

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 | | | |
| Accumulated depreciation | (13.494) | (12.348) | | | |
| Long-term investments (Note 7) | 1.043.376 | 1.715.073 | DEFERRED REVENUES | 10.479 | 32.620 |
| Investments in Group and associated companies | 990.099 | 3.773.835 | | | |
| Loans to Group and associated companies (Note 10) | 448.321 | 472.777 | | | |
| Long-term deposits and guarantees | 1.013 | 810 | | | |
| Tax receivables (Note 9) | 287.009 | 287.009 | | | |
| Investment valuation allowances | (683.066) | (2.819.358) | | | |
| 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 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