comunicaciones, S.A. (ATCO) and of its subsequent capital increase. This company has a 94.74% holding in Editorial Atlántida, S.A.

Telefónica incorporated Telefónica Intercontinental, S.A. with capital stock of Ptas. 250 million, and Telefónica Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A., Telefónica Comunicaciones Interactivas, S.A., Telefónica Procesos y Tecnología de la Información, S.A., Telefónica Data, S.A. and Telefónica Internet, S.A., all with capital stock of Ptas 10 million. Telefónica Intercontinental and Telefónica Procesos y Tecnología de la Información are consolidated by the global integration method.

In January, Telefónica Internacional, S.A. acquired an additional 3.33% of the Argentinian company Torneos y Competencias, S.A. reaching a 20% stake. The company, which was not included in consolidation in 1997, is currently carried by the equity method.

In 1998, the Argentinian company Cablevisión, S.A., 33.28% owned by Telefónica Internacional, S.A., was acquired in 1997 and consolidated that year at cost, was carried by the equity method in 1998. In December Telefónica Internacional, S.A. acquired an additional holding of 2.58% making a total holding of 35.86%.

In April Telefónica Medios de Comunicación, S.A. (TMC) acquired the remaining 51% of the capital stock of Gestora de Medios Audiovisuales de Fútbol, S.L. (GMAF). This company was carried by the equity method but is now consolidated by the global integration method.

In October Compañía de Telecomunicaciones de Chile, S.A. acquired 99.99% of the capital stock of VTR Larga Distancia, S.A. from V.T.R. S.A. for US\$ 50 million, equivalent to Ptas. 7,130 million.

Telefónica de Argentina, S.A. purchased 99.99% of the stocks of Advance, S.A. at an approximate price of US\$ 10.2 million, equivalent to Ptas. 1,455 million. 50% of this acquisition was from Telefónica Internacional.

In July, DTS Distribuidora de Televisión Digital, S.A. increased its capital by Ptas. 7,500 million with additional paid-in capital of Ptas. 22,500 million. Telefónica Media subscribed more than its proportional share to increase its holding in the Company from 35% to the current 36.95%. The company continues to be carried by the equity method.

In June Telefónica acquired 1,312,217 shares in Amper, S.A., at a cost of Ptas. 5,249 million, increasing its holding to 24.41%. The company continues to be carried by the equity method.

In July, the Telefónica Internacional Group, acquired 51% of Telefónica del Salvador, S.A. de C.V. in a public auction, through Telefónica El Salvador Holding, S.A. de C.V., a company incorporated for this tendering process. Later the Group sold 49% of that holding to MESOTEL, its local partner. After this transaction the Group's indirect holding in Telefónica El Salvador, S.A. had decreased to 26.01%.

Compañía de Telecomunicaciones de Chile, S.A. (C.T.C.) terminated the voluntary period for the conversion of convertible bonds into company shares. This conversion led to an increase in the group's holding, from 43.62% to 43.643%. The company is still consolidated by the global integration method.

In March Antena 3 de Televisión, S.A. increased its capital stock by Ptas. 2,778 million with additional paid-in capital of Ptas. 7,802 million. The capital increase was fully subscribed by a new stockholder, which meant that Telefónica Media, S.A.'s holding was reduced from 25% to 22.5%. Later, approximately 0.7% more of the capital stock was acquired, thus increasing the holding to 23.4%. The company is still carried by the equity method.

In April Audiovisual Sport, S.L., in which GMAF has a 40% holding, increased its capital stock by Ptas. 7,950 million. GMAF subscribed its proportional number of shares to maintain its holding.

In December Hispasat, S.A. increased its capital stock by Ptas. 3,000 million. Telefónica subscribed its proportional part of the capital increase, acquiring its 22.74% entitlement and paying 25% in the transaction.

In July Telefónica Publicidad e Información acquired 75% of Venturini España, S.A. at a cost of Ptas. 420 million, bringing its holding in Venturini España to 100%. The company, which was previously carried by the equity method, is now consolidated by the global integration method. As a result of this transaction Venturini, S.A., a wholly owned subsidiary of Venturini España, S.A. was consolidated by the global integration method.

In December 1997, Madrid 112, S.A. increased its capital stock. Telefónica Soluciones Sectoriales, S.A., which had a 49% holding in the company, did not subscribe all the shares to which it was entitled, and its holding was thus reduced to 24.5%. The company is still carried by the equity method.

Audiovisual Realtime Bit, S.A. (ARTBIT) increased its capital stock from Ptas. 100 million to Ptas. 200 million. Telefónica Media, S.A. had a 25% holding in the company but did not exercise its right to subscribe stock, and so this holding was reduced to 12.5%. Telefónica Soluciones Sectoriales, S.A., subscribed a number of shares equivalent to 12.5% of the capital stock, and acquired an additional 5% from other sources. The company is still carried in the financial statements of the Telefónica Group by the equity method.

Telefónica Soluciones Sectoriales, S.A. acquired 25% of the stocks of ZZJ Mundovisión, which has a total capital stock of Ptas. 20 million.

Estrategias Telefónicas, S.A. took part in the incorporation of Gestión de Servicios de Emergencia y Atención al Ciudadano, S.A., subscribing and paying for 51% of the Ptas. 100 million that made up its capital stock.

In June, Telefónica Servicios Avanzados de Información, S.A. acquired an additional 12% of the capital stock of Hispaservices, S.A. to increase its holding in the latter to 100%. In December Hispaservices was dissolved.

In November Bitel Baleares Innovación Telemática, S.A. increased its capital stock by Ptas. 100 million which was fully subscribed and paid by Telefónica Soluciones Sectoriales, S.A. , which has a 44% holding in the company.

In December Telefónica Servicios y Contenidos por la Red, S.A. increased its capital stock by Ptas. 700 million, which was fully subscribed and paid by Telefónica.

In March REM Infográfica, S.A. carried out an "accordion" transaction (reduction and subsequent increase of capital stock) as a result of which capital stock increased from Ptas. 10 million to Ptas. 25 million with additional paid-in capital of Ptas. 375 million. Producciones Multitemáticas, S.A., which previously held 100% of the capital stock of this company only subscribed enough shares to leave its holding a 42.52% of the current capital stock of the company. The company, which was consolidated by the global integration method, is now, after this reduction in the holding, carried by the equity method.

In April, the Telefónica Internacional Group sold the 25% holding that it possessed in the Argentinian company Multicanal, S.A. As a result of this sale, the Group recorded income of Ptas. 17,718 million (see Note 8-b). In 1997, this company was carried by the equity method.

In June Telefónica sold its entire 36.56% holding in Indra SSI, S.A. The Telefónica Group recorded income of Ptas. 2,862 million on the sale transaction.

In the same month the sale of the Colombian company Compañía Celular de Colombia, S.A. (Cocelco) was recorded. Telefónica, S.A. itself had a direct holding of 14.51% in the company and Telefónica Internacional Group indirectly held 20.25%. The gain that Telefónica Group obtained on this sale was Ptas. 1,977 million. The company was carried by the equity method.

In February Telefónica Cable, S.A. sold 10% of its holding in Telefónica Cable Castilla y León, S.A. to a non-Group buyer, reducing its holding to 51%. This company is still consolidated by the global integration method.

Telefónica Cable, S.A. sold 34% of its holding in Telefónica Cable Extremadura, S.A. (previously Sociedad General de Cablevisión Granada, S.A.). This company is still consolidated by the global integration method.

In July Telefónica Cable sold 10% and 20% of Telefónica Cable Madrid y Telefónica Cable Catalunya to non-Group buyers, giving rise to gains of Ptas. 4 and 12 million, respectively. These companies are still consolidated by the global integration method.

## 1998

- In April the Telefónica Group acquired a 25% stake in Telefónica Cable, S.A., bringing its holding to 100%.
- Telefónica incorporated Telefónica Medios de Comunicación, S.A. and Telefónica Soluciones Sectoriales, S.A., and acquired all their capital stock. Both companies are consolidated by the global integration method.
- In November Telefónica acquired from SEPPA 23.78% of its shares in Telefónica Internacional de España, S.A. In December 1.25% of capital stock was sold to T.I. itself for holding as treasury stock. The company continues to be consolidated by the global integration method.
- In January Telefónica participated in the incorporation of DTS Distribuidora de Televisión Digital, S.A., subscribing 35% of its capital stock. In May, the aforementioned company was sold to Telefónica Multimedia, S.A. In November DTS increased its capital and Telefónica Multimedia subscribed its proportional share of capital stock. The company is carried by the equity method.
- In October, Telefónica acquired 3.5% of the capital stock of Portugal Telecom, S.A. The company is carried by the equity method.
- Telefónica left the Unisource consortium and on December 29, 1997, sold its 25% holding in Unisource N.V. to Telia AB, PTT Telecom BV and Swisscom. In 1997 the Telefónica Group recorded Ptas. 4,696 million of losses attributable to Unisource, which were recorded under the "Share in Losses of Companies Carried by the Equity Method" caption.

This purchase and sale transaction was carried out for a total of Fl 465 million (Ptas. 34,921 million at the date of acquisition), giving rise to a gain of Ptas. 20,556 million.

Previously, pursuant to the related company resolutions, Telefónica made a capital contribution of Fl 193 million to Unisource.

- Telefónica acquired all the shares of Telefónica Transmisión de Datos, S.A. and Telefónica VSAT, S.A. for Fl 455 million and Fl 10 million, respectively.

The purchase of Telefónica Transmisión de Datos, S.A. gave rise to goodwill of Ptas. 25,794 million in consolidated accounts, Ptas. 15,860 million having been used in consolidated accounts to amortize goodwill in consolidation. The remaining goodwill will be amortized over 20 years.

- In 1997 the Group acquired the following Argentinean companies, all with registered offices in Buenos Aires (Argentina):
  - Torneos y Competencias, S.A.: an Argentinean company whose main activity is the production of television programs relating to sports events, chiefly football, operating under various contracts granting it exclusive rights to this operation. In October 1997 T.I. acquired a 16.67% holding in this company for Ptas. 10,309 million. In January 1999 it acquired an additional 3.33%.
  - Cablevisión, S.A.: an Argentinean company that provides cable television services. In October 1997 T.I. acquired a 33.28% holding in this company for Ptas. 57,139 million.
  - Advance Telecomunicaciones, S.A.: an Argentinean company that provides on-line services and data transmission services. In September 1997 T.I. acquired a 50% holding in this company for Ptas. 757 million.
  - These three companies were included at cost in the consolidated financial statements.

- In March Telefónica Sistemas participated in the incorporation of Utilitel Comunicaciones, S.A. and subscribed 50% of its capital stock. In November Telefónica purchased all the shares in the company owned by Telefónica Sistemas. Utilitel is carried by the equity method.
- Pabellón de Operadores Europeos de Telecomunicaciones, S.A., which is carried in the Telefónica Group's financial statements by the equity method, was dissolved and liquidated in December.
- In August Telefónica Media, S.A. acquired 25% of the capital stock of Antena 3 de Televisión, S.A. The company is carried by the equity method.
- In July Telefónica Media, S.A. acquired 49% of the capital stock of Gestora de Medios Audiovisuales de Fútbol, S.L. In December this holding was sold to Telefónica Medios de Comunicación, S.A. The company is carried by the equity method.
- Telefónica Media, S.A. incorporated the wholly owned company Producciones Multitemáticas, S.A. and subscribed all its capital stock. The company is consolidated by the global integration method.
- In August Producciones Multitemáticas, S.A. acquired 20% of the capital stock of Lola Films, S.A. In December Lola Films, S.A. increased capital up to the current amount of Ptas. 1,050 million and Producciones Multitemáticas increased its holding in the company to 33.3%. The company is carried by the equity method.
- Telefónica Cable, S.A. sold to nongroup entities 34% of its holding in Telefónica Cable Madrid, S.A., its 31% holding in Telefónica Cable Navarra, S.A., 27% of the capital stock of Telefónica Cable Andalucía, S.A., and 24% of the capital stock of Telefónica Cable Castilla y León, S.A. The latter company increased capital by Ptas. 900 million in November. All the aforementioned companies continue to be consolidated by the global integration method.
- In November Telefónica Publicidad e Información, S.A. participated in the incorporation of Doubleclick Iberoamérica, S.L., in which it has a 90% holding. The company is consolidated by the global integration method.
- In July Rem Infográfica, S.A., which was 60% owned by T.P.I. in 1996, carried out an "accordion" transaction (reduction and subsequent increase of capital stock) as a result of which capital stock decreased from Ptas. 50 million to Ptas. 10 million, with additional paid-in capital of Ptas. 280 million. T.P.I. acquired the remaining 40% of capital stock from minority shareholders.
- The Telefónica Internacional de España group sold its holding in Sintelar and Sintel-Peru, both of which provide installation services, mainly in the telecommunications industry. The companies, each of which is 25% owned by Telefónica Internacional, operate in Argentina and Peru, respectively. The sale gave rise to losses of Ptas. 43 million and Ptas. 25 million, respectively. Net losses on these sales were recorded under the "Losses on Sales of Holdings in Consolidated Companies" caption in the statement of income.
- Telefónica sold to Rom Telecom, S.A. its 60% holding in Telefónica Romanía, S.A., which provides cellular mobile telephony services in Romania, for US\$ 13.5 million. The Telefónica Group relieved from its accounts all the assets and liabilities contributed by this company to consolidation, giving rise to a gain of Ptas. 197 million on this transaction, which was recorded under the "Gains on Sales of Holdings in Consolidated Companies" caption in the statement of income.
- From January 1, 1997, CRT, a company that was acquired in December 1996, became a member of the consolidated Group, having been carried at cost at 1996 year-end. The Group's ownership interest in the aforementioned company amounts to 10.3% of its total common and preferred shares of capital stock, through the various holdings owned by Group companies in the consortium, which was awarded 35% of the company's common voting stock.
- In 1997 Compañía Celular de Colombia, S.A. and Multicanal, S.A. were excluded from consolidation. As a result of negotiations in 1997 for the sale of the holdings in these two companies, Compañía Celular de Colombia, S.A. was sold in January 1998; Multicanal, S.A. will be sold by May 1998 (the exercise date of put & call option contracts entered into in October 1997).
- In addition, the Group increased its holding in Cointel from 33.16% to 50%, involving a disbursement of US\$ 554.25 million. The Group also increased to 100% its holding in STARTEL, a CTC group company, for US\$ 425 million. Telefónica Internacional de España, S.A. sold its direct holding in TASA (1.0816%), obtaining a gain of Ptas. 6,494 million.
- In January Telefónica Sistemas, S.A. acquired an additional 49% of the capital stock of Hispaservices, S.A., bringing its holding to 88%. The company, which was carried by the equity method in 1996, was consolidated by the global integration method in 1997.
- Telefónica Sistemas was also involved in the following transactions:
  - In January the company Buildnet, S.A. was incorporated with capital stock of Ptas. 150 million. Telefónica Sistemas participated in the incorporation of this company and acquired 33.5% of its capital stock. The company is carried by the equity method.
  - In April the company Agencia de Certificación Electrónica, S.A. was incorporated with capital stock of Ptas. 250 million. Telefónica Sistemas acquired a 40% holding in this company. The company is carried by the equity method.
  - In January the company Servicio Educación a Distancia (S.E.D.) was incorporated with capital stock of Ptas. 10 million. Telefónica Sistemas acquired a 40% holding in this company. The company is carried by the equity method.
- Negocios Cibernéticos, S.A., a subsidiary 50% owned by Telefónica Sistemas, was dissolved and liquidated in 1998.

- Telefónica Soluciones Sectoriales, S.A. participated in the incorporation of the following companies:
  - Caser MVS, with capital stock of Ptas. 580 million, is 49% owned by T.S. Sectoriales.
  - Incatel, with capital stock of Ptas. 50 million, is 40% owned by T.S. Sectoriales.
  - QSL, with capital stock of Ptas. 60 million, is 33.33% owned by T.S. Sectoriales.

These three companies are carried by the equity method.

### EXHIBIT III

#### GOODWILL IN CONSOLIDATION

The detail of the balance of goodwill in consolidation, the related accumulated amortization and the variations therein in 1998 is as follows:

Goodwill in Consolidation	Millions of Pesetas					
	Balance at 12/31/1997	Additions	Retirements	Transfers	Translation Differences	Balance at 12/31/1998
<b>Companies consolidated by the global integration method:</b>						
Advance Telecomunicaciones						
AKI	—	—	—	323	(20)	303
C.T.C. (Chile)	5,508	—	—	—	—	5,508
Cointel	—	12,611	—	67,968	—	80,579
G.M.A. Fútbol	—	(3,051)	—	8,957	—	5,906
Instacom	1,587	—	—	—	(142)	1,445
Intercom	(137)	—	—	—	12	(125)
Invercom	8,822	6,862	—	—	(686)	14,998
Multicable T.V. (Chile)	1,302	—	—	—	(116)	1,186
Publiguías (Chile)	426	—	—	—	—	426
SATLINK	—	—	—	1,533	(92)	1,441
Startel	56,801	318	—	—	(5,346)	51,773
T. L. D. (Puerto Rico)	7,479	—	—	—	—	7,479
T. Perú Holding	461	—	—	—	—	461
T. T. Datos	25,794	(10)	—	—	—	25,784
Telefónica Cable	127	—	—	—	—	127
Telefónica Internacional	46,865	—	—	—	—	46,865
Telefónica Multimedia (Perú)	—	2,224	—	—	—	2,224
Venturini Española	—	17	—	—	—	17
VTR	—	5,629	—	—	—	5,629
	<b>155,035</b>	<b>25,764</b>	—	<b>78,781</b>	<b>(6,390)</b>	<b>253,190</b>
<b>Companies carried by the equity method:</b>						
Amper	—	3,720	—	—	—	3,720
Antena 3	18,446	(2,072)	—	—	—	16,374
C.R.T.	42,898	49,059	—	—	—	91,957
Cablevisión	—	—	(5,000)	44,156	—	39,156
CALL Center	—	71	—	—	—	71
Cointel (Argentina)	67,968	—	—	(67,968)	—	—
Compuserve Argentina	—	—	(48)	648	(39)	561
DTS Dº TV Digital	—	1,110	—	—	—	1,110
G.M.A. Fútbol	8,957	—	—	(8,957)	—	—
Lola Films	142	35	—	—	—	177
Portugal Telecom	30,657	(602)	—	—	—	30,055
Recoletos Cía Editorial	—	16,403	—	—	—	16,403
Torneos y Competencias	—	—	—	7,229	—	7,229
Venworld (Venezuela)	22,330	—	—	—	—	22,330
ZZJ Mundovisión	—	76	—	—	—	76
	<b>191,398</b>	<b>67,800</b>	<b>(5,048)</b>	<b>(24,892)</b>	<b>(39)</b>	<b>229,219</b>
<b>Total goodwill</b>	<b>346,433</b>	<b>93,564</b>	<b>(5,048)</b>	<b>53,889</b>	<b>(6,429)</b>	<b>482,409</b>

1998 transfers include the consolidation of Cablevisión and Torneos y Competencias which were recorded at cost the previous year.

The goodwill generated through the acquisition of companies by the American operators is recorded in local currency, and is affected by variations in exchange rates, the amounts of which are shown in the translation differences column.

Amortization of Goodwill in Consolidation	Balance at 12/31/1997	Millions of Pesetas					Translation Differences	Balance at 12/31/1998
		Additions	Retirements	Transfers				
<b>Companies consolidated by the Global integration method:</b>								
Advance Telecomunicaciones	—	81	—	—	(4)	77		
AKI	—	16	—	—	(1)	15		
C.T.C. (Chile)	4,254	111	—	—	—	4,365		
Cointel	—	3,291	—	13,702	—	16,993		
G.M.A. Fútbol	—	1,334	—	622	—	1,956		
Instacom	588	140	—	—	(59)	669		
Intercom	(50)	(13)	—	—	5	(58)		
Invercom	3,126	500	—	—	(299)	3,327		
Multicable T.V. (Chile)	307	124	—	—	(33)	398		
Publiguías (Chile)	214	14	—	—	—	228		
SATLINK	—	79	—	—	(4)	75		
Startel	198	2,707	—	—	(137)	2,768		
T. L. D. (Puerto Rico)	3,740	249	—	—	—	3,989		
T. Perú Holding	143	19	—	—	—	162		
T. T. Datos	15,860	496	—	—	—	16,356		
Telefónica Cable	8	6	—	—	—	14		
Telefónica Internacional	391	2,333	—	—	—	2,724		
Telefónica Multimedia (Peru)	—	—	—	—	—	—		
Venturini España	—	16	—	—	—	16		
VTR	—	76	—	—	(3)	73		
	<b>28,779</b>	<b>11,579</b>	—	<b>14,324</b>	<b>(535)</b>	<b>54,147</b>		
<b>Companies carried by the equity method:</b>								
Amper	—	93	—	—	—	93		
Antena 3	768	834	—	—	—	1,602		
C.R.T.	4,285	3,288	118	—	—	7,691		
Cablevisión	—	2,051	—	—	—	2,051		
CALL Center	—	5	—	—	—	5		
Cointel (Argentina)	13,702	—	—	(13,702)	—	—		
Compuserve Argentina	—	28	—	—	(1)	27		
DTS D <sup>a</sup> TV Digital	—	23	—	—	—	23		
G.M.A. Fútbol	622	—	—	(622)	—	—		
Lola Films	4	9	—	—	—	13		
Portugal Telecom	511	1,490	—	—	—	2,001		
Recoletos Cía Editorial	—	684	—	—	—	684		
Torneos y Competencias	—	361	—	—	—	361		
Venworld (Venezuela)	13,398	687	—	—	—	14,085		
ZZJ Mundovisión	—	3	—	—	—	3		
	<b>33,290</b>	<b>9,556</b>	<b>118</b>	<b>(14,324)</b>	<b>(1)</b>	<b>28,639</b>		
<b>Total accumulated amortization</b>	<b>62,069</b>	<b>21,135</b>	<b>118</b>	<b>0</b>	<b>(536)</b>	<b>82,786</b>		
<b>Goodwill in consolidation</b>								
<b>Unamortized goodwill in consolidation</b>	<b>284,364</b>		<b>72,429</b>	<b>(5,166)</b>	<b>53,889</b>	<b>(5,893)</b>	<b>399,623</b>	

Amortization period: 20 years; GMA-Fútbol 5 years.

Goodwill in Consolidation	Millions of Pesetas					
	Balance at 12/31/1996	Additions	Retirements	Transfers	Translation Differences	Balance at 12/31/1997
<b>Companies consolidated by the global integration method:</b>						
C.T.C. (Chile)	5,508	—	—	—	—	5,508
Instacom	1,334	—	—	—	253	1,587
Intercom	(111)	—	—	—	(26)	(137)
Invercom	—	—	—	8,822	—	8,822
Multicable T.V. (Chile)	1,095	—	—	—	207	1,302
Publiguías (Chile)	426	—	—	—	—	426
Rem Infográfica	—	143	—	—	—	143
Servicios y Contenidos por la Red	126	—	—	—	—	126
Startel	—	56,801	—	—	—	56,801
T.L.D. (Puerto Rico)	7,479	—	—	—	—	7,479
T. Perú Holding	461	—	—	—	—	461
T. T. Datos	—	25,794	—	—	—	25,794
Telefónica Cable	—	127	—	—	—	127
Telefónica Internacional	—	46,865	—	—	—	46,865
TMP Worldwide	8	—	—	—	—	8
	<b>16,326</b>	<b>129,730</b>	—	<b>8,822</b>	<b>434</b>	<b>155,312</b>
<b>Companies carried by the equity method:</b>						
Antena 3	—	18,446	—	—	—	18,446
C.R.T.	—	85	—	42,813	—	42,898
Cointel (Argentina)	23,836	44,132	—	—	—	67,968
G.M.A. Fútbol	—	8,957	—	—	—	8,957
Invercom	7,423	—	—	(8,822)	1,399	—
Lola Films	—	142	—	—	—	142
Multicanal	9,155	—	(9,155)	—	—	—
Portugal Telecom	—	30,657	—	—	—	30,657
Siris y DBKOM	1,130	—	(1,130)	—	—	—
Sofres, A.M.	157	—	—	—	—	157
Unisource, N.V.	7,742	—	(7,742)	—	—	—
Venworld (Venezuela)	22,330	—	—	—	—	22,330
	<b>71,773</b>	<b>102,419</b>	<b>(18,027)</b>	<b>33,991</b>	<b>1,399</b>	<b>191,555</b>
<b>Total goodwill</b>	<b>88,099</b>	<b>232,149</b>	<b>(18,027)</b>	<b>42,813</b>	<b>1,833</b>	<b>346,867</b>

1997 transfers include the consolidation of CRT, which was recorded at cost the previous year.

Amortization of Goodwill in Consolidation	Balance at 12/31/1996	Millions of Pesetas					Translation Differences	Balance at 12/31/1997
		Additions	Retirements	Transfers				
<b>Companies consolidated by the Global integration method:</b>								
C.T.C. (Chile)	3,703	551	—	—	—	—	—	4,254
Instacom	399	141	—	—	—	48	588	
Intercom	(28)	(13)	—	—	—	(9)	(50)	
Invercom	—	849	—	2,247	—	30	3,126	
Multicable T.V. (Chile)	148	126	—	—	—	33	307	
Publíguías (Chile)	171	43	—	—	—	—	214	
Rem Infográfica	—	143	—	—	—	—	143	
Servicios y Contenidos por la Red	126	—	—	—	—	—	126	
Startel	—	192	—	—	—	6	198	
T.L.D. (Puerto Rico)	2,992	748	—	—	—	—	3,740	
T. Perú Holding	97	46	—	—	—	—	143	
T. T. Datos	—	15,860	—	—	—	—	15,860	
Telefónica Cable	—	8	—	—	—	—	8	
Telefónica Internacional	—	391	—	—	—	—	391	
TMP Worldwide	8	—	—	—	—	—	8	
	<b>7,616</b>	<b>19,085</b>	—	<b>2,247</b>	—	<b>108</b>	<b>29,056</b>	
<b>Companies carried by the equity method:</b>								
Antena 3	—	768	—	—	—	—	768	
C.R.T.	—	4,285	—	—	—	—	4,285	
Cointel (Argentina)	7,898	5,804	—	—	—	—	13,702	
G.M.A. Fútbol	—	622	—	—	—	—	622	
Invercom	1,889	—	—	(2,247)	—	358	0	
Lola Films	—	4	—	—	—	—	4	
Multicanal	704	—	(704)	—	—	—	0	
Portugal Telecom	—	511	—	—	—	—	511	
Siris y DBKOM	1,130	—	(1,130)	—	—	—	0	
Sofres, A.M.	157	—	—	—	—	—	157	
Unisource, N.V.	7,742	—	(7,742)	—	—	—	0	
Venworld (Venezuela)	11,165	2,233	—	—	—	—	13,398	
	<b>30,685</b>	<b>14,227</b>	<b>(9,576)</b>	<b>(2,247)</b>	—	<b>358</b>	<b>33,447</b>	
<b>Total accumulated amortization</b>	<b>38,301</b>	<b>33,312</b>	<b>(9,576)</b>	—	—	<b>466</b>	<b>62,503</b>	
<b>Goodwill in consolidation</b>								
<b>Unamortized goodwill in consolidation</b>	<b>49,798</b>	<b>198,837</b>	<b>(8,451)</b>	<b>42,813</b>	<b>1,367</b>	<b>284,364</b>		

Amortization period: 10 years; GMA-Fútbol 5 years.

## EXHIBIT IV

### MINORITY INTERESTS

#### Minority interests-

This caption relates to the share of minority stockholders in the equity and income/loss for the year of the Group companies consolidated by the global integration method.

As of December 31, 1998, the balance of this caption comprised the holdings of minority stockholders in the following companies:

Company	% of Minority Interests	Net Worth	Millions of Pesetas			Variation in % of Minority Interests	Balance at 12/31/1998
			Translation Differences	Income (Loss)			
Cointel	50.00	72,276	(4,474)	19,418		—	87,670
C.T.C. Chile, S.A.	56.36	189,196	(14,036)	17,755		—	192,915
Fonditel	19.00	795	—	176		—	971
Mensatel	10.00	187	—	(71)		—	116
Publiguías, S.A.	45.07	929	84	838		—	1,851
Telefónica Argentina, S.A.	41.68	131,886	(6,971)	34,883		—	159,798
Telefónica del Perú Holding	10.00	29,991	(1,425)	198		—	28,764
Telefónica del Perú, S.A.	65.00	120,521	(25,803)	19,409		—	114,127
Telefónica Larga Distancia, Inc.	21.00	2,776	(171)	(81)		—	2,524
Other companies	—	1,648	(37)	26		4	1,191
<b>Total</b>		<b>550,205</b>	<b>(52,833)</b>	<b>92,551</b>		<b>4</b>	<b>589,927</b>

As of December 31, 1997, the balance of this caption comprised the share of minority stockholders in the following companies:

Company	% of Minority Interests	Net Worth	Millions of Pesetas			Variation in % of Minority Interests	Balance at 12/31/1997
			Translation Differences	Income (Loss)			
C.T.C. Chile, S.A.	56.38	90,532	51,006	27,425		—	168,963
Fonditel	19.00	658	—	138		—	796
Mensatel	10.00	106	—	(70)		—	36
Publiguías, S.A.	45.07	360	559	856		—	1,775
Telefónica del Perú Holding	10.00	27,691	1,726	1,169		—	30,586
Telefónica del Perú, S.A.	65.00	109,791	42,188	36,244		—	188,223
Telefónica Internacional, S.A.	—	—	—	6,930	(6,930)	0	0
Telefónica Larga Distancia, Inc.	21.00	3,551	(837)	62		—	2,776
Other companies	—	1,084	(1,300)	1,288	(130)	—	942
<b>Total</b>		<b>233,773</b>	<b>93,342</b>	<b>74,042</b>	<b>(7,060)</b>		<b>394,097</b>

**Variations in minority interests**

The variations in minority interests in 1998 were as follows:

Company	Balance at 12/31/1997	Capital Contributions and Company Additions	Income (Loss) for the Year	Variation in Translation Differences	Other Variations	Capital Reductions and Company Retirements	Dividends Paid	Balance at 12/31/1998
Cointel	0	94,703	19,418	(4,474)	—	(18,328)	(3,649)	87,670
C.T.C. Chile, S.A.	168,963	33,591	17,755	(14,596)	(4,436)	—	(8,362)	192,915
Fonditel	796	—	175	—	—	—	—	971
Mensatel	36	150	(70)	—	—	—	—	116
Publiguías, S.A.	1,775	—	838	84	—	—	(846)	1,851
Telefónica Argentina, S.A.	0	241,878	34,883	(5,804)	—	(89,176)	(21,983)	159,798
Telefónica del Perú Holding	30,586	—	198	(1,425)	—	—	(595)	28,764
Telefónica del Perú, S.A.	188,223	—	19,409	(25,803)	—	(55,994)	(11,708)	114,127
Telefónica Larga Distancia, Inc.	2,776	—	(81)	(171)	—	—	—	2,524
Other companies	942	206	26	(37)	259	(197)	(8)	1,191
<b>Total</b>	<b>394,097</b>	<b>370,528</b>	<b>92,551</b>	<b>(52,226)</b>	<b>(4,177)</b>	<b>(163,695)</b>	<b>(47,151)</b>	<b>589,927</b>

**Variations in minority interests**

The variations in minority interests in 1997 were as follows:

Company	Balance at 12/31/1996	Capital Contributions and Company Additions	Income (Loss) for the Year	Variation in Translation Differences	Other Variations	Capital Reductions and Company Retirements	Dividends Paid	Balance at 12/31/1997
C.T.C. Chile, S.A.	125,114	—	27,425	28,770	—	—	(12,346)	168,963
Fonditel	631	27	138	—	—	—	—	796
Mensatel	106	—	(70)	—	—	—	—	36
Publiguías, S.A.	1,254	—	856	276	—	—	(611)	1,775
Telefónica del Perú Holding	29,690	—	1,169	698	—	—	(971)	30,586
Telefónica del Perú, S.A.	142,179	—	36,244	23,659	—	—	(13,859)	188,223
Telefónica Internacional, S.A.	66,775	—	6,930	6,430	(80,135)	—	—	0
Telefónica Larga Distancia, Inc.	2,343	—	62	371	—	—	—	2,776
Other companies	6,601	696	1,288	857	(7,152)	(1,281)	(67)	942
<b>Totals</b>	<b>374,693</b>	<b>723</b>	<b>74,042</b>	<b>61,061</b>	<b>(87,287)</b>	<b>(1,281)</b>	<b>(27,854)</b>	<b>394,097</b>

## EXHIBIT V

### DEBENTURES AND BONDS

The breakdown of debentures and bonds outstanding as of December 31, 1998, and their principle characteristics, is as follows:

Telefónica and Instrumentality Companies	Currency	% Interest Rate	1999	2000	Maturity 2001	2002	2003	Subsequent Years	Total
<b>Debentures and Bonds:</b>									
JULY 1989	Ptas.	12.00	—	—	—	—	—	10,380	10,380
DECEMBER 1989 (*)	Ptas.	3.21	800	—	—	—	—	—	800
JANUARY 1990	Ptas.	12.00	—	—	—	—	220	27,601	27,821
FEBRUARY 1990 SERIES A	Ptas.	12.60	—	9,350	—	—	—	—	9,350
FEBRUARY 1990 SERIES B	Ptas.	12.60	—	—	—	—	—	1,367	1,367
FEBRUARY 1990 SERIES C	Ptas.	12.60	—	—	—	—	—	626	626
FEBRUARY 1990 SERIES D	Ptas.	12.89	—	18,646	—	—	—	—	18,646
FEBRUARY 1990 SERIES E	Ptas.	12.85	—	—	—	—	—	6,072	6,072
FEBRUARY 1990 SERIES F	Ptas.	12.58	—	—	—	—	—	666	666
DECEMBER 1990	Ptas.	13.58	—	—	—	—	—	55,454	55,454
MARCH 1991	Ptas.	14.48	2,886	—	—	—	—	—	2,886
APRIL 1991 SERIES A	Ptas.	13.50	—	—	10,000	—	—	—	10,000
APRIL 1991 SERIES B	Ptas.	13.67	—	—	53,693	—	—	—	53,693
JULY 1997 (Convertible)	US\$	2.13	—	—	—	92,516	—	—	92,516
D SEPTEMBER 2001	Ptas.	10.25	—	—	68,813	—	—	—	68,813
B NOVEMBER 2000	Ptas.	10.06	—	20,439	—	—	—	—	20,439
C NOVEMBER 2002	Ptas.	10.06	—	—	—	19,316	—	—	19,316
B OCTOBER 2000	Ptas.	8.00	—	12,372	—	—	—	—	12,372
C OCTOBER 2004	Ptas.	8.25	—	—	—	—	—	11,520	11,520
<b>Debentures Subtotal:</b>			<b>3,686</b>	<b>60,807</b>	<b>132,506</b>	<b>111,832</b>	<b>220</b>	<b>113,686</b>	<b>422,737</b>
APRIL 1991	Ptas.	14.52	132,310	—	—	—	—	—	132,310
JULY 1991	Ptas.	14.52	9,628	—	—	—	—	—	9,628
OCTOBER 1997	Ptas.	5.325	—	—	—	—	—	12,449	12,449
DECEMBER 1997	US\$	6.375	—	—	—	—	71,331	—	71,331
MARCH 1998	Ptas.	4.84	—	—	—	—	—	70,000	70,000
<b>Bonds Subtotal</b>			<b>141,938</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>71,331</b>	<b>82,449</b>	<b>295,718</b>
<b>Total Issues:</b>			<b>145,624</b>	<b>60,807</b>	<b>132,506</b>	<b>111,832</b>	<b>71,551</b>	<b>196,135</b>	<b>718,455</b>

(\*) Average interest rate for 1998 on floating-rate issues.

Foreign Operators Debentures and Bonds	Currency	% Interest Rate	Maturities					Subsequent Years	Total
			1999	2000	2001	2002	2003		
Yankee Bonds 1996	US\$	7.63	—	—	—	—	—	28,521	28,521
Series D 1989	UF	5.80	1,662	—	—	—	—	—	1,662
Series E 1991	UF	6.00	1,385	1,385	1,385	1,385	694	—	6,234
Series F 1991	UF	6.00	317	317	317	317	317	3,957	5,542
Series H 1994	UF	5.80	2,217	2,217	2,217	2,217	2,217	5,540	16,625
Series I 1994	UF	5.50	277	554	554	554	554	6,373	8,866
Series J 1998	UF	6.75	—	—	663	663	663	4,661	6,650
Series K 1998	UF	6.75	—	—	—	—	—	17,732	17,732
<b>CTC CHILE:</b>			<b>5,858</b>	<b>4,473</b>	<b>5,136</b>	<b>5,136</b>	<b>4,445</b>	<b>66,784</b>	<b>91,832</b>
Series G 1996	N. Sol	VAC+ 5.1	3,673	—	—	—	—	—	3,673
Series I 1996	N. Sol	VAC+ 5.6	—	—	4,400	—	—	—	4,400
Single Series (3rd) 1997	N. Sol	12.38	—	6,091	—	—	—	—	6,091
Single Series (4th) 1998	US\$	14.40	—	—	7,463	—	—	—	7,463
<b>Telefónica del Perú:</b>			<b>3,673</b>	<b>6,091</b>	<b>11,863</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>21,627</b>
Debentures 1993	US\$	8.38	—	42,782	—	—	—	—	42,782
Debentures 1994	US\$	11.88	—	—	—	—	—	42,782	42,782
Debentures 1998	US\$	9.13	—	—	52,550	—	—	—	52,550
Debentures 1998	US\$	Libor+(1.125 a 1.625)	—	—	—	—	—	57,043	57,043
<b>TASA</b>			<b>0</b>	<b>42,782</b>	<b>52,550</b>	<b>0</b>	<b>0</b>	<b>99,825</b>	<b>195,157</b>
Series A 1997	US\$	8.85	—	—	—	—	—	32,087	32,087
Series B 1997	US\$	10.38	—	—	—	—	—	24,956	24,956
Cointel			0	0	0	0	0	57,043	57,043
<b>Total Issues:</b>			<b>9,531</b>	<b>53,346</b>	<b>69,549</b>	<b>5,136</b>	<b>4,445</b>	<b>223,652</b>	<b>365,659</b>
<b>Total Group Issues:</b>			<b>155,155</b>	<b>114,153</b>	<b>202,055</b>	<b>116,968</b>	<b>75,996</b>	<b>419,787</b>	<b>1,084,114</b>

(\*) Average interest rate for 1998 on floating-rate issues.

The detail of the maturities and redemption values as of December 31, 1998, is as follows:

Debentures and zero-coupon bonds (Issue value + Accrued Interest as of 12/31/1998)	Maturity Date	% Redemption Rate	Value per Books	Redemption Value
<b>DEBENTURES</b>				
February 1990 Series D	02/26/2000	336.154 %	18,646	21,447
February 1990 Series E	02/26/2005	613.338 %	6,072	12,776
February 1990 Series F	02/26/2010	1,069.470 %	666	2,503
December 1990	12/28/2005	675.000 %	55,454	135,000
March 1991	03/01/1999	295.022 %	2,886	2,950
April 1991 Series B	04/17/2001	360.000 %	53,693	72,000
D September 2001	09/19/2001	265.543 %	68,813	89,687
<b>BONDS</b>				
April 1991	04/15/1999	295.740 %	132,310	137,519
July 1991	07/15/1999	295.740 %	9,628	10,351
<b>Total Issues</b>			<b>348,168</b>	<b>484,233</b>

## EXHIBIT VI

The detail, by type of derivative, of the (notional) contractual values of the derivatives held by the Group as of December 31, 1998, is as follows:

Type of Risk Hedged	Equivalent Value in pesetas	Millions			
		Value	Group Pays Currency	Value	Group Receives Currency
Interest rate risk:	<b>771,364</b>				
Pta. Interest rate swaps	435,246				
Foreign currency interest rate swaps	203,419	1,425	US\$	1,425	US\$
	12,449	15,000	PTE	15,000	PTE
Interest rate options	120,250				
Exchange risk:	<b>1,080,848</b>				
Exchange swaps	8,926			120,000	ITL
	23,074			17,000	JPY
	65,235			394	ECU
	13,769	543	FRF	83	ECU
	133,119			919	US\$
	624,471	4,406	US\$		
Exchange rate options	90,579	654	US\$		
	61,899	49,355	JPY	349	US\$
Forward	43,232			305	US\$
	60	0.4	US\$		
	3	0.1	FRF		
	64			0.3	GBP
	6,424	48	ARS	45	US\$
	8,565	29,920	CLP	60	US\$
	1,428	30	PEN	10	US\$
Balance sheet risk	<b>6,566</b>				
Hedging of Telefónica stocks	4,916	726,750	Shares		
	1,650			306,000	Shares
<b>Total</b>	<b>1,858,778</b>				

The detail, by type of derivative, of the (notional) contractual values of the derivatives held by the Group as of December 31, 1997, is as follows:

Type of Risk Hedged	Notional Value In pesetas	Millions			
		Value	Group Pays Currency	Value	Group Receives Currency
Interest Rate Risk:	<b>509,698</b>				
Pta. interest rate swap	194,786				
Currency interest rate swaps	148,817	980	US\$	980	US\$
	12,437	15,000	PTE	15,000	PTE
Interest rate options	120,250				
Currency interest rate options	33,408	220	US\$	220	US\$
Exchange risk:	<b>297,309</b>				
Exchange swaps	8,926			120,000	ITL
	23,074			17,000	JPY
	37,389			227	ECU
	15,340	607	FRF	93	ECU
	61,788			432	US\$
	95,589	654	US\$		
Forward	32,372			219	US\$
	209	1.4	US\$		
	11,894	35	CLP	78	US\$
	10,728	194	PEN	71	US\$
<b>Total</b>	<b>807,007</b>				

Millions of Pesetas					
Hedged Instrument	Amount	Up to 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years
Promissory notes	279	279	—	—	—
Loans	1,293,643	640,438	203,347	86,808	363,050
Peseta loans	356,617	90,000	71,610	20,000	175,007
Foreign currency loans	937,026	550,438	131,737	66,808	188,043
MTN debentures and bonds	316,038	0	90,388	85,650	140,000
Peseta debentures and bonds	168,600	—	28,600	—	140,000
Foreign currency debentures and bonds	147,438	—	61,788	85,650	—
Without underlying instrument (liability)	242,252	121,673	90,579	0	30,000
Interest rate swaps	30,000	—	—	—	30,000
Exchange rate options	152,478	61,899	90,579	—	—
Forward	59,774	59,774	—	—	—
Without underlying instrument (asset)	6,566	6,566	0	0	0
Deposit	6,566	6,566	—	—	—
<b>Total</b>	<b>1,858,778</b>	<b>768,956</b>	<b>384,314</b>	<b>172,458</b>	<b>533,050</b>

The detail, by maturity, of the hedging transactions as of December 31, 1997, is as follows:

Millions of Pesetas					
Hedged Instrument	Amount	Up to 1 Year	1 to 3 Years	3 to 5 Years	Over 5 Years
Promissory notes	4,564	4,564	—	—	—
Loans	561,263	36,261	350,460	0	174,542
Peseta loans	281,873	2,094	159,826	—	119,953
Foreign currency loans	279,390	34,167	190,634	—	54,589
MTN debentures and bonds	90,388	0	0	90,388	0
Peseta debentures and bonds	28,600	—	—	28,600	—
Foreign currency debentures and bonds	61,788	—	—	61,788	—
Without underlying instrument (liability)	137,207	93,620	43,587	0	0
Interest rate swaps	0	—	—	—	—
Exchange rate options	0	—	—	—	—
Forward	137,207	93,620	43,587	—	—
Without underlying instrument (asset)	0	0	0	0	0
Deposits	0	—	—	—	—
<b>Total</b>	<b>793,422</b>	<b>134,445</b>	<b>394,047</b>	<b>90,388</b>	<b>174,542</b>

# **Management Report**



Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails.

1998 saw the total liberalization of the telecommunications sector in Spain, with the starting up of a second operator for fixed telephony at the beginning of the year, and December 1 being the date on which the market opened up to all those players interested in providing services and/or operating networks. Within this scenario, Telefónica has had to face competition in a regulatory framework that has not proven to be unbiased, and as the dominant operator it has been subjected to certain commitments at the same time as having restrictions enforced.

Nevertheless, Telefónica is tackling this new situation with great competitive capacity, as has been shown by those services that were already under a competitive regime, and in the market segments where the greatest vigour has been witnessed, cellular and data transmission, Telefónica has more than proven its leadership throughout 1998.

On the other hand, the Group's growth has basically derived from the nurturing of businesses other than that of basic telephony in Spain, reflecting an ever-increasing degree of diversification in terms of revenues and profits, combined with the fact that both Telefónica Internacional (TISA) and Telefónica Móviles never cease to improve their position, now making up more than 47.8% of consolidated net income. Telefónica Móviles, in particular, recorded operating revenues amounting to 13.8% of the figure registered for the whole Group before consolidation adjustments, and made a net contribution to consolidated profit of Ptas 80,311 million, 36.9% of the whole.

In the international arena, the Telefónica group has further strengthened its role as Latin America's leading operator, principally through its acquisitions in Brazil. This has meant that the number of lines managed by TISA in the region has risen by 6.04 million new fixed lines and 0.87 million new cellular customers. TISA has also taken up participations in operators that manage an additional 1.59 million cellular customers. The figures mentioned are those taken at the moment of acquisition.

In order to finance, to a certain extent, these acquisitions, which will mean enhanced value for the Telefónica shareholder, as well as financing potential business opportunities, the Company launched a capital increase with the issuing of 85.4 million shares, which provided funding to the tune of Ptas 427,032 million.

The year-end figures for those operators in which Telefónica controls the management totalled 33,362 million fixed lines, 8,398 million cellular customers and 874.3 thousand pay-TV subscribers, with their respective percentages within the Spanish domestic market standing at 52.2%, 58.3% and 33%.

During the course of 1998, Telefónica initiated the restructuring of the Group, shaping Telefónica S.A. into a holding, geared around which are seven main business lines developed by their corresponding subsidiary. This restructuring aims to achieve a higher degree of alignment within the organization as a whole and the Group's new situation, at the same time as improving the attributing of responsibilities for the different business lines. This process was completed at the beginning of 1999.

Telefónica's stock market performance for 1998 has been outstanding, reaching, at year-end, a stock market value of Ptas 6.47 trillion, with the value of the shares rising 45.1% when the figure for the Ibex-35 rose 35%, with Telefónica shares registering the highest trading volume on all Spanish stock exchanges, standing at Ptas 8.4 trillion.

## **LIBERALIZATION IN SPAIN**

### **Fixed telephony**

In January 1998, Retevisión started up operations, initially as a provider of domestic and international long distance telephony services, which marked the end of the monopoly on the only service remaining under this regime. In September, this same company began to provide provincial calls. Coinciding with this, the cable operators that had been granted licences to offer their services in specified regions began providing cable TV throughout the course of the year, as well as offering their subscribers telephone services, metropolitan calls, and the provision of lines.

On April 26, the new General Telecommunications Law came into force, which, throughout the year, has been completed by the Ministry of Public Works and the Telecommunications Market Commission (CMT) to include all the necessary rules and regulations regarding the total liberalization of the market on December 1. This comes only 11 months after the date on which the majority of the European Union countries liberalized their telecommunications markets, January 1, 1998, and is ahead of other countries such as Portugal and Ireland

which were also included in the extension period granted to Spain, although the latter has only needed to use 11 months of this period.

The most significant legislation approved during the course of 1998 regarding for the telecommunications business has been: the ruling on Interconnections, that of the granting of Licences to the various operators, and the Offer for Reference Interconnection (ORI), which lays down the regulations for interconnection services and the prices to be charged to other operators.

Since December 1, 1998, the Telecommunications Market Commission (CMT) has been solely responsible for the regulating of the telecommunications market, and has tended to apply a criteria that favours the new arrivals. Telefónica has not ceased in its efforts to legally oppose this practice, so that this bias, which benefits our competitors, be reduced to a minimum and lasts as short a time as possible. In particular, the fact that Telefónica is considered to be the dominant operator, means that until at least December 31, 2005, the Company will be obliged to fulfill certain obligations that we believe to be unfair.

On December 1, 1998 a second domestic operator, Lince, began to operate in Spain, using the commercial name, UNI2. It began offering national and international long distance calls, although these services could have been provided by any other operator which, having obtained the corresponding licence, would have been able to, by that date, have completed its technical capacity. At the aforementioned date the Regulator (CMT) had not granted any of the licences applied for; but in the months of December and January it proceeded to grant 11 licences for the whole national area and 5 for provincial and regional areas. Of the licences for the whole national area, 3 of them are solely for the provision of the telephony service, 2 are for the laying and exploiting of the public networks, and 6 are for smaller provincial and regional areas, but they combine both the provision of the telephony service and the laying and exploiting of public networks. These licences are totally independent of those originally granted to cable operators which now, under the new General Telecommunications Law, can broaden their scope to include other services.

All this means that 1999 stands to be an extremely competitive year, once the companies with new licences start operating, and given the combined interests shared by the domestic and cable TV operators who have the same shareholders (this being the case of both Retevisión and Lince) as well as signed collaboration agreements.

At year end 1998, Retevisión had gained a significant slice of domestic traffic, about 10%, while in the Basque country the operator Euskaltel surpassed 20%. This has been principally due to the easy indirect access of the competitors to Telefónica's transit network, a condition imposed on the dominant operator, Telefónica, by the

Regulator, as neither of the two operators mentioned previously is currently able to provide direct access to many of its customers. On the other hand, the entrance of Lince and the other cable operators has not had much effect on the market share.

The total liberalization of the sector has been introduced without the necessary tariff rebalancing having taken place in fixed telephony. This is still pending approval by the Government Executive Committee on Economic Affairs, which therefore means that these tariffs are not in line with real costs, they are below real costs in those services where the competition has not yet begun, and above costs in long distance services where competition is rife. As a consequence, the last tariff adjustment made on July 30, with reductions averaging 5%, 15% and 12% in provincial, interprovincial and international services, respectively, and a Pta 200 increase in the subscriber charge and an average 14% increase in metropolitan calls, is a step in the right direction in terms of tariff rebalancing, but is not sufficient according to Telefónica's criteria. At the same time as applying the new tariffs, billing in seconds has been introduced for all the above mentioned types of calls, something that the competition already practiced and has always used in its marketing.

The maintaining of some prices below costs (subscriber charge) when providing the customer with a telephone line, results in what is called Access Deficit. The need to offset this, when the operator who provides this service is not free to set prices that allow him to cover costs, is not only recognized in EU directives but also in Spanish legislation, so Telefónica has presented an estimation of the deficit to the Regulator, in order to discuss the most appropriate form of compensation. To date no solution has been found.

On the other hand, the prices set by the ORI regarding the payment to be made to Telefónica by its competitors for the use of our network for the access and connection of calls, are also lower than the costs incurred, a fact that has resulted in Telefónica having presented a claim before the Spanish National Courts (Audiencia Nacional), as the complaints previously made to the Regulator were to no avail, stating that it considers this ruling to be biased, at the same time as seriously jeopardizing its competitive position.

All of these factors combined have meant that different discount policies have had to be applied to these types of calls on which competition has focused its efforts, at the same time as basing them on the customer segment targeted, in order to maintain competitive prices. The newest policies have been those of Planes Claros (Transparent Plans) which target the segments of residencial and small businesses, along with those aimed at Internet users. The total figure for these discounts in 1998 has surpassed Ptas 28 billion.

At the same time, our range of services has grown, combining, on many occasions, several individual services and others of different kinds

(lines, equipment, television, Internet access, etc.) within the same package, in order to offer our customers enhanced services.

Both the discounts and the combined service offers must previously be presented to the Regulator, as this procedure must be fulfilled before the launching of any commercial product is permitted

#### **Cellular telephony**

Regarding cellular services, Telefónica's competitors have been limited to two for the time being, due to the restricted availability of radioelectric spectrum. These two cellular operators are Airtel and Retevisión Móvil who was granted the third licence and began operating in January 1999 under the name trademark, Amena. This last operator will be allowed to offer its services throughout the whole country despite not having yet completed its network. This comes as a result of the agreements signed with both Telefónica Móviles and Airtel which will provide roaming services for Amena's customers, over a two-year period, in areas where the latter does not have coverage.

The growth in this service, which gathered momentum over the course of the year, has meant that at year-end penetration stood at around 18% of the population. Of the overall annual increase in domestic customers, Telefónica Móviles has managed to gain 63%, raising its number of customers by over 1,700,000.

On July 31, the Government's Delegate Committee on Economic Affairs approved the new tariffs for analog cellular telephony for which Telefónica is the sole operator with exclusive rights. These tariffs had not been revised since July 1994, in order to allow the development of competition in the new GSM services that were already liberalized. Once the development of the GSM services had been assured, and Airtel had entered the market, the Ministry of Public Works decided to adjust the existing tariffs to allow Telefónica Móviles to provide offers that could compete with other services and, therefore allowing the end user to benefit from the real advantages of competition.

#### **INTERNATIONAL EXPANSION**

Over 1998, the financial investments were principally focused on the taking up of participations in different Latin American operators by Telefónica Internacional (TISA), these being the following:

- The privatization of the state-owned telecommunications system in Brazil, Telebras;
- TISA, through the consortium Tele Brasil Sul, which includes the Brazilian company RBS, Portugal Telecom, BBV and Iberdrola, was granted a controlling stake in Telesp Participações S.A., one of the most important holding companies for fixed telephony, which in turn controls the

operators Telesp S.A. and CTBC in the state of São Paulo. The cost for the Group totalled Ptas 473,286 million, and the number of lines managed at the moment of awarding was 6.04 million.

- TISA in the consortium with Iberdrola, which was later joined by the Japanese operator NTT DoCoMo and the industrial group of the same nationality, Itochu, were awarded a controlling stake in Tele Sudeste Celular Participações S.A., which in turn controls the cellular operators in the states of Rio de Janeiro and Espírito Santo. The cost for the Group totalled Ptas 164,293 million, and the number of cellular customers managed at the time of awarding was 635,000.
- TISA acquired a minority stake in Tele Leste Celular Participações S.A. for an amount of Ptas 21,130 million, along with Iberdrola who holds the majority participation. This consortium controls the operators that provide cellular services in the states of Bahía and Sergipe.
- Forming part of the consortium Portelcom, TISA acquired a minority stake in Telesp Celular Participações S.A. for an amount of Ptas 166,848 million. Portugal Telecom holds a majority stake in this company which is responsible for the operating of cellular services in the state of São Paulo.
- The acquisition, through the consortium Telefónica do Brasil, of 50.1% of the shares with voting rights of the Companhia Riograndense de Telecomunicações (CRT). The cost for TISA amounted to Ptas 64,945 million, and, as a result of this transaction, its participation in the operator rose to 16.7%.
- The awarding of 51% of Intel in its privatization process, the company granted the second licence for the operating of telecommunications services in El Salvador. The cost for TISA amounted to Ptas 4,940 million. On October 1, this new Telefónica de El Salvador began operating six weeks after the awarding.

These investments, especially the high investment made in Brazil, act, not only as a vehicle for expansion and the consolidation of our leadership position in Latin America, but also represent, for both the Group and our suppliers, a new market to which our technology, developments and know-how can be exported. These exports will steadily come through the management contracts, already existing or to be created, with participated operators, other advisory contracts, and the sale of products, services and information and management systems developed by the Group. Neither must the revenues that will come from the opening up of these markets be forgotten, along with the increases in international transit traffic, as much of this will be routed through Spain instead of through other countries, as is currently the case.

On the other hand, the company Telefónica Intercontinental S.A. has been incorporated to act as the head of one of the seven Lines of Activity into which the Group has been divided. Its purpose is to develop Telefónica's presence in international marketplaces other than that of the American continent. Telefónica Intercontinental and Portugal Telecom have created a joint venture to carry out investments in the Mediterranean area.

### ECONOMIC RESULTS

When comparing the figures for 1998 and 1997, which will be done throughout this section, it is necessary to bear in mind the adjustments made to the results published for the latter year, which are reflected in Note 2.c) of the Annual Accounts, due for the change in the consolidation process applied for Telefónica Argentina. On the other hand, any reference made to the variation rate when comparing 1997 with 1996 corresponds to the figures exactly as they were originally published. The recent acquisitions or increases in the participations in the Brazilian operators only affect the item Revenue from Associated Companies, any other adjustments that have been made for 1998 which may vary the interannual comparision are of minor importance and are specified within the figures.

Consolidated net income for the Telefónica Group amounted to Ptas 217,584 million, reflecting an interannual growth of 14.5%, slowing when compared with 1997, a year that witnessed 18.6% growth. The most outstanding performance has been registered by Telefónica Móviles, whose net contribution to consolidated income amounted to Ptas 80,311 million, rising 188.7% over the figure for the previous year, and representing 36.9% of the income for whole Group.

Besides the favourable trend recorded by the Telefónica Móviles Group, other aspects that have had a particularly outstanding effect on the profit and loss account are outlined below:

- The slowdown in the increase in Telefónica's operating revenues (reduced to 2.9% in 1998), principally due to the new situation regarding competition in basic telephony combined with the tariff cuts.
- The slowdown in the increase in operating revenue for the Telefónica Internacional Group (down to 7.7% in 1998) as a consequence of the slowdown in the growth of the most important Latin American economies due to the mid-year crisis.
- The moderation in the growth (3.6%) of the Group's operating expenses, that is personnel expenses, supplies, outsourcing and subcontracts, local taxes and the net variation in stocks and construction in progress which has meant that their weight over operating revenue has gone down by one percentage point (going from 48.4% to 47.4%).

- The 10.6% increase in interest on debts which has derived from the Telefónica Internacional Group, and is closely linked with the new investments in the Brazilian market.
- Significant increase in the extraordinary results, principally in Telefónica S.A., as a consequence of the provisions for the early and voluntary retirements underway.

### Operating revenue

Operating revenue rose 5.9% to reach Ptas 3,059,899 million. Its main component, revenue from sales and provision of services, which makes up 95% of the total figure, contributed Ptas 2,906,021 million, growing by 5.7%, while internal expenditure capitalized in fixed assets rose 2.9% to stand at Ptas 124,310 million.

Of the revenue from sales and provision of services, those generated by the parent, which amounted to Ptas 1,652,389 million, made up 48.6% of the total before adjustments for intragroup sales, while those contributed by the Telefónica Móviles Group made up 13.8%, and those of the Telefónica Internacional Group, 26.3%. The remaining subsidiaries contributed 11.3% of the overall amount.

The parent, Telefónica, registered a slowdown in its growth in revenue from operations, 2.9% compared to 9% in 1997, principally due to the Spanish market opening up to competition and the tariff cuts, although these continue within an unbalanced structure.

Revenue from basic telephony rose 2.8% to total Ptas 1,378,535 million, reflecting a 2.8% interannual increase. The loss of market share in domestic long distance traffic to Retevisión, and the introduction of the discounts included in the Transparent Plans (Planes Claros) had a negative effect on this growth rate. On the other hand, the favourable factors have been the 4.2% growth in average billable plant in service in equivalent lines, and the 9.5% increase in average usage per line which rose to 11.85 minutes per day.

International communications have also been affected by the higher degree of competition, the tariff cuts and the discount schemes introduced. The favourable performance reflected by outgoing traffic, registering a 6.9% increase, has partly offset this effect. As a consequence, the revenue derived from this item stood at Ptas 129,622 million, having gone down 3.7%.

Regarding the total traffic billed to end customers, which grew by 12.1%, the most important contributors being those of metropolitan traffic, in which that derived from Infovía almost doubled, and that routed to mobile networks grew by 33.3%.

Other services whose growth in revenue has been favourable are: leased circuits which rose 15.08% to reach Ptas 112,938 million, and the ISDN, Intelligent Network and Digital Exchanges which recorded Ptas 119,529 million, rising 38.1% over the figure for the previous year.

The Telefónica Móviles Group's revenue grew 29.0% to total Ptas 468,202 million. This favourable performance, derived almost in its entirety from the cellular telephony services, can be put down to the increase in users, despite the slight decrease in minutes of usage, per customer (2%), combined with the roaming and value added services.

At the end of 1998, Telefónica Móviles had 4,894,264 customers, with this figure having risen 53.5%, and maintaining a 69.4% market share in cellular telephony (65% digital). The highest customer growth has been witnessed in prepaid cards, with this having surpassed 1,800,000. Regarding the MoviStar service, its customers have risen 92% to stand at 4,001,072. On the other hand, the market shares in radio-paging and trunking stood at 78% in both cases. Including these services the total number of customers amounted to 5,310,307.

The Telefónica Internacional Group's revenue from sales amounted to Ptas 893,073 million, reflecting 7.7% growth when compared with the figures registered for 1997, which correspond to the consolidation of Telefónica de Argentina's results, carried out using the global integration method. While the growth in Argentina and Chile has been significant (14%), that of Peru fell 10%. In all three cases, the conversion into pesetas must be taken into account.

In Argentina the growth has been boosted by the increase in the number of cellular customers which went up by 33%, combined with the number of fixed telephony lines in service which rose 6%.

In Chile, despite the fact that when one considers the revenue recorded for the year the figure reflects 20% growth, the effect of the exchange rate on the Chilean peso and the peseta against the dollar has cut this growth to 14%. The customer base has shown a favourable trend, both in fixed telephony (10.7%) and cellular telephony (151.8%), therefore permitting the aforementioned increase in revenue, even though traffic per fixed line has gone down, as has the revenue derived from our cellular customers.

In Peru, the revenues in nuevos soles have reflected a low growth trend, only registering 2%, and the effect of the exchange rate has been similar to that of Chile. The performance of revenue is a consequence of the effects of "El Niño" on the Peruvian economy, along with the tariff cuts carried out in September in order to face the imminent opening up of the market. On the other hand, there was an extraordinary write-off of customer receivables of a certain age, which had a Pta 41,304 million effect on the provision for bad debts. The installed plant, in terms of fixed lines, grew 6.7% over the year, and the number of cellular customers rose by 57%.

#### **Operating expenses**

Personnel expenses went up 1.5% to Ptas 650,171 million. The sustaining of this moderate rate can be put down to the streamlining

of the Telefónica workforce (5,982 fewer employees than at year end 1997, 9.3% of the workforce at that moment), as a consequence of the early and voluntary retirement schemes, launched in 1994, and ratified in the 97/98 Collective Bargaining, which establishes the possibility of those employees over 55 years old taking voluntary retirement. 1998 witnessed the extending of this scheme to include employees of over 53.

The total number of employees within the companies that are globally consolidated stands at 101,809 at December 31, 1998, of which 58,127 correspond to Telefónica.

Supplies rose 8.6%, to reach over Ptas 28,000 million, of which more than half Ptas 17,000 million, corresponded to the higher payments made to Airtel for the calls made to their customers, due to the boom in the cellular market in Spain. The Group's expenses for subcontracts grew by 2.6%, particularly affected by the 6.8% rise in Telefónica's expenses, as a result of the significant increase in advertising expenses and sales commissions, caused by the entrance of competitors in the domestic basic telephony business.

The variation in operating provisions rose substantially over the year to close at Ptas 106,105 million. This growth derives principally for the bad debts incurred by the Latin American companies, due to the economic crisis, the restructuring of tariffs in Argentina and the problems posed by the phenomenon "El Niño" in Peru. This explains why this item has totalled Ptas 79,842 million in Telefónica Internacional.

Depreciation on fixed assets grew 4.3% to reach Ptas 725,434 million. The provisions in Telefónica were somewhat lower than those of the previous year (Ptas 463,762 million in 1998, compared with Ptas 466,461 in 1997), principally caused by the lower investment activity in tangible assets. The investments carried out by Telefónica Internacional and Telefónica Móviles resulted in rises in their respective provisions. Therefore it must be underlined that since September the administrative concessions gleaned from the acquisition of the new Brazilian companies have begun to be amortized.

#### **Operating income**

The performances of the different components that make up this item have resulted in an overall figure for operating expenses in 1998 of Ptas 2,244,621 million, reflecting 6.9% growth, significantly lower than the figure for 1997 (16.5%).

The slowdown in overall operating expenses has permitted operating margin to rise 3.3% from Ptas 789,275 million, including the consolidation of TASA by global integration in 1997, to Ptas 815,278 million. This increase, despite being lower than that registered for 1997 (14.7%), is more than acceptable when it is considered that the year was one of regulatory changes and increasing liberalization within the

domestic marketplace, which caused the slashing of this margin in Telefónica by Ptas 18,859 million.

In relative terms, operating income has remained almost stable going from 28.7% to 28.1% of the total figure for operating revenue. Looking at the figure company by company, Telefónica registered Ptas 388,271 million, dropping 4.6% over the 1997 figure, Telefónica Móviles recorded Ptas 129,013 million compared with Ptas 53,311 million the previous year; and Telefónica Internacional reflected 53.2% growth to total Ptas 268,320 million.

#### **Income from ordinary activities**

The item interest on debts has risen due to the increase in the debt needed to finance the Telefónica Internacional Group's investments in Brazil. These expenses stood at Ptas 241,200 million, reflecting a 10.6% increase, compared with the figure of 4.5% registered in 1997. Exchange losses amounted to Ptas 22,580 million, compared with Ptas 21,124 million in 1997.

Telefónica's interest on debts has continued to fall, dropping Ptas 21,314 million (15.6%) due to the tight rein kept on its indebtedness and the reduction in interest rates. On the other hand, in Telefónica Internacional the figure for this item rose by Ptas 53,128 million, doubling that of 1997.

Regarding the earnings from the companies consolidated using the equity method amounted to Ptas 12,199 million, with the Brazilian operators acquired in the privatization process of Telebras contributing Ptas 7,351 million. The contribution made by the other Telefónica-participated Brazilian operator, CRT, totalled Ptas 2,885 million.

The amortization of goodwill fell 36.6% to reach Ptas 21,153 million, despite the increase in this item, as a result of the maximum amortization period going from 10 to 20 years.

As a consequence of all these performances, income from ordinary activities rose 5.3% to Ptas 576,706 million, somewhat lower than the 1997 figure of 15.1%. In relative terms this margin represents around 20% of revenue from operations.

#### **Pre-tax income**

The trend followed throughout the year in both the case of extraordinary revenue and expenses has resulted in a negative figure of Ptas 174,696 million net extraordinary results, 30.8 % up on the 1997 figure. This derives principally from the greater provisions made by Telefónica to cover the early retirement schemes already underway, the compensation paid to Airtel, fulfilling a ministerial resolution, and the severance payments made to TASA employees.

Both extraordinary revenue and expenses rose Ptas 459,500 million, due to the entering in accounts of the new early retirement scheme referred to under the heading "Other Events of Relevance".

Pre-tax income amounted to Ptas 402,010 million, reflecting a 2.9% decrease over 1997, with Telefónica de Argentina being consolidated using the global integration method.

#### **Net income**

Corporate tax fell 12.2%, to total Ptas 91,875 million when comparing it with the Profit and Loss Account for 1997 in which Telefónica de Argentina was consolidated by global integration. It should be underlined that in fiscal 1998, Telefónica Internacional was included in the consolidated tax group.

The results from minority shareholders totalled Ptas 92,551, dropping 22.5% compared with the 1997 figure, reflecting TASA's consolidation by global integration. It must be taken into account that the item minority shareholders at year-end 1997 only included the 76.22% stake in TISA held by Telefónica, as the remaining percentage was held by the Patrimonio del Estado.

The Telefónica Group's net income finally stood at Ptas 217,584 million, having risen 14.5%. Of this figure Telefónica Móviles contributed Ptas 80,311 and Telefónica Internacional Ptas 23,860 million.

#### **INVESTMENT ACTIVITY**

In 1998, the Telefónica Group invested a total amount of Ptas 2,115,414 million, 71.8% more than in 1997 (excluding TASA's investment figures for 1997, but including those of 1998). This figure was mainly channelled into investments made in the international arena and the media sector.

Ptas 636,495 million was invested in fixed assets, which is almost exactly the same amount as the previous year. This has happened due to the significant 12% cut made in Telefónica's tangible investment figures, which in absolute terms reflects a figure of Ptas 41,000 million. This reduction has had two instigators, the greater degree of selection in investment, and the lower investment need in the creation of plant and infrastructure within a competitive environment.

Investment in intangible assets totalled Ptas 98,584 million, rising 93.1%, and, finally, financial investment stood at Ptas 1,380,335 million, growing 153% over the figure for 1997.

The company-by-company breakdown is as follows: Telefónica contributed 47.5% of investment in fixed assets, while the Telefónica Servicios Móviles Group contributed 8.8%, and the Telefónica Internacional Group approximately 42%. Regarding investment in intangible assets, Telefónica and the Telefónica Servicios Móviles Group contributed 59.3% and 36.8%, respectively. Finally, most of the financial investment was made by the Telefónica Internacional Group in the transactions previously mentioned.

## FINANCING

- Telefónica's Board of Directors, at its meeting held on March 25, approved the launching of a capital increase in the form of one new share for every 11 old shares held. This operation was totally subscribed to and paid-in by May 12. The effective amount, standing at Ptas 427,032 million, further strengthens the Group's financial structure, at the same time as addressing the Company's financing needs, particularly in the case of the acquisition of the Brazilian operators.
- Following a similar trend, the Extraordinary Shareholders' Meeting, held on June 24, approved the launching of two free capital increases to be charged to the unrestricted reserves, to be carried out within a maximum period of 12 months from the date of the Extraordinary Shareholders' Meeting. This decision comes within the Company's policy of finding alternative forms of shareholder retribution to substitute the traditional cash payment, as it had been decided that no distribution of dividends would be charged to the 1998 results, in order to strengthen the Company's self-financing capacity to take on value generating projects, allowing the shareholder to obtain liquidity through the trading of shares.
- The main debt financing operations undertaken throughout the year have been the following:
  - In March 1998, Telefónica issued simple debentures for an amount of Ptas 70,000 million, with 10-year maturity and a fixed interest rate of 4.8414%.
  - Due to the awarding of the aforementioned Brazilian operators, Telefónica Internacional accounted debt amounting to 60% of the deferred payment to the Brazilian Government. The loan totals Reals 3,813 million, with a 12% fixed interest rate plus inflation. The principal and the interest are to be paid in two equal installments, the first on August 4, 1999 and the second on the same date of 2000. The loan has an advanced cancellation clause which cuts the interest rate to 9% plus inflation.
  - In order to cover the repayment of this debt, and given the situation in Brazil triggered by the economic crisis last summer, on October 1, TISA subscribed a \$2,354 million foreign debt issued by the Brazilian Government, with a net annual interest rate of 11.875% and the right for TISA to make advanced repayment of the debt at any time during the life of the issue.
  - Throughout the year, two loan transactions have taken place with the European Investment Bank, the first denominated in dollars and pesetas, and the second solely in dollars. Both loans carry 10-year maturity and are for

amounts of Ptas 65,000 million and Ptas 40,000 million, respectively.

## RESEARCH AND DEVELOPMENT

The Telefónica Group's research and development policy is considered a vital instrument in its aim to gain competitive edge, and to focus and boost state-of-the-art technology. The company Telefónica Investigación y Desarrollo (TIDSA) is mainly responsible for these activities, divided into the following areas:

- Development of Telephone Services: value-added services for the residential sector, cellular and multimedia and the computerizing of customer care mechanisms.
- Development of Interactive Services: information services and the new infrastructures necessary to provide these, mainly for Internet purposes.
- Development of Management Systems, applying innovative solutions for the management of networks and services, and the Development of Business Back-up Systems.
- Enhancement of the business service, improving the technological capacity of the networks, services, software, and information technologies. This area plays an active role in European projects developed by the EU.

Of TIDSA's activity throughout 1998, 79% has been carried out for Telefónica and 21% for other Group Businesses, particularly Telefónica Móviles, Telefónica Data and Telefónica Media.

Likewise, 1998 has seen the setting of the bases to further develop Telefónica's Latin American operators. To this end, projects have been carried out for Telefónica de Argentina, Telefónica del Perú, Chile's CTC, and projects have also been consolidated for Brazil's Telesp, the fruits of which will be reaped in 1999.

Research and development expenses amounted to Ptas 21,928 million in 1998, compared with Ptas 19,683 million in 1997.

## NEW ORGANIZATIONAL STRUCTURE

The Annual General Shareholders' Meeting, at its meeting held on March 17, 1998, approved the Group's new organizational structure, aimed at further increasing shareholder value through achieving the ranking of Telefónica as the world's fifth most important telecommunications operator.

The aforementioned new organization breaks the Group down into Business Lines for which each subsidiary is responsible for the developing of its area, with a Corporate Core acting as the Group's flagship, providing cohesion with the Group, at the same time as taking advantage of synergies in order to gain optimum global results. With this in mind, on April 15, 1998, Telefónica de España, S.A. changed its name to Telefónica S.A. through the signing of public deeds

before a notary, thereby consolidating its position as the Group's leader.

Telefónica is therefore the image of our global trademark, under which each and every subsidiary will develop its particular business line. Our new corporate image will gradually be introduced in all the countries where Telefónica operates, as well as appearing on all our products and services.

Our basic telephony business in Spain will be developed by a newly-formed company under the name of Telefónica, Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A., to which all the necessary assets for this business line were transferred on January 4, 1999. This company will control the subsidiaries that develop their activities within the aforementioned business area (Telefónica Sistemas, Telyco, Telefónica Cable and Telefónica Soluciones Sectoriales).

This transfer was enacted through the launching of two capital increases, for which Telefónica, S.A. was fully subscribed to, contributing the aforementioned equity and share participations, both at net book value.

The other main Business Lines within the Spanish market are: the operating of cellular communications, carried out by Telefónica Servicios Móviles, S.A., and the developing of media communications for which Telefónica Media, S.A. is responsible. These two companies continue to control their respective subsidiaries and participated companies, Mensatel and Radiored in the case of the former, and Antena 3 Televisión, Vía Digital, Telefónica Servicios Audiovisuales, Telefónica Medios de Comunicación, and ST-Hilo, among others, in the latter case.

Regarding Telefónica's international presence, this is principally geared around Telefónica Internacional S.A. who is responsible for our activities in the American continent. This Business Line, along with the other three domestic businesses mentioned, made up the bulk of the Group's activities as of 1998.

In order to further enhance this new reorganization, and with a mind to dedicating the necessary attention and funds to any opportunities or business lines reflecting high growth potential, three other Business Lines have been created. The first of which was launched in 1998 and has been undertaken by Telefónica Intercontinental S.A. who is responsible for exploring the convergence opportunities in markets other than those of Spain and the American continent, paying particular attention to the Mediterranean area. The other two, for which it is still early days, will be developed by Telefónica Data S.A., and Telefónica Comunicaciones Interactivas S.A., both of which will operate in the Spanish market and in others where Telefónica is already present.

Telefónica Data will be responsible for offering our corporate customers data transmission and multimedia services, on one single

platform that will integrate the assets of companies already active in this line of business, both in Spain (Telefónica Transmisión de Datos) and Latin America. The range of services will include long-standing features such as X-25 and Frame Relay, as well as others related to Internet protocol (IP), electronic sales, integrated sales, voice and data integrated services, private virtual networks through IP networks, etc..

Telefónica Comunicaciones Interactivas will focus on the global development and provision of all the services and activities connected with Internet and interactive features aimed at the end-user, particularly concentrating on all our Spanish-Portuguese speaking customers.

#### OTHER EVENTS OF RELEVANCE

- A streamlining scheme for the workforce of Telefónica Sociedad Operadora de los Servicios de Telecomunicaciones en España is to be drawn up over the next two years, going one step beyond the early and voluntary retirement scheme already underway. This new scheme includes employees of 52 years old or over. Foreseeing the payments that may have to be made, extraordinary provisions for an amount of Ptas 459,500 million have been created, charging Ptas 298,675 million net of taxes to the unrestricted reserves.
- On October 2, Telefónica, through its subsidiary Telefónica Intercontinental, signed an agreement with three leading Turkish industrial groups to jointly participate in the bidding process for the third cellular telephony licence in Turkey which is to take place shortly.
- Telefónica Internacional, in conjunction with Telecom Portugal and the BMCE, one of Morocco's leading banking groups, have announced their participation in the bidding process for the second GSM licence in Morocco.
- On June 25, Telefónica and Indra Sistemas, S.A. formalized a sale and purchase contract by which the former would sell its 36.56% stake in Indra SSI back to the latter, and in compensation would receive 9.4% of Amper, S.A.'s share capital, currently pertaining to Indra Sistemas.
- At the beginning of August, Telefónica announced its intention to float its subsidiary, Telefónica Publicidad e Infomación, on the stock market. This company is responsible for the editing of the Yellow Pages and also focuses on the development and marketing of directories and information. This operation is due to take place in the second quarter of 1999.
- Note 23 of the Annual Accounts states the events of particular relevance that have occurred since December 31, 1998, of which the most significant has been that of exercising the right to make advanced repayment of the debt signed with the

Brazilian government, advancing the part of the debt to be paid in installments derived from the acquisition of the Brazilian operators.

#### TREASURY STOCK

The 100,000 shares of treasury stock accounted at year-end 1997 were sold at an average price of Ptas 3,689. Throughout 1998, 757,000 treasury stock shares, with a nominal value of Ptas 500 each, were acquired, at an average price of Ptas 6,906, of which 1,350 were sold at this same price. Neither of the sales operations generated capital gains.

At year-end, the Telefónica Group possessed treasury stock amounting to 0.074% of the parent, made up of 755,650 shares, valued at Ptas 6,906, constituting a total amount of Ptas 5,218 million.

If one considers the shares derived from the last capital increase, carried out with a ratio of one new share for every 50 old ones, and one then deducts the Ptas 355 million provision, the resulting amount would total Ptas 4,863 million, with a book value of Ptas 6,310 per share.

At December 31, the total volume of coverage operations on treasury stock carried out by Telefónica amounted to Ptas 6,566 million. Two call option operations were sold for a total of 726,750 shares, with a countervalue in pesetas of 4,916 million, and one put option operation was also sold of 306,000 shares with a countervalue in pesetas of 1,650 million.

#### ASSUMPTION OF THE CODE OF GOOD GOVERNANCE

The following intends to provide information on the degree to which Telefónica has assumed the Good Governance Code ("Olivencia Report").

##### A) Introduction.

Telefónica has its own rules of governance, not only those stated in its Bylaws, but also the Rules and Regulations laid down by the Board of Directors. These aim to define the principles to be followed by the Board of Directors of Telefónica, S.A., as well as regulating the organizing and functioning of this same Board, and the setting of rules of conduct for its members in order to achieve the best degree of efficiency and management possible.

It therefore must be stated that the aforementioned Rules and Regulations, were approved by the Board of Directors of Telefónica on January 29, 1997 not only prior to the "Olivencia Report", but also previous to the creation of the special Committee that drafted this same Report.

Nevertheless, the rules of governance stated in the aforementioned Rules and Regulations are largely analogues of or, in some cases, identical to the criteria laid out in the Code of Good Governance, to such a degree that some fragments are identical.

This has come about as both the Telefónica Board of Director's Rules and Regulations and the Code of Good Governance were originally based on each other, and it can even be said that the Rules and Regulations were a forerunner to Code of Good Governance.

Following 18 months of compliance with the Board of Telefónica's Rules and Regulations, and as a result of the experience gleaned from the application of these Rules and the publication of the Code of Good Governance, the Board realized that these Rules should be modified and some of the recommendations made in the Code should also be included.

The new Telefónica Rules and Regulations were approved on July 22, 1998, and the National Securities Market Commission (CNMV) was duly informed.

Among the modifications and new rules introduced, the following are of particular significance:

- a) It is stated that the criteria to which the Board of Directors must, at all times, adhere is that of creating maximum value for the Company, in turn enhancing shareholder value, strictly abiding by generally accepted principles and ethics.
- b) All the functions and responsibilities to be specifically executed by the Board are laid down, with no possibility of delegating any of these functions or responsibilities.
- c) The regulations concerning the Board's committees have been significantly modified, introducing a greater degree of flexibility, in such a way that the Board may, at any time, determine the number of committees necessary, as well as controlling their scope and make up. These regulations also state the possibility of creating committees to study specific questions whose transcendence or degree of importance justify this. It is also stated that there should be, at all times, a Standing Committee, Auditing and Control Committee, and a Committee for Appointments and Salaries.
- d) The regime to be followed regarding transactions between the Company and its core shareholders is also stated.

##### B) Mission and scope of the Board of Directors.

The Rules and Regulations in force empower the Board of Directors to act as a body that supervises and controls the Company's activity, delegating the management of the day-to-day activities to the Executive Committee and the management team.

Without affecting that previously mentioned, and in order to permit the highest degree of diligence in the carrying out of its supervisory functions, the Board itself is obliged to exercise the activities outlined below, as well as those responsibilities of a legal or statutory nature that are of exclusive knowledge of the Board:

- a) The approving of the Company's general strategies.
- b) The appointing and, should it be the case, dismissal of the Company's top management and that of the companies that constitute the consolidated Group.
- c) The appointing and, should it be the case, dismissal of the management members of the Company's subsidiaries.
- d) The identifying of the Company's principal risks and the introduction and supervising of the appropriate internal control and information systems.
- e) The defining of the policies regarding the informing and communication with shareholders, the market and public opinion.
- f) The setting of the treasury stock policy within a framework that, should it be the case, would be determined by the Annual General Shareholders' Meeting.
- g) The authorizing of Company operations with core shareholders and Board members that could pose conflict of interests.
- h) In general the carrying out of corporate or financial operations of particular importance for the Company.

In accordance with these same ideas, and bearing in mind that Telefónica is the head of a major, complex group of companies, the Board of Directors reserves the exclusive right to make certain decisions regarding the activities of its principal subsidiaries or participated companies forming part of the Group. Therefore, should any of the aforementioned companies undertake any agreements of particular significance or relevance regarding matters that have been duly identified, these must be previously submitted for approval by the Board of Directors of Telefónica.

The restructurizing of the Group that took place in 1998 has, in no way, jeopardized the Board's supervising and control of the Group's activities.

As has been mentioned previously, the Board's Rules and Regulations state that the outstanding function of this body is to, at all times, aim to enhance the Company's value to a maximum, strictly abiding by the generally accepted principles and ethical values.

### C) The composition and structure of the Board of Directors.

The Board of Directors of Telefónica currently comprises the following 20 members, whose names, positions and year of joining are also listed:

- 3 executive members:
  - Juan Villalonga Navarro, Chairman (1996)
  - Javier Revuelta del Peral, Executive Vice Chairman (1997)
  - Juan Perea Sáenz de Buruaga (1997)
- 6 dominical members:
  - José María Concejo Alvarez, Vice Chairman (Banco Bilbao Vizcaya, 1978)
  - Isidro Fainé Casas, Vice Chairman (La Caixa, 1994)
  - Francisco Gómez Roldán, Vice Chairman (Argentaria, 1995)
  - José Javier Echenique Landiribar (Banco Bilbao Vizcaya, 1995)
  - Antonio Massanell Lavilla (La Caixa, 1995)
  - Miguel Zorita Lees (Argentaria, 1996)
- 9 independent members, of acknowledged professional prestige, independent from the management team and the core shareholders:
  - César Alierta Izuel (1997)
  - Gaspar Ariño Ortiz (1997)
  - Pedro Ballvé Lantero (1997)
  - Maximino Carpio García (1997)
  - Alberto Cortina de Alcocer (1997)
  - Ignacio Larracoechea Jausoro (1997)
  - Juan Antonio Sagardoy Bengoechea (1997)
  - Martín Velasco Gómez (1997)
  - Carles Vilarrubí Carrió (1996)
- 2 members whose incorporation derives from Telefónica's international alliances:
  - Miguel Horta e Costa, representing Portugal Telecom (1998)
  - Bert C. Roberts, representing MCI-WorldCom (1998)
- Regarding the Secretary of the Board - whose function is to supervise the correct functioning of the Board, ensure that the Board's actions are legal, both formally and materially, and, to guarantee that the procedure and rules of governance are respected, as well as duly recording the minutes of the Board meetings and to certify the agreements taken at these meetings - this role has been fulfilled by José María Mas Millet (1997), who at the same time acts as the Company's General Secretary, with Diego L Lozano Romeral in the position of Vice Secretary (1997).
- As a consequence, the make up of the Board of Directors respects the recommendations made in the Code of Good Governance, as the number of external members

(dominical and independent) is far greater than the number of executive members (17 compared with 3), and the number of independent members is greater than the number of dominical members (9 compared with 6), bearing in mind that in the Company's current share configuration the proportion of floating capital is considerably higher than the sum of the stable share participations represented by the dominical members.

#### D) Board Committees

##### a) Standing Committee

Both the Company's Bylaws and the Board's Rules and Regulations state the need for the existence of a Standing Committee with the capacity to take decisions on general matters, and, consequently, be delegated all the powers that correspond to the Board, except those that are legally or stated in the ByLaws as intransferable.

The aforementioned Standing Committee currently comprises the following members:

- Juan Villalonga Navarro, Chairman, (1996)
- Javier Revuelta del Peral, Vice Chairman, (1997)
- Isidro Fainé Casas, Vice Chairman, (1994)
- Francisco Gómez Roldán, Vice Chairman, (1996)
- Cesar Alierta Izuel (1999)
- Alberto Cortina de Alcocer (1999)
- José Javier Echenique Landiribar (1997)
- Juan Perea Sáenz de Buruaga (1997)
- José María Mas Millet, Secretary (1997)

The relationship between the Board and its Standing Committee is based on principles of transparency, in such a way that, at all times, the Board is totally aware of the agreements and decisions taken by the Standing Committee.

##### b) Other Committees

The Rules and Regulations allow the Board to form one or several Committees to which it commends the checking and close supervising of any area of particular relevance for the Company's good governance, or the analysing of a specific aspect or question whose importance determines this.

These Committees are not recognized as social organs, they are created as instruments at the service of the Board, to whom they must present the conclusions reached regarding the matters they have been commended.

These Committees are: the Committee for Auditing and Control, the Committee for Appointments and Salaries, the Human Resources Committee and the Regulatory Committee.

The Auditing and Control Committee's principal function is that of supporting the Board in its role of supervisor and controller, particularly in matters regarding the correct application of generally accepted accounting principles, and to check the adapting and integration of the internal control systems in the drawing up of the individual and consolidated accounts.

The Auditing and Control Committee currently comprises the following members:

- Chairman: Isidro Fainé Casas (1998)
- Members : José María Concejo Alvarez (1998)  
Maximino Carpio García (1998)

The Appointments and Salaries Committee is responsible for informing of the proposals for the naming of Board members, members of Board Committees and Company and subsidiary top management. It also approves the contracts and salary brackets of the top management, it sets the salary regime to be applied to the Board members, it provides information on the bonus scheme, and draws up a register of the payments made to the Board members and top management.

The Appointments and Salaries Committee currently comprises the following members:

- Chairman: Francisco Gómez Roldán (1998)
- Members: Alberto Cortina de Alcocer (1998)  
Cesar Alierta Izuel (1998)

Finally, the Human Resources Committee and the Regulatory Committee- whose functions are to inform and propose to the Board the adoption of the opportune agreements to be made regarding the policies to be followed on matters of personnel and regulation, respectively- comprise the following members.

- Human Resources Committee:
  - Pedro Ballvé Lantero (1998)
  - Antonio Massanel Lavilla (1998)
  - Juan Antonio Sagardoy Bengoechea (1999)
- Regulatory Committee:
  - Gaspar Ariño Ortiz (1998)
  - José Javier Echenique Landiribar (1998)
  - Martín Velasco Gómez (1998)
  - Miguel Zorita Lees (1998)

Regarding the figure of the Chairman of the Board- the Company's highest executive- he must, at all times, adhere to the criteria and directives set by the Board of Directors and its Committees, which undoubtedly reduces the risk of any one person wielding excessive power, as any agreement

or decision of particular significance for the Company, must be submitted to the prior approval of the Board or the corresponding Committee.

#### **E) Functioning and performance of the Board of Directors.**

Over 1998, the Board of Directors held 12 ordinary meetings and 2 extraordinary meetings. Of these 14 meetings, 10 were held at the Company's head offices; 2 in the same place as the two General Shareholders' Meetings held over the course of the year, and the remaining 2 were held, one in the head offices of "Antena 3 de Televisión, S.A.", and the other, in São Paulo, Brazil. The reasoning behind these last two venues was to gain direct knowledge of both Antena 3 de Televisión's activities, and the Brazilian operators recently acquired.

The Board's Standing Committee held 16 ordinary meetings, resorting to, on two occasions, the adopting of written agreements without session in accordance with the legislation in force.

All the meetings held by the Board and the Standing Committee have strictly adhered to the Bylaws and Regulations in force, with all the subjects presented having been treated with due deliberation and with the necessary decisions having been taken. The members have participated freely in the debates and discussions, stating their opinions when they have deemed it necessary, all of which is recorded in the minutes of each meeting.

The degree of transparency and information offered to and by the Board over the year has been of the highest standard, with frequent attendance at the meetings by the Group companies' top management, to discourse on their respective areas of responsibility.

It should be remembered, at this stage, that Telefónica's Board members are entitled, at any given moment, to access to any information they should deem necessary on any aspect of the Company, in order to carry out their responsibilities. The external Board members may proceed to hire, at the Company's expense, legal and financial advisors, accountants or other experts, to assist them in the exercising of their functions.

#### **F) Remuneration of Board members.**

As laid down in the Board's Rules and Regulations, the setting of the remuneration of the Board members comes under the responsibilities of the Appointments and Salaries Committee, which- as stated in the aforementioned Rules and Regulations- will ensure that the Board's salaries are in line with those paid in the market by other companies with features similar to those of the Company.

Throughout 1998, the payments made to the members of the Board of Directors- the figure for which, in accordance with the norms in force, is stated in the Annual Report- have, at all times, adhered to the criteria laid down by the Appointments and Salaries Committee.

The above mentioned Committee, in its report on 1998, deemed that the existing policy on the payment of Board members, was in accordance with that of the market and proposed that it be maintained throughout 1999, which means that any increase should be in line with the Company's results and the enhancement of its value, in order to achieve a greater degree of alignment between the payments made to the Board members and the interests of the shareholders which are of utmost importance.

#### **G) Member loyalty commitments.**

The Board of Telefónica's Rules and Regulations dedicates a 12-point clause to describing the members' principal rights and obligations, specifying, in great detail, situations of conflict of interests, the use of Company assets, the use of non-public information and the exploiting of business opportunities for one's own benefit, as a result of access to privileged information , due to their position as member of the Board.

The Company's loyalty commitments, as stated in the Rules and Regulations, also extend to the core shareholders, who must exercise confidentiality on any transaction between the Company and their respective company, unless otherwise stated by the Board of Telefónica.

Over 1998, no problem whatsoever of the kind outlined above was registered.

#### **H) Transparency in the relationship with shareholders, the market and the auditors.**

The Rules and Regulations specify in detail the channels through which relations are to be established between the Company and its shareholders (both retail shareholders and institutional investors and shareholders), the Board of Directors and the regulatory bodies and supervisors of those markets on which Company securities are issued, and between the Board and the Company's auditors.

Over 1998, no problem of any significance related to any of these aspects has been recorded, as the degree of transparency and information with which the Company has acted at all times on the markets where its shares are traded is worthy of mention.

Several years ago, with this in mind, Telefónica created a department called "Shareholder Care Service" which is

responsible for the Company's relations with its retail shareholders, providing a 24-hour free-phone service (which, over 1998, received 386,000 calls), a quarterly publication (whose last edition totalled 180,000 copies) and an Internet website (which received 2,264,000 visits over 1998).

Lastly, the Board of Directors, through its Auditing and Control Committee, maintains a stable and professional

relationship with the Company's Auditors, strictly respecting its independence.

The aforementioned Committee has examined the contractual relations, independent from the carrying out of its function of verifying the annual figures, existing between the Company and its Auditors ("Arthur Anderson and Cía, S. Com"), having found no deterioration in the independence principles of the Auditor.



## **Financial Exhibits**

	SELECTED FINANCIAL DATA. CONSOLIDATED					(Million of Euros)
	1994	1995	1996	1997	1998	1998 \$ (3)
Revenue from operations	9,489.1	10,461.0	12,056.7	14,202.5	17,465.5	20,205.9
Operating expenses	4,846.6	5,104.1	6,148.7	7,221.0	8,286.0	9,586.1
Financial expenses	1,419.0	1,344.2	1,240.6	1,329.7	1,715.4	1,984.5
Depreciation and amortization (1)	3,095.9	3,413.7	3,573.2	4,073.8	4,696.1	5,432.9
Net income	676.8	800.6	963.3	1,142.3	1,307.7	1,512.9
Cash flow	3,875.0	4,509.7	4,875.6	5,778.3	6,515.7	7,538.0
Share capital	2,823.2	2,823.2	2,823.2	2,823.2	3,079.8	3,563.0
Shareholders' equity	9,087.5	9,294.5	11,201.4	11,968.4	13,500.0	15,618.2
Long-term debt	11,105.3	10,436.7	10,054.4	11,519.2	13,695.4	15,844.2
Financial debt	11,665.7	11,189.2	11,704.4	13,926.7	19,210.9	22,225.1
Investment (2)	2,942.6	3,803.8	4,352.8	4,122.3	4,417.9	5,111.1

(1) Including depreciation of fixed assets, amortization of deferred interest expenses, amortization of goodwill and dismantled plant pending depreciation.

(2) Fixed and intangible.

(3) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

**TELEFONICA GROUP: OPERATING REVENUE** (Million of Euros)

						Increase %		
	1994	1995	1996	1997	1998	Over 97	Average accumulated	1998 \$ (I)
<b>Parent company</b>								
Basic telephony	5,941.9	6,268.5	7,353.4	8,059.1	8,285.1	2.8	8.7	9,585.0
Telephone service	4,823.4	5,071.0	5,696.1	6,057.3	6,046.1	(0.2)	5.8	6,994.7
Leased circuits	205.0	179.1	440.6	589.8	678.8	15.1	34.9	785.3
Ibercom	329.2	351.7	416.5	377.8	376.0	(0.5)	3.4	435.0
Digital exchanges, intelligent network, ISDN and other	40.4	117.2	299.9	520.3	718.3	38.1	105.3	831.0
Equipment	451.7	456.7	430.9	441.5	385.5	(12.7)	(3.9)	446.0
Advertising	92.2	92.8	69.4	72.4	80.4	11.0	(3.4)	93.0
International communication services	837.5	872.8	818.1	809.3	779.0	(3.7)	(1.8)	901.2
Telephone service	770.7	806.2	739.9	725.1	696.6	(3.9)	(2.5)	805.9
Leased circuits	34.2	44.3	59.1	69.7	73.8	5.9	21.2	85.3
Retransmissions	32.6	22.3	19.1	14.5	8.7	(40.2)	(28.2)	10.0
Public telephony	378.3	393.4	388.6	409.9	424.2	3.5	2.9	490.8
Data transmission	262.8	232.2	268.3	327.6	362.3	10.6	8.4	419.2
Mobile services	279.3	459.7	—	—	—	—	—	—
Other	14.4	23.3	24.8	41.0	80.4	96.3	53.8	93.0
<b>Total revenue from operations for Telefónica</b>	<b>7,714.2</b>	<b>8,249.9</b>	<b>8,853.2</b>	<b>9,646.9</b>	<b>9,931.0</b>	<b>2.9</b>	<b>6.5</b>	<b>11,489.2</b>
<b>Group</b>								
Telefónica Internacional Group	1,330.9	1,689.1	1,992.9	2,663.3	5,367.5	101.5	41.7	6,209.7
Telefónica Servicios Móviles Group	58.0	232.3	1,557.3	2,181.6	2,814.0	29.0	164.0	3,255.5
Telefónica Public Telecommunication	128.4	199.5	243.3	263.2	300.3	14.1	23.6	347.4
Telefónica Publicidad e Información Group	171.7	182.7	213.0	285.3	393.0	37.7	23.0	454.7
Telefónica Data Transmission	—	—	—	—	425.0	—	—	491.6
Other subsidiaries	762.5	875.8	1,044.0	1,191.3	1,180.7	(0.9)	11.6	1,366.0
Sales among group companies	(676.6)	(968.4)	(1,847.0)	(2,029.0)	(2,946.0)	45.2	44.4	(3,408.2)
<b>Total revenue from operations for Group Companies</b>	<b>1,774.9</b>	<b>2,211.0</b>	<b>3,203.5</b>	<b>4,557.7</b>	<b>7,534.5</b>	<b>65.4</b>	<b>43.5</b>	<b>8,716.6</b>
<b>Total revenue from operations for Telefónica Group</b>	<b>9,489.1</b>	<b>10,460.9</b>	<b>12,056.7</b>	<b>14,202.6</b>	<b>17,465.5</b>	<b>23.0</b>	<b>16.5</b>	<b>20,205.8</b>

(I) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

**RESULTS - PROFIT MARGINS. CONSOLIDATED** (Million of Euros)

DESCRIPTION	1994	1995	1996	1997	1998	Increase %		
						Over 97	94-98	Average accumulated 1998 \$ (I)
+Operating revenue	9,489.1	10,460.9	12,056.6	14,202.5	17,465.5	23.0	16.5	20,205.9
-Operating expenses	4,846.6	5,104.1	6,148.7	7,220.9	8,286.0	14.7	14.3	9,586.1
Personnel expenses	3,130.8	3,266.8	3,333.7	3,431.1	3,907.6	13.9	5.7	4,520.7
Taxes	155.2	166.3	211.0	233.0	289.2	24.2	16.8	334.6
Subcontracts	1,560.6	1,671.0	2,604.0	3,556.8	4,089.2	15.0	27.2	4,730.8
+Internal expenditure capitalized in fixed assets	729.6	730.5	765.2	708.8	747.1	5.4	0.6	864.3
= <b>Operating margin</b>	<b>5,372.1</b>	<b>6,087.3</b>	<b>6,673.1</b>	<b>7,690.4</b>	<b>9,926.6</b>	<b>29.1</b>	<b>16.6</b>	<b>11,484.1</b>
+Other operating revenue	181.7	200.8	226.9	248.2	116.4	(53.1)	(10.5)	134.7
-Depreciation of fixed assets	2,731.8	3,014.0	3,162.7	3,622.1	4,359.9	20.4	12.4	5,044.0
-Other operating expenses	59.2	58.4	116.0	132.2	145.5	10.1	25.2	168.3
-Other provisions and charges	164.0	151.2	159.7	214.9	637.7	196.7	40.4	737.8
= <b>Operating profit</b>	<b>2,598.8</b>	<b>3,064.5</b>	<b>3,461.6</b>	<b>3,969.4</b>	<b>4,899.9</b>	<b>23.4</b>	<b>17.2</b>	<b>5,668.7</b>
+Financial income	104.3	113.0	115.1	152.5	240.2	57.5	23.2	277.9
+Exchange income	28.7	76.2	64.2	49.0	95.1	94.3	34.9	110.0
-Interest expenses	1,238.0	1,209.0	1,096.0	1,180.6	1,551.0	31.4	5.8	1,794.4
-Exchange losses	148.1	115.3	122.9	126.6	135.7	7.2	(2.2)	157.0
-Amortization of deferred charges	32.9	19.9	21.7	22.6	28.7	27.2	(3.4)	33.2
+Revenue from associated companies	111.3	52.6	46.9	59.8	73.3	22.5	(9.9)	84.8
-Amortization of goodwill	37.2	42.0	100.9	200.2	127.0	(36.6)	35.9	146.9
= <b>Profit from ordinary activities</b>	<b>1,386.9</b>	<b>1,920.1</b>	<b>2,346.3</b>	<b>2,700.7</b>	<b>3,466.1</b>	<b>28.3</b>	<b>25.7</b>	<b>4,009.9</b>
+Extraordinary income	241.6	179.5	192.0	310.5	3,090.8	895.5	89.1	3,575.8
-Extraordinary expenses	596.9	755.1	880.2	981.9	4,140.8	321.7	62.3	4,790.5
= <b>Income before tax</b>	<b>1,031.6</b>	<b>1,344.5</b>	<b>1,658.1</b>	<b>2,029.3</b>	<b>2,416.1</b>	<b>19.1</b>	<b>23.7</b>	<b>2,795.2</b>
-Corporate tax	183.8	236.5	342.1	442.0	552.2	24.9	31.6	638.9
= <b>Net income</b>	<b>847.8</b>	<b>1,108.0</b>	<b>1,316.0</b>	<b>1,587.3</b>	<b>1,863.9</b>	<b>17.4</b>	<b>21.8</b>	<b>2,156.3</b>
-Minority interest	171.0	307.4	352.7	445.0	556.2	25.0	34.3	643.4
= <b>Net income attributed to Telefónica</b>	<b>676.8</b>	<b>800.6</b>	<b>963.3</b>	<b>1,142.3</b>	<b>1,307.7</b>	<b>14.5</b>	<b>17.9</b>	<b>1,512.9</b>
<b>Net income</b>	<b>847.8</b>	<b>1,108.0</b>	<b>1,316.0</b>	<b>1,587.3</b>	<b>1,863.9</b>	<b>17.4</b>	<b>21.8</b>	<b>2,156.3</b>
+Amortization of deferred charges	32.9	19.9	21.7	22.6	28.7	27.2	(3.4)	33.2
+Depreciation of fixed assets	2,731.8	3,014.0	3,162.7	3,622.1	4,359.9	20.4	12.4	5,044.0
+Dismantled plant pending depreciation	294.0	337.8	288.0	229.0	180.5	(21.2)	(11.5)	208.8
+Amortization of goodwill	37.2	42.0	100.9	200.2	127.0	(36.6)	35.9	146.9
-Revenue from associated companies	111.3	52.6	46.9	59.8	73.3	22.5	(9.9)	84.8
+Dividends of associated companies	42.6	40.6	33.3	177.0	28.9	(83.7)	(9.2)	33.5
= <b>Cash flow</b>	<b>3,875.0</b>	<b>4,509.7</b>	<b>4,875.7</b>	<b>5,778.4</b>	<b>6,515.6</b>	<b>12.8</b>	<b>13.9</b>	<b>7,537.9</b>

(I) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

	BALANCE SHEET. CONSOLIDATED					
ITEMS	1994	1995	1996	1997	1998	(Million of Euros) 1998 \$ (2)
<b>SUBSCRIBED SHARES NOT PAID-IN</b>	0.1	1.0	—	2.7	3.1	3.6
<b>FIXED ASSETS</b>	24,183.4	24,729.8	27,978.0	29,973.1	39,993.4	46,268.3
Capital increase expenses	2.1	4.3	3.5	14.0	97.9	113.2
Net intangible assets	1,804.3	1,906.6	2,030.4	2,140.3	6,612.2	7,649.7
Property, plant and equipment	37,933.0	39,297.2	42,219.1	45,714.2	52,324.3	60,534.0
Depreciation of fixed assets	(16,539.5)	(17,676.2)	(18,335.7)	(20,783.5)	(24,502.7)	(28,347.2)
Net fixed assets	21,393.5	21,621.0	23,883.4	24,930.7	27,821.6	32,186.8
Investments	983.5	1,197.9	2,060.7	2,888.1	5,461.7	6,318.6
<b>GOODWILL ON CONSOLIDATION</b>	323.0	286.6	299.3	1,709.0	2,401.8	2,778.7
<b>DEFERRED EXPENSES</b>	1,120.8	849.3	783.1	812.0	831.6	962.1
<b>CURRENT ASSETS</b>	2,976.2	3,091.6	3,621.1	4,914.8	6,330.3	7,323.5
Subscribed shares not paid-in	—	—	—	—	—	—
Inventories	152.4	174.5	203.4	226.5	295.5	341.9
Accounts receivable	2,222.5	2,397.1	3,051.8	3,781.8	5,269.0	6,095.7
Short-term financial investments	439.2	410.2	215.4	757.8	363.0	420.0
Treasury stock	—	—	—	2.2	29.2	33.8
Cash	107.8	71.7	76.0	62.7	143.0	165.4
Prepayments	54.3	38.1	74.5	83.8	230.6	266.7
<b>ASSETS=LIABILITIES AND SHAREHOLDERS' EQUITY</b>	28,603.5	28,958.3	32,681.5	37,411.6	49,560.2	57,336.2
<b>SHAREHOLDERS' EQUITY</b>	9,087.5	9,294.5	11,201.4	11,968.4	13,500.0	15,618.1
Paid-in share capital	2,823.2	2,823.2	2,823.2	2,823.2	3,079.8	3,563.0
Reserves	5,587.5	5,840.1	7,612.5	8,228.8	9,112.5	10,542.2
Net income for year	676.8	800.6	963.3	1,142.3	1,307.7	1,512.9
Interim dividend	—	(169.4)	(197.6)	(225.9)	—	—
<b>MINORITY INTERESTS</b>	1,756.7	1,885.7	2,252.0	2,368.6	3,545.6	4,101.8
<b>DEFERRED INCOME</b>	450.9	548.5	614.3	676.0	729.4	843.8
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>	1,628.0	1,730.9	2,023.1	2,337.3	5,963.9	6,899.7
<b>LONG-TERM DEBT</b>	11,105.3	10,436.7	10,054.4	11,519.2	13,695.4	15,844.3
Debentures, bonds and promissory notes issued	4,335.2	3,870.2	3,932.9	4,296.8	5,583.1	6,459.2
Debt with credit institutions	5,514.9	5,420.4	5,068.6	5,665.9	7,025.1	8,127.4
Debt with associated companies	1.3	—	1.7	—	—	—
Other creditors (1)	1,253.9	1,146.1	1,051.2	1,556.5	1,087.2	1,257.7
<b>SHORT-TERM DEBT</b>	4,575.0	5,062.1	6,536.3	8,542.2	12,125.9	14,028.5
Debentures, bonds and promissory notes issued	759.4	650.0	886.0	1,707.0	1,410.5	1,631.8
Debt with credit institutions	795.4	1,011.2	1,470.2	2,022.6	5,316.7	6,150.9
Debt with associated companies	67.8	116.5	171.0	90.6	104.2	120.5
Other trade accounts	1,604.3	1,545.3	2,251.3	2,111.7	2,328.7	2,694.1
Other creditors	1,150.2	1,567.3	1,600.7	2,301.1	2,697.6	3,120.9
Prepayments	197.9	171.8	157.1	309.2	268.2	310.3

(1) Including tax debts amounting to 447, 427, 415, 502 and 706 million euros respectively, not considered for the calculation of the financial debt ratio.

(2) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

**ECONOMIC / FINANCIAL INDICATORS. CONSOLIDATED** (Figures in %, Unless Otherwise indicated)

	1994	1995	1996	1997	1998
Operating margin/Revenue from operations (1)	56.6	58.2	55.3	54.1	56.8
Financial expenses/Revenue from operations (2)	15.0	12.8	10.3	9.4	9.8
Operating margin/Average net plant (3)	26.6	28.3	29.3	31.5	37.6
Fixed asset coverage (4)	93.8	92.4	90.0	88.8	86.6
Self-financing ratio (5)	115.9	104.1	96.4	121.4	139.8
Financial debt ratio (6)	49.8	47.9	44.7	47.3	51.0
Debt repayment capacity/(years) (7)	3.7	3.0	2.8	2.7	3.3
Financial expenses coverage (times) (8)	1.2	1.5	1.7	2.0	2.0

(1) Operating revenue - Operating expenses + Internal expenditure capitalized in fixed assets /Operating revenue.

(2) Financial expenses + Exchange losses + Amortization of deferred charges /Operating revenue.

(3) Operating margin /Average net fixed assets.

(4) Shareholders' equity + Outside shareholders' interests + Deferred income + Provisions + Long- term debt / Fixed assets + Goodwill on consolidation + Deferred expenses.

(5) Net income - Telefónica Dividends + Minority Interests Dividends + Depreciation of plant and equipment + Intangible depreciation + Dismantled plant pending depreciation + Amortization of goodwill - Revenue from associated companies + Dividend from associated companies/Capital expenditure in fixed assets + Capital expenditure in intangible assets.

(6) Interest bearing debt / Shareholders' equity + Outside shareholders' interests + Deferred income + Tax debts + Interest bearing debt.

Interest bearing debt: Long-term debt - Tax debts + Short-term debentures, bonds and promissory notes issue + Short-term debts with credit institutions - Short-term financial investments - Cash.

(7) Interest bearing debt / Cash flow - Internal expenditure capitalized in fixed assets. Cash-flow: Net income + Amortization of deferred expenses + Depreciation of fixed assets + Dismantled plant pending depreciation + Amortization of goodwill - Revenue from associated companies + Dividends from associated companies.

(8) Income before tax + Financial expenses + Exchange losses + Amortization of deferred charges - Internal expenditure capitalized in fixed assets /Financial expenses + Exchange losses + Amortization of deferred charges.

**TELEFÓNICA IN THE SPANISH ECONOMY** (Telefónica as a % of national total (revised series))

	1994	1995	1996	1997	1998
Gross value added	2.01	1.97	1.88	1.85	1.71
Gross operating profit	2.49	2.40	2.24	2.23	2.10
Gross savings	4.31	3.64	3.67	3.43	3.16
Gross capital formation	3.17	3.03	2.66	2.45	2.08

**PRICES (1)**

GDP deflator	4.0	4.8	3.2	2.0	2.1
Consumer prices (annual average)	4.7	4.7	3.6	2.0	1.8
Telefónica (2)	0.0	(1.4)	(1.4)	(3.6)	(1.7)

(1) Growth rates.

(2) Price index variation of basic telephony tariffs.

Sources: I.N.E and Telefónica.

**GROSS VALUE ADDED** (Real growth rates in %)

	1994	1995	1996	1997	1998
National economy	2.3	2.7	2.4	3.5	3.8
Services sector	2.9	2.8	2.4	3.2	3.3
Telefónica	4.9	7.5	1.7	7.9	(0.4)

Sources: I.N.E and Telefónica.

SELECTED FINANCIAL DATA. TELEFONICA DE ESPAÑA	(Million of Euros)				
	1994	1995	1996	1997	1998
Revenue from operations	7,714.2	8,249.9	8,853.2	9,646.9	9,931.1
Operating expenses	3,414.9	3,665.4	4,326.5	4,837.1	5,189.3
Financial expenses	1,278.0	1,150.3	993.3	945.0	718.8
Depreciation and amortization (1)	2,808.4	3,039.0	2,851.2	3,045.2	2,979.2
Net income	551.3	638.2	723.7	804.0	902.3
Cash flow	3,359.7	3,677.2	3,574.9	3,849.2	3,881.5
Share capital	2,823.2	2,823.2	2,823.2	2,823.2	3,079.8
Shareholders' equity	8,742.8	8,839.0	10,422.0	10,695.2	12,018.9
Long-term debt	9,033.2	8,192.5	7,419.2	6,936.5	6,460.4
Financial debt	9,952.0	9,243.5	8,388.3	8,501.1	7,576.9
Investment (2)	2,445.4	2,624.7	2,375.2	2,335.5	2,166.3
					2,506.2

(1) Including depreciation of fixed assets, amortization of deferred interest expenses and dismantled plant pending depreciation

(2) Fixed and intangible

(3) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

**RESULTS - PROFIT MARGINS. TELEFÓNICA DE ESPAÑA** **(Million of Euros)**

DESCRIPTION	1994	1995	1996	1997	1998	Increase %		
						Over year 97	Average accumulated 94-98	1998 \$ (I)
+Operating revenue	7,714.2	8,249.9	8,853.2	9,646.8	9,931.1	2.9	6.5	11,489.3
-Operating expenses	3,414.9	3,665.4	4,326.5	4,837.1	5,189.3	7.3	11.0	6,003.5
Personal expenses	2,534.0	2,606.3	2,659.9	2,693.0	2,635.3	(2.1)	1.0	3,048.8
Taxes	153.7	162.6	175.4	187.3	194.4	3.8	6.1	224.9
Supplies and subcontracts	727.2	896.5	1,491.2	1,956.8	2,359.6	20.6	34.2	2,729.8
+Internal expenditure capitalized in fixed assets	443.3	433.7	420.3	392.0	365.4	(6.8)	(4.7)	422.7
<b>=Operating margin</b>	<b>4,742.6</b>	<b>5,018.2</b>	<b>4,947.0</b>	<b>5,201.7</b>	<b>5,107.2</b>	<b>(1.8)</b>	<b>1.9</b>	<b>5,908.5</b>
+Other operating revenue	150.2	178.0	226.1	252.2	254.4	0.9	14.1	294.3
-Depreciation of fixed assets	2,483.0	2,683.4	2,546.7	2,803.5	2,787.3	(0.6)	2.9	3,224.6
-Other operating expenses	68.8	43.8	123.5	128.1	141.0	10.1	19.7	163.1
-Other provisions and charges	135.7	122.5	64.3	75.4	99.7	32.3	(7.4)	115.4
<b>=Operating profit</b>	<b>2,205.3</b>	<b>2,346.5</b>	<b>2,438.6</b>	<b>2,446.9</b>	<b>2,333.6</b>	<b>(4.6)</b>	<b>1.4</b>	<b>2,699.7</b>
+Financial income	86.5	94.3	163.4	198.1	398.5	101.1	46.5	461.0
+Exchange income	—	32.4	26.6	10.8	22.2	106.3	—	25.7
-Interest expenses	1,099.1	1,031.0	897.3	820.3	692.3	(15.6)	(10.9)	800.9
-Exchange losses	147.5	101.6	79.4	112.0	15.0	(86.6)	(43.5)	17.3
-Amortization of deferred charges	31.4	17.8	16.5	12.7	11.5	(9.6)	(22.2)	13.3
<b>=Profit from ordinary activities</b>	<b>1,013.8</b>	<b>1,322.8</b>	<b>1,635.4</b>	<b>1,710.8</b>	<b>2,035.5</b>	<b>19.0</b>	<b>19.0</b>	<b>2,354.9</b>
+Extraordinary income	178.3	97.7	96.2	230.1	2,890.1	1,156.0	100.6	3,343.5
-Extraordinary expenses	533.4	692.5	890.9	1,010.9	3,957.9	291.6	65.0	4,578.9
<b>=Income before tax</b>	<b>658.7</b>	<b>728.0</b>	<b>840.7</b>	<b>930.0</b>	<b>967.7</b>	<b>4.0</b>	<b>10.1</b>	<b>1,119.5</b>
-Corporate tax	107.4	89.8	117.0	126.0	65.4	(48.1)	(11.7)	75.6
<b>=Net income</b>	<b>551.3</b>	<b>638.2</b>	<b>723.7</b>	<b>804.0</b>	<b>902.3</b>	<b>12.2</b>	<b>13.1</b>	<b>1,043.9</b>
+Amortization of deferred charges	31.4	17.8	16.5	12.7	11.5	(9.6)	(22.2)	13.3
+Depreciation of fixed assets	2,483.0	2,683.4	2,546.7	2,803.5	2,787.3	(0.6)	2.9	3,224.6
+Dismantled plant pending depreciation	294.0	337.8	288.0	229.0	180.4	(21.2)	(11.5)	208.7
<b>= Cash flow</b>	<b>3,359.7</b>	<b>3,677.2</b>	<b>3,574.9</b>	<b>3,849.2</b>	<b>3,881.5</b>	<b>0.8</b>	<b>3.7</b>	<b>4,490.5</b>

(I) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

	<b>BALANCE SHEET. TELEFONICA DE ESPAÑA</b>					(Million of Euros)
ITEMS	1994	1995	1996	1997	1998	1998 \$ (3)
<b>FIXED ASSETS</b>	<b>20,511.9</b>	<b>20,210.7</b>	<b>21,308.9</b>	<b>21,819.1</b>	<b>25,133.3</b>	<b>29,076.7</b>
Capital increase expenses	1.0	0.7	0.4	0.2	83.9	97.1
Net intangible assets	425.7	537.5	666.1	784.0	1,002.0	1,159.2
Property, plant and equipment	33,611.7	33,005.1	33,586.0	33,877.9	33,839.1	39,148.4
Depreciation of fixed assets	(14,924.9)	(15,626.4)	(15,602.2)	(16,718.2)	(17,854.8)	(20,656.2)
Net fixed assets	18,686.8	17,378.7	17,983.8	17,159.7	15,984.3	18,492.2
Investments	1,398.4	2,293.8	2,658.6	3,875.2	8,063.1	9,328.2
<b>DEFERRED EXPENSES</b>	<b>1,089.7</b>	<b>814.8</b>	<b>736.5</b>	<b>725.4</b>	<b>629.2</b>	<b>727.9</b>
<b>CURRENT ASSETS</b>	<b>1,820.0</b>	<b>2,021.2</b>	<b>2,389.7</b>	<b>2,916.9</b>	<b>4,564.6</b>	<b>5,280.8</b>
Inventories	25.8	25.9	27.9	28.3	25.8	29.9
Accounts receivable	1,733.5	1,884.5	2,231.3	2,529.1	2,702.7	3,126.8
Short-term investments	20.2	66.2	87.8	319.6	1,758.5	2,034.4
Treasury stock	—	—	—	2.2	29.2	33.8
Cash and banks	28.2	32.3	31.5	25.2	39.8	46.0
Prepayments	12.3	12.3	11.2	12.5	8.6	9.9
<b>ASSETS= LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>23,421.6</b>	<b>23,046.7</b>	<b>24,435.1</b>	<b>25,461.4</b>	<b>30,327.1</b>	<b>35,085.4</b>
<b>SHAREHOLDERS' EQUITY</b>	<b>8,742.8</b>	<b>8,839.0</b>	<b>10,422.0</b>	<b>10,695.2</b>	<b>12,018.9</b>	<b>13,904.7</b>
Paid-in share capital	2,823.2	2,823.2	2,823.2	2,823.2	3,079.8	3,563.0
Reserves	5,368.3	5,547.0	7,072.7	7,293.9	8,036.8	9,297.8
Net income for year	551.3	638.2	723.7	804.0	902.3	1,043.9
Interim dividend	—	(169.4)	(197.6)	(225.9)	—	—
<b>DEFERRED INCOME</b>	<b>405.9</b>	<b>474.4</b>	<b>571.9</b>	<b>625.5</b>	<b>630.2</b>	<b>729.0</b>
<b>PROVISIONS FOR LIABILITIES AND CHARGES</b>	<b>1,396.8</b>	<b>1,448.4</b>	<b>1,635.6</b>	<b>1,521.8</b>	<b>4,616.5</b>	<b>5,340.8</b>
<b>LONG-TERM DEBT</b>	<b>9,033.2</b>	<b>8,192.5</b>	<b>7,419.2</b>	<b>6,936.5</b>	<b>6,460.4</b>	<b>7,474.0</b>
Debentures, bonds and promissory notes issued	3,825.6	3,433.4	3,386.5	3,186.6	2,939.3	3,400.5
Debt with credit institutions	3,357.9	2,982.7	2,521.2	2,042.4	2,162.3	2,501.5
Debt with group and associated companies	844.1	897.4	761.0	1,065.4	976.0	1,129.1
Other creditors (1)	1,005.6	879.0	750.5	642.1	382.8	442.9
<b>SHORT-TERM DEBT</b>	<b>3,842.8</b>	<b>4,092.4</b>	<b>4,386.4</b>	<b>5,682.4</b>	<b>6,601.2</b>	<b>7,636.9</b>
Debentures, bonds and promissory notes issued	751.8	629.1	703.2	1,578.2	1,267.2	1,466.0
Debt with credit institutions	496.0	714.2	365.7	352.6	1,871.9	2,165.6
Debt with group and associated companies (2)	228.2	553.8	801.0	815.2	904.0	1,045.9
Other trading debts	1,261.7	717.8	1,042.9	901.0	722.4	835.7
Other creditors	952.7	1,325.3	1,335.9	1,888.0	1,689.6	1,954.7
Prepayments	152.4	152.2	137.7	147.4	146.1	169.0

(1) Including tax debts amounting to 314.2, 265.3, 230.5, 225.6 and 274.7 million euros respectively, not considered for the calculation of the financial debt ratio.

(2) Including loan debts amounting to 33.6, 71.6, 250.0, 204.2 and 50.4 million pesetas respectively, considered for the calculation of the financial debt ratio.

(3) Figures in million dollars. 31-12-98 exchange rate: €1 = \$1.1569

**ECONOMIC/FINANCIAL INDICATORS. TELEFÓNICA DE ESPAÑA**

(Figures in %, Unless Otherwise indicated)

	1994	1995	1996	1997	1998
Operating margin/Revenue from operations (1)	61.5	60.8	55.9	53.9	51.4
Financial expenses/Revenue from operations (2)	16.6	13.9	11.2	9.8	7.2
Operating margin/Average net plant (3)	25.1	27.8	28.0	29.6	30.8
Fixed assets coverage (4)	90.6	90.1	90.9	87.7	92.1
Self-financing ratio (5)	120.9	123.1	128.6	139.6	178.1
Financial debt ratio (6)	51.3	49.1	42.8	42.4	37.0
Debt repayment capacity(years) (7)	3.4	2.8	2.7	2.5	2.2
Financial expenses coverage (times) (8)	1.2	1.3	1.4	1.6	1.8

(1) Operating revenue - Operating expenses + Internal expenditure capitalized in fixed assets /Operating revenue.

(2) Financial expenses + Exchange losses + Amortization of deferred charges /Operating revenue.

(3) Operating margin /Average net fixed assets.

(4) Shareholders' equity + Deferred income + Provisions + Long- term debt /Fixed assets + Deferred expenses .

(5) Net income - Telefónica Dividends + Depreciation of plant and equipment + Intangible depreciation + Dismantled plant pending depreciation / Capital expenditure in fixed assets + Capital expenditure in intangible assets.

(6) Interest bearing debt / Shareholder's equity + Deferred income + Tax debts + Interest bearing debt.

Interest bearing debt: Long-term debt - Tax debts + Short-term debentures, bonds and promissory notes issued + Short-term debts with credit institutions + Short-term group and associated companies loans - Short-term financial investments- Cash.

(7) Interest bearing debt / Cash-flow - Internal expenditure capitalized in fixed assets. Cash-flow: Net income + Amortization of deferred expenses + Depreciation of fixed assets + Dismantled plant pending depreciation.

(8) Income before tax + Financial expenses + Exchange losses + Amortization of deferred charges - Internal expenditure capitalized in fixed assets /Financial expenses + Exchange losses + Amortization of deferred charges.

## **Shareholder Information**

## SHARE CAPITAL

	PESETAS				
	1994	1995	1996	1997	1998
Share Capital (Mill. ptas.)	469,735.41	469,735.41	469,735.41	469,735.41	512,438.95
Earnings per share (ptas.)	119.86	141.80	170.61	202.31	212.30
Price / earnings ratio	12.97	11.85	17.67	21.50	29.72
Payout (%)	55.06	53.60	52.17	50.42	—
Price / Cash flow per share	2.27	2.10	3.49	4.25	5.97

\* Consolidated figures

	EUROS				
	1994	1995	1996	1997	1998
Share Capital (Mill. euros)	2,823.17	2,823.17	2,823.17	2,823.17	3,079.82
Earnings per share (euros)	0.72	0.85	1.03	1.22	1.28
Price / earnings ratio	12.97	11.85	17.67	21.50	29.72
Payout (%)	55.06	53.60	52.17	50.42	—
Price / Cash flow per share	2.27	2.10	3.49	4.25	5.97

\* Consolidated figures

At December 31<sup>st</sup>, 1998 Telefónica's share capital stood at Ptas 512,438,950,000 (Euros 3,079,820,117.08) divided into 1,024,877,900 bearer shares with a nominal value of Ptas 500 each (Euros 3.005060). At its meeting of December 16<sup>th</sup>, 1998, the Board of Directors agreed to increase the share capital in 20,497,558 shares, through the execution of one of the two capital increases approved by the Extraordinary General Shareholders' Meeting of June 24<sup>th</sup>, 1998. The trading period on the Spanish Stock Exchanges for the subscription rights was from December 30<sup>th</sup>, 1998 to January 30<sup>th</sup>, 1999, with the shares admitted to trading on the Spanish Stock Exchanges on February 19<sup>th</sup>.

The capital increases approved by Telefónica's Board of Directors and carried out throughout 1998 were the following:

Date	Number of shares issued	Issue price				Total Issue (Million)	
				Nominal		Effectivo	
		Pesetas	Euros	Pesetas	Euros	Pesetas	Euros
3-25-98	85,406,438	5,000.0	30.05	42,703	256.65	427,032	2,566.51
5-27-98 (*)	642	4,809.2	28.90	0.321	0.0019	3,087	0.0186
12-16-98 (**)	20,497,558	—	—	10,248	61.59	—	—

(\*) Conversion of 20 convertible bonds with a face value of \$ US 1,000 each.

(\*\*) Share capital increase charged to the free reserves, one new share for every 50 old ones, as approved by the Extraordinary General Shareholders' Meeting of June 24<sup>th</sup>, 1998. From December 30<sup>th</sup>, 1998 through to January 30<sup>th</sup>, 1999 the subscription rights were traded, concluding with the allotment of the aforementioned new shares.

## QUOTATION OF SHARES

Telefónica shares are quoted on the continuous markets of all the Spanish Stock exchanges (Madrid, Barcelona, Bilbao and Valencia) and on the following foreign exchanges: London, París, Frankfurt, Tokyo, New York (\*) and the London Stock Exchange's SEAQ International.

Option contracts on Telefónica shares are carried out on the Spanish Financial Futures Market (MEFF-RV) and on the American Stock Exchange (AMEX) (\*)

(\*) Quotes American Depository Receipts (ADR) 1 ADR = 3 shares

## QUOTATION OF TELEFÓNICA SHARES

The table below reflects maximum, minimum and closing prices, in pesetas and euros on the continuous Spanish market.

	MAXIMUM		MINIMUM		CLOSING	
	pesetas	euros	pesetas	euros	pesetas	euros
1994	2,185	13.13	1,450	8.71	1,555	9.35
1995	1,795	10.79	1,470	8.83	1,680	10.10
1996	3,060	18.39	1,690	10.16	3,015	18.12
1997	4,845	29.12	2,970	17.85	4,350	26.14
1998 1 <sup>st</sup> quarter	7,200	43.27	4,495	27.02	6,920	41.59
1998 2 <sup>nd</sup> quarter	7,650	45.98	5,990	36.00	7,090	42.61
1998 3 <sup>rd</sup> quarter	8,010	48.14	4,505	27.08	5,180	31.13
1998 4 <sup>th</sup> quarter	6,960	41.83	4,655	27.98	6,310	37.92



I.T.: International Telecommunications index (Source: "Capital International Perspective")

G.T.: Telefónica Group (Information in accordance with Spanish accounting principles)

International comparisons at 12/31/98

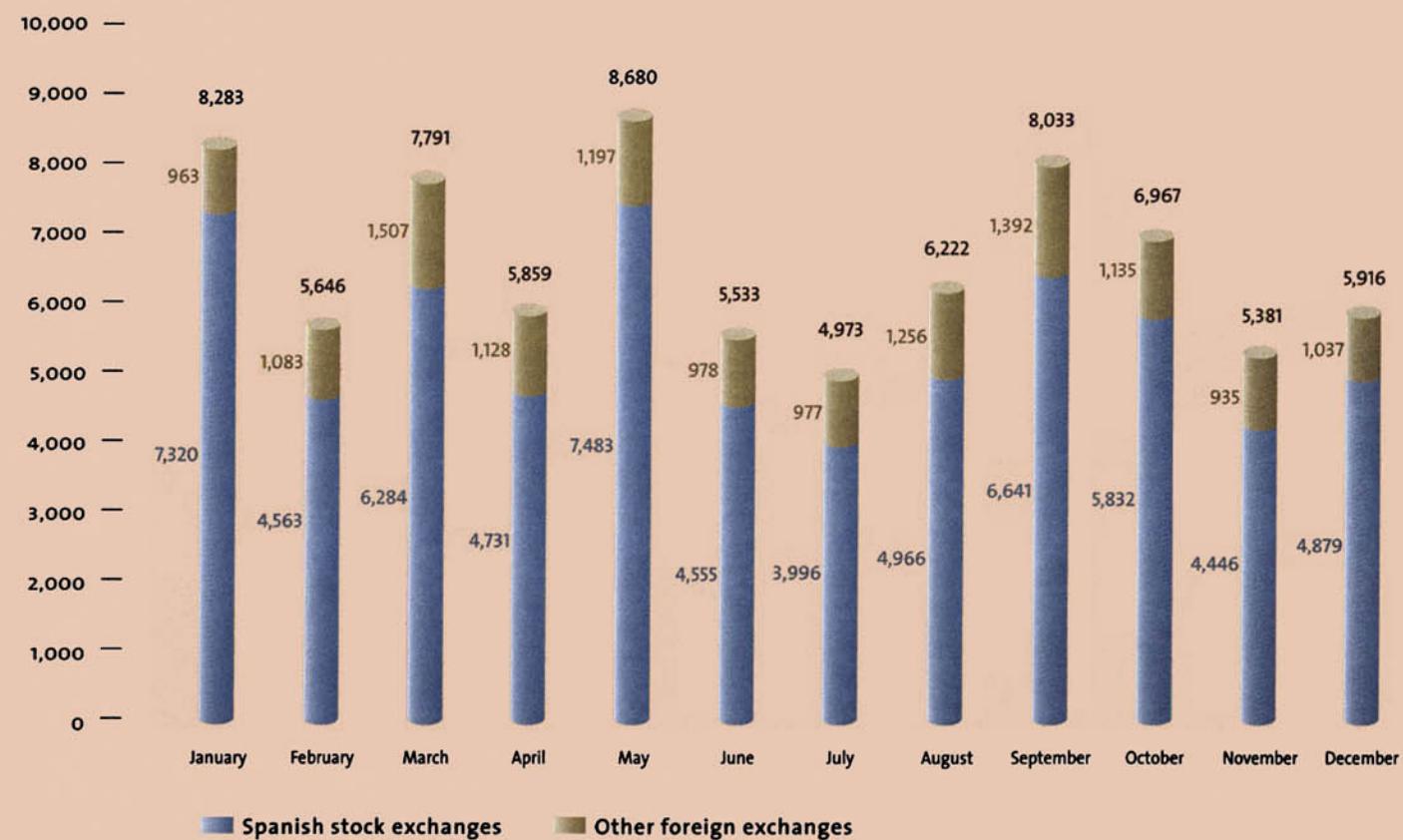
DIVIDENDS PAID OVER RECENT YEARS WERE:

	1995		1996		1997	
	PESETAS	EUROS	PESETAS	EUROS	PESETAS	EUROS
Interim	30	0.18	35	0.21	40	0.24
Final	46	0.28	54	0.32	62	0.37
Total	76	0.46	89	0.53	102	0.61

At the Extraordinary Annual General Shareholders' Meeting held on June 24<sup>th</sup>, 1998, Telefónica announced its new policy, aimed at offering the alternative forms of reimbursement to that of dividend payments. With this new dividend policy in mind, the aforementioned Meeting approved two free capital increases, acknowledging, in both cases, the shareholder's pre-emptive rights to one new share for every 50 old ones. The first of these two increases took place between December 30<sup>th</sup>, 1998 and January 30<sup>th</sup>, 1999.

Average daily trading of Telefónica shares

Thousands  
of shares



## SIGNIFICANT PARTICIPATIONS IN TELEFÓNICA, S.A.

Under the stipulations of the Royal Decree 116/14/1992, since December 14, 1995, Telefónica's shares have been represented as book entries and therefore the official shareholder list has ceased to exist.

At December 31<sup>st</sup>, 1998 the significant holdings in Telefonica's capital stock were the following:

SHAREHOLDER	% SHARE CAPITAL
Corporación Bancaria de España,S.A. (Argentaria) (*)	5.02
Banco Bilbao Vizcaya, S.A. (*)	4.673
Caja de Ahorros y Pensiones de Barcelona, S.A. (*)	5.01

(\*) Significant holdings registered in the National Securities Market Comission's public records.

## STOCK MARKET CAPITALIZATION

Pesetas	1994	1995	1996	1997	1998	Average increase % 98/94
Telefónica (billion pesetas)	1,460.9	1,578.3	2,832.5	4,086.6	6,466.9	45.05
Total Madrid Stock Exchange (billion pesetas)	20,351	22,899	31,579	44,260	56,985	29.35
Telefónica's weighting on the Spanish Continuous market:						
(*) Ibex 35 (%)	12.30	12.71	14.25	14.61	17.07	—
Madrid Stock Exchange index (%)	10.44	9.44	11.46	11.63	13.31	—

(\*) Telefónica's weighting on the Index on the last business day of each year.

Euros	1994	1995	1996	1997	1998	Average increase % 98/94
Telefónica (billion euros)	8.78	9.49	17.02	24.56	38.87	45.05
Total Madrid Stock Exchange (billion euros)	122.31	137.63	189.79	266.01	342.48	29.35
Telefónica's weighting on the Spanish Continuous market:						
(*)Ibex 35 (%)	12.30	12.71	14.25	14.61	17.07	—
Madrid Stock Exchange index (%)	10.44	9.44	11.46	11.63	13.31	—

(\*) Telefónica's weighting on the Index on the last business day of each year.

## TELEFÓNICA GROUP SHARES

	Stock market cap. (mill. \$ US)		Closing price ADR's (\$ US)		Price/earnings ratio		Price/Cash Flow (**)		Dividend yield (%)	
	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998
CTC Chile	6,718	4,950	29.88	20 <sup>7/10</sup>	16.0	11.7	6.07	6.1	2.6	2.4
Telefónica Argentina (*)	8,782	5,981	37.25	27 <sup>15/16</sup>	18.5	11.7	7.2	4.5	2.8	4.8
Telefónica del Perú	5,451.6	2,967	23 <sup>5/16</sup>	12 <sup>11/16</sup>	13.9	13.7	9.4	6.8	3.1	2.8 (***)
CANTV	5,832	2,545	41 <sup>5/8</sup>	17 <sup>13/16</sup>	11.2	8.5	5.3	2.5	0.5	9.0
<b>Holdings in Brazil:</b>										
Telesp (fixed)	—	7,399	—	22 <sup>1/8</sup>	—	12.7	—	4.5	—	2.3
Telesp (cellular)	—	2,341	—	17 <sup>1/2</sup>	—	n.d.	—	n.d.	—	n.d.
Telesudeste (cellular)	—	1,384	—	20 <sup>11/16</sup>	—	9.1	—	5.7	—	4.1
Telereste (cellular)	—	190	—	28 <sup>3/8</sup>	—	4.6	—	2.7	—	10.3

(\*) The 1997 and 1998 figures are based on the quotation of 12/31/97 and 12/31/98 and, the figures for the financial balance sheets closed at 9/30/97 and 9/30/98.

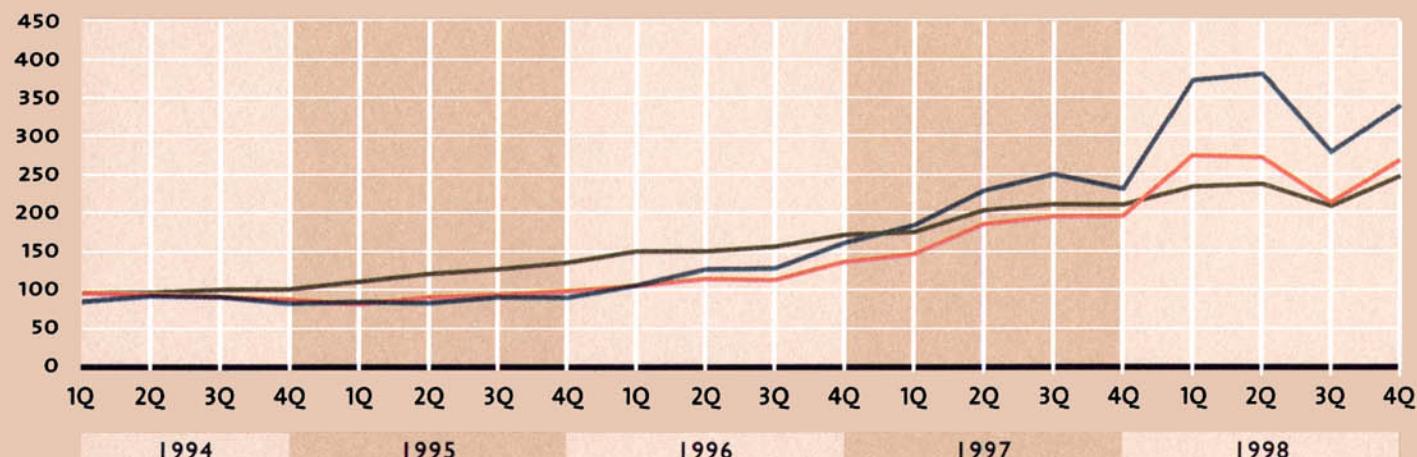
(\*\*) Operating cash flow : Net income plus Depreciation and Amortization.

(\*\*\*) 1998 final dividend pending approval by the General Shareholders' Meeting of the Company.

## Quotes American Depository Receipts (ADR's)

Company	Number of shares per ADR	Company	Number of shares per ADR
CTC Chile	4 shares	Telesp (fixed)	1,000 shares
Telefónica Argentina	10 shares	Telesp (cellular)	2,500 shares
Telefónica del Perú	10 shares	Telesudeste (cellular)	5,000 shares
CANTV	7 shares	Telereste (cellular)	50,000 shares

## Trading index: Telefónica shares



MADRID STOCK EXCHANGE INDEX

DOW JONES

TELEFÓNICA

**Management**

## **BOARD OF DIRECTORS**

As it stood at the date of publication of this Annual Report:

### **CHAIRMAN**

Juan Villalonga Navarro

### **EXECUTIVE VICE-CHAIRMAN**

Javier Revuelta del Peral

### **VICE-CHAIRMEN**

José María Concejo Álvarez  
Isidro Fainé Casas  
Francisco Gómez Roldán

### **DIRECTORS**

César Alierta Izuel	José Maldonado Ramos
Gaspar Ariño Ortiz	Antonio Massanell Lavilla
Pedro Ballvé Lantero	Juan Perea Sáenz de Buruaga
Maximino Carpio García	Bert C. Roberts, Jr.
Alberto Cortina de Alcocer	Juan Antonio Sagardoy Bengoechea
José Javier Echenique Landiribar	Martín Velasco Gómez
Miguel Horta e Costa	Carles Vilarrubi Carrió
Ignacio Larracoechea Jausoro	

### **SECRETARY OF THE BOARD** (non Director)

José María Mas Millet

### **ASSISTANT SECRETARY** (non Director)

Diego L. Lozano Romeral

NOTE: On 24 february 1999, José Maldonado Ramos  
was appointed member of the Board of Directors,  
in place of Miguel Zorita Lees.

## **MANAGEMENT COMMITTEE**

As it stood at the date of publication of this Annual Report:

### **CHAIRMAN**

Juan Villalonga Navarro

### **EXECUTIVE VICE-CHAIRMAN**

Javier Revuelta del Peral

### **VICE-CHAIRMEN**

Isidro Fainé Casas  
Francisco Gómez Roldán

### **MEMBERS**

Cesar Alierta Izuel	José Javier Echenique Landiribar
Alberto Cortina de Alcocer	Juan Perea Sáenz de Buruaga

### **SECRETARY**

José María Mas Millet

**NOTE:** On 27 January 1999, Cesar Alierta Izuel and Alberto Cortina de Alcocer,  
were appointed Members of the Management Committee,  
in place of Ignacio Larracoechea Jausoro and Martín Velasco Gómez.

## **EXECUTIVE COMMITTEE**

As it stood at the date of publication of this Annual Report:

### **CHAIRMAN**

Juan Villalonga Navarro

### **VICE-CHAIRMEN**

Javier Revuelta del Peral

### **MEMBERS**

Fernando Abril-Martorell Hernández	Luis Martín de Bustamante Vega
Arturo Baldasano Supervielle	Juan José Nieto Bueso
Guillermo Fernández Vidal	Juan Perea Sáenz de Buruaga
Luis Lada Díaz	Pedro Pérez Fernández de la Puente
Domingo Lampaya Latorre	Andrés Tejero Sala
Julio Linares López	Antonio Viana-Baptista
Luis López-van Dam de Lorenzo	Angel Vilá Boix

### **SECRETARY**

José María Mas Millet



## **Highlights 1998**

## JANUARY

- **Telefónica** approves the appointment of Javier Benjumea, chairman of Abengoa; César Alierta, chairman of Tabacalera; and Alberto Cortina, co-chairman of Banco Zaragozano, as new Board Directors.
- **Telefónica Internacional** appoints John Reed, chairman of Citicorp-Citibank, and Nelson Sirotsky, chairman of RBS as new Directors of the Board.
- For the second consecutive year, **Telefónica** makes it possible for nearly 9,000 Spanish relief workers in Third World countries to call their families in Spain free of charge, through the program "**No relief worker without communications**".
- **Telefónica** pays a dividend charged to 1997 of **40 pesetas per share**, which represents an increase of 14.3% compared to the previous year.

## FEBRUARY

- **MoviStar** extends GSM coverage in the US as a result of roaming agreements with **American Personal Communications (APC)** and **BellSouth Mobility DCS**.
- **Telefónica** launches its customer plans for 1998, the broadest range of products and services, offering customers important savings and quality benefits; chiefly:

**Basic Line, Duplo Line, Comprehensive Maintenance Service, and the "Clear Plans".**

- **Telefónica** sponsors the Spanish team participating in the **1998 Special Olympic Games** for the handicapped in Nagano.

of **Telefónica de España**.

The executive president of **Telefónica Media** will be Arturo Baldasano.

- **Telefónica** expands the capacity of **InfoVía** to 34,000 access modems, seeing that the figures

## MARCH

- **Telefónica** teams up with **WorldCom** and **MCI** to address telecoms opportunities in Europe, the US and Latin America.
- **Telefónica and Portugal Telecom** strengthen their alliance and agree to promote joint investments in markets outside the Portuguese- and Spanish-speaking countries.
- **Telefónica** doubles its value in just over 12 months, to Pta. 6 billion. In hardly more than a year, **the company's shares appreciated 114%**.



for this service are keeping in pace with the increasing interest in access to information services and the Internet.

## APRIL

- **EstraTel** is the first member of the Spanish Telephone Marketing Association to obtain the AENOR quality certificate.
- **Telefónica** expands the terms of its collaboration with the **Xunta de Galicia** to include the implementation of new broadband ATM technologies for the communications network of the regional administrative bodies in Galicia.

- **Telefónica** announces the payment of a complementary dividend of Pta. 62 per share, effective 18 May.

## MAY

- Juan Villalonga and the president of the region of Castilla and León, Juan José Lucas, sign an MoU for the installation of an R&D center in Boecillo Technological Park.

- **Telefónica** successfully completes the largest rights issue in European stock-market history, bringing the company 427.032 billion pesetas in new funds.

- **Telefónica** launches "Domo", its new basic telephone. The new terminal, presented in the Queen Sofía Art Museum,

incorporates new features and was chosen as the result of a customer survey.

- **Telefónica** offers its business clients new IP Services conceived as a hub for in-house business communications (**Servicios Uno-IP**) as well as for communications between companies and individuals (**Servicios InfoVia Plus**).

- The new organizational structures of **Telefónica** are approved. Julio Linares joins the **Corporate Center** to direct **Strategy and Technology**. Carlos Díaz Guerra becomes **President of Telefónica I+D**, after stepping down as general manager for **Infrastructure in Telefónica de España**, where he is succeeded by José Aspas, who was formerly in charge of SMEs.



## JUNE

- **Telefónica's Board of Directors** resolves to propose to the **Extraordinary Shareholders' Meeting** the distribution of two free shares for each 50 held, through **two capital increases** charged to reserves.

- **Telefónica** launches its new "Company Savings Plans" (**MasterBono Básico** and **MasterBono Mega VIP**), which provide discounts of up to 25% on interprovincial calls made during business hours.

- The **Telefónica Virtual Shop** opens for business on **InfoVia** and the Internet, a new way to purchase or rent the products and services of the **Telefónica Group** companies.

- **Telefónica** acquires 50,1% of **Companhia Riograndense de Telecomunicações (CRT)** of Brazil for Pta.154.823 billion. **CRT** is the principal telecoms operating company of the Brazilian state of Rio Grande do Sul.

- The **CRT shareholders' assembly** approves the entry of new partners and appoints new members to the Board of Directors. **Telefónica Internacional, RBS, CTC, TASA, Portugal Telecom, BBV and Iberdrola** enter as new partners in **Telefónica do Brasil**.

- **Telefónica** makes available to business customers its new **Centrex**

**Service** which provides all of the facilities of a modern exchange without the need for equipment, investments or maintenance.

## JULY

- **Iberdrola and La Caixa** become partners of **Telefónica Cable in Catalonia**.

**Telefónica Cable Catalunya** expects to be ready to start operations by the end of the year, with investments in infrastructure totalling Pta 100 billion.

- **Telefónica and the Ministry of Education and Culture** sponsor the program "**Education on the Network**", designed to promote the educational use of the Internet in Spanish classrooms.

- **Telefónica and Indra** win the bidding for the "**One-Stop-Shopping**" project initiated by the ministries of **Development and Public Administration** and designed to bring public institutions closer to the citizen.

- **Telefónica de España** restructures its territorial organization through regional head offices that seek to raise productivity and efficiency levels in the different regional spheres of activity. All areas are grouped under four units: **Infrastructure, Companies, General Public and Human Resources**.

- **Telefónica de Argentina** appoints Carlos Fernández-Prida as its new

president, replacing Luis Martín de Bustamante, who became chief executive officer of **Telefónica de España**.

- **Telefónica** renews its contract with **AECOC** as official EDI service provider for the distribution sector. This service allows business to handle an annual turnover of 1 trillion pesetas.

- **Telefónica Internacional** wins the bidding for El Salvador's Intel. The operation marks the point of departure for **Telefónica de Centroamérica**, created to serve as a vehicle for future investments in the region.

- **Telefónica Móviles** is the only mobile telecoms operator to obtain the AENOR Certificate of Environmental Management

- **Telefónica** wins the principal Brazilian operating companies in the privatization of **Telebrás**. **Telesp**, the most important, which operates in the state of São Paulo, was acquired for 5.783 billion reais, 749.744 billion pesetas. **Telefónica** also won the bid for **Tele Sudeste Celular**, the cellular telephone company which operates in Rio de Janeiro and Espírito Santo, for 1.360 billion reais.

- **Telefónica** considers the new tariff structure imposed by the Ministry of Development as an important step

in the process of **tariff rebalancing**, but cautions that the process should continue until all the remaining imbalances are eliminated. The monthly fee and the price of metropolitan calls are still among the lowest in the European Union.

## AUGUST

- **Fundación Telefónica** is created to promote the development of applications that utilize telecommunications technologies to effectively address the needs of society.

- **Telefónica** appoints Fernando Xavier Ferreira, until now chief executive of **Telebrás**, as president of **Telesp**.

- **Telefónica Móviles** launches the **MoviStar "Exact Contract"**, a new mobile telephony service in Spain, which introduces billing based on usage measured in seconds.

- **Telefónica and Mesotel** acquire **Intel**, operating company of El Salvador.



## SEPTEMBER

- **Telefónica** cuts the price of provincial calls 10% to 15%. The "Plan Claro Provincial" offers discounts on calls to a maximum of 20 numbers chosen by the customer.
- **MoviLine** lowers its prices up to 53% per minute of conversation, and reduces the monthly charge 10% to 12% and the service startup fee by 65%. **MoviLine** customers thus enjoy maximum coverage in Spain with the most competitive prices.

- **Telefónica** lowers Internet rates as much as 51.85%, and fulfills, in record time, its commitment to lower tariffs for Internet users



LOS PLANES claros  
para EMPRESAS

with a new set of discount plans, the **BonoNet** and **MasterNet** plans.

- **Telefónica's Board of Directors** approves the implementation of the corporate restructuring plan, a new management model adapted to the realities of the liberalized telecoms market and its global scope. This measure implies the transfer of the telecommunications business in Spain to **Telefónica Sociedad Operadora de Servicios de Telecomunicaciones en España, S.A.**

## OCTOBER

- **Telefónica de El Salvador** starts operations only a month and a half after its acquisition.
- **Telefónica**, through its affiliate **Telefónica Intercontinental**, associates with three local groups to bid together for a mobile phone licence in **Turkey**.
- **Telefónica** collaborates with those affected by **hurricane Georges** in the Dominican Republic, by forgoing charges on calls to Spain over the weekend.
- **TTD** confirms its leadership of the data transmission sector in Spain, where it holds a 92% market share, and signs up the 100,000th customer to connect to its network.
- **Telefónica** collaborates with the families of the victims of the **Lake Banyoles** tragedy.

- Launch of **InfoNegocio**, the most competitive **Internet** services offering for enterprise on the market, in terms of price and quality.

- **Telefónica**, the only Spanish company to appear in the Fortune list of "The World's Most Admired Companies", **ranks number 10** among global telecoms operators.

- **Telefónica, Sermepa, 4B and CECA** launch a system to ensure the security of electronic commerce.

- **Telefónica**, in line with its support of social welfare institutions and projects, is the principal sponsor of the **Special European Championship Games** for the handicapped.

## NOVEMBER

- **Telefónica** creates two new lines of business: **Telefónica Data**, whose chief executive officer is Guillermo Fernández Vidal, handles the data transmission business on a global scale, and **Telefónica Comunicaciones Interactivas**, whose executive president is Juan Perea, handles the **Internet** business and all of the associated "on-line" services, on a global scale.
- Antonio Viana Batista replaces Juan Perea as chief executive officer of **Telefónica Internacional**.
- **Telefónica** offers free communication services to the victims of **hurricane Mitch** and, with the aim

of guaranteeing normal service, sends to the area several **MoviStar Global satellite communications units**.

- **Telefónica** gains a 30% market share in **El Salvador** in less than two months' time. The Spanish company donates \$500,000 and sets aside the average proceeds from all telephone calls as a contribution towards the reconstruction of the country in the wake of **hurricane "Mitch"**.

- Juan Villalonga proposes to the **Board of Directors** that the company pay no dividend against 1998 earnings. The chairman of **Telefónica** also announced he will propose that the company carry out the first of two **1-for-50** bonus issues.

- **Telefónica** is elected the year's best advertising company, according to a yearly ranking published by **Control**, a leading Spanish advertisers' magazine.

- **Telefónica** presents its new trademark, under which it will operate worldwide. The company regroups its operating units and presents a new corporate identity. This new identity, together with the new logo, reflect a vision of the growth, strength, stability and financial soundness of the company.

- **Telefónica's Virtual Shop** launches a multimedia offering which includes telephone equipment and maintenance, **Vía Digital** and **TeleLine**. The offer intends

to facilitate greater familiarity of consumers with the telecommunications of the future.

## DECEMBER

- The three core reference shareholders of **Telefónica** (**La Caixa**, **Banco Bilbao Vizcaya** and **Argentaria**), enter the share capital of **Grupo Telefónica Telefactoring**.

- **Telefónica** reduces average repair time to five days thanks to the implementation of a new customer care system accessible through the commercial information number 1004.

- **Telefónica** offers Spanish and Latin American children the possibility of sending their letters to the **Magi** and **Father Christmas**, direct, via the **Internet**.

- **Telefónica** offers, for the first time in Spain, voice over Internet, which will reduce the price of calls up to 46%. With its services **UNO IP VOZ** and **InfoVía Plus Voz**, **Telefónica** is pioneering a new stage in voice communications for enterprise.

- **Telefónica's InfoVía Plus** network already carries out over a half-million **Internet** connections daily, with complete normality. Nevertheless, **Telefónica** recommends Internet service providers to speed up the migration of their users to avoid problems when **InfoVía** is finally terminated.



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