TERRA NETWORKS, S.A.

Financial Statements for 2004 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, 2004, 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 2004 financial statements of Terra Networks España, S.A., which was effectively wholly-owned by Terra Networks, S.A., whose gross investment as of that date amounted to €93,973 thousand (see Note 7). 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 2004 figures for each item in the balance sheet and statements of operations and of changes in financial position, the figures for 2003. Our opinion refers only to the 2004 financial statements. Our auditors' report dated February 25, 2004, on the 2003 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 which was qualified for the same uncertainty as that described in paragraph 5 to this report. 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 income for the year by €303,399 thousand and €26,945 thousand, respectively, and to increase reserves by €27,717 thousand (see Note 4-c to the financial statements referred to above).

4. On February 23, 2005, the Board of Directors of Terra Networks, S.A., approved the plan for the merger of Telefónica, S.A. and the Company. This merger has not yet been approved by the respective Stockholders’ Meetings. In this connection, the financial statements referred to above were prepared without taking into account the effects, if any, that could arise from the aforementioned merger.

   As of December 31, 2004, the “Long-Term Investments” caption included a balance of €287,009 thousand, relating to prepaid income taxes and tax assets capitalized for tax losses incurred in 2001 and prior years (see Note 9). The directors of Terra Networks, S.A.

consider that, subject to the materialization of certain circumstances and the fulfillment of certain assumptions, and based on the projections and business plans prepared by their external advisers for the next ten years, in the context of the aforementioned merger, this amount is recoverable in the aforementioned period of time. 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 makes this necessary.

5. As indicated in Note 14-d)1, as of the date of this Auditors' Report no decision had yet been handed down in relation to the claim for damages of an unquantified amount, filed by IDT (International Discount Telecommunications Corporation) against Terra Networks, S.A., Terra Networks USA, Inc. and Telefónica, S.A. The Company's directors and their external legal advisers consider that Terra Networks, S.A., has solid arguments on which to oppose the claims; although at the present stage of the proceedings they consider that they cannot predict the final outcome thereof.

6. In our opinion, based on our audit and on the report of BDO Audiberia Auditores, S.L., except for the effects of any adjustment that might have been required had the final outcome of the uncertainty described in paragraph 5 above been known, the financial statements for 2004 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, 2004, 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.

7. The accompanying management report for 2004 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 2004. 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, S.L.
Registered in ROAC under no. S0692

Javier Acevedo Jiménez de Castro

February 24, 2005

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.

BALANCE SHEETS AS OF DECEMBER 31, 2004 AND 2003

(Thousands of Euros)

ASSETS	12/31/04	12/31/03	STOCKHOLDERS' EQUITY AND LIABILITIES	12/31/04	12/31/03
FIXED AND OTHER NONCURRENT ASSETS:			**STOCKHOLDERS' EQUITY (Note 8):**		
Intangible assets, net (Note 5)	**174.333**	**13.333**	Capital stock	1.149.883	1.202.936
Research and development expenses	**-**	-	Additional paid-in capital	3.975.217	5.126.134
Intellectual property	11.032	10.546	Other reserves	121.534	165.863
Computer software	43.102	40.783	Accumulated losses	(3.803.587)	(3.611.784)
Intangible assets in progress	11	2.484	Income / (Loss) for the year	190.917	(191.803)
Other intangible assets	181.990	232			
Accumulated amortization	(61.802)	(40.712)	**Total stockholders' equity**	**1.633.964**	**2.691.346**
Property and equipment, net (Note 6)	**1.863**	**4.843**			
Plant and machinery	4.926	6.484			
Computer hardware	8.237	8.233			
Furniture	1.071	1.200			
Other tangible fixed assets	1.123	1.274	**DEFERRED REVENUES**	**10.479**	**32.620**
Accumulated depreciation	(13.494)	(12.348)			
Long-term investments (Note 7)	**1.043.376**	**1.715.073**			
Investments in Group and associated companies	990.099	3.773.835			
Loans to Group and associated companies (Note 10)	448.321	472.777	**PROVISION FOR CONTINGENCIES AND EXPENSES (Note 7)**	**408.428**	**417.751**
Long-term deposits and guarantees	1.013	810			
Taxe receivables (Note 9)	287.009	287.009			
Investment valuation allowances	(683.066)	(2.819.358)	**LONG-TERM PAYABLES TO GROUP COMPANIES (Note 10)**	**26.183**	**26.183**
Long-term treasury stock (Note 8-a)	**15.120**	**126.262**			
Total fixed and other noncurrent assets	**1.234.692**	**1.859.511**			
CURRENT ASSETS:			**CURRENT LIABILITIES:**		
Accounts receivable-	**67.769**	**90.839**	Payable to Group companies (Note 10)	41.590	132.340
Receivable from Group and associated companies (Note 10)	63.399	83.532	Trade accounts payable	28.567	32.169
Other accounts receivable	4.370	7.307	Taxes payable (Note 9)	3.402	3.362
Tax receivables (Note 9)	**6.812**	**19.279**	Other nontrade payables	3.529	4.495
Short-term investments in Group companies (Note 10)	**826.204**	**1.360.913**	Accrual accounts	67	153
Other short-term investments	**13.760**	-	**Total current liabilities**	**77.155**	**172.519**
Cash	**7**	**33**			
Accrual accounts	**6.965**	**9.844**			
Total current assets	**921.517**	**1.480.908**			
TOTAL ASSETS	**2.156.209**	**3.340.419**	**TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES**	**2.156.209**	**3.340.419**

The accompanying Notes 1 to 18 are an integral part of the balance sheet as of December 31, 2004.

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.

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

(Thousands of Euros)

DEBIT	2004	2003	CREDIT	2004	2003
EXPENSES:			**REVENUES:**		
Procurements	58	2.225	Net sales and services	27.856	40.646
Personnel expenses (Note 11)	16.826	19.067		**27.856**	**40.646**
Depreciation and amortization expense	22.747	10.956			
Advertising and publicity	975	2.468			
Rent and royalties	3.005	3.152			
Professional services	9.316	7.382			
Other operating expenses	8.402	14.027			
	61.329	**59.277**			
Operating income		**-**	**Operating loss**	**33.473**	**18.631**
Financial expenses with Group companies	1.746	-			
Financial expenses on other debts	589	1.061	Financial revenues from investments in Group companies (Note 10)	36.334	34.059
Other financial expenses	-	770	Financial revenues from investments in other companies	383	-
Exchange losses	5.216	11.573	Exchange gains	29.442	2.054
Financial income	**58.608**	**22.709**	**Financial loss**	**-**	**-**
Income from ordinary activities	**25.135**	**4.078**	**Loss on ordinary activities**	**-**	**-**
Variation in investment valuation allowances (Note 7)	135.714	203.548			
Extraordinary expenses and losses (Note 12)	20.770	4.343	Other extraordinary revenues (Note 12)	30.434	12.010
Extraordinary income	**-**	**-**	**Extraordinary loss**	**126.050**	**195.881**
Income before taxes	**-**	**-**	**Loss before taxes**	**100.915**	**191.803**
Corporate income tax (Note 9)	**-**	**-**	Corporate income tax (Note 9)	291.832	**-**
Net income for the year	**190.917**	**-**	**Loss for the year**	**-**	**191.803**

The accompanying Notes 1 to 18 are an integral part of the statement of operations for the year ended December 31, 2004.

(17) STATEMENTS OF CHANGES IN FINANCIAL POSITION

APPLICATION OF FUNDS	Thousands of Euros 2004	Thousands of Euros 2003	SOURCE OF FUNDS	Thousands of Euros 2004	Thousands of Euros 2003
Capital reduction	123.311	73.616	Funds obtained from operations	323.207	22.701
Distribution of dividend	1.122.123	-	Disposal of Lycos, Inc.	88.878	-
Fixed assets additions:			Fixed asset disposals:		
*Intangible assets	950	5.754	*Intangible assets	407	-
*Property and equipment	787	2.659	*Property and equipment	2.368	-
*Investments in Group and associated companies	21.883	10.885	*Investments in Group and associated companies	17.956	7.656
Conversion to capital of short-term receivables	-	36.385	Provision for contingencies and expenses	622	5.456
Deferred revenues	22.141	-	Transfer to short term of long-term debt	428	-
Transfer to long term of short-term loans	-	469.020	Deferred revenues	-	21.264
Acquisition of treasury stock	15.120	-	Transfer to long term of short-term debt	-	26.183
Loans to Group and associated companies	-	1.867	Options exercised	85	-
			Retirement of treasury stock	123.311	73.616
			Variation in working capital due to sale of Lycos, Inc.	285.026	-
TOTAL FUNDS APPLIED	**1.306.315**	**600.186**	**TOTAL FUNDS OBTAINED**	**842.288**	**156.876**
FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED	**-**	**-**	**FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED**	**464.027**	**443.310**

VARIATION IN WORKING CAPITAL	Thousands of Euros Increase 2004	Increase 2003	Decrease 2004	Decrease 2003
Accounts receivable		-	23.070	6.841
Tax receivables		-	12.467	7.183
Short-term investments		-	520.949	487.189
Cash		24	26	
Accrual accounts		-	2.879	1.352
Current liabilities	95.364	59.231		
TOTAL	**95.364**	**59.255**	**559.391**	**502.565**
VARIATION IN WORKING CAPITAL		**-**	**464.027**	**443.310**

Terra Networks, S.A.

Financial Statements
for 2004 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 2004 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 formed or acquired subsidiaries in most of the countries in which it provides its services. Specifically, as of December 31, 2004, and once Lycos, Inc. had been excluded from the scope of consolidation, the Terra Networks, S.A. and Subsidiaries Group ("the Terra Group") was providing services through direct or indirect holdings in Spain, Germany, Austria, Denmark, France, the Netherlands, Italy, the U.K., Sweden, Switzerland, the U.S., Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Honduras, México, Nicaragua, Panama, Peru, Puerto Rico, the Dominican Republic, Uruguay and Venezuela. The holdings in Germany, Austria, Denmark, France, the Netherlands, Italy, the U.K., Sweden and Switzerland are the result of the continuation within the Terra Group of Lycos Europe N.V. following the sale of Lycos, Inc.

Divestment of Lycos, Inc.

On October 5, 2004, Terra Networks, S.A. executed the agreement reached on July 31, 2004, with the Korean company Daum Communications, Corp. whereby Terra Networks, S.A. sold all the shares of Lycos, Inc. to the Korean company once the required administrative authorizations had been obtained, in particular, the approval of the U.S. antitrust authorities.

Prior to the sale, Lycos, Inc. transferred certain assets to Terra Networks, S.A., including the equity interests in Lycos Europe, N.V., and Terra Networks USA, LLP. and other financial assets.

The book value of the assets transferred was €332.9 million, the detail being as follows:

Asset Transferred	Thousands of Euros
Lycos Europe, N.V.	47,880
Cash	68,855
Accounts receivable from Terra Networks, S.A.	88,804
Accounts receivable from Terra Networks Operations	20,287
Loan to Terra Networks, S.A.	106,353
Loan to One Travel.com, Inc.	728
TOTAL	332,907

The selling price of Lycos Inc. was set at US$ 108 million, and the gain on the transaction, taking into account the value of the assets received, amounted to €26 million and is recorded under the "Other Extraordinary Revenues" caption in the accompanying statement of operations (see Note 12).

Payment of dividend

On June 22, 2004, the Stockholders' Meeting of Terra Networks, S.A., approved the payment of a fixed cash dividend of €2 gross on each of the Company's outstanding shares, with a charge to the "Additional Paid-in Capital" account. The dividend was paid on July 30, 2004, for a total amount of €1,136 million (see Note 8).

Restructuring process

In order to create a more streamlined and flexible organization that is closer to its end customers, in 2004 the Terra Networks Group decided to change both its organizational and corporate structure. Thus, from the standpoint of its leverage in the

Telefónica Group, a rationalization process was carried out, in which areas and functions were simplified, which affected both the corporate centers (Terra Networks, S.A. and Terra Networks Latam, E.T.V.E., S.L.) and various subsidiaries (Lycos, Inc. and Terra Networks México, S.A. de C.V., among others). The Group's presence was also strengthened in the markets in which the Telefónica Group has a presence.

In order to carry out its restructuring process, Terra Networks, S.A. considered it necessary to reduce labor costs and, accordingly, in March 2004, presented a Labor Force Reduction Plan. This Plan consists of three phases, two of which were completed in 2004 and a third phase which is planned for 2005.

As of December 31, 2004, the first two phases had affected 58 persons and the expenses arising from the process were recorded under the "Extraordinary Expenses" caption (see Note 12) in the accompanying statement of operations. Since this restructuring process is voluntary for the company, no provisions were recorded in the financial statements as of December 31, 2004, for the costs that might be incurred in the third phase.

Acquisition of treasury stock and capital reductions

On July 15, 2004, Barclays Bank, S.A. sold to Terra Networks, S.A., outside the market, 7,000,000 shares issued by the latter, at a price of €2.16 per share, under the agreements between the two entities. These shares were initially acquired by Banco Zaragozano, S.A. (which was succeeded by Barclays Bank, S.A. as a result of the merger of the two banks) as the agent financial institution for the Stock Option Plan for the Terra Group's employees (see Note 14-a). The aforementioned 7,000,000 shares acquired by Terra Networks, S.A. are held as treasury stock to be retired, if applicable, pursuant to a resolution of the Stockholders' Meeting.

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 assumed by the Company as a result of the integration of Lycos, Inc. These shares represent 4.41% of the capital stock of Terra Networks S.A. The aforementioned 26,525,732 shares of treasury stock were retired in accordance with a resolution of the Stockholders' Meeting of Terra Networks, S.A., held on June 22, 2004 (see Note 8), to reduce capital stock by €53,053 thousand.

These shares were acquired from Citibank, NA in order to be able to recognize the new tax asset that arose in 2004 and those that might arise in subsequent years. This was achieved through the inclusion of Terra Networks, S.A. in the Telefónica consolidated tax group in 2004 since, once this acquisition had been made, Telefónica, S.A. had an ownership interest of 75.29% of the effective capital stock of Terra Networks, S.A. (capital stock less treasury stock). As a result of the aforementioned integration, an account receivable from Telefónica, S.A. amounting to €291,832 thousand as of December 31, 2004, was recognized in this connection (see Note 9).

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, the Board of Directors of Terra Networks, S.A., in accordance with the opinion issued by the investment banks Citigroup and Lehman Brothers, deemed 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.

On July 25, 2003, the CNMV informed the Parent 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.

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

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 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 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 additional payments up to a total amount of US$ 675 million for the products and services purchased from the Terra 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 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 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 Parent Company’s Board of Directors, the capacity of the new strategic alliance agreement to create value for the Terra 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 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 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 2004 the aforementioned minimum annual value was generated for the Terra Group.

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, as well as on the 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.

As of December 31, 2004 and 2003, the Company's stockholders were as follows:

Stockholder	Percentage of Ownership	
	12/31/04	12/31/03
Telefónica, S.A.	75.87 (*)	71.97(*)
Treasury stock	1.22	4.41
Other stockholders	22.91	23.62
Total	**100.00**	**100.00**

(*) Telefónica's effective ownership interest (capital less treasury stock) is 76.80% and 75.29%, respectively.

As of December 31, 2004, the "Other Stockholders" caption included the holdings owned by Caja de Ahorros y Pensiones de Barcelona (1.197%), the purpose of which is to provide coverage for the Stock Option Plans for the Terra Group's employees (see Notes 8 and 14-a and 14-b). If these options are not exercised by the time they mature, the shares will be retired.

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 2004 financial statements will be submitted for approval by the Stockholders' Meeting, and it is considered that they will be approved without any changes. The 2003 financial statements were approved by the Stockholders' Meeting on June 22, 2004.

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, 2004, 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) DISTRIBUTION OF INCOME

In 2004, Terra Networks, S.A. earned income of €190,917 thousand.

The proposed distribution of 2004 income that the Company's Board of Directors will submit for approval by the Stockholders' Meeting is as follows: a) to allocate 10% of the income for the year (€19,092 thousand) to the legal reserve; and b) to offset "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. Additionally, due to the divestment at Lycos, Inc. on October 5, 2004, the goodwill assigned to the agreement entered into by Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A., which had been included in the value of the portfolio of Lycos, Inc. under the "Long-Term Investments" caption in the balance sheet as of December 31, 2003 (see Note 7), was reclassified to the "Other Intangible Assets" caption for a net amount of €181,805 thousand. This asset is being amortized on a straight-line basis over the term of the aforementioned agreement (six years).

€21,108 thousand of amortization of intangible assets were charged to the 2004 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

€1,639 thousand of depreciation of property and equipment were charged to the 2004 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 on the liability side of the balance sheet. In 2004 €11,950 thousand were reversed with a charge to this caption (see Note 7).

As a general rule, and pursuant to current accounting legislation, the Company amortizes goodwill over ten years. The "Investment Valuation Allowance" account includes €37,350 thousand that were recorded in 2004 in order to reflect the same amortization of Goodwill in the individual financial statements as that recorded in the consolidated financial statements.

The investment in Uno-e Bank, S.A. is valued at the guaranteed amount of €148.5 million based on the capital increase which placed the final holding of Terra Networks, S.A. at year-end at 33%, and the Company acquired the right to sell it to BBVA for the aforementioned amount.

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 would be as follows:

	Increase (Decrease)
Assets	(303,399)
Stockholders' equity	772
Revenues	512,622
Income / Loss for the year	(26,945)

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 9, although Terra Networks, S.A. and other Spanish Group companies have formed part of the consolidated Tax Group of which Telefónica, S.A. is the Parent Company since January 1, 2004, it is considered that tax assets relating to tax losses incurred from that date onwards and contributed to the Tax Group will be recoverable as taxable income is generated by the Tax Group which can be offset in accordance with accounting legislation. In 2004 an account receivable from Telefónica, S.A. of €291,832 thousand was recognized in this connection.

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 positive net 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 as of December 31, 2004, arises, as described in Note 1, from the acquisition from Barclays Bank, S.A. of 7,000,000 shares at a price of €2.16 per share, as the agent financial institution for the Stock Option Plan for the Terra Group's employees. Since the underlying book value of these shares is higher than the acquisition price thereof, it was not necessary to record any value adjustment. The coverage of the stock option plans continues to be guaranteed by Terra Networks, S.A. since the shares acquired are solely for delivery to employees or for sale on their behalf when they exercise their options or, in accordance with the resolutions of the Company's Stockholders' Meetings of June 8, 2000 and April 2, 2003, for retirement if, on maturity of the options, they still have not been exercised.

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

(5) INTANGIBLE ASSETS

The detail of the balance of the "Intangible Assets" caption and of the variations therein in 2004 is as follows:

	Thousands of Euros				
	Balance at 12/31/03	Additions	Retirements	Transfers	Balance at 12-31-04
Intellectual property	10,546	409	-	77	11,032
Computer software	40,783	509	-	1,810	43,102
Intangible assets in progress	2,484	10	(356)	(2,127)	11
Other intangible assets	232	22	(69)	181,805	181,990
Accumulated amortization	(40,712)	(21,108)	18	-	(61,802)
Total intangible assets, net	**13,333**	**(20,158)**	**(407)**	**181,565**	**174,333**

The "Transfers" column for 2004 includes basically the reclassification of the full amount of the goodwill assigned to the agreement entered into between Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A. from the "Investments in Group Companies" caption for a net amount of €181,805 thousand (see Note 5).

(6) PROPERTY AND EQUIPMENT

The detail of the balance of the "Property and Equipment" caption and of the variations therein in 2004 is as follows:

	Thousands of Euros				
	Balance at 12/31/03	Additions	Retirements	Transfers	Balance at 12/31/04
Plant	6,484	168	(1,969)	243	4,926
Computer hardware	8,233	52	(56)	8	8,237
Furniture	1,200	72	(207)	6	1,071
Other tangible fixed assets	1,274	495	(629)	(17)	1,123
Accumulated depreciation	(12,348)	(1,639)	493	-	(13,494)
Total property and equipment, net	**4,843**	**(852)**	**(2,368)**	**240**	**1,863**

The retirements from the various "Property and Equipment" captions relate mainly to the assets that were written off following the transfer of the building in which the Company was carrying on its activity. The "Losses on Property and Equipment" caption includes €1,961 thousand relating to these asset retirements.

(7) LONG-TERM INVESTMENTS

The detail of the "Long-Term Investments" caption and of the variations therein in 2004 is as follows:

	Balance at 12-31-03	Additions	Retirements	Transfers	Balance at 12-31-04
Investments in Group and associated companies	3,773,835	65,897	(2,595,036)	(254,597)	990,099
Loans to Group and associated companies (Note 10)	472,777	11,428	(17,956)	(17,928)	448,321
Long-term deposits and guarantees	810	203	-	-	1,013
Tax receivables (Note 9)	287,009	-	-	-	287,009
Investment valuation allowances for Group and associated companies	(2,819,358)	(135,714)	2,193,662	78,344	(683,066)
Total long-term investments, net	**1,715,073**	**(58,186)**	**(419,330)**	**(194,181**	**1,043,376**

The "Additions" caption includes the capital increases in the period and the holdings in Lycos Europe, N.V. and Terra Networks USA, Inc., which Lycos Inc. transferred to Terra Networks, S.A. prior to their sale (see Note 1).

The "Retirements" caption includes mainly the sale of the holding in Lycos, Inc. on October 5, 2004, and the repayment of the loans to various companies.

The "Transfers" caption includes the reclassification to the "Other Intangible Assets" caption of the goodwill associated with the Strategic Alliance entered into with Telefónica, the net book value of which amounted to €181,805 thousand as of October 5, 2004. In addition, this caption includes the capitalization of long-term Terra Networks España, S.A. loans amounting to €17,500 thousand.

In 2004 the credit balances of the investment valuation allowance amounting to €11,950 thousand, which had been recorded under the "Provisions for Contingencies and Expenses" caption, were reversed. The balance of the "Provisions for Contingencies and Expenses" caption includes as of December 31, 2004, a total amount of €400,345 thousand relating to the aforementioned item.

At 2004 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, 2004, the goodwill relating to One Travel.com, Inc. (in which Terra Networks, S.A. owns an indirect holding through Terra Networks Asociadas, S.L.), was written down by €8,892 thousand and no amount relating to the tax assets was reversed since the recoverability thereof was deemed to be reasonably assured.

The detail of the direct investments in Group and associated companies as of December 31, 2004, is as follows (amounts in thousands of euros):

Company, Line of Business and Address	% of Direct and Indirect Ownership	Gross Book Value at 12/31/04	Net Worth at 12/31/04	Accumulated Allowance (*)
Terra Intangibles, S.A (formerly Terra Interactiva de Contenidos, S.A.) ISP Vía Dos Castillas, 33. Pozuelo de Alarcón, Madrid	100%	19,293	13,885	(5,408)
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%	93,973	(374,082)	(468,059)
Terra Business Travel, S.A. (formerly Terra Lycos, S.A.) Brokerage activities and/or organization of tourist services. Travel agency. Vía Dos Castillas, 33. Pozuelo de Alarcón - Madrid	100%	560	555	(5)
LE Holding Corporation Portfolio company Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, USA	100%	(**)	(**)	(**)
Lycos Europe, N.V. Internet Portal Richard Holkade 30-34, Haarlem, the Netherlands	Indirect holding of 32.1% through L.E. Holding Corp.	47,880	46,567	(1,313)
Terra Networks USA, Inc. (1) Internet Portal 1201 Brickell Avenue Suite 700 Miami, Florida 33131, USA	100%	7,764	6,972	(792)
Uno-e Bank, S.A. On-line bank Julián Camarillo, 4, Edificio C, 28037 Madrid	33%	189,832	119,530	(41,332)
Cierv, S.L. Design of communications products Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	100%	10,077	Not available	(10,077)
Corporación Real Time Team, S.L. Design, programming, advertising and consulting on the Internet Claudio Coello, 32, 1ext,	100% Indirect holding of 12.04% through CIERV, S.L and 87.96% through Terra Networks	12,398	Not available	(20,437)
Terra Networks Latam E.T.V.E, S.L. (formerly Terra Networks Asociadas Extranjeras, S.L.) Administration and management of foreign securities Vía Dos Castillas, 33. Pozuelo de Alarcón, Madrid	100%	540,693	90,558	(450,135)

Company, Line of Business and Address	% of Direct and Indirect Ownership	Gross Book Value at 12/31/04	Net Worth at 12/31/04	Accumulated Allowance (*)
Terra Lycos Holding, B.V. Portfolio company Koningslaan 34 1075 AD Amsterdam, the Netherlands	100%	18	Not available	(18)
Terra Networks Asociadas, S.L. Portfolio company Vía Dos Castillas, 33. Pozuelo de Alarcón, Madrid	100%	61,115	(17,673)	(78,788)
Terra Networks Colombia Holding, S.A. (1) Portfolio company Diagonal 97, Nº 17-60, Oficina 402. Bogotá, Colombia	90%	6,496	(2,901)	(7,047)
Total Group and associated companies		**990,099**		**(1,083,411)**

(*) Including provisions for contingencies and expenses
(**) Less than €1,000
(1) Consolidated data

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, 2004, 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 2004 are described below:

Lycos, Inc.

On October 5, 2004, Terra Networks, S.A. executed the agreement reached on July 31, 2004, with the Korean company Daum Communications, Corp. whereby Terra Networks, S.A. sold all the shares of Lycos, Inc. to the Korean company once the required administrative authorizations had been obtained, in particular, the approval of the U.S. antitrust authorities.

Prior to the sale, Lycos, Inc. transferred certain assets to Terra Networks, S.A., including the equity interests in Lycos Europe, N.V., and Terra Networks USA, LLP. and other financial assets (see Note 1). The gain on the transaction, taking into account the value of the assets received, amounted to €26,171 thousand and is recorded under the "Other Extraordinary Revenues" caption in the accompanying statement of operations (see Note 12).

Terra Networks España, S.A.

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

In December 2004 Terra Networks España, S.A. concluded its merger with Ordenamiento de Links Especializados, S.L. (OLE).

In 2004 Terra Networks España, S.A. capitalized long-term loans totaling €17.5 million. In addition, Terra Networks España, S.A. repaid loans amounting to €3 million and paid interest on long-term loans amounting to €9,451 thousand. In 2004, OLE repaid loans amounting to €3,005 thousand to Terra Networks, S.A.

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., Terra Networks Caribe, S.A. and Terra Networks Panamá, S.A., which engage in the development of the Internet business in their respective countries.

In 2004 Terra Networks Guatemala, S.A. carried out capital increases totaling US$858 thousand which were subscribed in full by Terra Networks, S.A. In December 2004 this amount was contributed to Terra Networks Latam, E.T.V.E., S.L.

Terra Networks Argentina, S.A.

In 2004 Terra Networks Argentina, S.A. carried out capital increases totaling US$1,212 thousand which were subscribed in full by Terra Networks, S.A. In December 2004 this amount was contributed to Terra Networks Latam E.T.V.E., S.L.

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

In 2004 Terra Networks México Holding, S.A. carried out capital increases totaling US$1,197, which was subscribed in full by Terra Networks, S.A. In December 2004 this amount was contributed to Terra Networks Latam E.T.V.E., S.L.

Terra Networks Venezuela, S.A.

In 2004 Terra Networks Venezuela, S.A. increased capital by a total of US$256 thousand, and this amount was subscribed in full by Terra Networks, S.A. In December 2004 this amount was contributed to Terra Networks Latam, E.T.V.E. S.L.

Terra Networks Colombia Holding, S.A.

In 2004 Terra Networks Colombia Holding, S.A. increased capital by US$6,227 thousand, and this amount was subscribed in full by Terra Networks, S.A.

Terra Networks Asociadas, S.L.

In 2004, Terra Networks, S.A. granted loans to Terra Networks Asociadas, S.L. totaling €9,506 thousand.

With this financing Terra Networks Asociadas, S.L. performed, among other transactions, capital increases at Inversis Networks, S.A., Educaterra and Maptel amounting to €1,601 thousand, €6,235 thousand and €1,041 thousand, respectively, and granted loans to One Travel.com, Inc., amounting to €774 thousand.

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

In 2004 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 €3,522 thousand.

Also, Terra Networks, S.A. granted a loan of €1,900 thousand to Terra Networks Latam E.T.V.E., S.L.

Terra Lycos, S.A.

In 2004 Terra Lycos, S.A. carried out capital increases amounting to €500 thousand, which were subscribed in full by Terra Networks, S.A.

Lycos Europe Holding Corp.

Lycos Europe Holding Corp. was formed on June 7, 2004 under Delaware State law, with a capital stock of 3,000 shares of US$ 0.001 par value each. The Company's sole stockholder is Terra Networks, S.A. and it was formed solely to act as the holding company of the shares of Lycos Europe, N.V. and to facilitate the transfer thereof on the sale of Lycos, Inc. (see Note 1).

(8) STOCKHOLDERS' EQUITY

The variations in equity accounts in 2004 were as follows:

	Thousands of Euros					
	Capital Stock	Additional Paid-in Capital	Other Reserves	Accumulated Losses	Income for the Year	Total
Balance at December 31, 2003	**1,202,936**	**5,126,134**	**165,863**	**(3,611,784)**	**(191,803)**	**2,691,346**
Capital reduction	(53,053)	(70,258)	-	-	-	(123,311)
Treasury stock value adjustment	-	-	(2,865)	-	-	(2,865)
Transfers	-	55,138	(55,138)	-	-	-
Distribution of dividends		(1,135,883)	13,760	-	-	(1,122,123)
Exercise of options		86	(86)	-	-	-
Distribution of income	-	-	-	(191,803)	191,803	-
Income for the year	-	-	-	-	190,917	190,917
Balance at December 31, 2004	**1,149,883**	**3,975,217**	**121,534**	**(3,803,587)**	**190,917**	**1,633,964**

a) Capital stock-

As of December 31, 2004, the Company's capital stock consisted of 574,941,513 fully subscribed and paid shares of €2 par value each.

On July 14, 2004, a capital reduction of €53,053 thousand was executed in a public deed following the retirement of 26,526,402 shares of treasury stock of €2 par value each, pursuant to a resolution adopted by the Stockholders' Meeting on June 22, 2004. These shares, which related to surplus shares left over from the Lycos, Inc. employee stock option plans, were 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. As of December 31, 2004, these Terra Networks, S.A. shares were recorded under the "Treasury Stock" caption. The capital retirement reduced the balances of the "Capital Stock", "Additional Paid-in Capital" and "Treasury Stock" captions by €53,053 thousand, €70,258 thousand and €123,311 thousand, respectively.

As of December 31, 2004, the Company held 7,000,000 shares of treasury stock acquired from Barclays Bank, S.A. These shares are covering the stock option plan for employees of Terra Group (see Notes 1 and 4-g). These shares, which should be retired at the next Stockholders' Meeting, represent 1.217% of the capital stock, are valued at €2.16 and amount to €15,120 thousand, and this amount is recorded under the "Treasury Stock" caption on the asset side of the accompanying balance sheet.

b) Additional paid-in capital-

In a single session on June 22, 2004, the Stockholders' Meeting of Terra Networks, S.A. approved the payment of a fixed cash dividend of €2 gross on each of the Company's outstanding shares with a charge to the "Additional Paid-in Capital" caption. The effect on the "Additional Paid-in Capital" caption in this connection amounted to €1,136 million.

c) 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 through 2003, the balance of the legal reserve was zero as of December 31, 2004.

d) Reserve for treasury stock-

In accordance with Article 79.3 of the revised Spanish Corporations Law, the Company has recorded a restricted reserve of €15,120 thousand for a total of 7,000,000 shares of treasury stock.

e) Reserves for retired capital-

Pursuant to Article 167 of the revised Corporations Law, the Company recorded a restricted reserve of €92,654 thousand for the amount of the par value of the shares retired in 2004 and previous years in order to avoid its creditors having the right to contest the aforementioned capital reductions.

f) 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 outstanding Stock Option Plans on Terra Networks, S.A. shares.

As of December 31, 2004, 13,879,903 shares had been issued to cover these Stock Option Plans on shares of Terra Networks, S.A.

As described in Note 1, on July 15, 2004, Barclays Bank, S.A. sold to Terra Networks, S.A., outside the market, 7,000,000 shares issued by the latter, at a price of €2.16 per share. These shares continue to cover the Stock Option Plans for Terra Group employees in progress at that date and are recorded under the "Treasury Stock" caption on the asset side of the accompanying balance sheet (see Note 4-g); however, these shares must be retired at the next Stockholders' Meeting.

In addition to the aforementioned shares of treasury stock, the financial institution Caja de Ahorros y Pensiones de Barcelona, as agent bank for the various stock option plans outstanding as of December 31, 2004, owns 6,879,903 shares.

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 shares issued by Terra Networks, S.A. on which the related purchase options are not 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.

(9) TAX MATTERS

a) Tax receivables and taxes payable-

The detail of the "Tax Receivables" and "Taxes Payable" captions in the accompanying balance sheet as of December 31, 2004, is as follows:

	Thousands of Euros	
	Long Term	Short Term
Tax receivables:		
Withholdings from income from movable capital receivable	-	6,154
Prepaid income taxes	55,839	-
Tax loss carryforwards	231,170	-
VAT refundable	-	658
Other tax receivables	-	-
Total	**287,009**	**6,812**
Taxes payable:		
Personal income tax withholdings	-	805
Accrued social security taxes	-	357
Other taxes payable	-	2,240
Total	-	**3,402**

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-c).

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 2004 year-end the Company had recorded an account receivable of €287,009 thousand relating to prepaid taxes and tax loss carryforwards earned prior to January 1, 2004. 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.

The detail of the tax loss carryforwards as of December 31, 2004, is as follows:

Thousands of Euros	Tax Losses
1999	93,516
2000	534,074
2001	863,272
2002	1,015,675
2003	186,722
2004	884,220
Total	**3,577,479**

The reconciliation as of December 31, 2004, of the loss before taxes for the year to the tax loss for corporate income tax purposes, and the definitive reconciliation of the loss before taxes for the year to the tax loss for 2003 following the filing of the tax return are as follows:

Thousands of Euros	2004	2003
Loss for the year before taxes	100,915	191,803
Tax asset earned in the sale of Lycos, Inc.	776,379	-
Permanent differences	(4,983)	(52,620)
Timing differences	11,909	47,539
Tax loss	**884,220**	**186,722**

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.

In connection with the sale of the holding in Lycos Inc. (see Note 1), Terra Networks, S.A. recognized a tax asset amounting to €272 million in 2004, which was included in the total tax asset of €306 million recognized in 2004. This tax asset arose from the difference between the selling price of the shares of Lycos Inc. (€89 million) and the value at which the capital increase through which this company was acquired was recorded, net of the adjustments (mainly provisions to the investment valuation allowance) which had already been tax deductible prior to the sale.

Additionally, the Company is considering the possibility of reporting a higher tax loss for 2004, for an amount of up to €7,418 million, as a result of using as the acquisition value for tax purposes the value that would result from using the market value of the Lycos Inc. shares received, rather than the book value at which they were recorded, in conformity with Article 159 of the Spanish Corporations Law. However, since this has been rejected by the tax authorities in replies to the requests for tax rulings on similar cases, and in view of the uncertainties concerning the final decision that may be adopted, as of the date of preparation of these financial statements no effect for accounting purposes was taken into account in this connection.

c) Application of the consolidated tax regime

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

Accordingly, in the period from 2001 to December 31, 2003 (see Note 9-d) the companies resident in Spain that met the requirements provided for in Articles 78 *et seq.* of Corporate Income Tax Law 43/1995 were taxed under the consolidated tax regime as Tax Group no. 111/01, of which Terra Networks, S.A. was the Parent Company. This Tax Group was dissolved on December 31, 2003.

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 included in the Group.

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 of Terra Networks, S.A. (capital stock less treasury stock). The inclusion of Terra Networks, S.A. in the Telefónica, S.A. Consolidated Group enabled the new tax asset generated from January 1, 2004, to be used earlier, since the related tax losses can be offset against the taxable income earned by the consolidated Tax Group the Parent Company of which is Telefónica, S.A. The tax assets generated prior to 2004 by the present Terra Networks, S.A. Consolidated Group are not transferable and can only be offset against the taxable income generated by the Terra Networks, S.A. Consolidated 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 Legislative Royal Decree 4/2004 approving the revised Corporate Income Tax Law, for tax purposes it will no longer be the Parent Company of its subsidiaries in Spain and, accordingly, Tax Group no. 111/01 was dissolved in 2004, making 2003 the last year in which the Group was taxed under the consolidated tax regime as an independent Group.

Following the inclusion in the Telefónica consolidated Tax Group in 2004, Terra Networks, S.A. recorded under the "Short-Term Loans to Group Companies" caption on the asset side of the balance sheet the tax asset relating to the losses incurred in the year amounting to €291,832 thousand (see Note 10).

(10) GROUP COMPANIES

The detail of the balances arising from transactions with Group companies as of December 31, 2004, is as follows:

	Thousands of euros				
	Long-Term Investments	Short-Term Investments	Receivable from Group Companies	Long-Term Debt	Payable to Group Companies
Telefonía y Finanzas, S.A. (Telfisa)	-	501,385	-	-	1
Terra Networks Perú, S.A.	-	413	3,597	-	(86)
Terra Networks Brasil, S.A.	-	-	19,239	-	2,444
Terra Networks Guatemala, S.A.	-	-	1,158	-	17
Telefónica, S.A.	-	291,832 (*)	3,113	26,183	(219)
Terra Lycos Intangibles, S.A.	-	-	229	-	13,537
Terra Networks Colombia, S.A.	-	-	23	-	617
Terra Networks México, S.A. de C.V.	-	-	10,297	-	(259)
Telefónica Procesos Técnicos Informáticos, S.A.	-	-	-	-	88
Terra Networks Colombia Holding, S.A.	-	-	1,816	-	129
Telefónica Móviles de España, S.A.	-	-	531	-	186
TPI España, S.A.	-	-	-	-	180
Terra Networks España, S.A.	397,027	13,297	7,516	-	1,756
Azeler Automoción, S.A.	-	-	52	-	-
Endemol Group	-	-	519	-	668
Terra Networks Chile S.A.	-	-	7,218	-	2,147
Telefónica de España, S.A.U.	-	-	170	-	440
Ifigenia Plus, S.L.	3,471	-	157	-	2
Terra Networks Operations, Inc.	-	-	100	-	15,699
Terra Networks USA, Llc.	-	18,595	230	-	399
Terra Networks Argentina S.A.	-	-	3,795	-	2,557
Terra Networks Caribe, S.A.	-	-	83	-	127
Terra Networks LATAM, S.L.	16,830	-	47	-	526
T.Soluciones Informáticas y Comunicaciones, S.A.	-	-	-	-	51
Maptel Networks, S.A.	2,271	-	825	-	5
Rumbo, S.A.	3,757	-	806	-	-
Educaterra, S.L.	472	-	397	-	222
Telefónica I+D, S.A.	-	-	-	-	461
Terra Venezuela, S.A.	-	-	177	-	3
Terra Asociadas, S.L.	24,471	-	-	-	-
T.Datacorp, S.A.	-	-	103	-	-
Onetravel.com, Inc.	-	682	-	-	-
Telefónica Contenidos, S.A.	-	-	206	-	23
Aremate.com, Inc.	-	-	505	-	-
Iniciativas Residenciales en Internet, S.L.	-	-	429	-	-
Other group and associated companies	22	-	43	-	(131)
Total	**448,321**	**826,204**	**63,399**	**26,183**	**41,590**

(*) See Note 9.

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:					
Red Universal de Marketing y Bookings Online, S.A.	Euros	400,000	12/13/2006	0%	400
Red Universal de Marketing y Bookings Online, S.A.	Euros	1,490,085	05/09/2007	0%	1,490
Red Universal de Marketing y Bookings Online, S.A.	Euros	650,000	12/23/2007	0%	650
Red Universal de Marketing y Bookings Online, S.A.	Euros	675,000	12/23/2007	0%	675
Red Universal de Marketing y Bookings Online, S.A.	Euros	300,000	11/30/2008	0%	300
Red Universal de Marketing y Bookings Online, S.A.	Euros	242,000	11/30/2008	0%	242
Terra Networks España, S.A.	Euros	397,027,003	11/30/2008	0%	397,027
Ifigenia Plus, S.L.	Euros	3,470,538	11/30/2008	0%	3,471
T.N. Latam E.T.V.E., S.L.	Euros	16,830,000	11/30/2008	0%	16,830
T.N. Asociadas, S.L.	Euros	24,470,373	11/30/2008	0%	24,471
Maptel Networks, S.L.	Euros	2,271,012	11/30/2008	0%	2,271
Educaterra, S.L.	Euros	472,000	11/30/2008	0%	472
Terra Lycos Holding BV	Euros	22,000	10/28/2009	0%	22
Total long term loans to Group and associated companies					**448,321**
Short term:					
Telefonía y Finanzas, S.A. (Telfisa)	Euros	501,386,040	N/A	2.57%	501,386
Terra Networks, Perú, S.A.	U.S. Dollars	540,000	30/11/2005	0%	413
One Travel.com, Inc	U.S. Dollars	881,274	30/09/2005	Libor +2 b. p.	682
Terra Networks USA, Inc.	U.S. Dollars	25,431,452	05/10/2005	4%	18,385
Telefónica, S.A.	Euros				291,832
Accrued interest					13,506
Total short-term loans to Group and associated companies					**826,204**

The loans and credits granted to Spanish companies are participating loans and do not earn interest until these companies start to generate income. In 2004 Terra Networks España began to generate income and, accordingly, the interest on these participating loans amounting to €13,297 thousand was recorded under the "Short-Term Loans to Group and Associated Companies" caption.

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

The financial revenues earned in the year on the aforementioned loans and credits amounted to €36,334 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, 2004, is as follows:

	Thousands of Euros
Wages and salaries	14,220
Severance costs	-
Social security costs	1,398
Contributions to pension plans	271
Other employee welfare expenses	937
Total	**16,826**

The average number of employees, by category, in the year ended December 31, 2004, was as follows:

Category	Average No. of Employees
Executive Vice Presidents	8
Senior Vice Presidents	5
Vice Presidents	11
Directors	31
Managers	35
Graduates	43
Clerical staff	21
Total	**154**

As described in Note 1, in 2004 the Group carried out a labor force restructuring process, through a Labor Force Reduction Plan, giving rise to a significant reduction in personnel expenses and in the number of employees; consequently, the average number of employees dropped from 176 in 2003 to 154 in 2004.

(12) EXTRAORDINARY EXPENSES AND LOSSES

The detail of the extraordinary expenses and losses as of December 31, 2004, is as follows:

	Thousands of Euros
Early termination of contracts	8,496
Labor force and business restructuring costs	7,252
External consulting expenses	3,009
Losses on retirements of assets	2,013
Total	**20,770**

As described in Note 1, in order to create a more streamlined and flexible organization that is closer to its end customers, in 2004 the Terra Networks Group decided to change both its organizational and corporate structure. Thus for the purpose of its leverage in the Telefónica Group, a rationalization process was carried out, in which areas and functions were simplified, which affected both the corporate centers (Terra Networks, S.A. and Terra Networks Latam, E.T.V.E., S.L.) and various subsidiaries (Lycos, Inc. and Terra Networks México, S.A. de C.V., among others). The Group's presence was also strengthened in the markets in which the Telefónica Group has a presence. All this gave rise to a significant drop in personnel costs and to a reduction of the average headcount in 2004 to 154 persons, as compared with the average headcount of 176 persons in 2003. The expenses incurred in this process were recorded under the "Early Termination of Contracts", "Labor Force and Business Restructuring Costs" and "External Consulting Expenses" captions in 2004.

€946 thousand were recorded under the "Labor Force and Business Restructuring Costs" caption in the 2004 statement of operations in relation to indemnity payments to directors and senior executives.

The detail of the "Other Extraordinary Revenues" caption as of December 31, 2004, is as follows:

	Thousands of Euros
Gain on the sale of Lycos, Inc. (Note 1)	26,171
Repayment of advances collected	2,875
Other extraordinary revenues	1,388
Total	**30,434**

(13) DIRECTORS' COMPENSATION AND OTHER BENEFITS

In the year ended December 31, 2004, the compensation and other benefits paid to the Board members, which were recorded in the accompanying statement of operations, were as follows (in thousands of euros):

	2004
Salaries of executive directors	461
Indemnity payments to directors of Lycos, Inc.	511
Compensation of Board members	571
Fees for attending Committee meetings	32
Total	**1,575**

As described in Note 14, as of December 31, 2004, the Board members of the Terra Group hold no purchase options on Terra Networks, S.A. shares.

As of December 31, 2004, there were no other commitments to the directors.

The information presented below is required mainly under the provisions of the Corporations Law and the Securities Market Law:

1) The directors who hold equity investments in companies engaging in identical, similar or complementary business activities are as follows:

Board member	Ownership Interest in	% of Ownership	Line of Business	Functions Performed or Positions Held
Francisco Moreno de Alborán y Vierna	Jazztel, S.A.	0.1	Telecommunications	-
Angel Vilá	Telefónica, S.A.	< 0.01	Telecommunications	Corporate Development General Manager
Enrique Used Aznar	Amper, S.A. Telefónica, S.A.	0.39 < 0.01	Telecommunications Telecommunications	Chairman Board Member
Telefónica Data Corp, S.A. (Antonio Viana-Baptista)	Telefónica, S.A. Telefónica Móviles, S.A. Portugal Telecom SGPS, S.A. PT Multimedia	< 0.01 < 0.01 < 0.01 < 0.01	Telecommunications Wireless Telecommunications Telecommunications Internet	Board Member Executive Chairman Board Member Board Member

2) The directors do not perform any activities as independent professionals or as employees, that are identical, similar or complementary to those that constitute the Company's corporate purpose, except for the following, who perform them under the terms and conditions indicated below:

Antonio Viana-Baptista, representative of the director of Telefónica DataCorp, S.A.

Activity Carried on	Type of Arrangement under which the Activity is Carried on	Company through which the Activity is Carried on	Positions Held or Functions Performed at the Company through which the Service is Provided
Director	Employment relationship	Telefónica, S.A. Telefónica Móviles, S.A. Telefónica de Argentina, S.A.	Board Member Executive Chairman Board Member
Director	Employment relationship	Telefónica Internacional, S.A. Brasilcel, N.V. Telefónica Móviles España, S.A. Telefónica de España, S.A.	Board Member Board Member Board Member Board Member
Director	Employment relationship	Portugal Telecom SGPS, S.A.	Board Member

Enrique Used Aznar

Activity Carried on	Type of Arrangement under which the Activity is Carried on	Company through which the Activity is Carried on	Positions Held or Functions Performed at the Company through which the Service is Provided
Director	Employment relationship	Amper, S.A. Telefónica, S.A. Telefónica del Perú, S.A. Telecomunicaciones de Sao Paulo, S.A. Telefónica Internacional, S.A.	Chairman Board Member Board Member Board Member Board Member

Luis Bassat Coen

Activity Carried on	Type of Arrangement under which the Activity is Carried on	Company through which the Activity is Carried on	Positions Held or Functions Performed at the Company through which the Service is Provided
Director	Employment relationship	Telefónica, Publicidad e Información, S.A. Ogilvy Interactive, S.A.	Board Member Chairman

Carlos Fernández-Prida Méndez-Núñez

Activity Carried on	Type of Arrangement under which the Activity is Carried on	Company through which the Activity is Carried on	Positions Held or Functions Performed at the Company through which the Service is Provided
Director	Employment relationship	Telefónica de Argentina, S.A.	Board Member

Joaquín Faura Batlle

Activity Carried on	Type of Arrangement under which the Activity is Carried on	Company through which the Activity is Carried on	Positions Held or Functions Performed at the Company through which the Service is Provided
Director	Employment relationship	Endemol Interactive	Board Member

In 2004 Terra Networks, S.A. held eleven Board of Directors' meetings, eleven meetings of the Audit and Control Committee and nine meetings of the Appointments and Compensation Committee.

(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 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 Group. The main features of these options are as follows:

1. Each of the stock options under the Plan entitles the participant (employee or executive) 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 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 Group through that date.

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 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, at the recommendation of the Appointments and Compensation Committee, the Board of Directors approved at its meetings on January 30, July 25 and September 26, 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.

On April 28 and 29, 2004, Terra Networks, S.A. entered into contracts with La Caixa and Barclays Bank (which absorbed Banco Zaragozano and succeeded it in all its rights and obligations), respectively, to extend the contracts executed on October 5, 1999; the term of the contract with La Caixa was extended through April 30, 2006, and that of the contract with Barclays Bank through July 15, 2004.

On June 22, 2004, the Stockholders' Meeting of Terra Networks, S.A. resolved, in connection with item IV on the agenda relating to the "Reduction of capital stock through the retirement of shares of treasury stock, with disapplication of the creditors' right to contest, and delegation of power in connection with the coverage of the Option Plans", to delegate powers to the Board of Directors of Terra Networks, S.A., in connection with the coverage of the Option Plans of Terra Networks, S.A., so that it can decide, if necessary or appropriate in view of the evolution of the share market price, to eliminate such coverage or to continue without coverage or, if appropriate, to establish any other coverage system to cater for the obligations arising from the Option Plans, thus extending the power conferred under the resolution adopted by the Stockholders' Meeting on October 1, 1999, in relation to item two on the Agenda.

On July 15, 2004, in compliance with the aforementioned contract dated October 5, 1999, and with the extension dated April 29, 2004, Terra Networks, S.A. purchased from Barclays Bank, outside the market, the 7,000,000 Terra Networks, S.A shares owned by the latter. These shares were classified as treasury stock and will be retired, if so decided, at the Stockholders' Meeting.

On July 22, 2004, the Board of Directors of Terra Networks, S.A., after obtaining a favorable report from the Audit and Control Committee, resolved to reduce by €2 the exercise price of the Terra Networks, S.A. stock options granted to the beneficiaries of the Terra Group's Stock Option Plans, on or after the date of dividend payment with a charge to additional paid-in capital approved by the Stockholders' Meeting of Terra Networks, S.A., i.e. on or after July 30, 2004.

As of December 31, 2004, options on 3,118,870 shares had been assigned to Terra Group employees and executives, all of which relate to the second phase of the Option Plan, since the rights relating to the first phase expired in April. The weighted average stock option exercise price is €14.21.

As of December 31, 2004, the Terra Group's executives held 650,000 stock options under the Terra Networks, S.A. Stock Option Plan, the weighted average exercise price of which is €16.37.

As of December 31, 2004, no directors of Terra Networks, S.A. held any stock options.

The information on the options under the Terra Networks, S.A. Stock Option Plan not yet exercised as of December 31, 2004, is as follows:

Range of Prices in the Year	No. of Options Not Yet Exercised	Weighted Average Price in the Year
€4.48 – €5.07	153,400	4.81
€5.33 – €6.90	359,000	6.41
€7.09 – €7.51	124,500	7.26
€9.68 – €17.78	1,746,920	17.14
Total outstanding options at 12/31/04	**2,383,820**	**14.21**

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.

On June 22, 2004, the Stockholders' Meeting of Terra Networks, S.A. resolved, inter alia, to reduce capital stock by €53,052,804 for the purpose of retiring 26,526,402 shares of treasury stock. The resolution expressly stated that 26,507,482 of the shares to be retired had been acquired by Terra Networks, S.A. from Citibank N.A. and were classified as treasury stock to cover the obligations arising from the Lycos Inc. Stock Option Plans assumed by Terra Networks, S.A. under section D) of the resolution adopted by the Stockholders' Meeting on June 8, 2000, in connection with item five on the Agenda (in the revised version approved by the Stockholders' Meeting on June 7, 2001).

Also, under the aforementioned capital reduction resolution, the Board of Directors of Terra Networks, S.A. was expressly empowered to decide, if necessary or appropriate in view of the evolution of the share market price, to eliminate such coverage or to continue without coverage or, if appropriate, to establish any other coverage system to cater for the obligations arising from the Option Plans of Lycos, Inc.

On July 22, 2004, the Board of Directors of Terra Networks, S.A., after obtaining a favorable report from the Audit and Control Committee, resolved to reduce by €2 the exercise price of the Terra Networks, S.A. stock options granted to the beneficiaries of the Terra Group's Stock Option Plans, on or after the date of dividend payment with a charge to additional paid-in capital approved by the Stockholders' Meeting of Terra Networks, S.A., i.e. on or after July 30, 2004.

On July 31, 2004, Terra Networks, S.A. and the Korean company Daum Communications entered into a contract for the sale of all the Lycos, Inc. shares. The transaction was finally implemented on October 5, 2004, once the required administrative authorizations had been obtained, in particular, the approval of the U.S. antitrust authorities.

Under the contract for the sale of the shares, Terra Networks, S.A. undertook to continue to assume the obligations arising from the Stock Option Plans of Terra Networks, S.A. vis-à-vis the beneficiaries of Lycos, Inc., although it was established that Lycos, Inc. could carry out, for the account and at the expense of Terra Networks, S.A., such actions as might be necessary or appropriate in connection with the exercise of the options by the beneficiaries.

As of December 31, 2004, the employees, executives and directors of Lycos had exercised 1,089,238 options, and a commitment to exercise 10,863,239 options at a weighted average price of US$ 18.00 had been made.

The information on the options under the Terra Networks, S.A. Stock Option Plan resulting from the assumption of the Stock Option Plans of Lycos, Inc. shares not yet exercised as of December 31, 2004, is as follows:

Range of Prices in the Year	No. of Options Not Yet Exercised	Weighted Average Price in the Year
€0 – €4	1,012,338	2.71
€4 – €8	162,296	6.63
€8 – €12	4,285,262	9.83
€12 – €24	4,668,293	19.18
Total outstanding options at 12/31/04	**10,128,189**	**13.38**

c) Guarantee commitments to third parties-

As a holding company, in the course of its business operations Terra Networks, S.A. has performed various transactions in which it is standard practice to receive or provide guarantees on liabilities, contingencies, etc. arising from the investments forming the subject matter of the transactions.

Company management considers that the liabilities, if any, which might arise from the aforementioned commitments would not have a significant impact on the Company.

As of December 31, 2004, Citibank International PLC, Sucursal en España, for the account of Terra Networks, S.A., issued two counterguarantee letters for the following companies vis-à-vis various agencies or entities, the detail being as follows:

	2004
Lycos, Inc.	7,342
One Travel.com	596
Total	**7,938**

At the date of preparation of these financial statements, the guarantee provided for Lycos, Inc. had been released.

d) Litigation in progress-

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

On January 31, 2001, International Discount Telecommunications Corporation (IDT) commenced proceedings at the New Jersey Courts in the U.S. against Telefónica, S.A., Terra Networks, S.A. and Lycos, Inc. This complaint is based on the purported breach of the joint venture agreement entered into between IDT and Terra Networks, S.A. in October 1999, on the purported nonperformance of the obligations under the agreement to terminate the joint venture agreement, on purported fraud and contravention of the legislation governing the purchase and sale of securities (Federal Securities Exchange Act) and, lastly, on purported fraudulent concealment of information.

After this complaint was filed, it was amended by IDT, which eliminated all explicit reference to a claim for damages of a specified amount, since this was contrary to the U.S. legislation under which the claim was filed. The lawsuit is currently for an unspecified amount, without prejudice to the possibility of the claim for damages being specified and quantified in the course of the proceeding.

In May 2002 the Court set aside the part of the complaint relating to the charges filed for the purported breaches of the joint venture agreement.

In July 2002 IDT added to the "second amended claim" a new claim that Telefónica, S.A. would be liable, as a controlling person, 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.

On July 2, 2003, Telefónica S.A., Terra Networks S.A. and Lycos Inc. filed a summarized request for the taking of evidence and prepared pleadings requesting that certain charges be set aside, including the breach of the securities legislation claimed against Telefónica, S.A.

In September 2004 IDT filed a third claim, identical to the second, against the three companies, except in this case the claim against Telefónica, S.A. was based on its liability as the controlling company of the defendant Terra Networks, S.A.

Terra Networks, S.A. and Telefónica S.A. have filed an answer and, in turn, Telefónica S.A. has pleaded a want of jurisdiction.

In September 2004 the Court resolved not to continue with the proceedings against Lycos, Inc.

On October 4, 2004, a conference took place with the Judge in charge of the case who resolved to take expert evidence (reports and examinations). A date has yet to be set for the parties to file before the Judge supervising the evidence proposed by the parties a complete Pre-trial Order which includes a summary of the claims and related answers and of the evidence taken. As a guide, our lawyers consider that the trial is most likely to be held in the last quarter of 2005, and will at least examine the alleged infringement by Terra Networks, S.A. of the Federal Securities Exchange Act, in relation to its failure to advise IDT of the transaction with Lycos, Inc. prior to April 30, 2000.

The external legal counsel of Terra Networks, S.A. considers that the Company has a sound defense to counter the claim, although based on the current status of the proceedings, they do not consider that they are in a position to predict its outcome.

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 to stay the resolution as an injunctive measure, which was set aside by the Court of First Instance and the Madrid Provincial Appellate Court.

Aside from the aforementioned procedures, two arbitration proceedings were filed against Terra Networks, S.A., as follows:

- The first by Master Equities (minority stockholder of Bumeran Participaciones S.R.L.); and

- The second by the other minority stockholders of Bumeran Participaciones S.R.L. (Lorne Consultants, S.A. , Regent Equities, S.A., Pablo Larguia and Century Equities, S.A).

The current status of the proceedings is as follows:

- A favorable ruling was handed down to Terra Networks, S.A., which was acquitted of the two arbitration proceedings through the Awards dated March 15, 2004, which are now firm and final.

- In the proceeding to contest the resolutions adopted on December 18, 2002, by the Stockholders' Meeting of Bumeran Participaciones, S.R.L., which is being heard by the Majadahonda Court of First Instance 6 through the Order dated June 24, 2004, the Court ordered all the plaintiffs to discontinue the proceedings, and, consequently, that these proceedings to be stayed. This Decision was clarified by the aforementioned Court through an Order dated July 28, 2004, which upheld that the proceeding should be stayed. One of the plaintiffs (Master Equities) appealed to the Madrid Provincial Appellate Court, while the remainder accepted the Court's Decision. The Madrid

Provincial Appellate Court has yet to hand down a decision on the proceeding and to order the definitive stay of proceedings or, where appropriate, the continuation of the proceeding to contest the resolutions of the Stockholders' Meeting. The external legal counsel of Terra Networks, S.A. considers that, if the Madrid Provincial Appellate Court confirms the Decision dated June 24, 2004, handed down by the Majadahonda Court of First Instance 6, the proceeding would be definitively concluded, without any type of liability for Terra Networks, S.A. The outcome of the Appeal and the conclusion of the Proceeding will not have a significant impact on the financial statements of Terra Networks, S.A.

3. Collective lawsuits filed by stockholders of Terra Networks, S.A. in the U.S., 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 Nasdaq 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 in the event that the plaintiffs put forward appropriate 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 collect the same sum from the placement institutions. The Accord and Satisfaction does not resolve the dispute between the plaintiffs and the placement institutions.

On February 15, 2005, the Judge hearing the case approved, on a preliminary basis, the Accord and Satisfaction, although he suggested to the parties involved specific minor amendments to the wording of the Agreement before its definitive approval, scheduled by the Court to take place on March 18, 2005. Accordingly, the Company is confident that the outcome of the litigation will not have an adverse effect on 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 New York State 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 are founded mainly on the claim that the price offered to the stockholders of Terra Networks, S.A. was not in keeping with the intrinsic value of the Company's shares, and seek to not have the tender offer approved or, alternatively, to have damages awarded to them.

In connection with the status of the first claim, formal notice was served on the directors domiciled in Massachusetts. The time period allowed for filing an answer has been extended without any deadline, as has the time period for production of the documents requested, which may be demanded by the plaintiffs by serving 30 days' prior notice. However, no formal notice of the second complaint has yet been served.

Based on the opinion of the legal counsel of Terra Networks, S.A., in no case has the plaintiff filed before the Court an injunctive measure and, accordingly, any subsequent petition filed would be ineffective. Also, the external legal counsel of Terra Networks, S.A. considers that should a claim be filed for damages, Terra Networks, S.A. would have strong grounds on which to contest such a claim and, accordingly, the Company is confident that the outcome of the litigation would 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.

In September 2004 the other stockholders of IMDI (minority stockholders) filed a further claim against Lycos Inc. (no action was brought against Terra Networks, S.A.), which, in turn, petitioned for it to be added to the first complaint. At the end of November 2004 Terra Networks, S.A. learned that the first plaintiffs had extended their claim to it, to its current Chairman and Board of Directors and to Terra Networks USA, Inc. and Terra Networks Operations, Inc. On February 14, 2005, an Accord and Satisfaction was reached with the first plaintiffs in which Terra Networks, S.A. agreed to pay an amount for which a provision had already been recorded in the accompanying financial statements.

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

Lycos Inc. filed a complaint against Overture Services Inc., which is being processed by the Massachussets District Court, claiming that the latter company infringed certain contractual agreements, such as those relating to the non-assignment of contracts, confidentiality and payment, provided for in the Integration and Distribution contract entered into by the parties on September 30, 2001, as a result of which Overture was acquired by Yahoo!.Inc., which is a direct competitor of Lycos Inc. The amount of this complaint has not been quantified.

In turn, Overture Services Inc. filed a counterclaim against Lycos, Inc. alleging that it was in fact Lycos Inc. that was in breach of contract by infringing the principle of good faith.

The possibility of commencing negotiations for a possible Accord and Satisfaction between the co-litigant parties is being studied. The Company considers that the economic agreement that will be reached will not have an adverse effect on its net worth.

7. Universal Communications Systems, Inc.

In July 2004 Universal Communications Systems, Inc. filed a complaint amounting to US$ 300 million against Lycos, Inc. at the Courts of Florida, claiming that consumer fraud had been committed and that UCSY's brand had been diluted (through the Ranging Bull website forums - a Lycos finance web site similar to Invertia). The litigation was made public and was assumed by the Korean company Daum Communications, Corp. under the purchase and sale agreement entered into by it as a result of its acquisition of Lycos, Inc.

Without prejudice to the foregoing, the plaintiffs recently filed a new complaint against Terra Networks, S.A. in 2005, of which we have not been duly summonsed in conformity with the Hague Convention and, accordingly, the claim has not yet been received in the name of Terra Networks, S.A. The procedural strategy to be followed by Terra Networks, S.A. in relation to this claim is being evaluated.

(15) PAYMENTS TO AUDITORS

The payments made by Terra Networks, S.A. in 2004 to the various member firms of the Deloitte & Touche Worldwide Organization, to which Deloitte, S.L., the Company's auditor, belongs, amounted to €435 thousand.

The detail of the foregoing amount is as follows:

	Thousands of euros
Audit of financial statements	314
Other audit services	121
Work additional to or other than audit services	-
Total	435

(16) SUBSEQUENT EVENTS

a) Changes in the Board of Directors-

On February 10, 2005, the Board of Directors of Terra Networks, S.A. accepted the resignation of the directors Ángel Vilá Boix and Telefónica Data Corp. Also, on that same date the Board of Directors of Terra Networks, S.A. appointed the Company stockholders Alfonso Merry del Val Gracie and Fernando Labad Sasiaín as new directors by co-optation to cover the aforementioned vacancies.

b) Merger with Telefónica, S.A.

The Boards of Directors of Telefónica, S.A. and Terra Networks, S.A. resolved at their respective meetings held on February 23, 2005, to approve a plan for the merger by absorption of Terra Networks, S.A. into Telefónica, S.A. through the dissolution without liquidation of the former and the transfer *en bloc* of all its assets and liabilities to the latter, which will acquire, by way of universal succession, the rights and obligations of Terra Networks, S.A.

The exchange ratio for the shares of the companies to be merged, which was determined on the basis of the actual net worth values of Telefónica, S.A. and Terra Networks, S.A., will be as follows: two (2) shares of Telefónica, S. A., of one euro (€1) par value each, for every nine (9) shares of Terra Networks, S.A., of two euros (€2) par value each.

Pursuant to Article 226 of the Mercantile Register Regulations, a copy of the Merger Plan was filed at the Barcelona and Madrid Mercantile Registries.

Also, the Board of Directors of Terra Networks, S.A. resolved to propose to the Company's next Stockholders' Meeting that a dividend be distributed in cash with a charge to the "Additional Paid-in Capital" account of €0.60 gross for each of the Company's outstanding shares carrying dividend rights on the payment date. This payment will be made prior to the registration of the aforementioned merger at the Mercantile Registry.

It is noted that this agreement was adopted within the framework of the negotiation process with Telefónica, S.A. relating to the aforementioned merger between the two entities. The exchange ratio initially proposed by Telefónica, S.A. of two shares of Telefónica, S.A. for every nine shares of Terra Networks, S.A. was maintained and, accordingly, this distribution represents a significant improvement in the valuation of Terra Networks, S.A. for the purpose of the merger.

c) Sale of One Travel.com, Inc

On February 11, 2005, Terra Networks Asociadas, S.L. (a subsidiary of Terra Networks, S.A.) resolved to sell its holding in OneTravel.com, Inc., representing 54.1% of the capital stock, within the framework of various agreements entered into by OneTravel.com, Inc. with the U.S. company RCG Companies, Inc. aimed at the merger of the two companies. The execution of this merger depends on the obtainment of the internal approval of the respective companies.

The transaction totals US $25.5 million, of which US $2.5 million will be paid when the agreement is signed, US $10.5 million when the merger is formalized and US $12.5 million will be deferred for a period of between six months and one year through a bond convertible into shares of the buyer.

INCLUIR EL CUADRO DE FINANCIACIÓN. NOTA 17

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

Thousands of Euros	2004
Income for the year	190,917
Intangible asset amortization expense	21,108
Property and equipment depreciation expense	1,639
Gains on long-term investment disposals	(26,171)
Variations in investment valuation allowances	135,714
Funds obtained from operations	**323,207**

(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

2004 MANAGEMENT REPORT

Introduction

The Terra Group's 2004 earnings were significantly better than those for 2003 thanks to a considerable marketing effort and the organizational and corporate restructuring process carried out, despite the increasingly competitive environment and the difficulties resulting from certain regulatory decisions.

The Terra Group changed its structure and made various divestments, including most notably the sale of its shares of Lycos, Inc., in order to create an organization that is more versatile, flexible and focused on maximizing the satisfaction of its customers by providing them with the best range of products on the market.

In 2004 the Terra Group simultaneously focused on developing and launching new products in the various regions in which it operates, which permitted it to increase its customer base considerably and to achieve a high level of customer loyalty.

This strategy enabled the Terra Group to consolidate its position as the leading Internet company in Spain and in Latin America, in the three main businesses in which it operates: access, portal and value added services.

The Terra Group's strategy for the future will be to concentrate on the development and marketing of value added services linked to access, focusing on broadband, and on increasing and consolidating its portal audiences. All of this while strictly controlling the funds that make it possible to achieve the levels of efficiency required in order to implement a more commercial and customer-centered corporate model that is profitable for its stockholders.

Total customers

As of December 31, 2004, the Terra Group had 6.3 million subscribers paying for Internet access and value-added services, which represents an increase of 25% in comparison with 2003. The figure for subscribers is based on services contracted, since certain customers may have contracted access products and value added services at the same time.

Pay access subscribers totaled 1.8 million as of December 31, 2004, up 9% on 2003 year-end. Noteworthy in this connection was the 66% increase in broadband customers (mainly ADSL), which totaled 1.1 million at year-end, of which 68% relate to Brazil, 18% to Spain and 12% to Chile.

Value-added services customers totaled 4.5 million as of December 31, 2004, an increase of 33%, of which 3.2 million are a result of the Alliance with Telefónica.

Business performance and results

1.- Revenues

The Terra Group's total accumulated revenues as of December 2004 amounted to €540 million, down 1% on the revenues obtained in 2003. It should be taken into account that the year-on-year variation was affected by changes in the scope of consolidation, including most notably the sale of the shares of Lycos, Inc. in the first few days of October 2004. Therefore, since in 2004 Lycos's results were only consolidated from January 1 to September 30, in the comparisons that exclude the change in scope of consolidation, Lycos's contribution in the last three months of the year (October, November and December) was eliminated in 2003. Excluding this change in the scope of consolidation and the effect of fluctuations in the exchange rates of certain currencies with respect to the euro, the currency in which the Terra Group consolidates its financial statements, revenues in 2004 would have been 8% higher than in 2003.

Of the total revenues, the Strategic Alliance with the Telefónica Group contributed €134 million in 2004, which is on a par with the revenues amounting to €101 million in 2003.

Revenues are generated by the following four business lines.

I) Access services

This line of business generated revenues of €237 million in 2004, equal to 44% of total operating revenues and, in constant euro terms, represents growth of 10% with respect to the preceding year.

Noteworthy as regards access was the increase in and improvement of broadband access services; a special mention should be given to the doubling of the speed of this service in both Spain and Latin America.

In Spain, the marketing drive focused on the sale of the broadband products "ADSL Home", a product available 14 hours a day, and "ADSL Plus", a product available 24 hours a day, which is being offered with an Antivirus service included.

In Brazil the pay access business performed particularly well and its position was consolidated in the latter quarters, enabling the Group to continue to head the ADSL market with a market share of 50%.

In the future this line of business will be affected by the forging of the commercial agreement between Terra México and Alestra whereby the latter will manage the operation of the Internet access services provided by Terra in the Mexican market.

II) Advertising and e-commerce

This business line contributed revenues of €120 million in 2004, 22% of total operating revenues which, in constant euro terms, represented a drop of 10% with respect to 2003.

In 2004 this line of business was affected by:

- the reduction of Lycos's revenues, which culminated with the sale in October 2004 of this company's shares, which contributed revenues of €35 million in the year to this line of business; and
- the reduction of the revenues of One Travel, a company at which it was decided to divest, and which contributed revenues of €26 million in 2004.

The other businesses achieved growth of 23% in advertising and e-commerce revenues in 2004 with respect to 2003, excluding the impact of exchange rates.

The Terra Group continued its pledge to focus on providing integral marketing services that give advertisers access to a more segmented public and make it possible to increase the effectiveness of the Internet as an advertising medium.

In September 2004 the Terra Group and Google entered into an agreement that permits the quality of Terra's search engine in all its portals in Spain and Latin America to be improved, making it possible for Terra's users to access the most powerful search engine technology available. The agreement also includes other lines of action, in various formulas for the joint marketing of the service using Terra's portals in all the countries in which it is present, which will result in higher revenues for the Company.

III) Communications, portal and content sale services

This line of business contributed revenues of €122 million in 2004, equivalent to 23% of total operating revenues which, in constant euro terms, represented growth of 6% with respect to 2003. Excluding the change in the scope of consolidation arising from the sale of Lycos in October 2004, this business line's revenues would have increased by 12% with respect to 2003.

These revenues include services provided to residential customers, professionals and SMEs, either directly or through corporations, and primarily, the Telefónica Group, through the Strategic Alliance, which contributed 57% of the total revenues in this connection.

This business line was strengthened by the launch of new Communication and Contents products and services. These products and services include most notably the following:

- Terra Secure Connection: a selection of services related with PC security and protection
- Terra Antivirus: products intended to detect and block PC viruses.
- Terra Mail Plus Kit: a package that offers e-mail with extras: increased capacity, increased security and greater access flexibility.

- Terra Fútbol with Real Madrid and Barcelona: a premium area with exclusive content of the two most popular soccer clubs in Spain; news alerts, Real Madrid SMS/MMS: an information service for wireless telephones with the latest news on the club and live coverage from start to finish of matches and goals.
- Terra Música Premium (Terra Premium Music): the first platform for listening to and downloading digital music via the Internet in Spain.
- Fotologs: a web photo album enabling photos to be shared.

IV) SMEs, corporate services and other

This business line contributed revenues of €62 million in 2004, accounting for 11% of total operating revenues which, in constant euro terms, represented growth of 2% with respect to 2003. The Strategic Alliance with the Telefónica Group contributed 33% of these revenues, through the provision of e-learning services and several Internet and technology consulting projects.

2.- EBITDA

The Terra Group has seen a progressive and continuous improvement in its earnings before interest, taxes, depreciation and amortization (EBITDA), and it achieved positive EBITDA in all four quarters of 2004. The Company's EBITDA in 2004 amounted to €21 million, and the EBITDA margin on revenues was 4%, in contrast with the EBITDA of -€29 million recorded in 2003, with a margin on revenues of -5%.

In 2004 significant personnel restructuring processes took place mainly in Spain, the U.S., Mexico and at Group level, contributing to a significant reduction in personnel expenses and to a reduction of the average labor force from 2,300 persons in 2003 to 2,018 persons in 2004. The headcount at 2004 year-end was 1,606, as compared with 2,255 at 2003 year-end.

3.- Net income

Net income totaled €164 million in 2004, as compared with a loss of €173 million in 2003.

In 2004, thanks to the inclusion of Terra in the Telefónica S.A. consolidated Tax Group, the Terra Group recognized a tax asset of €306 million arising basically from the sale of the shares of Lycos, Inc. Also, in 2004 an extraordinary net loss of €26 million was recognized, which includes, inter alia, the cost of the aforementioned restructuring processes.

4.- Main investments

a) Lycos Europe

Lycos Europe is one of Europe's leading portals, with 23 million single users per month and a presence in ten countries. It ended 2004 with revenues of €104 million, compared with the €85 million obtained in 2003. The development and adaptation of new products,

the forging of new commercial agreements, its expense containment policy and the write-downs and restructuring processes carried out in previous years enabled the Company to achieve EBITDA of -€34 million in 2004, compared with the -€40 million reported in 2003, and a net loss of €45 million, as compared with the loss of €56 million incurred in 2003 (1).
Lycos Europe commenced 2005 by reinforcing its strategy of focusing on key products, seeking to reduce its cost structure, to balance its revenues and to generate a high proportion of these revenues through pay services. To this end, in 2004 the Company acquired the Internet access company Tiscali Sweeden.

(1) Based on information presented to the Audit Committee.

b) Uno- e

Uno-e ended 2004 with an ordinary margin of €59 million, a positive operating margin of €20 million and net income of €8 million, which represents a very significant improvement compared with 2003 and signified that the bank has managed to report significant profits following the integration of the consumer finance division of Finanzia. In 2004 the bank managed to maintain the funds managed in a very aggressive market, since it was managing 0.6 % more funds than at 2003 year-end. 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. A salient feature of the year was a significant reduction in delinquency in relation to consumer financing with respect to 2003 and to the budget. These results were achieved in the first full year of integration, and place Uno-e in an excellent position to face up to the coming years.

c) One Travel

Gross sales in 2004 amounted to US$ 93 million, down 12% with respect to 2003. EBITDA was -€2.1 million in 2004, compared with -€0.5 million in 2003, due to lower consolidated revenues and the heavy dependence of these revenues on the sale of airline tickets, a business with a scant margin and for which there is a very competitive market. The consolidation of this company from April 2003 gave the Terra Group additional revenues of €31 million in 2003 and of €26 million in 2004.

4.- Cash

The "Cash" balance as of December 31, 2004, amounted to €529 million. The balance dropped in 2004 due mainly to the payment of a dividend of €1,136 million (€2 per share) at the end of July. Excluding the impact of this dividend payment, the Terra Group would have generated positive cash flow for the first time in its history of €71 million in 2004.

Research and development

As part of its technological strategy to develop products and services for the Internet, the Terra Group places special emphasis on its research, development and innovation program, for which it is closely backed by highly prestigious companies in the industry, (such as Telefónica I+D), and which it coordinates actively and on an ongoing basis with the programs of other companies in the Telefónica Group, which is undoubtedly one of the main benchmarks in this area in the world.

In 2004 the Terra Group consolidated its active involvement in the European Celtic (Cooperation for a European Sustained Leadership in Telecommunications) initiatives program, as part of its work towards the development of applications and services and of proposals for the Sixth European Union Framework Program, which addresses the possibility of creating virtual communities that will provide a new generation of real-time multimedia communications services. Terra Networks is also participating, together with other Telefónica Group companies, in other highly significant European projects, such as Akogrimo (relating to mobile access to online services) and others included in the Eureka! program.

The monitoring of, active involvement in and promotion of open source development initiatives focused on the development of communication services is a firm pledge of the Terra Group for the open collaborative environments for software development.

In 2004 projects were also performed aimed at introducing information technologies within the framework of solutions for SMEs, focusing particularly on communications and e-commerce, since the Terra Group considers these to be essential tools for increasing the productivity and the business opportunities of these fundamental leverages to the world economy.

In the multimedia and entertainment services fields, the development of advanced on-line games platforms, streaming and downloading of audiovisual contents and systems for the management of rights on digital content were areas on which the research and development program focused most closely in 2004. The launch in the market of products such as "Terra Música" is a direct consequence of our R+D+i capability in this area.

As a general rule, the aforementioned developments are planned on the basis of the Company's Innovation Plan and are carried out in strict compliance with a methodology aimed at the development of "Seis Sigma" quality products and services.

Management team changes

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 resignations of Luis Ramón Arrieta Durana and Joaquim Agut Bonsfills from the Board of Directors of Terra Networks, S.A.

The Stockholders' Meeting of Terra Networks, S.A. held on June 22, 2004, resolved, inter alia, to ratify the appointment by cooptation of Joaquim Faura Battle as a director of the Company, for a period of five years pursuant to legislation and the Company's bylaws.

The Board of Directors' Meeting of Terra Networks, S.A. held on February 10, 2005, accepted the resignation from their posts of the directors Angel Vilá Boix and Telefónica Data Corp. Also, at that meeting, the Board of Directors of Terra Networks, S.A. appointed by cooptation the stockholders of the Company Alfonso Merry del Val Gracie and Fernando Labad Sasiaín as new directors to fill the aforementioned vacancies.

Sale of Lycos

On October 5, 2004, Terra Networks, S.A. executed the agreement entered into on July 31, 2004, with the Korean company Daum Communications, Corp. whereby Terra sold all of the shares of Lycos, Inc. to that company.

Before the sale, Lycos, Inc. transferred certain assets to Terra Networks, S.A., including the holdings in Lycos Europe, N.V., and Terra Networks USA, LLP and other financial assets.

The book value of the transferred assets was €332.9 million. The selling price of Lycos, Inc. was set at US$ 108 million, and the gain from the transaction, taking into account the value of the assets received, amounted to €26 million.

Payment of dividend

On June 22, 2004, the Stockholders' Meeting of Terra Networks, S.A. approved with a sufficient majority, the payment of a dividend with a charge to the "Additional Paid-in Capital" caption (Resolution Six).

The extraordinary dividend was paid in cash on July 30, 2004 with a charge to the "Additional Paid-in Capital" caption for a fixed amount of €2 gross per share on the Company's outstanding shares, giving a total dividend of €1,136 million.

Capital reduction

On June 22, 2004, the Stockholders' Meeting approved, inter alia, a capital reduction through the retirement of shares of treasury stock. Capital stock was reduced by €53,052,804, in order to retire 26,526,402 shares of treasury stock of €2 par value each.

As a result of this capital reduction, the Company's capital stock consisted of 574,941,513 fully subscribed and paid shares of €2 par value each.

Treasury stock

On July 15, 2004, Terra Networks, S.A. announced that Barclays Bank had sold it, outside the market, 7,000,000 Terra Networks, S.A. shares at a price of €2.16 per share.

Consequently, as of December 31, 2004, Terra Networks owned 7,000,000 shares of treasury stock, covering the Stock Option Plan for employees of the Terra Group. These shares, which must be retired at the next Stockholders' Meeting, represent 1.217% of capital stock, are valued at €2.16 and are recorded for a total amount of €15,120,000 under the "Treasury Stock" caption on the asset side of the accompanying balance sheet.

Events subsequent to year-end

a) Merger with Telefónica, S.A.

On February 9, 2005, Terra Networks, S.A. received an invitation from Telefónica, S.A. to merge the two companies.

At an extraordinary meeting on February 10, 2005, the Board of Directors of Terra Networks, S.A. was informed of the invitation of Telefónica S.A., and resolved to initiate a period of study and negotiation to determine the degree to which a potential merger would be in the interest of Terra Networks, S.A., and to study the terms and conditions thereof. For this purpose, the Board of Directors of Terra Networks, S.A., in the absence of the nominee directors appointed at the behest of Telefónica S.A. and in a process led by the independent directors, resolved to appoint Lehman Brothers and Citigroup as financial advisers in this transaction.

The Boards of Directors of Telefónica, S.A. and Terra Networks, S.A. resolved at their respective meetings held on February 23, 2005, to approve a plan for the merger by absorption of Terra Networks, S.A. into Telefónica, S.A., through the dissolution without liquidation of the former and the transfer *en bloc* of all its assets and liabilities to the latter, which will acquire, by way of universal succession, the rights and obligations of Terra Networks, S.A.

The exchange ratio for the shares of the companies to be merged, which was determined on the basis of the actual net worth values of Telefónica, S.A. and Terra Networks, S.A., will be as follows: two (2) shares of Telefónica, S. A., of one euro (€1) par value each, for every nine (9) shares of Terra Networks, S.A., of two euros (€2) par value each.
Also, the Board of Directors of Terra Networks, S.A. resolved, within the framework of the negotiations with Telefónica, S.A. in relation to the merger of the two companies, to propose to the Company's next Stockholders' Meeting that a dividend be distributed in cash, with a charge to the "Additional Paid-in Capital" account, of €0.60 gross for each of the Company's outstanding shares carrying dividend rights on the payment date. This payment will be made prior to the registration of the aforementioned merger at the Mercantile Registry.

b) Sale of One Travel.com, Inc

On February 11, 2005, Terra Networks, S.A. resolved to sell its holding in One Travel.com, Inc., representing 54.15% of the capital stock, within the framework of various agreements entered into by between OneTravel.com, Inc. and the U.S. company RCG Companies, aimed at the merger of the two companies. The value of the transaction totals US$ 25.5 million.