TERRA NETWORKS, S.A.

Financial Statements for 2003
together with Auditors' Report

Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain. In the event of a discrepancy, the Spanish-language version prevails.

AUDITORS' REPORT ON FINANCIAL STATEMENTS

To the Stockholders of
Terra Networks, S.A.:

1. We have audited the financial statements of TERRA NETWORKS, S.A. comprising the balance sheet as of December 31, 2003, and the related statement of operations and notes to financial statements for the year then ended. The preparation of these financial statements is the responsibility of the Company's directors. Our responsibility is to express an opinion on the 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 financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made. Our work did not include an examination of the 2003 financial statements of Terra Networks España, S.A., a wholly-owned investee of Terra Networks, S.A. The financial statements of Terra Networks España, S.A. were audited by BDO Audiberia Auditores, S.L. and our opinion as expressed in this report on the financial statements of Terra Networks, S.A. is based, with respect to the ownership interest in Terra Networks España, S.A., solely on the report of the aforementioned auditors.

2. As required by Spanish corporate law, for comparison purposes the directors present, in addition to the 2003 figures for each item in the balance sheet and statements of operations and of changes in financial position, the figures for 2002. Our opinion refers only to the 2003 financial statements. Our auditors' report dated February 26, 2003, on the 2002 financial statements contained an unqualified opinion.

3. Since the Company is the head of a group and meets certain requirements, it is obliged under current legislation to prepare separate consolidated financial statements, on which we issued our auditors' report on this same date containing an unqualified opinion. The effect of consolidation, which was performed on the basis of the individual accounting records of the companies composing the Terra Group, with respect to the individual financial statements referred to above, was to decrease assets and the loss for the year by €353,201 thousand and €19,093 thousand, respectively, and to increase reserves by €10,102 thousand (see Note 4-c to the financial statements referred to above).

4. As indicated in Note 1, the Company and its investees engage mainly in various lines of business relating to the use of the Internet and the Company has incurred losses since inception through December 31, 2003. The business plan prepared by Company management for the next four years envisages the obtainment of income in 2005, provided that certain trends and assumptions are borne out. On the basis of this plan and the results forecast for the next ten years, as of December 31, 2003, the Group has maintained a balance of €287,009 thousand under the "Long-Term Investments" caption, relating to prepaid income taxes and tax assets for tax losses incurred in 2001 and prior years (Notes 4-d and 10). In view of the nature of any business plan, which is based on future expectations, significant differences may arise between the projected and actual results. Management of Terra Networks, S.A. intends to update the plan every year and, in any case, whenever the evolution of the business calls for this. The financial position as of December 31, 2003, amply covers the cash needs envisaged in the aforementioned plan for 2004.

5. In our opinion, based on our audit and on the report of BDO Audiberia Auditores, S.L., the financial statements for 2003 referred to above present, in all material respects, a true and fair view of the net worth and financial position of Terra Networks, S.A. as of December 31, 2003, and of the results of its operations and of the funds obtained and applied by it in the year 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 basis consistent with that of the preceding year.

6. The accompanying management report for 2003 contains the explanations which the directors consider appropriate about the Company's situation, the evolution of its business and other matters, but is not an integral part of the financial statements. We have checked that the accounting information in the management report is consistent with that contained in the financial statements for 2003. Our work as auditors was confined to checking the management report with the aforementioned scope, and did not include a review of any information other than that drawn from the Company's accounting records.

DELOITTE & TOUCHE ESPAÑA, S.L.
Registered in ROAC under no. S0692

Javier Acevedo Jiménez de Castro

February 25, 2004

TERRA NETWORKS, S.A.

BALANCE SHEETS AS OF DECEMBER 31, 2003 AND 2002

(Thousands of Euros)

ASSETS	12/31/03	12/31/02	STOCKHOLDERS' EQUITY AND LIABILITIES	12/31/03	12/31/02
FIXED AND OTHER NONCURRENT ASSETS:			**STOCKHOLDERS' EQUITY (Note 8):**		
Intangible assets, net (Note 5)	**13.333**	**14.757**	Capital stock	1.202.936	1.216.321
Research and development expenses	-	156	Additional paid-in capital	5.126.134	5.491.533
Intellectual property	10.546	10.350	Other reserves	165.863	26.216
Computer software	40.783	33.348	Accumulated losses	(3.611.784)	(1.410.129)
Intangible assets in progress	2.484	**2.469**	Loss for the year	(191.803)	(2.201.655)
Other intangible assets	232	1.278			
Accumulated amortization	(40.712)	(32.844)	**Total stockholders' equity**	**2.691.346**	**3.122.286**
Property and equipment, net (Note 6)	**4.843**	**5.964**			
Plant and machinery	6.484	-			
Computer hardware	8.233	8.412			
Furniture	1.200	1.073			
Other tangible fixed assets	1.274	5.739	**DEFERRED REVENUES**	**32.620**	**11.359**
Accumulated depreciation	(12.348)	(9.260)			
Long-term investments (Note 7)	**1.715.073**	**1.764.503**			
Investments in Group and associated companies	3.773.835	4.099.904			
Loans to Group and associated companies (Note 10)	472.777	1.890	**PROVISIONS FOR CONTINGENCIES AND EXPENSES (Note 7)**	**417.751**	**403.278**
Long-term deposits and guarantees	810	810			
Taxes receivable (Note 9)	287.009	287.009			
Investment valuation allowance	(2.819.358)	(2.625.110)	**LONG-TERM PAYABLES TO GROUP COMPANIES (Note 10)**	**26.183**	**-**
Long-term treasury stock (Note 8 a)	**126.262**	**-**			
Total fixed and other noncurrent assets	**1.859.511**	**1.785.224**			
CURRENT ASSETS:			**CURRENT LIABILITIES:**		
Accounts receivable	**90.839**	**97.680**	Payable to Group companies (Note 10)	132.340	168.783
Receivable from Group companies (Note 10)	83.532	96.737	Trade accounts payable	32.169	27.864
Other accounts receivable	7.307	943	Taxes payable (Note 9)	3.362	3.728
Taxes receivable (Note 9)	**19.279**	**26.462**	Other nontrade payables	4.495	3.085
Short-term investments (Note 10)	**1.360.913**	**1.848.102**	Accrual accounts	153	28.290
Cash	**33**	**9**	**Total current liabilities**	**172.519**	**231.750**
Accrual accounts	**9.844**	**11.196**			
Total current assets	**1.480.908**	**1.983.449**			
TOTAL ASSETS	**3.340.419**	**3.768.673**	**TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES**	**3.340.419**	**3.768.673**

The accompanying Notes 1 to 18 are an integral part of the balance sheet as of December 31, 2003.

TERRA NETWORKS, S.A.

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

(Thousands of Euros)

DEBIT	2003	2002	CREDIT	2003	2002
EXPENSES:			**REVENUES:**		
Procurements	2.225	198	Net sales and services	40.646	44.702
Personnel expenses (Note 11)	19.067	16.997		**40.646**	**44.702**
Depreciation and amortization expense	10.956	39.987			
Advertising and publicity	2.468	13.714			
Rent	3.152	3.870			
Professional services	7.382	8.623			
Other operating expenses	14.027	16.674			
	59.277	**100.063**			
Operating income	**-**	**-**	**Operating loss**	**18.631**	**55.361**
			Financial revenues from investments in Group companies (Note 10)	34.059	48.661
Financial expenses on other debts	1.061	1.842	Financial revenues from investments in other companies	-	248
Other financial expenses	770	-	Exchange gains	2.054	12.505
Exchange losses	11.573	12.582			
Financial income	**22.709**	**46.990**	**Financial loss**	**-**	**-**
Income from ordinary activities	**4.078**	**-**	**Loss on ordinary activities**	**-**	**8.371**
Variation in investment valuation allowances (Note 7)	203.548	1.519.076			
Extraordinary expenses and losses (Note 12)	4.343	362.259	Other extraordinary revenues	12.010	920
Extraordinary income	**-**	**-**	**Extraordinary loss**	**195.881**	**1.880.415**
Income before taxes	**-**	**-**	**Loss before taxes**	**191.803**	**1.888.786**
Corporate income tax (Note 9)	-	312.869		-	-
Net income for the year	**-**	**-**	**Loss for the year**	**191.803**	**2.201.655**

The accompanying Notes 1 to 18 are an integral part of the statement of operations for the year ended December 31, 2003.

(17) STATEMENTS OF CHANGES IN FINANCIAL POSITION

APPLICATION OF FUNDS	Thousands of Euros 2003	Thousands of Euros 2002	SOURCE OF FUNDS	Thousands of Euros 2003	Thousands of Euros 2002
Capital reduction	76.616	144.161	Funds obtained from operations	22.701	23.948
Fixed assets additions:			Fixed asset disposals:		
*Intangible assets	5.754	7.525	*Intangible assets	-	1.195
*Property and equipment	2.659	2.704	*Property and equipment	-	598
*Investments in Group and associated companies	10.885	134.799	*Investments in Group and associated companies	81.272	151.748
Period provision for contingencies and expenses	-	21.000	Period provision for contingencies and expenses	5.456	-
Loans to Group and associated companies	1.867	106.186	Transfer to long term of short-term debt	26.183	-
Net transfer of long-term investments	-	9.817	Transfer to short term of long-term loans	-	393.847
Transfer to long term capitalization of short-term accounts receivable	36.385	-	Deferred revenues	21.264	11.002
Transfer to long term of short-term loans	469.020	-			
TOTAL FUNDS APPLIED	**603.186**	**282.031**	**TOTAL FUNDS OBTAINED**	**156.876**	**582.338**
FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED	**-**	**156.146**	**FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED**	**446.310**	**-**

VARIATION IN WORKING CAPITAL	Thousands of Euros			
	Increase		Decrease	
	2003	2002	2003	2002
Accounts receivable	-	-	6.841	5.859
Taxes receivable	-	2.677	7.183	-
Short-term investments	-	227.451	487.189	-
Cash	24	5		-
Accrual accounts	-	9.811	1.352	-
Current liabilities	59.231	-		77.939
TOTAL	**59.255**	**239.944**	**502.565**	**83.798**
VARIATION IN WORKING CAPITAL	**-**	**156.146**	**443.310**	**-**

Terra Networks, S.A.

Financial Statements
for the Year Ended 2003
together with Auditors' Report

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 18). In the event of a discrepancy, the Spanish-language version prevails

TERRA NETWORKS, S.A.

NOTES TO 2003 FINANCIAL STATEMENTS

(1) COMPANY DESCRIPTION

Terra Networks, S.A. ("the Company") was incorporated for an indefinite period of time in Madrid on December 4, 1998, under its original name of Telefónica Comunicaciones Interactivas, S.A. The Company changed its corporate name to Telefónica Interactiva, S.A. on February 17, 1999, and to Terra Networks, S.A. on September 7, 1999.

Its registered office is at calle Nicaragua, 54, Barcelona.

Its corporate purpose is the provision and operation of Spanish and international telecommunications services, the provision of related content production services for on-line access, interactive services, and the provision and operation of current and future information and communications services and technologies, subject in all cases to the applicable legislation and to the prior obtainment, where necessary, of such administrative authorizations or licenses as might be required.

The Company may also engage in the design, development, manufacture and marketing of supplementary equipment and systems for the functioning of said communications and in the provision of services relating to project coordination and management and to the installation, maintenance, operation, management, administration and marketing of, and counseling on, communications systems.

All the business activities composing the corporate purpose may be carried on in Spain and abroad, and the Company may perform them directly or through interests in the business activities of other companies with a similar corporate purpose, either by promoting the foundation or formation of such companies or by acquiring holdings in their capital.

In order to carry on its business activities, Terra Networks, S.A. has incorporated subsidiaries in most of the countries in which it provides its services. Specifically, as of December 31, 2003, the Terra Lycos Group had direct or indirect holdings in Spain, France, Italy, Germany, the U.K., the Netherlands, Austria, Switzerland, Denmark, Sweden, Belgium, the U.S., Mexico, Brazil, Guatemala, Argentina, Peru, Chile, Colombia, Venezuela, Uruguay, El Salvador, Costa Rica, Honduras, Nicaragua, Panama, the Dominican Republic, Puerto Rico, China, Singapore, Taiwan, the

Philippines, Malaysia, India, Indonesia, South-East Asia and Thailand. The holdings in France, Italy, Germany, the U.K., the Netherlands, Austria, Switzerland, Denmark, Sweden, Belgium, China, Singapore, Taiwan, the Philippines, Malaysia, India, Indonesia, South-East Asia and Thailand arose as a result of the merger with Lycos, Inc., which was approved by the Board of Directors of Terra Networks, S.A. on May 16, 2000. The European companies, other than those in Spain, are owned through Lycos Europe, N.V., a subsidiary of Lycos, Inc., and the Asian holdings are owned through Lycos Asia Limited.

Alliances with Bertelsmann AG and alliance agreement with Telefónica S.A.

On May 16, 2000, Terra Networks, S.A., Telefónica, S.A., Lycos, Inc. and Bertelsmann AG entered into agreements for cooperation in the access to the new content of the Terra Lycos Group and joint marketing campaigns. Under the agreement, Bertelsmann AG would make payments amounting to US$ 325 million for the products and services purchased from the Terra Lycos Group in the first two years following the merger of Terra Networks, S.A. and Lycos, Inc. The agreement also stated that Bertelsmann AG would make certain payments up to a total amount of US$ 675 million for the products and services purchased from the Terra Lycos Group in the first three years following the second anniversary of the merger of Terra Networks, S.A. and Lycos, Inc., and Telefónica, S.A. undertook to purchase goods and services from the Terra Lycos Group during that period for the amount of the purchases not made by Bertelsmann AG, up to a total amount of US$ 675 million. On February 12, 2003, Terra Networks, S.A. and Telefónica, S.A. entered into a framework strategic alliance agreement to replace the aforementioned strategic agreement of May 16, 2000. Also, all the former signatories of the aforementioned agreement entered into a new preferential interest agreement that will enable them to continue to explore opportunities for mutually providing communications, development and content services in the on-line market.

The new agreement between Terra Networks, S.A. and Telefónica, S.A. was entered into in response to, on the one hand, the changes in the Internet businesses and, in particular, the development of broadband technology and, on the other, the need to adapt the range of products and services offered by the Terra Lycos Group under the agreement dated May 16, 2000, to the aforementioned new market conditions and to the specific needs of the Telefónica Group in the markets in which it operates.

As reflected by a study carried out by an independent appraiser at the request of the Company's Board of Directors, the capacity of the new strategic alliance agreement to create value for the Terra Lycos Group and its stockholders is at least equal to that of the agreement which it replaces. The alliance makes maximum use of the capacity of the Telefónica Group, as a connectivity and broad and narrow band Internet access provider, and of the Terra Lycos Group, as a portal, aggregator, provider and manager of wireline telephony Internet content and services in the residential, SOHO and, when so agreed, SME market. The framework agreement defines a new model for relations between the two companies that will make it possible to make better use of their respective capacities to promote their Internet growth, in order to harness synergies and create value for the two Groups, ensuring the generation for the Terra Lycos Group of a minimum annual value of €78.5 million throughout the term of the agreement. This amount is the difference between the revenues arising from the services provided under the framework agreement and the costs and investments directly associated therewith. The terms of the framework agreement is six years, extendible for successive 12-month periods.

In compliance with the terms of the framework strategic alliance agreement, in 2003 the aforementioned minimum annual value was generated for the Terra Lycos Group.

Tender offer

On June 19, 2003, the Spanish National Securities Market Commission ("CNMV") authorized Telefónica S.A. to submit a tender offer for all the Terra Networks, S.A. shares listed and traded on the Spanish computerized trading system (continuous market) and on Nasdaq (National Association of Security Dealers Automated Quotations, U.S.A), after Telefónica, S.A.[1], had submitted the mandatory application for authorization and the information memorandum for the launch of a tender offer, pursuant to the applicable legislation.

The tender offer, as described in the related information memorandum registered with the CNMV on June 19, 2003, was instrumented as an acquisition in cash, the consideration being €5.25 per share of Terra Networks, S.A. The tender offer was subject to the acquisition by Telefónica, S.A. of a number of Terra Networks, S.A. shares, which, together with those already owned by Telefónica and frozen until the date of publication of the results of the tender offer, accounted for at least 75% of the capital stock of Terra Networks, S.A. at the date of publication of the results of the tender offer. Also, Telefónica, S.A. expressly reserved the right to waive this condition, on the date of expiration of the tender offer acceptance period (July 23, 2003).

On June 26, 2003, in accordance with the opinion issued by the investment banks Citigroup and Lehman Brothers, deemed that the tender offer for all the shares of Terra Networks, S.A. to be fair and reasonable for the stockholders. Also, in keeping with this positive assessment, the Board of Directors indicated its willingness to accept the tender offer for the 2,420,468 shares formerly held by Lycos, Inc. The directors who individually owned Terra Networks, S.A. shares and the director appointed by BBVA also indicated their willingness to accept the offer.

[1] Resolution adopted at the meeting of the Board of Directors of Telefónica, S.A. on May 28, 2003.

On July 25, 2003, the CNMV informed the Company that the tender offer launched by Telefónica, S.A. for 370,675,587 shares of Terra Networks, S.A. had been accepted for 202,092,043 shares, representing 54.52% of the shares for which the tender offer was launched, and 33.60% of the target company's capital stock.

Also on July 25, 2003, Telefónica S.A. confirmed through a relevant fact disclosure its decision to waive the minimum limit to which the tender had been restricted. Consequently, the resulting direct holding represented 71.97% of the total capital stock of Terra Networks, S.A.

Acquisition of treasury stock

On December 16, 2003, the Board of Directors of Terra Networks, S.A., pursuant to the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of 26,525,732 shares of Terra Networks, S.A. owned by Citibank, NA, as the agent bank for the Stock Option Plans established by the Company on the integration of Lycos, Inc. These shares represent 4.41% of the capital stock of Terra Networks S.A. The shares were acquired at the prices at which Citibank, NA had acquired the Lycos Inc' shares to cover the latter company's Stock Option Plans for its employees at the date of their acquisition.

These shares were acquired in order to be able to recognize the new tax asset arising in 2004 and, possibly, in subsequent years. This was achieved through the inclusion of Terra Networks, S.A. in the Telefónica consolidated Tax Group in 2004, since, once the acquisition had been made, Telefónica, S.A.'s ownership interest accounted for 75.29% of the effective capital stock (capital stock less treasury stock) of Terra Networks, S.A.

Terra Networks, S.A. stockholders

Terra Networks, S.A. is listed on the Spanish continuous market (in the special securities trading segment known as the "New Market") and, consequently, on the four Spanish Stock Exchanges, in addition to the New York Stock Exchange (NASDAQ). At its meeting of December 11, 2003, the Technical Advisory Committee of the Ibex Indexes resolved, in accordance with the Technical Standards for the Composition and Calculation of the Ibex 35 indexes, to exclude the Terra Networks (TRR) securities from the Index, effective January 2, 2004 .

Stockholder	Percentage of Ownership	
	12/31/03	12/31/03
Telefónica, S.A.	71.97(*)	38.58
Citibank, NA	-	4.59
Other stockholders	28.03	56.83
Total	**100.00**	**100.00**

(*) Telefónica's effective ownership percentage (capital less treasury stock) is 75.29%.

The purpose of the holding owned by Citibank, NA in 2002 was to provide coverage for the Lycos, Inc. Stock Option Plan. As of December 31, 2003, the "Other Stockholders" caption included both the in treasury stock (4.41%) and the holdings owned by Banco Zaragozano (1.16%) and Caja de Ahorros y Pensiones de Barcelona (1.15%), the purpose of which is to provide coverage for the Stock Option Plans for the Terra Lycos Group's employees (see Notes 8-e and 14). If these options are not exercised by the time they expire, the shares will be retired.

Asset write-downs

Whenever circumstances arise which are likely to lead to significant variances with respect to business projections and, in any case, in the last quarter of the each year, the Company reviews its subsidiaries' business plans and, on the basis of quantitative and qualitative factors, evaluates whether it is necessary to write down the value of their goodwill and other intangible assets used in their operations. When factors making it necessary to perform write-downs are identified, the Company determines the amount thereof by comparing the book value of the goodwill and other intangible assets with their market value. The Company calculates the market value mainly using the discounted cash flows method, i.e. taking the present value of the estimated future cash flows. At the end of 2003 the objective of these analyses, based on the estimated future value that each of the businesses and countries will generate, was to determine the recovery of the goodwill, recognized tax assets, and other fixed assets in the consolidated balance sheet of the Terra Lycos Group, in accordance with the accounting principle of prudence in valuation.

As a result of this situation and these studies, in accordance with the accounting principle of prudence in valuation, as of December 31, 2003, it was not deemed necessary to write down the goodwill relating to the direct holdings of Terra Networks, S.A. or to reverse any amounts of the tax assets recognized.

Environmental matters

In view of the business activities carried on by Terra Networks, S.A., it does not have any environmental liabilities, expenses, assets, provisions or contingencies that might be material with respect to its net worth, financial position or results. Therefore, no specific disclosures relating to environmental issues are included in these notes to financial statements.

(2) BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

a) True and fair view-

The accompanying financial statements, which were prepared by the Company's directors from the accounting records of Terra Networks, S.A., are presented in accordance with the Spanish National Chart of Accounts and, accordingly, give a true and fair view of the Company's net worth, financial position and results of operations.

The 2003 financial statements will be submitted for approval by the Stockholders' Meeting, and it is considered that they will be approved without any changes. The 2002 financial statements were approved by the Stockholders' Meeting on April 2, 2003.

The figures in the accompanying balance sheets, statements of operations and notes to financial statements are expressed in thousands of euros, unless otherwise stated.

b) Accounting policies-

The financial statements as of December 31, 2003, were prepared by applying the Spanish generally accepted accounting principles and valuation methods described in Note 4. All obligatory accounting principles with a significant effect on the financial statements were applied in their preparation.

(3) ALLOCATION OF LOSS

The Company's directors propose that the loss for 2003 be allocated in full to "Accumulated Losses".

(4) VALUATION STANDARDS

The main valuation methods applied by the Company in preparing its financial statements, in accordance with the Spanish National Chart of Accounts, were as follows:

a) Intangible assets-

Computer software is recorded at cost only when it will foreseeably be used over several years, in which case it is amortized on a straight-line basis over three years. Software maintenance expenses are expensed currently.

Intellectual property is recorded at the amounts paid for the acquisition from third parties of title to, or the right to use, the Terra brand name, and is amortized on a straight-line basis over five years.

The "Other Intangible Assets" caption includes the rights acquired under long-term contracts for services and content. These rights are amortized on a straight-line basis over the related contract term.

€7,545 thousand of amortization of intangible assets were charged to the 2003 statement of operations (see Note 5).

b) Property and equipment-

Property and equipment are carried at cost.

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 Company depreciates its property and equipment by the straight-line method at annual rates based on the following years of estimated useful life:

	Years of Estimated Useful Life
Plant	10
Furniture	5
Computer hardware	3
Other tangible fixed assets	4-6
Other fixtures	10

€3,411 thousand of depreciation of property and equipment were charged to the 2003 statement of operations (see Note 6).

c) Long-term investments-

The investments in Group and associated companies are recorded at the lower of cost or underlying book value of the holdings, adjusted by the amount of the unrealized gains disclosed at the time of the acquisition and still existing at the date of subsequent valuation.

Unrealized losses (cost higher than market or fair value at year-end) are recorded under the "Investment Valuation Allowances" caption up to the limit of cost. Should unrealized losses exceed cost, reducing the value of the latter to zero, the overprovision is reclassified for balance-sheet purposes to the liability "Provisions for Contingencies and Expenses" caption. €9,016 thousand were recorded in this connection with a charge to 2003 income (see Note 7).

The "Investment Valuation Allowances" account includes €52,310 thousand recorded in 2003 in order to include in the individual financial statements the same amortization of goodwill as that recorded in the consolidated financial statements.

As a general rule, and pursuant to current accounting legislation, the Company amortizes goodwill over ten years. Under current legislation, the Company is not required to prepare consolidated financial statements because it is consolidated in a higher group, the parent company of which is governed by Spanish legislation. However, the Company prepares separate consolidated financial statements. The effect on the accompanying financial statements of fully consolidating the majority holdings and of accounting for the other holdings by the equity method is as follows:

	Thousands of Euros
	Increase (Decrease)
Assets	(353,201)
Stockholders' equity	29,195
Revenues	505,981
Loss for the year	(19,093)

d) Corporate income tax-

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, net of tax relief and tax credits, excluding tax withholdings and prepayments.

In 1999, 2000 and 2001 the Company recorded the tax asset for the tax losses incurred in these years, since it considered their recoverability to be reasonably assured on the basis of the business plan then in force.

As indicated in Note 1 and based on the annual analysis of the expectations for the generation of future income, in 2003 the Company, in accordance with the accounting principle of prudence in valuation, did not record the tax asset relating to the 2003 loss (see Note 9).

e) Foreign currency transactions-

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

Exchange losses are recorded as financial expenses in the year in which they arise.

The positive net differences in each group of currencies are recorded under the "Deferred Revenues" caption on the liability side of the balance sheet, unless exchange losses in a given group have been charged to income in prior years or in the current year, 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 or in the current year.

f) Recognition of revenues and expenses-

Revenues and expenses are recognized when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises. However, in accordance with the accounting principle of prudence, the Company only records realized income at year-end, whereas foreseeable contingencies and losses, including possible losses, are recorded as soon as they become known.

g) Treasury stock-

Treasury stock is valued at the lower of cost, comprising the total amount paid for its acquisition, or market. The market value is taken to be the lowest of underlying book value, the average market price in the last quarter of the year or the year-end market price.

The amount reflected in the "Treasury Stock" account arose mainly as a result, as described in Note 1, of the reclassifications from the "Long-Term Investments" caption due to the acquisition by Terra Networks, S.A. of 26,525,732 shares of Terra Networks, S.A. held by Citibank, NA as the agent bank for the Stock Option Plans assumed by the Company as a result of the integration of Lycos Inc. Additionally, pursuant to former agreements between Lycos, Inc., and the CMGL Group, Lycos, Inc., Lycos, Inc., on behalf of Terra Networks, S.A., acquired 18,920 shares for a total amount of €1,000, for the coverage of the Stock Option granted to the employees of Lycos, Inc. in the initial stage. As a result, as of December 31, 2003, there were 26,544,652 shares of treasury stock representing 4.41% of capital stock.

An adjustment of €165,521 thousand was made to the value of the treasury stock due to the difference between the acquisition price of these shares and their underlying book value, and this amount was recorded with a charge to "Additional Paid-in Capital", since these shares are restricted as to their use (see Note 8-a). Terra Networks, S.A. continues to guarantee coverage of the options plans, since these shares were acquired exclusively to be delivered to its employees or to be sold on their behalf when they exercise their options or, pursuant to the resolutions of the Stockholders' Meetings of June 8, 2000 and April 2, 2003, to be retired if the options are not exercised before they mature.

The Company recorded the related restricted reserve pursuant to Article 79.3 of the revised Corporations Law (see Note 8-c).

(5) INTANGIBLE ASSETS

The detail of the balance of the "Intangible Assets" caption and of the variations therein in 2003 is as follows:

	Thousands of Euros				
	Balance at 12/31/02	Additions	Retirements	Transfers	Balance at 12-31-03
Research and development expenses	156	-	-	(156)	-
Intellectual property	10,350	135	-	61	10,546
Computer software	33,348	3,325	-	4,110	40,783
Intangible assets in progress	2,469	2,265	-	(2,250)	2,484
Other intangible assets	1,278	29	-	(1,075)	232
Accumulated amortization	(32,844)	(7,545)	-	(323)	(40,712)
Total intangible assets, net	**14,757**	**(1,791)**	**-**	**367**	**13,333**

The additions to the "Intellectual Property" caption relate mainly to the acquisition by Terra Networks, S.A. of title to trademarks and domains in various countries.

The additions to the "Computer Software" caption include the acquisition of the right to use various licenses for the games platform.

The additions to the "Intangible Assets in Progress" caption relate to the amount of the construction certificates for the work on the building in which the Company carries on its business activities.

(6) PROPERTY AND EQUIPMENT

The detail of the balance of the "Property and Equipment" caption and of the variations therein in 2003 is as follows:

	Thousands of Euros				
	Balance at 12/31/02	Additions	Retirements	Transfers	Balance at 12/31/03
Plant	-	2,044	-	4,440	6,484
Computer hardware	8,412	401	-	(580)	8,233
Furniture	1,073	127	-	-	1,200
Other tangible fixed assets	5,739	87	-	(4,552)	1,274
Accumulated depreciation	(9,260)	(3,411)		323	(12,348)
Total property and equipment, net	**5,964**	**(752)**	**-**	**(369)**	**4,843**

The "Plant" caption includes additions due to investments made in the building in which the Company carries on its business activities.

(7) LONG-TERM INVESTMENTS

The detail of the "Long-Term Investments" caption and of the variations therein in 2003 is as follows:

	Thousands of Euros					
	Balance at 12-31-02	Additions	Retirements	Transfers	Write-downs	Balance at 12-31-03
Investments in Group and associated companies	4,099,904	10,885	(373,339)	36,385	-	3,773,835
Loans to Group and associated companies (Note 10)	1,890	1,867	-	469,020	-	472
Long-term deposits and guarantees	810	-	-	-	-	810
Taxes receivable (Note 9)	287,009	-	-	-	-	287,009
Investment valuation allowances for Group and associated companies	(2,625,110)	(203,548)	284	9,016	-	(2,819,358)
Total long-term investments, net	**1,764,503**	**(190,796)**	**(373,055)**	**514,42**	**-**	**1,715,073**

The additions to the "Investments in Group and Associated Companies" caption include €10,885 thousand of capital increases subscribed by Terra Networks, S.A. through monetary contributions to foreign subsidiaries.

The "Retirements" caption mainly includes €291,783 thousand relating to the reclassification of the underlying book value of the treasury stock acquired in connection with the Lycos Inc. Stock Option Plans and the capital reduction of €73,616 thousand, relating to cancelled options (see Note 8-a).

The "Transfers" caption includes €32,377 thousand and €4,008 thousand of short-term loans to subsidiaries and accounts receivable from subsidiaries, respectively, which were converted into capital. This caption also includes the reclassification of loans to subsidiaries that were renegotiated this year and mature after 12 months and of €9,016 thousand of balances payable to the liability side of the balance sheet, under the "Provisions for Contingencies and Expenses" caption, the balance of which as of December 31, 2003, included a total of €412,295 thousand in this connection.

In 2003 Terra Networks, S.A. contributed investments in Latin American companies to Terra Networks Latam, S.L. for a total amount, net of the related investment valuation allowance of €46,115 thousand. This contribution is recorded in the "Transfers" column.

As explained in Note 1, at 2003 year-end an exhaustive analysis was carried out of the evolution of the subsidiaries' business plans, based on the new market circumstances in general and on the Internet industry in particular, in order to determine the recoverability of the goodwill and tax assets recognized based on the estimated future generation of value of each of the businesses and countries, in accordance with the accounting principle of prudence in valuation. Based on this analysis, as of December 31, 2003, the goodwill relating to Ifigenia Plus, S.L. (in which Terra Networks, S.A. owns an indirect holding through Terra Networks Asociadas, S.L.), was written down by €6,452 and no amount relating to the tax assets was reversed.

The detail of the direct investments in Group and associated companies as of December 31, 2003, is as follows (amounts in thousands of euros):

Company, Line of Business and Address	% of Direct and Indirect Ownership	Gross Book Value	Net Worth at 12/31/03	Accumulated Allowance (*)
Terra Lycos Intangibles, S.A (formerly Terra Interactiva de Contenidos, S.A.) ISP Paseo de la Castellana, 92, Madrid	100%	19,293	13,954	(5,339)
Terra Networks España, S.A. (formerly Telefónica Servicios y Contenidos por la Red, S.A.) ISP and Portal Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	100%	76,469	(401,414)	(477,884)
Terra Lycos, S.A. (formerly Terra Networks Intangibles, S.A.) ISP Paseo de la Castellana, 92, Madrid	100%	60	55	(5)
Lycos, Inc. (formerly Lycos Virginia, Inc.) Internet Portal 100 Fifth Avenue, Waltham, U.S.A.	100%	2,867,132	426,376	(2,185,361)
Uno-e Bank, S.A. On-line bank Julián Camarillo, 4, Edificio C, 28037 Madrid	33%	189,832	111,462	(41,333)
Cierv, S.L. Design of communications products Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	100%	10,077	(**)	(10,077)
Corporación Real Time Team, S.L. Design, programming, advertising and consulting on the Internet Claudio Coello, 32, 1ext, Madrid	100% 12.04% indirectly through CIERV, S.L and 87.96% through Terra Networks	12,398	(**)	(20,437)
Terra Networks Latam, S.L. E.T.V.E (formerly Terra Networks Asociadas Extranjeras, S.L.) Administration and management of foreign securities Paseo de la Castellana, 92. Madrid	100%	537,171	110,475	(426,973)
Terra Lycos Holding, B.V. Portfolio company Koningslaan 34 1075 AD Amsterdam, Netherlands	100%	18	18	(18)
Terra Networks Asociadas, S.L. Portfolio company Paseo de la Castellana, 92, Madrid	100%	61,116	(2,329)	(63,444)
Terra Networks Colombia Holding, S.A. (1) Portfolio company Avda. 100, 7-33. Santa Fe de Bogotá, Colombia	5%	269	(9,792)	(783)
Total Group and associated companies		**3,773,835**		**(3,231,654)**

(*) Including provisions for contingencies and expenses.

(**) Data not available as of the date of the preparation of the financial statements.

The accumulated investment valuation allowance was recorded mainly as a result of the losses incurred by the companies from the date of their acquisition through December 31, 2003, and includes the allowance for the amortization of the goodwill recorded in the consolidated financial statements.

The main additions, incorporations, disposals and transfers of companies in 2003 are described below:

Terra Networks España, S.A.

In 2003 Terra Networks, S.A. granted loans totaling €14 million to this subsidiary, which also repaid loans totaling €17.5 million.

Terra Networks España, S.A. currently provides Internet access and portal services in Spain.

Terra Networks Brasil, S.A.

Terra Networks Brasil, S.A. has majority holdings in various Internet companies. It engages mainly in the provision of Internet access, the marketing of software developed by third parties, the provision of services related to access networks and the performance of business activities as an Internet portal.

In 2003 Terra Networks, S.A. granted loans totaling US$ 4 million to this subsidiary, which also repaid loans of US$16 million.

In December 2003 Terra Networks, S.A. contributed its investments in Terra Networks Brasil, S.A. to Terra Networks Latam, S.L. E.T.V.E. for a net amount of €23,920 thousand.

Terra Networks Guatemala, S.A.

Terra Networks Guatemala, S.A. has holdings in Terra Networks El Salvador, S.A. de C.V., Terra Networks Costa Rica, S.A. de C.V., Terra Networks Honduras, S.A. de C.V. Terra Networks Nicaragua, S.A. de C.V. and Terra Networks Panamá, S.A., which engage in the development of the Internet business in their respective countries.

In 2003 Terra Networks Guatemala, S.A. carried out capital increases totaling US$1,450 thousand which were subscribed in full by Terra Networks, S.A. In December 2003 this amount was contributed to Terra Networks Latam, S.L. E.T.V.E.

Terra Networks Argentina, S.A.

In 2003 Terra Networks Argentina, S.A. carried out capital increases totaling US$2,850 thousand which were subscribed in full by Terra Networks, S.A. Also, Terra Networks, S.A. converted loans totaling US $8,653 thousand to this subsidiary into capital.

In December 2003 Terra Networks, S.A. in Terra Networks Argentina, S.A.'s holding was contributed to Terra Networks Latam, S.L. E.T.V.E. for €10,173 thousand.

Terra Networks México Holding, S.A. de C.V.

In 2003 Terra Networks México Holding, S.A. converted debts totaling US$7,000 and accounts receivable totaling €4,008 thousand into capital, which was subscribed in full by Terra Networks, S.A.

In December 2003 Terra Networks, S.A.'s holding in Terra Networks México, S.A. was contributed to Terra Networks Latam, S.L. E.T.V.E. for €10,379 thousand.

Terra Networks Venezuela, S.A.

In 2003 Terra Networks Venezuela, S.A. increased capital by a total of US$400 thousand, and this amount was subscribed in full by Terra Networks, S.A. In December 2003 this amount was contributed to Terra Networks Latam, S.L. E.T.V.E.

Terra Networks Colombia Holding, S.A.

In 2003 Terra Networks Colombia Holding, S.A. increased capital by US$300 thousand, and this amount was subscribed in full by Terra Networks, S.A.

Uno-e Bank, S.A.

On January 10, 2003, Terra Networks, S.A. and BBVA entered into an agreement to integrate the consumer finance lines of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., in terms that were more in keeping with their respective interests than those provided for in the memorandum of understanding dated May 15, 2002. Accordingly, the memorandum of understanding was rendered null and void, and the definitive agreement was made conditional upon the relevant internal and administrative authorizations, which had to be secured prior to June 30, 2003, as a condition for the formalization and performance of the integration.

On that same date (January 10, 2003), BBVA and Terra Networks, S.A. entered into a liquidity agreement that would replace that dated May 15, 2002, once the aforementioned integration had taken place. This agreement establishes the following liquidity mechanism (put options) relating to the Uno-e Bank, S.A. shares owned by Terra Networks, S.A.: Terra Networks, S.A. has the right to sell to BBVA, and BBVA is obliged to acquire, Terra Networks, S.A.'s holding in Uno-e Bank, S.A. between April 1, 2005 and September 30, 2007, at market value, established as the higher of the two following values: (i) that determined by an investment bank; and (ii) that obtained by multiplying the income after taxes of Uno-e Bank, S.A. by the PER of BBVA, multiplied by the percentage of ownership of Terra Networks, S.A. that it is intended to sell as of that date.

Also, the exercise price of the aforementioned option may not be lower than €148.5 million if Uno-e Bank, S.A. does not achieve the net ordinary revenue and pre-tax income targets set for 2005 and 2006 in the aforementioned liquidity agreement.

Pursuant to the provisions of the aforementioned agreement of January 10, 2003 and having obtained the necessary authorizations, on April 23, 2003, BBVA and Terra Networks, S.A., at the Special Stockholders' Meeting of Uno-e Bank, S.A., unanimously approved a capital increase at Uno-e Bank, S.A. to be subscribed in full by Finanzia Banco de Crédito, S.A., through the nonmonetary contribution of the consumer finance business line of the latter, whose Special Stockholders' Meeting held on the same date approved the contribution and the subscription in full of the capital increase. This capital increase was executed in a public deed on June 19, 2003, and was registered at the Mercantile Registry on July 16, 2003.

This capital increase entailed the integration of the consumer finance business line of Finanzia Banco de Crédito, S.A. into Uno-e Bank, S.A., following which the holdings of the BBVA Group and Terra Networks, S.A. in Uno-eBank, S.A. stood at 67% and 33%, respectively.

Terra Networks Asociadas, S.L.

In 2003 Terra Networks, S.A. increased capital at Terra Networks Asociadas, S.L. by €600 thousand. With this capital contribution Terra Networks Asociadas granted a loan of US$685 thousand to Onetravel.com.

Also, Terra Networks, S.A. granted loans to Terra Networks Asociadas, S.L. totaling €14,527 thousand, with which Terra Networks Asociadas, S.L., among other transactions, increased capital at Terra Mobile, S.A., One Travel.com, Inc. and Inversis Networks, S.A. by €8,000 thousand, €3,336 thousand and €2,539 thousand, respectively.

Terra Networks Latam E.T.V.E. , S.L-

In 2003 Terra Networks, S.A. increased capital at Terra Networks Latam E.T.V.E., S.L. the consideration for which was the contribution of investments in Latin American companies amounting to €46,115 thousand.

Also, Terra Networks, S.A. granted a loan of US$5,000 thousand to Terra Networks Latam E.T.V.E., S.L., which was used by the latter to increase capital at Terra Networks Colombia Holding, S.A.

(8) STOCKHOLDERS' EQUITY

The variations in equity accounts in 2003 were as follows:

	Thousands of Euros					
	Capital Stock	Additional Paid-in Capital	Other Reserves	Accumulated Losses	Loss for the Year	Total
Balance at December 31, 2002	**1,216,321**	**5,491,533**	**26,216**	**(1,410,129)**	**(2,201,655)**	**3,122,286**
Capital reduction	(13,385)	(60,231)	-	-	-	(73,616)
Treasury stock value adjustment	-	(165,521)	-	-	-	(165,521)
Transfers	-	(139,647)	139,647	-	-	-
Allocation of loss	-	-	-	(2,201,655)	2,201,655	-
Loss for the year	-	-	-	-	(191,803)	(191,803)
Balance at December 31, 2003	**1,202,936**	**5,126,134**	**165,863**	**(3,611,784)**	**(191,803)**	**2,691,346**

a) Capital social-

As of December 31, 2003, the Company's capital stock consisted of 601,467,915 fully subscribed and paid shares of €2 par value each.

On June 5, 2003, the reduction of capital stock by €13,385 thousand, through the retirement of 6,692,344 shares of treasury stock of €2 par value each, was executed in a public deed, thereby complying with the capital reduction resolution adopted by the Stockholders' Meeting on April 2, 2003. These shares were left over from the Lycos, Inc. employee stock option plans. As of that date, these purchase options on Terra Networks, S.A. shares were recorded under the "Long-Term Investments" caption. The capital retirement reduced the balances of the "Capital Stock", "Additional Paid-in Capital" and "Long-Term Investments" by €13,385 thousand, €60,231 thousand and €73,616 thousand, respectively.

As of December 31, 2003, the Company held 26,544,652 shares of treasury stock acquired from Citibank, NA by virtue of the resolution of the Board of Directors of December 16, 2003, using the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003 (see Note 1). These shares are covering the stock option plan for employees of Lycos, Inc. and must be retired if the stock options are not exercised. They represent 4.41% of the capital stock, are valued at €4.76 and amount to €126,262 thousand, and this amount is recorded under the "Treasury Stock" caption on the asset side of the accompanying balance sheet.

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.

Except as mentioned above, 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. Since the Company has incurred losses since its incorporation, the balance of the legal reserve was zero as of December 31, 2003.

b) Reserve for treasury stock-

In accordance with Article 79.3 of the revised Spanish Corporations Law, the Company has recorded a restricted reserve of €126,262 thousand for a total of 26,544,652 shares of treasury stock.

c) Reserves for retired capital -

Pursuant to Article 167 of the revised Corporations Law, the Company recorded a restricted reserve of €39,596 thousand for the amount of the par value of the shares retired in 2002 and 2003 in order to avoid its creditors having the right to contest the aforementioned capital reductions.

d) Stock option plans-

The "Stockholders' Equity" caption includes the effect of the increase in capital stock and additional paid-in capital relating to the shares issued to cover the stock option plans involving Terra Networks, S.A. shares.

As of December 31, 2003, the detail of the shares issued to cover these stock option plans is as follows:

Total number of shares issued at December 31, 2003	**601,467,915**
Shares of treasury stock covering cancelled stock option rights of Lycos, Inc. employees	7,253,534
Shares of treasury stock covering stock option rights not yet exercised by Lycos, Inc. employees	19,272,198
Total, excluding shares covering stock options of Lycos, Inc. employees	**574,942,183**
Shares issued to cover stock option plans of Terra Networks, S.A. (Note 14-a)	13,945,556
Total, excluding shares covering stock option plans	**560,996,627**

On October 27, 2000, Terra Networks, S.A. and Citibank NA (the custodian of the options) entered into a contract to regulate all matters relating to the stock option plans on Terra Networks, S.A. shares for Lycos, Inc. employees.

On December 16, 2003, the Board of Directors of Terra Networks, S.A., exercising the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of the 26,525,732 shares of Terra Networks, S.A. owned by Citibank, NA as the agent bank for the stock option plans assumed by the Company as a result of the integration of Lycos, Inc. These shares continue to cover the stock option plans for Lycos Inc. employees that have not yet been exercised and are recorded for accounting purposes under the "Treasury Stock" caption (see Note 4-g) on the asset side of the accompanying balance sheet.

If after the option exercise period has expired certain options have not been exercised, Terra Networks, S.A. will have to retire the surplus shares. Accordingly, the Terra Networks, S.A. shares on which the related purchase options have not been exercised must be presented to the Stockholders' Meeting of Terra Networks, S.A. for their retirement, with the concomitant effect on the financial statements due to the reduction of capital stock and additional paid-in capital.

Of the 26,525,732 shares of treasury stock, as of December 31, 2003, there were 7,253,534 shares covering the purchase option rights under the aforementioned stock option plan for Lycos, Inc. employees that had been cancelled (either because the option exercise period has expired or because the beneficiaries of the rights were no longer at the company). These 7,253,534 shares of treasury stock must be presented by the Board of Directors to the Stockholders' Meeting for their retirement to be approved. The effect of this retirement of capital stock on the Parent Company's financial statements as of December 31, 2003, would be to reduce the "Capital Stock", Additional Paid-In Capital" and "Treasury Stock" captions by €14,507 thousand, €20,020 thousand and €34,527 thousand, respectively.

(9) TAX MATTERS

a) Taxes receivable and payable-

The detail of the "Taxes Receivable" and "Taxes Payable" captions in the accompanying balance sheet as of December 31, 2003, is as follows:

	Thousands of Euros	
	Long Term	Short Term
Taxes receivable:		
Withholdings on income from movable capital		17,665
Prepaid income taxes	55,839	-
Tax loss carryforwards	231,170	-
VAT refundable	-	1,558
Other taxes receivable	-	56
Total	**287,009**	**19,279**
	-	-
Taxes payable:	-	-
Personal income tax withholdings	-	773
Accrued social security taxes	-	380
Other taxes payable	-	2,209
Total	-	**3,362**

The prepaid income tax of €55,839 thousand relates to timing differences arising as a result of the difference between accounting and tax methods for recognizing certain items. These differences are due basically to the investment valuation allowance recorded in prior years in order to reflect in the financial statements the decline in the value of investments that exceeds the limit of the cost thereof (see Note 4-d).

The Company has the last four years open for review by the tax inspection authorities for all the taxes applicable to it. The Company's directors do not expect any additional material liabilities to arise for the Company in the event of a tax audit.

b) Corporate income tax-

Corporate income tax is calculated on the basis of income per books determined by application of generally accepted accounting principles, which does not necessarily coincide with taxable income.

Under current tax legislation, and following the modifications introduced by Law 24/2001 on Tax, Administrative, Labor and Social Security Measures, the tax loss of a given year can be carried forward for offset against the taxable income of the fifteen years following that in which income was first reported. At 2003 year-end the Company had recorded an account receivable of €287,009 thousand in recognition of the tax asset relating to tax losses incurred in prior years. The Company performed an analysis of the recoverability of the tax assets recognized, which focused on analyzing the impact that the future earnings expectations of the subsidiaries will have on Terra Networks, S.A. and, in particular, on the reversal of the investment valuation allowance recorded in the Company's individual financial statements.

These future earnings expectations were obtained from the projections and business plans used in the analysis of the recoverability of goodwill.

In 2002 and 2003 Terra Networks, S.A. did not recognize any tax assets for losses incurred in those years.

The detail of the tax loss carryforwards as of December 31, 2003, is as follows:

Thousands of Euros	Tax Losses
1999	93,516
2000	534,074
2001	863,272
2002	1,015,675
2003	127,895
Total	**2,634,432**

The reconciliation as of December 31, 2003, of the loss for the year to the tax loss for corporate income tax purposes, and the final reconciliation of the loss for the year to the tax loss for 2002 following the filing of the tax return are as follows:

Thousands of Euros	2003	2002
Loss for the year before taxes	191,803	1,888,786
Permanent differences	(52,311)	(420,014)
Timing differences	(11,597)	(453,097)
Tax loss	**127,895**	**1,015,675**

Terra Networks S.A.'s current business plan, approved by the Board of Directors, envisages the obtainment of sufficient taxable income to enable the aforementioned account receivable to be offset.

c) Application of the consolidated tax regime

On July 2, 2001, the Spanish tax authorities approved the application by the Terra Lycos Group of the consolidated corporate income tax regime from 2001 onwards.

Accordingly, since 2001 the companies resident in Spain that meet the requirements provided for in Articles 78 *et seq.* of Corporate Income Tax Law 43/1995 have been taxed under the consolidated tax regime as Tax Group no. 111/01, of which Terra Networks, S.A. is the Parent Company. This Tax Group will be dissolved in 2004 (see Note 9-d).

The Tax Group comprised 12 companies in 2003, the most noteworthy of which in terms of volume of business were: Terra Networks S.A., Terra Networks España, S.A. and Terra Networks Latam, E.T.V.E., S.L.

d) Inclusion in the Telefónica consolidated Tax Group

As described in Note 1, on December 16, 2003, the Board of Directors of Terra Networks, S.A., exercising the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of 26,525,732 Terra shares owned by Citibank, NA as the agent bank for the stock option plans assumed by the Company when Lycos, Inc. was integrated.

These shares were acquired in order to be able to recognize the new tax asset arising in 2004 and, possibly, in subsequent years. This was achieved through the inclusion of Terra Networks, S.A. in the Telefónica consolidated Tax Group in 2004 since, once the acquisition had been made, the Telefónica, S.A. ownership interest accounted for 75.29% of the effective capital stock (capital stock less treasury stock) of Terra Networks, S.A.. The inclusion of Terra Networks, S.A. in the Telefónica, S.A. consolidated Tax Group will enable the new tax asset that will be generated from January 1, 2004, to be used earlier, since the related tax losses can be offset against the taxable income earned by the Telefónica, S.A. consolidated Tax Group. The tax assets generated prior to 2004 by the present Terra Networks, S.A. consolidated Tax Group are not transferable and can only be offset against the taxable income generated by the Terra Networks, S.A. consolidated Tax Group companies.

As a result of the acquisition by Telefónica S.A. of an effective ownership interest of over 75% in Terra Networks, S.A., the Company considers that, pursuant to Corporate Income Tax Law 43/1995, for tax purposes it will no longer be the Parent Company of its Spanish subsidiaries and, accordingly, Tax Group no. 111/01 will be dissolved in 2004, making 2003 the last year in which it will be taxable under the consolidated tax regime as an independent Group.

(10) GROUP COMPANIES

The detail of the balances arising from transactions with Group companies as of December 31, 2003, is as follows:

	Thousands of Euros			
	Long-Term Investments	Short-Term Investments	Receivable from Group Companies	Payable to Group Companies
Telefonía y Finanzas, S.A. (Telfisa)	-	1,360,913	-	1
Terra Networks Perú, S.A.	428	-	2,973	113
Terra Networks Brasil, S.A.	-	-	24,468	3,153
Terra Networks Guatemala, S.A.	-	-	993	220
Telefónica, S.A.	-	-	2,844	934
Terra Lycos Intangibles, S.A.	-	-	344	13,537
Terra Networks Colombia, S.A.	-	-	585	129
Terra Networks México, S.A. de C.V.	-	-	274	-629
Terra Networks México Holding, S.A. de C.V.	-	-	11,187	754
Terra Networks Colombia Holding, S.A.	-	-	1,695	272
Telefónica Móviles de España, S.A.	-	-	531	174
Ordenamiento de Links Especializados, S.L.	3,005	-	124	124
Terra Networks España, S.A.	426,978	-	9,250	2,833
Azeler Automoción, S.A.	-	-	14	-
Grupo Endemol	-	-	259	668
Lycos, Inc.	-	-	3,369	85,392
Terra Networks Chile S.A.	-	-	5,410	2,325
Telefónica de España, S.A.U.	-	-	170	658
Ifigenia Plus, S.L.	5,971	-	676	10
Terra Networks Operations, Inc.	-	-	6,263	16,755
Terra Networks USA, Llc.	-	-	4,934	430
Terra Networks Argentina S.A.	-	-	3,631	3,174
Terra Networks Caribe, S.A.	-	-	84	192
Terra Networks LATAM, S.L.	14,930	-	1,421	163
T. Ingeniería y Seguridad, S.A.	-	-	-	345
Maptel Networks, S.A.	2,271	-	610	-
Rumbo, S.A.	3,757	-	-	-
Educaterra, S.L.	472	-	933	-
Telefónica I+D, S.A.	-	-	-	489
Terra Venezuela, S.A.	-	-	167	4
Terra Asociadas, S.L.	14,965	-	-	-
T.Datacorp, S.A.	-	-	103	-
Telefónica Contenidos, S.A.	-	-	206	-
Other group and associated companies	-	-	14	120
Total	**472,777**	**1,360,913**	**83,532**	**132,340**

The "Long-Term Investments" and "Short-Term Investments" captions include the loans and credits granted at long and short term, respectively, to subsidiaries, the main features of which are as follows:

Company	Currency	Principal	Maturity	Interest Rate	Equivalent Value in Thousands of Euros
Long term:					
Rumbo	Euros	400,000	12/13/06	0%	400
Rumbo	Euros	1,490,085	05/09/07	0%	1,490
Rumbo	Euros	650,000	12/23/07	0%	650
Rumbo	Euros	675,000	12/23/07	0%	675
Rumbo	Euros	300,000	11/30/08	0%	300
Rumbo	Euros	242,000	11/30/08	0%	242
Terra Networks España, S.A.	Euros	417,527,004	11/30/08	0%	417,527
Olé, S.A.	Euros	3,005,061	11/30/08	0%	3,005
Ifigenia Plus, S.L.	Euros	5,970,539	11/30/08	0%	5,971
T.N. Latam E.T.V.E., S.L.	Euros	14,930,000	11/30/08	0%	14,930
T.N. Asociadas, S.L.	Euros	14,965,304	11/30/08	0%	14,965
Maptel Networks, S.L.	Euros	2,271,012	11/30/08	0%	2,271
Educaterra, S.L.	Euros	472,000	11/30/08	0%	472
T.N. Perú, S.A.	U.S. Dollars	540,000	11/30/08	0%	428
Accrued interest					9,451
Total long term loans to Group and associated companies					**472,777**
Short term:					
Telefonía y Finanzas, S.A. (Telfisa)	Euros	1,360,905,000	N/A	2.57%	1,360,905
Accrued interest					8
Total short-term loans to Group and associated companies					**1,360,913**

The loans and credits granted to Spanish companies are participating loans and do not earn interest until these companies start to generate income.

The balances with Telfisa relate to the Company's current account at that company, which earns interest at market rates.

The financial revenues earned in the year on the aforementioned loans and credits amounted to €34,059 thousand. This amount was recorded under the "Financial Revenues from Investments in Group Companies" caption in the accompanying statement of operations.

(11) PERSONNEL EXPENSES

The detail of the "Personnel Expenses" caption as of December 31, 2003, is as follows:

	Thousands of Euros
Wages and salaries	16,104
Severance costs	15
Social security costs	1,532
Contributions to pension plans	267
Other employee welfare expenses	1,149
Total	**19,067**

The average number of employees, by category, in the year ended December 31, 2003, was as follows:

Category	Average No. of Employees
Executive Vice Presidents	7
Senior Vice Presidents	6
Vice Presidents	11
Directors	25
Managers	45
Graduates	57
Clerical staff	25
Total	**176**

(12) EXTRAORDINARY EXPENSES AND LOSSES

The detail of the extraordinary expenses and losses as of December 31, 2003, is as follows:

	Thousands of Euros
Cancellation of balances with subsidiaries	1,324
Consultancy expenses	3,000
Other extraordinary expenses	19
Total	**4,343**

The 2003 statement of operations does not include any amount for severance costs relating to directors, senior executives and labor force reduction plans.

(13) DIRECTORS' COMPENSATION AND OTHER BENEFITS

In the year ended December 31, 2003, the detail of compensation and other benefits paid to the Board members and recorded in the accompanying consolidated statements of operations amounted is as follows (in thousands of euros):

	2003
Executive directors' salaries	1,945
Board of Directors remuneration	706
Committee meeting attendance fees	40
Total	**2,691**

As described in Note 14, the Board members of the Terra Lycos Group during 2003 hold 8,717,026 purchase options on Terra Networks, S.A. shares, derived from the stock option plans of Terra Networks, S.A. and Lycos, Inc. In 2003 there were no changes with respect to 2002 in either the number of options assigned or their exercise price, and the weighted average exercise price was €18.40 as of December 31, 2003.

As of December 31, 2003, there were no other commitments to the directors.

The information presented below is required mainly as a result of the recent legal reforms affecting the Corporations Law and the Securities Market Law:

1) The directors who own equity interests in companies engaging in an identical, similar or complementary activity are as follows:

Board member	Ownership Interest in	% of Ownership	Line of Business	Functions Perfomed or office held
D. Angel Vilá	Telefónica, S.A.	< 0,01	Telecommunications	General Manager of Corporate Development
	Antena 3 TV, S.A.	< 0,01	Content Provider	-
D. Enrique Used Aznar	Amper, S.A.	0,39	Telecommunications	Chairman
	Telefónica, S.A.	< 0,01	Telecommunications	Board Member
Telefónica Data Corp, S.A.	Telefónica, S.A.	< 0,01	Telecommunications	Board Member
(D. Antonio Viana-Baptista)	Telefónica Móviles, S.A.	< 0,01	Mobile Telecommunications	Chairman
	Portugal Telecom SGPS, S.A.	< 0,01	Telecommunications	Board Member
	PT Multimedia	< 0,01	Internet	-
	Telecom Italia	< 0,01	Telecommunications	-
	Hellenic Telecom	< 0,01	Telecommunications	-

2) No director discharges, on his own account or for the account of others, an activity that is identical, similar or complementary to, the activity that constitutes the corporate purpose of the Company except the following directors and within the terms herein described:

D. Antonio Viana-Baptista acting on behalf of the Board Member Telefónica DataCorp, S.A.

Activity Performed	Type of activity	Company	Functions Perfomed or office held
Board Member	Account of others	Telefónica, S.A. Telefónica Móviles, S.A. Telefónica de Argentina, S.A.	Board Member Chairman Board Member
Board Member	Account of others	Telecomunicaciones de Sao Paulo, S.A. Brasilcel, N.V. Telecomunicaciones Móviles España, S.A. CTC, S.A.	Board Member Board Member Board Member Board Member
Board Member	Account of others	Portugal Telecom SGPS, S.A.	Board Member

D. Enrique Used Aznar

Activity Performed	Type of activity	Company	Functions Perfomed or office held
Board Member	Account of others	Amper, S.A. Telefónica, S.A. Telefónica del Perú, S.A. Telecomunicaciones de Sao Paulo, S.A.	Chairman Board Member Board Member Board Member

D. Luis Bassat Coen

Activity Performed	Type of activity	Company	Functions Perfomed or office held
Board Member	Account of others	Telefónica, Publicidad e Información, S.A. Grupo Bassat, Ogilvy	Board Member Board Member

D. Carlos Fernández-Prida Méndez-Núñez

Activity Performed	Type of activity	Company	Functions Perfomed or office held
Board Member	Account of others	Telefónica de Argentina, S.A.	Board Member

D. Joaquim Agut Bonsfills

Activity Performed	Type of activity	Company	Functions Perfomed or office held
Board Member	Account of others	Endemol Interactive	Board Member

(14) COMMITMENTS

a) *Terra Networks, S.A. Stock Option Plan-*

The Terra Networks, S.A. Stock Option Plan was approved by the Stockholders' Meeting on October 1, 1999, and was implemented by Board of Directors' resolutions adopted on October 18, 1999 and December 1, 1999.

The Plan provides for, through the exercise of the stock options by their holders, the ownership by the employees and executives of the Terra Lycos Group companies of a portion of the capital stock of Terra Networks, S.A. up to a maximum of 14,000,000 shares.

In order to establish the necessary coverage for the aforementioned Plan, on October 5, 1999, Banco Zaragozano, S.A., Caja de Ahorros y Pensiones de Barcelona and Terra Networks, S.A. entered into a contract under which these entities granted to Terra Networks, S.A. an irrevocable purchase option on 14,000,000 issued shares, which may be exercised at any time prior to April 30, 2004. These shares were subscribed in full by these banks (see Note 1).

The approval and implementation of this compensation system were notified to the Spanish National Securities Market Commission (CNMV) and were made public through the complete information memorandum verified and registered in the CNMV Official Register on October 29, 1999, and in the Prospectus presented to the Securities and Exchange Commission (SEC) in the U.S.

On December 1, 1999 and June 8, 2000, the Board of Directors, exercising the powers granted to it by the Stockholders' Meeting, implemented the First Phase of the Plan by granting options to employees of the Terra Lycos Group. The main features of these options are as follows:

1. Each of the stock options under the Plan entitles the employee to acquire one share of Terra Networks, S.A. at an exercise price of €11.81 per share.

2. The duration of the Plan is four years and three months (therefore ending on February 28, 2004), and the options may be exercised at a rate of one-third of those granted each year from the second year onwards.

3. The exercise of the options is conditional upon the beneficiary remaining a Terra Lycos Group employee.

In 2001 the Board of Directors implemented the Second Phase of the Terra Networks, S.A. Stock Option Plan, which was approved pursuant to a resolution of the Stockholders' Meeting of June 8, 2000, and launched pursuant to a resolution of the Board of Directors dated December 22, 2000, which authorized the launch of a Second Phase of the Stock Option Plan, at the recommendation of the Appointments and

Compensation Committee following a proposal by the Chairman, through the assignment of options to executives and employees who were already beneficiaries of the Stock Option Plan, in addition to the assignment of options to new employees who had joined the Terra Lycos Group.

The main features established by the Board of Directors for this assignment were as follows:

1. Each of the stock options under the Plan entitles the holder to acquire one share of Terra Networks, S.A. at an exercise price of €19.78 per share.

2. The duration of the Plan was modified by a resolution adopted by the Stockholders' Meeting on June 8, 2000, and was set at six years with a two-year grace period. The options can be exercised at a rate of one-quarter of those granted each year from the third year through the sixth year.

3. The exercise of the options is conditional upon the beneficiary remaining a Terra Lycos Group employee.

4. Options were granted to one executive director and four general managers and persons of similar category, and this was duly notified to the CNMV on December 29, 2000.

On February 21, 2001, the Board of Directors resolved to modify the resolution adopted on December 22, 2000, in respect of the duration and method of accrual of the stock options. Accordingly, the period for the exercise of the options assigned was set at five years, and the options may be exercised at a rate of one-quarter each year from the end of the first year.

In 2001, at the recommendation of the Appointments and Compensation Committee, the Board of Directors approved, each quarter, specifically at its meetings on May 10, July 25 and November 6, the assignment of options to new Company employees, and set the exercise price at the market price of the shares during the related quarter and with the same terms and conditions as regards exercise period and duration as those envisaged for the Second Phase of the Plan.

On June 7, 2001, the Stockholders' Meeting of Terra Networks, S.A. resolved to partially modify the resolution relating to the Stock Option Plan, which was ratified and approved by the Stockholders' Meeting on June 8, 2000, as regards the extension of the Stock Option Plan to Company executives and directors, and extended the option exercise period to ten years from that in which they were granted, stipulating that a portion of the options could be exercised each year during this period. As of the date of preparation of these financial statements, the Board of Directors had not implemented the extension of the duration of the options.

Also, in 2002 the Board of Directors approved the assignment of options to new Company employees, and set the exercise price at the market price of the shares during the related quarter and with the same terms and conditions as regards exercise period and duration as those envisaged for the Second Phase of the Plan. In addition, the assignment of further options was approved by the Board of Directors at its meeting on February 25, 2002.

In June 2002 it was decided to confine assignments of options to new hires, and that options could be assigned from that date onwards to professional categories 1 and 2.

As of December 31, 2003, options on 6,438,696 shares had been assigned to Terra Lycos Group employees, executives and directors, of which 1,555,554 relate to the First Phase of the Plan and the remainder to the Second Phase. The average stock option exercise price is €14.70.

As of the same date, the Terra Lycos Group's executives and directors held 1,185,252 stock options under the Terra Networks, S.A. Stock Option Plan, the weighted average price being €19.03.

The information on the options under the Terra Networks, S.A. Stock Option Plan not yet exercised as of December 31, 2003, is as follows:

Range of Prices in the Year	No. of Options Not Yet Exercised	Weighted Average Price in the Year
€3.89 – €4.87	148,250	4.09
€5.08 – €9.86	1,136,450	7.75
€10.14 – €13.00	1,907,754	11.79
€15.30 – €19.78	3,246,242	19.32
Total outstanding options at 12/31/03	**6,438,696**	**14.70**

b) Terra Networks, S.A. Stock Option Plan resulting from the assumption of the Stock Option Plans of Lycos, Inc.-

Under the agreements entered into for the acquisition of Lycos, Inc., it was agreed to exchange options on the shares of Lycos, Inc. for options on the shares of Terra Networks, S.A. On June 8, 2000, the Stockholders' Meeting of Terra Networks, S.A. resolved to assume the Stock Option Plans of Lycos, Inc., provided that the two companies merged.

On October 25, 2000, the Board of Directors of Terra Networks, S.A. approved (i) the exchange of options on Lycos, Inc. shares existing prior to the conclusion of the transaction for options on Terra Networks, S.A. shares; (ii) the transfer to Citibank, NA

(Agent Bank) of all the options on Lycos, Inc. shares so that they could be exercised early; and (iii) the entering into of a contract between Terra Networks, S.A. and the Agent Bank in connection with the new Terra Networks, S.A. Stock Option Plan.

As a result of the exchange of Lycos, Inc. stock options for Terra Networks, S.A. stock options, the employees, executives and directors of Lycos, Inc. received purchase options on 62,540,249 shares of Terra Networks, S.A. owned by the Agent Bank.

On June 7, 2001, the Stockholders' Meeting of Terra Networks, S.A. resolved to partially modify the resolution relating to the Stock Option Plan, which was ratified and approved by the Stockholders' Meeting on June 8, 2000, as regards the obligations arising from the assumption of the Lycos, Inc. stock options by Terra Networks, S.A., following the exchange of shares between the latter and Lycos, Inc., which may be covered with Terra Networks, S.A. shares held by Citibank, NA, as a result of the exchange of Lycos, Inc. shares held by Citibank, NA to cover the stock options of the employees and executives of Lycos, Inc.

As described in Note 1, on December 16, 2003, the Board of Directors of Terra Networks, S.A., exercising the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of 26,525,732 shares of Terra Networks, S.A. held by Citibank, NA as the agent bank for the stock option plans assumed by the Company as a result of the integration of Lycos, Inc. These shares continue to cover the Lycos Inc. employee Stock Option Plans at that date.

As of December 31, 2003, the employees, executives and directors of Lycos, Inc. had exercised 16,216,587 options, and a commitment to exercise 19,272,198 options at a weighted average exercise price of US$ 20.77 had been made.

As of that date, the executives and directors held stock option rights, derived from the Lycos, Inc. Stock Option Plans set up prior to the acquisition of Lycos, Inc. by Terra Networks, S.A., on 9,090,776 Terra Networks, S.A. shares, the weighted average exercise price of which is US$ 23.05.

Also, as of December 31, 2003, the members of the Board of Directors during 2003 who hold or have held executive posts at the Terra Lycos Group held 8,717,026 purchase options on Terra Networks, S.A. shares derived from the Terra Networks, S.A. and Lycos, Inc. Stock Option Plans, the weighted average exercise price of which is €18.40.

The detail of the variations in the options under the Lycos, Inc. Stock Option Plan as of December 31, 2003, is as follows:

Options	Number of Options	Total Exercise Price (Thousands of U.S. Dollars)	Weighted Average Price in the Year (U.S. Dollars)
Exercise price under €11	17,875,355	69,205	3.87
Exercise price over €11	44,664,894	892,510	19.98
Total options initially issued	**62,540,249**	**961,715**	**15.38**
Exercise price under €11	14,009,345	45,706	3.26
Exercise price over €11	2,207,242	33,089	14.99
Total options exercised	**16,216,587**	**78,795**	**4.85**
Exercise price under €11	1,843,461	10,648	5.78
Exercise price over €11	17,954,469	343,293	19.12
Total options cancelled and redeemed	**19,797,930**	**353,941**	**17.88**
Exercise price under €11	643,332	4,284	6.66
Exercise price over €11	6,610,202	124,357	18.81
Total options cancelled but not yet redeemed	**7,253,534**	**128,641**	**17.73**
Exercise price under €11	1,379,217	8,566	6.21
Exercise price over €11	17,892,981	391,770	21.89
Total outstanding options at 12/31/03	**19,272,198**	**400,367**	**20.77**

c) Litigation in progress-

<u>1. Complaint filed by IDT against Telefónica, S.A., Terra Networks, S.A. and Lycos, Inc.</u>

International Discount Telecomunications Corporation (IDT) filed a complaint at the New Jersey Courts in the U.S. against Telefónica, S.A., against Terra Networks, S.A., against Terra Networks U.S.A., Inc. and against "Lycos, Inc."

The complaint is based on the purported breach of the Joint Venture agreement entered into in October 1999 by IDT and Terra Networks, S.A. and failure to comply with the obligations arising from this termination agreement, on the alleged fraud in relation to and breach of the rules governing the issue of securities (Federal Securities Exchange Act) and, lastly, on the alleged fraudulent concealment of information.

The quantum of this lawsuit is currently indeterminate, without prejudice to the possibility of the plaintiff's claim for damages being specified and quantified in the course of the proceeding.

In May 2002, the Court of New Jersey decided to partially dismiss the complaint in relation to the purported breach of certain aspects of the Joint Venture agreement, and as a result of this decision, Terra Networks, U.S.A., Inc. was no longer included in the proceeding.

Subsequently, IDT inserted a new claim in the complaint, alleging that Telefónica, S.A. would be liable, as a controlling entity, for the fraud claimed against Terra Networks, S.A. in its negotiations with IDT, that led to the termination agreement. Telefónica, S.A. has filed objections against this claim which are currently before the Court. The defendants have filed an answer to the complaint and, in turn, Terra Networks S.A. has filed a counterclaim against it.

On July 2, 2003, in light of the evidence taken, Terra Networks, S.A., Lycos, Inc. and Telefónica, S.A. filed pleadings seeking summary trial to determine the claims and have others dismissed. In turn, IDT has petitioned to have the counterclaim filed by Terra Networks, S.A. dismissed.

The Company, based on the opinion of its legal counsel, considers that it has a sound defense against the claims filed against it and, accordingly, Terra Networks S.A. is confident that the outcome for Terra Networks, S.A. of the litigation arising from IDT's complaint should not de adverse.

2. Bumeran Participaciones, S.R.L. (liquidated company)

The minority stockholders of Bumeran Participaciones, S.R.L. (liquidated company) have filed complaints contesting the resolution adopted at the Stockholders' Meeting of December 18, 2002, to dissolve the company and appoint a liquidator.

They are seeking to have the courts set aside the aforementioned resolution to dissolve Bumeran Participaciones, S.R.L. having petitioned the court, unsuccessfully, to stay the resolution as an injunctive measure.

To date, the following litigious events have occurred:

- Initiation of the arbitration requested by Master Equities (a minority stockholder of Bumeran Participaciones, S.R.L.).

- On October 21, 2003, Terra Networks, S.A. had notice of a new request for arbitration by the other minority stockholders of Bumeran Participaciones, S.R.L. (Lorne Consultants, S.A., Regent Equities, S.A., Pablo Larguia y Century Equities, S.A.) being heard by the same arbitrator.

The quantum for both arbitrations is US$ 4.2 million.

- Proceeding to contest the resolutions adopted on December 18, 2002, by the Stockholders' Meeting of Bumeran Participaciones, S.R.L., which is being conducted at Majadahonda Court of First Instance 1.

- Proceeding to contest the resolutions adopted on November 26, 2002 by the Board of Directors of the aforementioned company.

On October 21, 2003, this party applied for joinder of the two proceedings, in view of the close connection between them.

The quantum of these two proceedings is indeterminate.

The two arbitrations and the proceedings contesting the resolutions of the Stockholders' Meeting and of the Board of Directors are all in progress.

The Company, based on the opinion of its legal counsel, is confident that the outcome of the lawsuit should not be adverse for Terra Networks, S.A.

3. Collective lawsuits filed by stockholders of Terra Networks, S.A. in the United States, in connection with the admission to listing of Terra

Terra Networks, S.A. has been summonsed to appear as a defendant in five complaints filed in the U.S. involving Terra Networks, S.A. and certain of its directors and executives who worked for the Company during the period of time when the Initial Public Offering was launched in the U.S. in 1999.

The five lawsuits filed against Terra Networks, S.A. are part of the more than one thousand complaints filed in the U.S. in 2000 and 2001 in connection with approximately three hundred IPOs. These complaints, challenging the allotments made under the IPOs, allege, principally, that the security placement institutions allotted shares to privileged customers in these IPOs, which had awakened great interest in the potential investors and for which the closing price on the first day was expected to be high. These complaints allege that in exchange for allotting shares to them, these customers agreed to buy shares on the secondary market at a predetermined price in order to keep the market value of the shares artificially high, and that the placement institutions received from their customers inflated fees or remuneration of another kind that could be deemed to be unlawful or unauthorized or to otherwise contravene SEC and NASD rules.

Also, the directors and executives of Terra Networks, S.A. negotiated and signed an agreement with the plaintiffs whereby the latter agreed to exclude the individual defendants from the proceedings, without prejudice to the possibility of including them once again if the plaintiffs found grounds for doing so.

In July 2002 Terra Networks, S.A. and other defendant securities issuers jointly filed a petition to have the joined claim dismissed. This petition was rejected by the judge on February 19, 2003.

The plaintiffs, the securities issuers (including Terra Networks, S.A.) and their insurance companies have finalized the terms of an agreement which mainly establishes that the insurance companies undertake to guarantee the availability of a certain sum of money on condition that the plaintiffs do not again collect the same sum from the placement institutions. The settlement does not resolve the dispute between the plaintiffs and the security placement institutions.

The Company, based on the opinion of its legal counsel, is confident that the aforementioned settlement will ultimately be ratified by the Court, and if otherwise, the Company considers that it has a sound defense against the claims filed against it and, accordingly, Terra Networks, S.A. is confident that the outcome of the litigation should not be adverse for Terra Networks, S.A.

4. Collective lawsuits filed by stockholders of Terra Networks, S.A in the U.S. in connection with the tender offer by Telefónica, S.A. for Terra Networks, S.A.

On May 29, 2003, two class actions were filed at the Supreme Court of the State of New York by stockholders of Terra Networks S.A. against Telefónica S.A., Terra Networks S.A. and certain former and current directors of Terra Networks S.A.

These actions mainly allege that the price offered to the stockholders of Terra Networks, S.A. is not consistent with the intrinsic value of the Company's shares, and request that the tender offer not be approved or, alternatively, that the stockholders be compensated.

The litigation process has been inactive since the complaints were filed.

The Company, based on the opinion of its legal counsel, considers that it has a sound defense in terms of both the form and the substance of the claims filed against it and, accordingly, is confident that the outcome of the litigation should not be adverse for Terra Networks, S.A.

5. Riaz Valani, Tabreez Verjee, Michael Downing and Global Asset Capital against Lycos, Inc.

On July 17, 2003, former stockholders of IMDI (the former owner of the Sonique product) filed a complaint against Lycos, Inc. and IMDI at the San Francisco State Court alleging breach of contract, willful interference and unfair practices in connection with the payment under the agreement for the acquisition of IMDI/Lycos, Inc. several years ago. The plaintiffs claim that Lycos, Inc. and IMDI did not measure the popularity of Sonique using a specific calculation which, according to the terms of the agreement, could have amounted to US$ 15 million. The claim seeks damages of an indeterminate quantum. Lycos, Inc. has replied to the claim denying the allegations made and intends to present a strong defense.

The Company, based on the opinion of its legal counsel, is confident that the outcome of the litigation should not be adverse for Terra Networks, S.A.

6. Lycos, Inc. against Overture Services, Inc.

Lycos Inc. has filed a complaint against Overture Services Inc. -which is being processed by the Massachusetts District Court- claiming that Overture Services Inc. has breached certain contractual agreements such those relating to nontransfer of contract, confidentiality and payment, under the Integration and Distribution agreement entered into by the parties on September 30, 2001, whereby Overture was acquired by Yahoo!.Inc., which is a direct competitor of Lycos Inc. The claim is for an indeterminate quantum.

In turn, Overture Services Inc. has filed a counterclaim against Lycos, Inc. alleging that it was the latter that had not fulfilled the terms of the contract, breaching the principles of good faith.

The Company, based on the opinion of its legal counsel, is confident that the outcome of the litigation should not be adverse for Terra Networks, S.A.

(15) PAYMENTS TO AUDITORS

The payments made by Terra Networks, S.A. in 2003 to the various member firms of the Deloitte & Touche International Organization, to which Deloitte & Touche España, S.L., the Company's auditor, belongs, amounted to €437 thousand.

The detail of the foregoing amount is as follows:

	Thousands of Euros
Audit of financial statements	219
Other audit services	182
Work additional to or other than audit services	36
Total	437

The payments made by the Terra Lycos consolidated Group in 2003 to the various member firms of the Deloitte & Touche International Organization, to which Deloitte & Touche España, S.L., the auditor of the consolidated Group, belongs, amounted to €1,390 thousand.

The detail of the foregoing amount is as follows :

	Thousands of Euros
Audit of financial statements	823
Other audit services	429
Work additional to or other than audit services	138
Total	1,390

The payments made to other auditors of the Terra Lycos Group in 2003 amounted to €578 thousand, the detail being as follows :

	Thousands of Euros
Audit of financial statements	42
Other audit services	11
Work additional to or other than audit services	525
Total	578

These fees include the amounts paid in connection with the fully consolidated Spanish and foreign Terra Lycos Group companies.

(16) SUBSEQUENT EVENTS

a) Changes in the Board of Directors-

On January 27, 2004, the Board of Directors of Terra Networks, S.A accepted the resignation of Mr. Edward M. Philip from the Board of Directors of Terra Networks, S.A.

On February 24, 2004, the Board of Directors of Terra Networks, S.A accepted the resignation of Mr. Joaquim Agut Bonsfills and Mr. Luis Ramón Arrieta Durana from the Board of Directors of Terra Networks, S.A.

INCLUIR EL CUADRO DE FINANCIACIÓN. NOTA 17

The reconciliation of the consolidated loss for the year to the funds obtained from operations is as follows:

Thousands of Euros	2003
Loss for the year	(191,803)
Intangible asset amortization expense	7,545
Property and equipment depreciation expense	3,411
Variations in investment valuation allowances	203,548
Funds obtained from operations	**22,701**

(18) EXPLANATION ADDED FOR TRANSLATION TO ENGLISH

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

Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails

TERRA NETWORKS GROUP

2003 MANAGEMENT REPORT

Introduction

The adverse macroeconomic situation affected the business performance of the Terra Lycos Group in 2003, although in recent months the new technologies industry appears to have revived to some extent. In the face of these difficulties the Terra Lycos Group boosted its most profitable and recurring revenue sources, backed by cost cutting and the centralization of production.

In 2003 the Terra Lycos Group continued to set its sights firmly on growth in its Internet access business, while it also increased its range of value-added services, both as regards communications (CSPs), such as its new messenger services and security (antispam, antivirus, firewall) kits, and content and portal services, such as Mundo ADSL, financial information subscription services and on-line dating.

As of December 31, 2003 the Terra Lycos Group had 5 million subscribers paying for Internet access and value-added services. Growth in this line of business has helped to make up for (i) the stagnancy of the on-line advertising market; (ii) the slow takeoff of the e-business in Spain and Latin America; (iii) the adverse impact of exchange rates on revenues; and (iv) the short-term drop in revenues due to the replacement of the agreement with Bertelsmann by the Strategic Alliance with the Telefónica Group.

The Framework Strategic Alliance Agreement with the Telefónica Group, entered into in February 2003 and effective January 1, 2003, defines a new, strengthened model for relations between the two companies for a term of six years, harnessing better their respective capabilities, while also fostering the growth and leadership of both companies in the Internet business. In 2003 the Telefónica Group met its commitments under the Strategic Alliance, which helped it to strengthen its supply to on-line customers and enabled the Terra Lycos Group to enhance its competitive position, to rationalize its production structure and raise its margins. The Alliance produced revenues of €101 million in 2003 and also created value (defined as the difference between revenues gained from the services provided and the costs and investments directly associated with such services) of €78.5 million, the minimum guaranteed amount for each of the six years of the term of the Alliance.

Also, the business performance was affected by certain organizational changes initiated in 2002, such as the centralization of the development of products, services and systems for customers. The new structure has given rise to cost savings, due to the centralization of certain transactions and engineering work and has contributed to improving the launch of new, enhanced products at a global level. Furthermore, the management of all the Latin American countries was grouped together in a single unit in order to maximize commercial synergies and minimize costs in the region and maintain the leadership position attained.

Business performance and results

1.- Revenues

The total revenues generated by the Terra Lycos Group in 2003 amounted to €547 million, down 12% from the 2002 figure. Excluding the adverse impact of the exchange rates of certain currencies with respect to the euro, the currency in which the Terra Lycos Group consolidates its financial statements, revenues in 2003 would have amounted to €621 million, which is on a par with the €622 million reported in 2002.

Revenues are generated by the following four business lines:

1.1.- Access and communication services

This line of business generated revenues of €216 million in 2003, accounting for 40% of total operating revenues and, in constant euro terms, represents growth of 9% with respect to the proceeding year.

As of December 31, 2003, pay access subscribers totaled 1.7 million, up 20% on 2002 year-end, of whom 63% related to Brazil and 21% to Spain. Noteworthy as regards access was the increase in and improvement of broadband (ADSL) access services in both Spain and the Latin American countries, particularly Brazil. As of 2003 year-end, ADSL access customers totaled 644,000, 70% more than at the end of 2002, of whom 61% related to Brazil and 26% to Spain.

In Spain a salient feature of the year was the launch of ADSL Home and ADSL a tu medida (customized broadband), with prices, features and service times that supplement the existing "ADSL Plus" premium 24-hour product. With this measure the Company aims to reach more market segments and promote residential Internet use. In the narrow band segment, various flat rate options were also launched, such as those for 24-hour, evening and night users.

In Brazil the pay access business performed particularly well in a scenario of free access market growth, in which the Terra Lycos Group does not operate directly. In Brazil, the Group remains market leader in the broadband market with a market share of close to 50%.

1.2.- Advertising and e-commerce

This business line contributed revenues of €143 million in 2003, 26% of the total operating revenues which, in constant euro terms represented a drop of 40% with respect to 2002. This business line was hit particularly hard by the fact that the agreement with Bertelsmann was not renewed and by the sluggish online advertising scenario.

The Terra Lycos Group has continued to focus on providing integral marketing services, which made it possible for it to forge stronger ties with customers and to give advertisers access to a highly segmented public and to maximize the effectiveness of the Internet as an advertising medium.

In October 2003, Lycos entered into a three-year agreement with Google Inc. to include the sponsored advertisements system (Google Adwords) in certain Terra Lycos web pages (the agreement covers the Lycos Search, HotBot, Sidesearch and Terra.com web sites).

1.3.- Communications, portal and content sale services

This line of business contributed revenues of €119 million in 2003, 22% of total operating revenues which, in constant euro terms, represented growth of 101% with respect to 2002. These revenues include services provided to residential customers at home, professionals SMEs, either directly or through corporations, such as Bancomer in Mexico and, primarily, the Telefónica Group, through the Strategic Alliance, from which 53% of total revenues in this line are obtained.

Customers for value-added services, known as OBP (Open, Basic, and Premium) customers, totaled 3.4 million as of December 31, 2003, of whom 2.3 million are customers arising from the Alliance with Telefónica.

This business line is being strengthened by the launch of new products and services in the Communication, content, Marketing and Tools areas, and by the improvements being made to the existing areas. These products and services include most notably the following:

⇒ Terra Messenger: a new real-time messenger service, affording Terra users the possibility of instant communication with each other and with Messenger users from other platforms;
⇒ Mundo ADSL: launched jointly by Terra and Telefónica, this product is designed to meet a broad range of communication, training and leisure needs, tailored to the requirements of customers;
⇒ Wireless Internet: a service for all broadband customers, broadening the range of high speed products using the new WiFi technology;
⇒ Redesign of the Matchmaker environment, an online dating portal;
⇒ Redesign of the InSite Search Engine marketing site;
⇒ Relaunch of the Quote.com, a financial site.

1.4.- Other services for SMEs and companies and other revenues

These two business lines contributed revenues of €68 million in 2003, accounting for 12% of total operating revenues which, in constant euro terms, represented growth of 45% with respect to 2002. The Strategic Alliance with the Telefónica Group contributed 26% of these revenues, through the provision of e-learning services and several Internet and technology consulting projects.

2.- EBITDA

The Terra Lycos Group continued to monitor and rationalize expenses in 2003, which contributed to the progressive and continued improvement of operating results before taxes, depreciation, amortization and leases (EBITDA) throughout the year, signfying that the target set for the whole year was met and positive EBITDA was achieved in the fourth quarter. The Company's EBITDA in 2003 were a loss off €-29.4 million, and the EBITDA margin on income was -5%. Therefore, the EBITDA for 2003 was a €91 million better than in 2002.
In 2003 a significant personnel restructuring process took place in the U.S., Mexico and Venezuela, helping to reduce the average labor force from 2,807 in 2002 to 2,300 in 2003. The average labor force at 2003 year-end was 2,255, as compared with 2,494 at 2002 year-end.

3.- Main investments

Lycos Europe

Lycos Europe is Europe's leading portal, with 25 million sole users per month and a presence in ten countries. It ended 2003 with revenues of €85 million. The forging of new agreements, its expense containment policy and the rationalization and restructuring processes carried out in previous years enabled the Company to increase its income for the year by 69%. Lycos Europe started 2004 by reinforcing its strategy of focusing on key products, reducing costs and seeking to balance its revenues to generate a high proportion of these revenues through pay services. Through this line the Company acquired United Domains and Buy Central to supplement its range of value-added services for companies and other users. At year-end the price of Lycos Europe shares had risen by 129% with respect to the beginning of the year.

Uno-e

Uno-e ended 2003 with a positive operating margin of €359 thousand, following the integration of the consumer finance line of business of Finanzia. The changes in the price strategy led to a reduction in the volume of deposits gained, which was partly offset by the strong growth in off-balance sheet products. Consumer financing grew by 9% and delinquency was strictly controlled. These results were achieved in a year of considerable organizational change, with the aforementioned integration, and place Uno-e in an excellent position to face up to the coming years.

One Travel

Gross sales rose by 20% with respect to 2002 to $106 million in a year in which the Iraq war and SARS had an adverse effect on demand in this industry. EBITDA improved by 50%, due to the increase in sales and the containment of overheads, despite the industry's narrowing margins caused by the aggressive strategies of airlines in a bid to recover sales and cushion the effect of the aforementioned circumstances. The consolidation of this company (acquisition of a majority stake in April 2003) gave Terra Lycos additional revenues of €31 million in 2003.

4.- Cash

Attention should also be drawn to the improvement in cash management. Cash consumption in 2003 was reduced substantially to €101 million, as compared to the €338 million consumed in 2002. As of December 31, 2003, the Terra Lycos Group had cash and liquid financial investments of €1,594 million, which enabled it to retain its privileged position in the industry in terms of liquidity.

Research and development

As part of its technological strategy to develop products and services for the Internet, the Terra Lycos Group places special emphasis on its research and development program, for which it is closely backed by prestigious companies in the industry, such as Telefónica I+D.

In 2003 the Terra Lycos Group became actively involved in the European Celtic (Cooperation for a European sustained Leadership in Telecommunications) initiatives program, in its line of action for the development of applications and services and in proposals for the Sixth European Union Framework Programme, which is addressing the possibility of creating virtual communities that will provide a new generation of real-time multimedia communications services.

The Terra Lycos Group maintains a firm commitment to the monitoring, active involvement and promotion of open source development initiatives focused on developing real-time communication services, through open cooperation environments for software development.

Within the context of solutions for SMEs, projects were performed for the introduction of information technologies focusing specifically on communications and e-commerce as tools to raise the productivity and increase the business opportunities of these fundamental elements of the world's economy.

In the multimedia and entertainment services fields, the development of advanced on-line games platforms and systems for the management of rights on digital contents were areas on which the research and development program very significant focused very closely in 2003.

As a general rule, the aforementioned development work is carried out in strict compliance with a methodology aimed at the development of "Seis Sigma" quality products and services.

Management team changes

At the Board meeting held on January 29, 2003, the shareholders Luis Bassat Coen and Luis Badía Almirall were appointed by cooptation to fill the vacancies left by the resignations of Jesús María Zabalza Lotina and Alejandro Junco de la Vega Elizondo.

Subsequently, at the Board meeting held on March 25, 2003, the shareholder J. Alfonso Bustamante Bustamante was appointed by cooptation to full the vacancy left by the resignation of Johannes Hendrikus Hubert De Mol.

At the Board meeting of October 29, 2003, Robert J. Davis resigned from his office as director.

At the Board meeting held on December 16, 2003, Joaquim Agut Bonsfills tendered his resignation as the Company's Executive Chairman and Joaquín Faura Batlle, as a director, was appointed by cooptation to full the vacancy due to the resignation of Robert J. Davis. Also at the meeting in question, the Board resolved to appoint Joaquín Faura Batlle as the Company's new Executive Chairman to replace Joaquim Agut.

On January 27, 2004, the Board of Directors of Terra Networks, S.A accepted the resignation of Edward M. Philip as a director of Terra Networks, S.A.

On February 24, 2004, the Board of Directors of Terra Networks, S.A accepted the resignation of Mr. Joaquim Agut Bonsfills and Mr. Luis Ramón Arrieta Durana from the Board of Directors of Terra Networks, S.A.

Tender offer of Telefónica, S.A. for Terra Networks, S.A. shares and exclusion from the IBEX 35 Index

On May 28, 2003, Telefónica, S.A. submitted a tender offer for all the shares of Terra Networks, S.A. that were listed for trading and traded both on the Spanish and U.S. Nasdaq markets.

The tender offer was subject to the acquisition by Telefónica, S.A. of a given number of Terra Networks, S.A. shares which, together with those already owned by Telefónica and frozen until the date of publication of the results of the tender offer, accounted for at least 75% of the capital stock of Terra Networks, S.A. at the date of publication of the results of the tender offer. Also, Telefónica, S.A. expressly reserved the right to waive this condition on the date of expiration of the tender offer acceptance period (July 23, 2003).

The tender offer launched by Telefónica, S.A. was accepted by 54.52% of the stockholders holding the shares on which the offer was targeted, representing 33.60% of the capital stock of Terra Networks, S.A., which, added to the ownership interest already held by Telefónica, S.A. in the capital stock of Terra Networks, S.A, gave Telefónica, S.A. a stake of 71.97% in the Company.

On July 25, 2003, Telefónica, S.A. confirmed through a relevant fact disclosure, its decision to waive the minimum limit to which the tender offer had been restricted. Consequently, the resulting direct holding represented 71.97% of the total capital stock of Terra Networks, S.A.

Also, in view of the reduced liquidity of Terra Networks, S.A. shares in the Spanish market, at its meeting on December 11, 2003, the Technical Advisory Committee of the Ibex Indexes resolved, in accordance with the Technical Standards for the Composition and Calculation of the Ibex 35 indexes, to exclude the Terra Networks (TRR) securities from the Index, effective January 2, 2004.

Treasury stock

On June 26, 2003, the Board of Directors of Terra Networks, S.A. indicated its willingness to accept the tender offer for the acquisition of shares launched by Telefónica, S.A. for the 2,420,468 shares of treasury stock held by Lycos, Inc. as of December 31, 2002, for an amount of €1,858 thousand.

On December 16, 2003, the Board of Directors of Terra Networks, S.A., exercising the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of 26,525,732 shares of Terra Networks, S.A. owned by Citibank, NA, as the agent bank for the Stock Option Plans established by the Company on the integration of Lycos, Inc. The shares were acquired at the prices at which Citibank, NA had acquired the Lycos Inc shares to cover the latter company's Stock Option Plans for its employees at the date of their acquisition.

Additionally, in December 2003 Lycos, Inc. acquired 18,920 shares for a total amount of €1 thousand as a result of the former agreements between Lycos Inc. and the CMGI Group relating to the coverage of the stock options granted to Lycos Inc. employees in the initial stage of the Plan.

The value adjustment to the treasury stock was made because of the difference between the acquisition price of the shares and their underlying book value, and this amount was recorded with a charge of €165,521 thousand, to "Additional Paid-in Capital", since these shares are restricted as to their use, as they are specifically earmarked for assignment to the employees or for sale on their behalf when they exercise their options or, pursuant to the resolutions of the Stockholders' Meetings of June 8, 2000 and April 2, 2003, they must be retired if the options are not exercised before the related exercise period expires.

Accordingly, the total number of shares of treasury stock held as of December 31, 2003, was 26,544,652, representing 4.41% of capital stock and valued at €4.76 per share. This amount is recorded under the "Treasury Stock" caption, on the asset side of the accompanying balance sheet at a total amount of €126,262 thousand.

In accordance with Article 79.3 of the revised Spanish Corporations Law, the Company has recorded the relevant restricted reserve.

Events subsequent to year-end

On February 11, 2004, Lycos, Inc. reduced its labor force by 118 employees as a result of the reorganization of its product and service portfolio and the outsourcing of its media sales force to 24/7 Real Media Inc., with which it has entered into an agreement for media sales and Ad-serving (advertisement placement) and analysis services.