TERRA NETWORKS, S.A.
and Subsidiaries

2004 and 2003 Consolidated Financial Statements together with 2004 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 consolidated financial statements

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

1. We have audited the consolidated financial statements of TERRA NETWORKS, S.A. and SUBSIDIARIES ("the Group") comprising the consolidated balance sheet as of December 31, 2004, and the related consolidated statement of operations and notes to consolidated financial statements for the year then ended. The preparation of these consolidated financial statements is the responsibility of the Parent Company's directors. Our responsibility is to express an opinion on the consolidated financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the consolidated financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made. 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. as of December 31, 2004, and whose assets, income before taxes and net sales represented 5.2%, 16.9% and 40.13%, respectively, of the related consolidated figures as of December 31, 2004. The aforementioned financial statements of Terra Networks España, S.A. were examined by other auditors (BDO Audiberia Auditores, S.L.), and our opinion as expressed in this report on the consolidated financial statements of Terra Networks, S.A. is based, with respect to the ownership interest in Terra Networks España, S.A., solely on the reports of the aforementioned auditors.

2. As required by Spanish corporate law, for comparison purposes the Parent Company's directors present, in addition to the 2004 figures for each item in the consolidated balance sheet and consolidated statements of operations and of changes in financial position, the figures for 2003. Our opinion refers only to the 2004 consolidated financial statements. Our auditors' report dated February 25, 2004, on the 2003 consolidated financial statements contained an unqualified opinion.

3. 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 consolidated 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 €289,678 thousand, relating to prepaid income taxes and tax assets capitalized for tax losses incurred in 2001 and prior years (see Notes 4-m and 14). 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.

4. The Company forms part of a group of companies whose parent company is Telefónica, S.A. 26% of the Terra Group's consolidated net sales and 31% of its consolidated operating expenses in 2004, arose as a result of transactions with Telefónica Group companies (see Note 16). Consequently, the business activities of Terra Networks, S.A. and Subsidiaries are influenced by these transactions.
5. As indicated in Note 17-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 consolidated financial statements 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. and Subsidiaries as of December 31, 2004, and of the results of their operations and of the funds obtained and applied by them 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 consolidated management report for 2004 contains the explanations which the directors of Terra Networks, S.A. consider appropriate about the situation of the Group, the evolution of its business and other matters, but is not an integral part of the consolidated financial statements. We have checked that the accounting information in the consolidated management report is consistent with that contained in the consolidated financial statements for 2004. Our work as auditors was confined to checking the consolidated management report with the aforementioned scope, and did not include a review of any information other than that drawn from the consolidated companies' accounting records.

DELOITTE, S.L.
Registered in ROAC under no. S0692

Javier Acevedo Jiménez de Castro

February 24, 2005

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 21). In the event of a discrepancy, the Spanish-language version prevails.

TERRA NETWORKS, S.A. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2004 AND 2003

	Thousands of Euros			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 10)**		
Start-up expenses	**560**	**892**	Capital stock	1.149.883	1.202.936
Intangible assets (Note 7)-	**223.945**	**80.267**	Additional paid-in capital	3.975.218	5.126.134
Rights on leased assets	-	14.338	Reserves of the Parent Company:		
Intellectual property	23.785	22.324	Unrestricted reserves	13.766	6
Computer software	102.188	94.456	Reserves for retired capital	92.648	39.596
Intangible assets in progress	11	2.699	Reserves for treasury stock	15.120	126.262
Other intangible assets	260.919	128.131	Accumulated losses	(1.714.160)	(703.941)
Allowances	(6.136)	(14.078)	Reserves at fully consolidated companies	(1.652.365)	(2.289.662)
Accumulated amortization	(156.822)	(167.603)	Reserves at companies accounted for by the equity method	(202.925)	(208.092)
Property and equipment (Note 8)-	**12.307**	**38.301**	Consolidation translation differences	(206.421)	(399.988)
Land and structures	5.789	14.736	Income for the year attributable to the Parent Company	163.972	(172.710)
Plant and machinery	11.474	15.163	**Total stockholders' equity**	**1.634.736**	**2.720.541**
Computer hardware	110.162	123.974			
Furniture	9.386	12.241			
Advances and construction in progress	430	151			
Other tangible fixed assets	2.741	3.045	**MINORITY INTERESTS (Note 11)**	**-**	**2.961**
Allowances	(13.483)	(17.042)			
Accumulated depreciation	(114.192)	(113.967)			
Long-term investments-	**505.850**	**546.311**	**NEGATIVE CONSOLIDATION GODWILL (Note 4-a)**	**-**	**6.615**
Investments accounted for by the equity method (Note 6)	51.111	68.634			
Other investments (Note 9)	201.583	264.096			
Loans to associated companies (Note 13)	3.757	16.029	**DEFERRED REVENUES**	**1.008**	**1.000**
Other loans	442	187			
Long-term deposits and guarantees	2.663	1.722			
Tax receivables (Note 14)	299.832	295.795	**PROVISIONS FOR CONTINGENCIES AND EXPENSES**	**25.416**	**22.896**
Allowance for investments accounted for by the equity method (Note 6)	(3.686)	(3.974)			
Investment valuation allowances (Note 9)	(49.852)	(83.906)			
Other investment valuation allowances	-	(12.272)	**LONG-TERM PAYABLES TO GROUP COMPANIES (Note 12)**	**26.183**	**26.192**
Long-term treasury stock (Note 10)	**15.120**	**126.262**			
Total fixed and other noncurrent assets	**757.782**	**792.033**			
			LONG-TERM DEBT	**1.227**	**694**
CONSOLIDATION GOODWILL (Notes 4-a and 5)	**97.446**	**422.095**			
DEFERRED CHARGES	**10.549**	**5.818**	**LONG-TERM DEFERRED TAX LIABILITY (Note 14)**	**14.991**	**3.020**
CURRENT ASSETS					
Inventories	**2.713**	**603**	**CURRENT LIABILITIES**		
Accounts receivable-	**122.772**	**142.647**	Payable to credit institutions (Note 7)	-	7.163
Trade receivables for sales and services	44.585	50.995	Payable to Telefónica Group companies (Note 12)	26.740	38.202
Receivable from Telefónica Group companies (Note 12)	64.444	57.417	Payable to associated companies (Note 13)	269	3.105
Receivable from associated companies (Note 13)	1.976	1.837	Trade accounts payable	79.358	98.155
Tax receivables (Note 14)	10.331	29.741	Other nontrade payables:		
Other accounts receivable	1.436	2.657	Taxes payable (Note 14)	9.275	14.497
Short-term investments-	**847.010**	**1.590.584**	Other nontrade payables	25.280	32.157
Loans to Telefónica Group companies (Note 12)	826.921	1.365.431	Accrual accounts	7.727	10.020
Other short-term investments (Note 4-i)	20.089	225.153	**Total current liabilities**	**148.649**	**203.299**
Cash	**7.172**	**8.937**			
Accrual accounts	**6.766**	**24.501**			
Total current assets	**986.433**	**1.767.272**			
TOTAL ASSETS	**1.852.210**	**2.987.218**	**TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES**	**1.852.210**	**2.987.218**

The accompanying Notes 1 to 21 are an integral part of the consolidated balance sheet as of December 31, 2004.

(20) CONSOLIDATED 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
Funds applied in operations	-	-	Funds obtained from operations	296.535	277
Distribution of dividend	1.122.123	-	Stock options exercised under ESOP	85	6.814
Additions to start-up expenses	187	169	Disposal of treasury stock	-	1.722
Intangible asset additions	15.483	63.952	Retirements of start-up expenses	-	81
Property and equipment additions	9.963	16.449	Retirements of intangible assets	1.746	1.070
Acquisitions of subsidiaries	1.756	15.385	Retirements of property and equipment	5.449	282
Additions to other long-term investments	658	6.208	Retirements of subsidiaries	35.749	184
Acquisition of treasury stock	15.120	-	Disposal of subsidiaries	88.878	-
Conversion to capital of short-term payables	5.025	8.751	Retirements of other long-term investments	262	121
Period provision for contingencies and expenses	-	-	Long-term debt	540	-
Long-term debt	-	489	Tax assets, net	828	757
Variations due to translation differences	2.608	52.836	Retirements of deferred charges	13	3.007
			Transfers to short term	-	26.490
			Provisions for contingencies and expenses	579	4.745
			Minority interests	-	3.496
			Deferred revenues	6	538
			Variation in working capital due to inclusion of equity interests	-	2.882
			Variation in working capital due to disposal of equity interests	16.064	-
TOTAL FUNDS APPLIED	**1.172.923**	**164.239**	**TOTAL FUNDS OBTAINED**	**446.734**	**52.466**
FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED			**FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED**	**726.189**	**111.773**

VARIATION IN WORKING CAPITAL	Thousands of Euros 2004 Increase	Thousands of Euros 2004 Decrease	Thousands of Euros 2003 Increase	Thousands of Euros 2003 Decrease
Inventories	2.110		188	-
Accounts receivable		19.875	-	4.716
Short-term investments		743.574	-	144.079
Cash		1.765	-	17.488
Accrual accounts		17.735	-	4.693
Current liabilities	54.650		59.015	-
TOTAL	**56.760**	**782.949**	**59.203**	**170.976**
VARIATION IN WORKING CAPITAL	**726.189**		**111.773**	

TERRA NETWORKS, S.A. AND SUBSIDIARIES

2004 AND 2003 CONSOLIDATED STATEMENTS OF OPERATIONS

	Thousands of Euros			Thousands of Euros	
DEBIT	**2004**	**2003**	**CREDIT**	**2004**	**2003**
EXPENSES:			**REVENUES:**		
Procurements:			Net sales:		
Total purchases from Telefónica Group companies (Note 15)	153.300	142.555	Net sales to Telefónica Group companies (Note 15)	139.241	130.615
Total purchases from associated companies	198	400	Net sales and services to associated companies	3.259	8.905
Other purchases and work performed by other companies	102.809	122.881	Net sales and services	396.662	405.571
Personnel expenses (Note 15)	95.785	119.653	Capitalized expenses of Group work on fixed assets	727	910
Depreciation and amortization expense	79.513	78.742	Other operating revenues from Telefónica Group companies (Note 15)	280	281
Variation in operating allowances	9.107	7.709	Other operating revenues	309	345
Other operating expenses:			**Total operating revenues (Note 15)**	**540.478**	**546.627**
Outside services provided by Telefónica Group companies (Note 15)	29.742	26.572			
Outside services provided by associated companies	193	152			
Outside services and other operating expenses (Note 15)	128.478	166.189			
Total operating expenses	**599.125**	**664.853**			
Operating income	**-**	**-**	**Operating loss**	**58.647**	**118.226**
			Revenues from equity investments	-	837
			Revenues from investments in and loans to Telefónica Group companies (Note 15)	23.308	35.021
Financial expenses on debts	3.120	3.899	Financial revenues from investment securities and loans	5.603	27.810
Exchange losses	5.468	2.442	Exchange gains	5.065	3.657
Other financial and similar expenses	8.142	4.029	Other financial and similar revenues	1.031	788
Financial income	**18.277**	**57.743**	**Financial loss**	**-**	**-**
Share in losses of companies accounted for by the equity method (Note 6)	14.843	34.734	Share in the income of companies accounted for by the equity method (Note 6)	284	
Amortization of consolidation goodwill (Note 5)	65.577	83.269	Reversal of negative consolidation goodwill	729	972
Income from ordinary activities	**-**	**-**	**Loss on ordinary activities**	**119.777**	**177.514**
Losses on property and equipment and intangible assets	5.062	800			
Losses on long-term investments	77	144	Gains on of long-term investment disposals (Note 15)	37.805	10.908
Extraordinary expenses and losses (Note 15)	61.907	17.564	Other extraordinary revenues (Note 15)	3.468	12.134
Extraordinary income	**-**	**4.534**	**Extraordinary loss**	**25.773**	**-**
Income before taxes and minority interests	**-**	**-**	**Loss before taxes and minority interests**	**145.550**	**172.980**
Corporate income tax (Note 14)	-	266	Corporate income tax (Note 14)	306.456	-
			Income attributed to minority interests (Note 11)	3.066	536
Net income for the year	**163.972**	**-**	**Net loss for the year**	**-**	**172.710**

The accompanying Notes 1 to 21 are an integral part of the 2004 consolidated statement of operations.

Terra Networks, S.A.
and Subsidiaries

2004 and 2003 Consolidated Financial Statements

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 21). In the event of a discrepancy, the Spanish-language version prevails.

TERRA NETWORKS, S.A.

AND SUBSIDIARIES

NOTES TO 2004 CONSOLIDATED FINANCIAL STATEMENTS

(1) DESCRIPTION OF THE TERRA NETWORKS GROUP

Terra Networks, S.A. ("the Parent 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 Parent 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 or other authorizations or licenses as might be required. The Parent 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 Parent Company may perform them directly or through interests in the business activities of other companies with a similar corporate purpose, either by promoting the foundation or formation of such companies or by acquiring holdings in their capital.

In order to carry on its business activities, Terra Networks, S.A. has incorporated 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, Mexico, Nicaragua, Panama, Peru, Puerto Rico, the Dominican Republic, Uruguay and Venezuela, (see Exhibit I). The holdings in Germany, Austria, Denmark, France, the Netherlands, Italy, the U.K., Sweden and Switzerland arose, after the sale of Lycos, Inc. as a result of the maintenance within the Terra Group of Lycos Europe N.V.

In 2004 and 2003 the main events affecting the consolidated financial statements were as follows:

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. These assets continued to form part of the Terra Group after the sale of Lycos, Inc.

The book value of the assets transferred was €332.9 million. 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 (see Note 15).

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 10).

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. All this gave rise to a significant drop in personnel costs and to a reduction of the headcount at 2004 year-end to 1,606 persons, as compared with the headcount of 2,255 persons at 2003 year end. The expenses incurred in this process are recorded under the "Extraordinary Expenses" caption (see Note 15) in the accompanying consolidated statement of operations.

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 17-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 10), 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 €307,126, as of December 31, 2004, was recognized in this connection (see Note 14).

Tender offer

On June 19, 2003, the Spanish National Securities Market Commission ("the 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 the U.S. Nasdaq index, 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 that the tender offer for all the shares of Terra Networks, S.A. was 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 notified 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 capital stock of Terra Networks, S.A.

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 offer had been restricted. Accordingly, the direct holding resulting from the tender offer represented 71.97% of the total capital stock of Terra Networks, S.A.

Alliances with Bertelsmann AG and 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

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

acquired from the Terra Group for the two years following the merger of Terra Networks, S.A. and Lycos, Inc. The agreement also established that Bertelsmann AG would make payments totaling US$ 675 million for the products and services acquired from the Terra Group for the three years following the second anniversary of the merger of the aforementioned companies, and Telefónica S.A. undertook to acquire goods and services from the Terra Group during that period for the amount of the purchases not made by Bertelsmann AG, up to 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 strategic agreement of May 16, 2000. Also, all the former signatories of the aforementioned agreement entered into a new preferential interest agreement which will enable them to continue to explore opportunities for the mutual provision of on-line communications, development and content services.

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 that 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 capabilities to promote their growth on the Internet, in order to harness synergies and create value for the two Groups, generating a minimum value of €78.5 million annually for the Terra Group 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 term of the Agreement is six years, extendible for successive 12-month periods (see Note 15).

In compliance with the terms of the Framework Strategic Alliance Agreement, in 2004 and 2003 the aforementioned annual minimum 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, and on 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 stockholders of Terra Networks, S.A. 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.A.`s effective percentages of ownership (capital stock less treasury stock) were 76.80% and 75.29%, respectively.

As of December 31, 2004 the "Other Stockholders" caption included the holding of Caja de Ahorros y Pensiones de Barcelona (1.197%), the purpose of which is to provide coverage for the Stock Option Plan for the Terra Group's employees (see Notes 10, 17-a and 17-b) and, if these options are not exercised, the shares will be retired.

Environmental information

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

(2) BASIS OF PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

a) True and fair view-

These consolidated financial statements, which were prepared by the Parent Company's directors from the accounting records of Terra Networks, S.A. and its subsidiaries, are presented in accordance with the Spanish National Chart of Accounts and Royal Decree 1815/1991 approving the rules for the preparation of consolidated financial statements, and, accordingly, give a true and fair view of the net worth, financial position and results of operations of the Parent Company and its subsidiaries. The financial statements of the subsidiaries were prepared by each company's directors in accordance with Spanish accounting principles and standards and with the applicable legislation in the countries in which these companies are located.

The 2004 consolidated financial statements will be submitted for approval by the Parent Company's Stockholders' Meeting, and it is considered that they will be approved without any changes.

The consolidated financial statements for 2003 were approved by the Stockholders' Meeting of Terra Networks, S.A. on June 22, 2004.

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

b) Consolidation principles-

The companies over which effective control is exercised by virtue of ownership of a majority of the voting rights in their representation and decision-making bodies were fully consolidated; those in which there is significant influence but not ownership of a majority of the voting rights or joint management with third parties are accounted for by the equity method.

In 2004 and 2003 all the subsidiaries (see Exhibit I) were fully consolidated, except for Red Universal de Marketing y Bookings Online, S.A., A tu hora, S.A., Azeler Automoción, S.A., Iniciativas Residenciales en Internet, S.A. and the associated companies of Lycos, Inc. (Lycos Europe N.V., Lycos Asia Limited and Lycos Ventures LP), which are accounted for by the equity method, since in the case of these companies, although control over their governing bodies is not exercised and a majority of the voting rights is not owned, there is a lasting relationship in which influence is exercised over their management.

In the specific case of the holding in Uno-e Bank, S.A., in 2003 the consumer finance business line of Finanzia Banco de Crédito, S.A. was integrated into Uno-e Bank, S.A., through a capital increase at Uno-e Bank, S.A. on April 23, 2003, following which the holding of Terra Networks, S.A. stood at 33%. Additionally, under the liquidity agreement entered into by Terra Networks, S.A. and BBVA on January 10, 2003, once the integration took place, Terra Networks, S.A. had the right to sell its holding in Uno-e Bank, S.A. to BBVA for a guaranteed minimum price of €148.5 million. Therefore, the holding in Uno-e Bank S.A. is valued at this amount (see Note 9).

Additionally, there are inactive companies whose effect on the consolidated financial statements is scantly material which are included in the consolidated balance sheet under the "Other Investments" caption at historical cost. The related investment valuation allowances were recorded where necessary (see Note 9).

All material balances and transactions between the consolidated companies were eliminated in consolidation. Also, the margins included in the billings of subsidiaries to other Terra Group companies for capitalizable goods and services were eliminated in consolidation.

The consolidated statement of operations includes the revenues and expenses of the companies excluded from the Terra Group through the date on which the holding was sold or the company concerned was liquidated, and those of the companies included in the Group from the date on which the holding was acquired or the company concerned was incorporated through year-end.

The result of accounting for the investments in associated companies by the equity method is reflected under the "Investments Accounted for by the Equity Method" caption on the asset side of the consolidated balance sheet and the "Share in Losses of Companies Accounted for by the Equity Method" caption in the consolidated statement of operations.

The equity of the minority stockholders in the net worth and results of the fully consolidated subsidiaries is recorded under the "Minority Interests" caption on the liability side of the consolidated balance sheet and the "Loss Attributed to Minority Interests" caption in the consolidated statement of operations, respectively.

In accordance with standard practice in Spain, the accompanying consolidated financial statements do not include the tax effect, if any, of transferring the reserves of the consolidated subsidiaries and of the holdings accounted for by the equity method to the Parent Company's accounts, since it is considered that these reserves will be used to finance each company, and the unrestricted reserves will not give rise to any significant additional tax costs.

c) Comparative information-

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 aforementioned Korean company. On September 30, 2004, Lycos, Inc. transferred certain assets amounting to €332.9 million to Terra Networks, S.A.

After the sale of Lycos, Inc., the Company reclassified the unallocated amount of the net book value relating to the Strategic Alliance Agreement with Telefónica, S.A., for a net amount of €181,805 thousand, from the "Consolidation Goodwill" caption to the "Other Intangible Assets" caption.

The corporate income tax recorded in the accompanying statement of operations relates to the recognition of the tax asset for tax losses incurred in 2004, which was recorded as a result of the inclusion of the Terra Group in the aforementioned Telefónica consolidated tax group on January 1, 2004.

d) Scope of consolidation-

The consolidated Terra Group companies and information thereon are described in Exhibit I.

The main changes in the scope of consolidation in 2004 and 2003 were as follows (in chronological order):

d.1.) Subsidiaries-

- 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, in particular, the approval of the U.S. Antitrust Authorities, had been obtained.

Prior to the sale, Lycos, Inc. transferred certain assets to Terra Networks, S.A., which included the equity interests in Lycos Europe, N.V., and in Terra Networks USA, LLP. and other financial assets. The gain on the transaction, taking into account the value of the assets received, amounted to €26,171 thousand, and this amount is recorded under the "Gains on Long-Term Investment Disposals" caption in the accompanying consolidated statement of operations (see Note 15).

- Tecnología y S.V.A., S.A.

On June 15 2004, Terra Networks México Holding, S.A. de C.V. sold the subsidiary Tecnología y S.V.A., S.A., giving rise to a gain of €10,772 thousand. This gain is recorded under the "Gains on Long-Term Investment Disposals" caption in the accompanying consolidated statement of operations (see Note 15).

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

In December 2004 a corporate reorganization was carried out through the contribution by Terra Networks, S.A. to Terra Networks Latam, E.T.V.E., S.L. (a wholly-owned subsidiary) of the holdings owned by Terra Networks, S.A. in 2004 in certain foreign companies located in Latin America for their net book value. In 2003 the Latin American holdings were also reorganized within the Group, involving their sale to various Terra Group companies by Terra Networks Latam E.T.V.E., S.L. for their net book values (see Exhibit I).

- OneTravel.com, Inc.-

On April 18, 2003, the Terra Group acquired a majority of the voting rights in this company, increasing its holding from 39.6% as of December 31, 2002, to 52.07%. In August 2003 the Terra Group concluded the share purchase agreements by virtue of which its holding in the capital stock of OneTravel.com, Inc., was increased from 52.07% to 54.15%. The effective amount disbursed in 2003 was €3.3 million.

- Capital increases without changes in percentages of ownership-

The detail of the capital increases at the Group's subsidiaries in 2004 is as follows:

Company	Capital Increase through Conversion of Debt to Capital Stock	Capital Increase through Fully Subscribed Monetary Contribution
Educaterra, S.L.	6,235 (*)	-
Maptel, S.A.U.	-	1,040 (*)
Terra Lycos, S.A.	-	500 (*)
T.N. España S.A.U.	17,500 (*)	4 (*)
T.N Guatemala, S.A.	-	1,060 (**)
T.N. México Holding, S.A. de C.V.	-	1,500 (**)
T.N. Argentina, S.A.	-	1,472 (**)
T.N. Venezuela, S.A.	-	325 (**)
T.N. Colombia Holding S.A.	-	7,550 (**)

(*) Amounts in thousands of euros.
(**)Amounts in thousands of U.S. dollars.

Additionally, in 2004 Emplaza, S.A. was dissolved and liquidated.

d.2) Associated companies-

- A Tu Hora, S.L.-

On September 2, 2004, Terra Networks Asociadas, S.L. sold the 50% holding it owned in the inactive company A Tu Hora, S.L. to Tele Pizza, S.A. for €100 thousand. Until that date, A Tu Hora, S.L. had been accounted for by the equity method in Terra Networks, S.A. This transaction gave rise to extraordinary income of €2,875 thousand due to the repayment of advances (see Note 15).

- Uno-e Bank, S.A.-

On January 10, 2003, Terra Networks, S.A. and BBVA entered into an agreement for the integration of the consumer finance line of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., in terms more suited to their respective interests than those established in the memorandum of understanding of May 15, 2002, which was then rendered null and void. The definitive agreement was subject to the related internal and administrative authorizations, which had to be granted before June 30, 2003, as a condition for the formalization and execution of the integration transaction.

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

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

In compliance with the terms of the aforementioned Agreement of January 10, 2003, and after obtaining the necessary authorizations, on April 23, 2003, BBVA and Terra Networks, S.A., at the Special Stockholders' Meeting of Uno-e Bank, S.A., unanimously approved a capital increase at Uno-e Bank, S.A. to be subscribed in full by Finanzia Banco de Crédito, S.A., through the nonmonetary contribution of the consumer finance business line of the latter, whose Special Stockholders' Meeting held on the same date approved the contribution and the subscription in full of the capital increase. This capital increase was recorded in a public deed dated June 19, 2003 and registered in the Mercantile Register on July 16, 2003.

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

- Terra Mobile, S.A.-

In 2003 Terra Networks Asociadas, S.L. sold its holding in the company for €1 to Telefónica Móviles, S.A., making the latter the sole shareholder of Terra Mobile. The sale gave rise to a gain of €10,526 thousand, since Terra Networks had recorded an allowance for the investment value for the negative underlying book value of Terra Mobile, S.A.

- Capital increases at other investees–

The detail of the capital increases at Terra Group associated companies in 2004 is as follows (amounts in thousands of euros):

Company	Capital Increase through Conversion of Debt into Capital	Capital Increase through Fully Subscribed Monetary Contribution
Inversis Networks, S.A.	-	1,601

(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 Parent Company in preparing the accompanying consolidated financial statements were as follows:

a) Consolidation goodwill-

Consolidation goodwill relates to the positive difference between the amounts paid to acquire the subsidiaries and the value of the proportional part of their equity at the acquisition date, net of value adjustments and allowances recorded before the date of first-time consolidation and after uniformity adjustments.

Pursuant to Royal Decree 1815/1991 regulating the rules for the consolidation and integration of companies, the difference arising in first-time consolidation between the acquisition cost recorded by the acquiring company and the equity of the acquired company is recorded under the "Consolidation Goodwill" caption on the asset side of the consolidated balance sheet. The recoverability of the goodwill depends on the fulfillment of the future business plans prepared by the Group. 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.

- *Amortization and write-down of goodwill*

The Parent Company amortizes goodwill systematically over the period in which it will contribute to the obtainment of revenues.

The amortization period is ten years, except for the portion of goodwill assigned to the agreement entered into by Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A., which will be recovered over the term of the agreement.

This goodwill was assigned to the intangible assets arising from the aforementioned contract, which guarantees the generation of a minimum annual value (see Note 1). Since the terms and conditions of the agreement were not modified and, therefore, the generation of value was not modified, as a result of the divestment of Lycos, Inc., on October 5, 2004, the Company reclassified it to the "Other Intangible Assets" caption for a net amount of €181,805 thousand (see Notes 5 and 7). Consequently, since that date, this asset has been amortized with a charge to the "Depreciation and Amortization Expense" caption in the consolidated statement of operations.

At each year-end, studies are made of the subsidiaries' business plans, based on the new circumstances in the market in general and in the Internet industry in particular. The objective of these analyses is to determine the recovery of the goodwill, recognized tax assets and other fixed assets in the consolidated balance sheet of the Terra Group, on the basis of the estimates of the future value that each of the businesses and countries will generate, in accordance with the accounting principle of prudence in valuation.

As a result of these studies, and in accordance with the accounting principle of prudence, the unamortized consolidation goodwill was written down by €8,892 thousand and €6,452 thousand as of December 31, 2004 and 2003, respectively. The write-down recorded in 2004 relates in full to One Travel.com , Inc. (see Notes 5 and 15).

There were no acquisitions in 2004 that generated goodwill. The €65,577 thousand of amortization of consolidation goodwill were charged to the 2004 consolidated statement of operations (see Note 5).

The goodwill generated in 2003 amounted to €3,730 thousand, and arose from the increases in the holding in OneTravel.com, Inc. €83,269 thousand of amortization of consolidation goodwill were charged to the 2003 consolidated statement of operations (see Note 5).

- *Goodwill arising from the acquisition of Lycos, Inc.*

For the purpose of calculating the goodwill arising from the acquisition of Lycos, Inc., the acquisition cost recorded in the individual financial statements of Terra Networks, S.A. was broken down in two different tranches:

1.- New shares of Terra Networks, S.A. issued, subscribed and paid in full, to cover the ordinary shares of Lycos, Inc. (239,491,725 shares issued at a par value of €11 each plus the expenses associated with the transaction).

2.- New shares of Terra Networks, S.A. issued, subscribed and paid in full, to cover the shares of Lycos, Inc. issued and subscribed relating to the aforementioned company's employees' stock option plans (62,540,249 shares issued at a value of €11 each). Until December 2003 these shares were deposited at Citibank, NA under a share deposit agreement (see Note 10).

For accounting purposes, a distinction was drawn between shares that covered options of employees of Lycos, Inc. with an exercise price equal to or greater than €11 and shares that covered options of employees of Lycos, Inc. with an exercise price of less than €11.

The varying accounting treatments of the differences between the acquisition price and the company's equity gave rise to the appearance of various accounts that have gradually ceased to exist:

- As the beneficiaries of the options exercised their right

- As Terra Networks, S.A., pursuant to the aforementioned resolutions of the Stockholders' Meeting, acquired the options that had not been exercised and subsequently retired the shares through a capital reduction.

- As a result of the divestment of Lycos, Inc.

On October 27, 2000, Terra Networks, S.A. and Citibank NA (the custodian of the options - see Note 10) entered into a contract to regulate all matters relating to the Stock Option Plans on Terra Networks, S.A. shares. Under this contract, Terra Networks, S.A. was able to acquire the shares held by the Agent Bank, for €11 per share, for their subsequent delivery to the beneficiaries of the plans once the latter exercised their options. When the option exercise period expired, in relation to the options that had not been exercised, Terra Networks, S.A., in accordance with the resolutions of the Company's Stockholders' Meetings of June 8, 2000 and April 2, 2003, acquired the excess shares and then retired them (see Note 10).

Note 17-b shows a detail of the options under the Lycos, Inc. employee stock option plan.

b) Transactions between consolidated companies-

All reciprocal receivables and payables between the consolidated companies, as well as the transactions giving rise to reciprocal expenses and revenues for them, were eliminated in consolidation. The results on intercompany transactions are eliminated and deferred until they have been realized vis-à-vis non-Group companies.

c) Uniformity of items in the individual financial statements of the consolidated companies-

In general, assets and liabilities and revenues and expenses of the companies included in the scope of consolidation are valued using uniform methods. However, in the specific case of the different methods that give rise to material differences, such methods were made uniform in consolidation by adapting them to the methods applied by the Parent Company.

d) Translation of the financial statements of consolidated foreign companies-

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

1. Capital stock and reserves, which were translated at the historical exchange rates.
2. Goodwill arising at the Parent Company as a result of the direct acquisition of foreign holdings, which, together with the related accumulated amortization, was translated at the historical exchange rates.
3. Income statement items, which were translated at the average exchange rates for the year, except for the amortization of the goodwill of the Parent Company, which was translated at the historical exchange rates, as described above.

The exchange differences arising from application of these methods are included under the “Stockholders’ Equity - Translation Differences” caption in the accompanying consolidated balance sheet, net of the portion of said difference relating to minority interests, which is recorded under the “Minority Interests” caption on the liability side of the accompanying consolidated balance sheet.

e) Start-up expenses-

Start-up expenses, which comprise incorporation, preopening and capital increase expenses, are recorded at cost.

They relate mainly to expenses such as lawyers' fees, public deed and registration expenses, etc., and advertising expenses incurred in launching the Terra brand name.

The Terra Group amortizes start-up expenses on a straight-line basis over five years.

€517 thousand and €910 thousand of amortization of start-up expenses were charged to the consolidated statement of operations in 2004 and 2003, respectively.

f) Intangible assets-

The intangible assets relate mainly to rights on leased assets, intellectual property, computer software and other intangible rights.

The rights under financial lease contracts are recorded at the cost of the related assets, and the total debt for lease payments plus the amount of the purchase option are recorded as a liability. The difference between the two amounts, which represents the interest expenses on the transaction, is recorded as a deferred expense and is allocated to income each year by the interest method. At present there are no financial lease contracts.

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

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.

The "Other Intangible Assets" caption includes intangible rights relating to the acquisition of franchises and customer rosters from third parties, which are amortized on a straight-line basis over three and five years, respectively, as well as rights acquired under long-term contracts for services and content, which are amortized on a straight-line basis over the contract term, and Internet capacity usage rights. Additionally, due to the divestment of Lycos, Inc. on October 5, 2004, the Company reclassified the goodwill assigned to the agreement entered into by Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A. 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).

The contribution of the intangible assets to the generation of future income is analyzed annually and allowances are recorded to cover the negative difference, if any, between the present value of the estimated future flows and the net book value of the assets. In 2004 and 2003 no provisions were recorded for the decline in value of intangible assets.

€53,494 thousand and €43,055 thousand of amortization of intangible assets were charged to the consolidated statement of operations in 2004 and 2003, respectively (see Note 7).

g) 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 contribution of property and equipment to the generation of future income is analyzed annually and allowances are recorded to cover the negative difference, if any, between the present value of the estimated future flows and the net book value of the assets. In 2004 and 2003 no provisions were recorded for the decline in value of property and equipment.

The Group 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
Structures	5-8
Plant	5-10
Furniture	5-11
Computer hardware	2-5
Other tangible fixed assets	4-6
Other fixtures	10

€25,502 thousand and €34,777 thousand of depreciation of property and equipment were charged to the 2004 and 2003 consolidated statements of operations, respectively (see Note 8).

h) Long-term investments-

Nonconsolidated investments and investments accounted for by the equity method are recorded in the consolidated balance sheet at the lower of cost or market.

The market value was determined as follows:

1. Listed securities:

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

2. Unlisted securities and companies accounted for by the equity method:

   The market value was taken to be the underlying book value of the investments adjusted by the amount of the unrealized gains disclosed at the time of the acquisition and still existing at year-end.

As mentioned in Note 2, the investment in Uno-e Bank, S.A. is valued at the guaranteed amount of €148.5 million based on the capital increase at this company, following which the holding of Terra Networks, S.A. at year-end was 33%, and it acquired the right to sell it to BBVA for the aforementioned amount.

In relation to the subsidiaries in which the Company's holding exceeds 50%, unrealized losses (cost higher than market value or underlying book 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 cost value to zero, the overprovision is reclassified for the purposes of the consolidated balance sheet to the liability "Provisions for Contingencies and Expenses" caption.

In relation to the subsidiaries in which the Company's holding is less than 50% and which are not accounted for by the equity method, the unrealized losses and/or gains (cost higher or lower, respectively, than market value or underlying book value at year-end) are recorded directly under the "Financial Revenues from Investment Securities and Loans" caption or the "Other Financial and Similar Expenses" caption, respectively, in the accompanying consolidated statement of operations.

i) Short-term investments-

The "Loans to Telefónica Group Companies" caption includes mainly two items:

- Short-term investments of cash balances at Telefónica y Finanzas, S.A. by Terra Networks, S.A. and various Terra Group companies, which earn interest at market rates (see Note 12), which as of December 31, 2004 and 2003, amounted to €519,795 thousand and €1,365,307 thousand, respectively. The interest earned on these investments is recorded under the "Revenues from Investments and Loans to Telefónica Group Companies" caption in the accompanying consolidated statement of operations.

- The account receivable from Telefónica, S.A. as a result of the inclusion of Terra Networks, S.A. in the Telefónica consolidated Tax Group amounting to €307,126 thousand as of December 31, 2004 (see Note 12).

Also, the "Other Short-Term Investments" caption included mainly the investments of Lycos, Inc. in monetary assets in the form of deposits at various financial institutions in U.S. dollars, which earned interest at market rates. These short-term investments amounted to US$ 274,689 thousand as of December 31, 2003, and the equivalent euro value was €217,491 thousand as of that date.

j) Classification of receivables and payables-

In the accompanying consolidated balance sheets, receivables and payables maturing in under 12 months from year-end are classified as short-term items and those maturing at over 12 months as long-term items.

k) Inventories-

Inventories are valued at the lower of cost or market. Obsolete, defective or slow-moving inventories have been reduced to realizable value. Allowances for the decline in value of inventories are recorded on the basis of the loss in value and turnover thereof, and also when promotional sales are made at a price below the acquisition or production cost.

l) 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 lower of underlying book value, the average market price in the last quarter of the year or the year-end market price.

The Company recorded the related restricted reserve pursuant to Article 79.3 of the revised Corporations Law (see Note 10-d).

Adjustments of €2,865 thousand and €165,521 thousand as of December 31, 2004 and 2003, respectively, were made to the value of the treasury stock due to the difference between the acquisition price of these shares and their underlying book value, and these amounts were recorded with a charge to the "Additional Paid-in Capital" caption, since these shares were not for unrestricted use, but rather were held for the sole purpose of covering stock option plans (see Note 10). Substantially all these shares of treasury stock were acquired from Citibank, NA as the agent bank for the stock option plans assumed by the Company as a result of the integration of Lycos Inc.

m) Corporate income tax-

This caption relates to both Spanish corporate income tax and the similar taxes to which the foreign Terra Group companies are subject.

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.

The Parent Company recognizes tax assets for accounting purposes after analyzing the budgets and business plans that evidence that they will be recovered in a period of less than ten years, which, under current accounting legislation, is the maximum period for recognizing tax assets for tax loss carryforwards.

As explained in Note 14, 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 €307,126 thousand was recognized in this connection.

n) 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 differences arising on adjustment to year-end exchange rates of fixed income securities and receivables and payables denominated in foreign currencies are classified by maturity and currency, and for this purpose currencies which, although different, are officially convertible are grouped together.

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 consolidated balance sheet, unless exchange losses in a given group have been charged to income in prior years or in the current year, in which case the net positive differences are credited to period income up to the limit of the negative net differences charged to income in prior years or in the current year.

o) 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 Group only records realized income at year-end, whereas foreseeable contingencies and losses, including possible losses, are recorded as soon as they become known.

Certain Terra Group companies, mainly Terra Networks España, S.A. and Terra Networks Brasil, S.A., entered into agreements with Telefónica Group companies in 2004 and 2003 for the sale of software package licenses and for the associated maintenance and support services. The software packages consist of applications that enable the Telefónica Group companies to include more features in their broad and narrow band retail Internet access services for residential and business customers.

The revenues from the sale of the aforementioned software licenses and initial charges are recorded when the licenses are delivered and title to them is transferred, since the associated costs have already been incurred by the delivery date. The software maintenance and support revenues are recorded when the services are provided (pursuant to the agreements, on a monthly basis). The main transactions with Telefónica Group companies are disclosed in Note 15.

For transactions in which the subsidiary One Travel.com. Inc (which operates as an on-line travel agency) bills the end customer for the total amount of the fare including taxes, assumes the risk of credit or default on the part of the end customer and has a minimum purchase commitment with its supplier or is authorized to establish the definitive price to be paid by the end customer, the "Net Sales and Services" caption includes the full amount billed. Also, for these sales, the "Other Purchases and Work Performed by Other Companies" caption includes the full cost of the products sold. When these conditions are not fulfilled, the commission earned by One Travel.com, Inc is recognized under the "Net Sales and Services" caption. €25,657 thousand and €20,936 thousand relating to transactions of One Travel.com, Inc were recorded under the "Net Sales" and "Other Purchases and Work Performed by Other Companies" captions, respectively, in the accompanying 2004 consolidated statement of operations.

(5) CONSOLIDATION GOODWILL

The variations in 2004 and 2003 in this caption in the accompanying consolidated balance sheet were as follows:

	Thousands of Euros						
	Balance at 01/01/04	Additions	Retirement/ Transfers	Amorti- zation	Write- downs	Translation Differences	Balance at 12/31/04
Terra Networks Brasil, S.A.	90,583	-	-	(16,464)	-	-	74,119
Subsidiaries of Terra Networks Brasil, S.A.	1,739	-	-	(1,444)	-	10	305
Terra Networks Guatemala, S.A.	1,704	-	-	(305)	-	-	1,399
Terra Networks Chile, S.A.	20,656	-	-	(3,541)	-	-	17,115
Lycos, Inc.	77,935	-	(69,066)	(9,601)	-	732	-
Strategic alliance with Telefónica, S.A.	213,888	-	(181,805)	(32,083)	-	-	-
One Travel.com, Inc.	15,590			(2,139)	(8,892)	(51)	4,508
Goodwill arising at fully or proportionally consolidated companies	422,095	-	(250,871)	(65,577)	(8,892)	691	97,446

	Thousands of Euros						
	Balance at 01/01/03	Additions	Retirements / Transfers	Amorti- zation	Write- downs	Translation Differences	Balance at 12/31/03
Terra Networks Brasil, S.A.	107,048	-	-	(16,465)	-	-	90,583
Subsidiaries of Terra Networks Brasil, S.A.	4,505	-	(1,083)	(1,883)	-	200	1,739
Terra Networks Guatemala, S.A.	2,009	-	-	(305)	-	-	1,704
Terra Networks Chile, S.A.	24,206	-	-	(3,541)	-	(9)	20,656
Lycos, Inc.	98,639	-	(2,216)	(13,335)	-	(5,153)	77,935
Strategic alliance with Telefónica, S.A.	256,666	-	-	(42,778)	-	-	213,888
Ifigenia Plus, S.L.	7,445	-	-	(993)	(6,452)	-	-
One Travel.com, Inc.	-	3,730	13,784	(2,039)	-	115	15,590
Goodwill arising at fully or proportionally consolidated companies	500,518	3,730	10,485	(81,339)	(6,452)	(4,847)	422,095
Goodwill arising at companies accounted for by the equity method	126,671	-	(124,741)	(1,930)	-	-	--
Total	**627,189**	**3,730**	**(114,256)**	**(83,269)**	**(6,452)**	**(4,847)**	**422,095**

As explained in Note 1, on October 5, 2004, the agreement for the sale of the shares of Lycos, Inc. was formalized and the remaining goodwill at that date was written of. Additionally, as a result of this divestment, the Company reclassified the goodwill assigned to the agreement entered into by Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A. to the "Other Intangible Assets" caption for a net amount of €181,805 thousand (see Note 7).

The additions to goodwill in 2003 arose as a result of the acquisitions of holdings in the various Terra Group companies (see Exhibit I). The amortization relates to the period from the date of acquisition of the holdings through December 31, 2004 and 2003, respectively.

The "Transfers" column for 2003 included €110,957 thousand relating to the reclassification of the full amount the goodwill of Uno-e Bank, S.A. to the "Other Investments" caption in the accompanying consolidated balance sheet.

As indicated in Note 4-a, as of December 31, 2004 and 2003, the unamortized balance of the goodwill was written down by €8,892 thousand and €6,452 thousand, respectively, and these amounts were recorded with a charge to the "Extraordinary Expenses and Losses" caption in the accompanying consolidated statements of operations (see Note 15).

(6) INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

The variations in 2004 and 2003 in this caption in the consolidated balance sheet and in the related allowances for decline in value were as follows:

	Thousands of Euros						
	Balance at 01/01/04	Exclusion of Companies	Prior Year' Expenses and Losses	Share in Income (Losses)	Transfers	Translation Differences	Balance at 12/31/04
De remate.com, Inc.	3,975	-	-	-	-	(289)	3,686
Azeler Automoción, S.A.	590	-	-	(21)	-	-	569
Rumbo, S.A.	-	-	-	284	(284)	-	-
Lycos Europe N.V.	61,939	-	(244)	(13,643)	-	(1,484)	46,568
Lycos Ventures LP	1,239	(392)	-	(168)	(716)	37	-
Lycos Asia Limited	-	-	(1,633)	(408)	2,041	-	-
Iniciativas Residenciales en Internet, S.A.	891	-	-	(603)	-	-	288
Investments accounted for by the equity method	**68,634**	**(392)**	**(1,877)**	**(14,559)**	**1,041**	**(1,736)**	**51,111**
Allowances	**(3,974)**	-	**-**	**-**	**-**	**288**	**(3,686)**

	Thousands of Euros						
	Balance at 01/01/03	Additions	Retirements	Share in Income (Losses)	Transfers	Translation Differences	Balance at 12/31/03
CIERV, S.L.	-	-	-	(1,268)	1,268	-	-
De remate.com, Inc.	4,789	-	-	-	-	(814)	3,975
OneTravel.com, Inc.	3,702	2,730	-	(126)	(5,795)	(511)	-
Uno-e Bank, S.A.	39,929	-	-	(2,383)	(37,546)	-	-
Azeler Automoción, S.A.	1,136	-	-	(546)	-	-	590
Rumbo, S.A.	-	-	-	(2,947)	2,947	-	-
Terra Mobile	-	8,000	(8,000)	-	-	-	-
A Tu Hora, S.A.	1,897	-	-	(1,897)	-	-	-
Lycos Asia Limited	-	-	-	(8,069)	7,210	859	-
Lycos Korea, Inc.	-			1,213	(1,093)	(120)	-
Lycos Europe N.V.	79,779	-	-	(17,632)	-	(208)	61,939
Lycos Ventures LP	1,732	12	(174)	(71)	10	(270)	1,239
Iniciativas Residenciales en Internet, S.A.	1,899	-	-	(1,008)	-	-	891
Investments accounted for by the equity method	**134,863**	**10,742**	**(8,174)**	**(34,734)**	**(32,999)**	**(1,064)**	**68,634**
Allowances	**(4,789)**	-	**-**	**-**	**-**	**815**	**(3,974)**

In 2003 the "Transfers" column included the reclassification of the investment in Uno-e Bank, S.A., together with the related goodwill, to the "Other Investments" caption in the accompanying consolidated balance sheet.

Also, in 2004 and 2003 the "Transfers" column includes the reclassification of the accounts payable by the companies accounted for by the equity method to the long-term "Provisions for Contingencies and Expenses" caption on the liability side of the consolidated balance sheet (see Note 4-h).

(7) INTANGIBLE ASSETS

The detail of the balances of the "Intangible Assets" caption and of the variations therein in 2004 and 2003 is as follows:

	Thousands of Euros						
	Balance at 01/01/04	Additions or Provisions	Retirements	Transfers	Exclusion of Companies	Translation Differences	Balance at 12/31/04
Rights on leased assets	14,338	-	(326)	-	(14,267)	255	-
Intellectual property	22,324	427	(252)	77	(57)	1,266	23,785
Computer software	94,456	14,717	(5,159)	7,719	(9,377)	(168)	102,188
Intangible assets in progress	2,699	12	(368)	(2,332)	-	-	11
Other intangible assets	128,131	327	(34,107)	396	(17,939)	2,306	79,114
Strategic alliance with Telefónica, S.A.	-	-	-	181,805	-	-	181,805
Allowances	(14,078)	-	-	8,463	-	(521)	(6,136)
Accumulated amortization	(167,603)	(53,494)	38,466	(8,856)	36,712	(2,047)	(156,822)
Total, net	**80,267**	**(38,011)**	**(1,746)**	**187,272**	**(4,928)**	**1,091**	**223,945**

	Thousands of Euros						
	Balance at 01/01/03	Additions or Provisions	Retirements	Transfers	Exclusion of Companies	Translation Differences	Balance at 12/31/03
Research and development expenses	155	-	-	(155)	-	-	-
Rights on leased assets	-	14,029	(11)	320			14,338
Intellectual property	23,052	156	-	811	(190)	(1,505)	22,324
Computer software	78,627	14,683	(1,270)	6,672	(431)	(3,825)	94,456
Intangible assets in progress	3,977	3,080	(585)	(3,661)	-	(112)	2,699
Other intangible assets	112,482	32,004	(846)	(611)	-	(14,898)	128,131
Allowances	(19,377)	-	791	1,441	-	3,067	(14,078)
Accumulated amortization	(141,830)	(43,055)	1,178	(1,127)	294	16,937	(167,603)
Total, net	**57,086**	**20,897**	**(743)**	**3,690**	**(327)**	**(336)**	**80,267**

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

The "Exclusion of Companies" column for 2004 includes mainly the effect of the exclusion from consolidation of Lycos, Inc. (see Note 1).

The additions to the "Other Intangible Assets" caption in 2003 included the acquisition of Internet capacity usage rights.

Additionally, in 2003 Lycos, Inc. converted operating lease contracts, amounting to €14,029 thousand, into capital lease contracts. This transaction was financed through a cash outlay of €3,755 thousand and initial financing of €10,274 thousand from credit institutions. As of December 31, 2003, this financing had been reduced to €7,163 thousand. There are no financial lease contracts as of December 31, 2004.

The "Translation Differences" column reflects the effect of exchange rate fluctuations on the beginning balances and the monetary adjustments that certain companies made to their balances to cater for the effect of inflation, in accordance with accounting practices in their respective countries.

In 2004 and 2003 the main additions to intangible assets related to acquisitions made by various Terra Group subsidiaries in Mexico, Brazil, Spain and the U.S., mainly under long-term content supply contracts and software licenses.

(8) PROPERTY AND EQUIPMENT

The detail of the balances of the "Property and Equipment" caption and of the variations therein in 2004 and 2003 is as follows:

	Thousands of Euros						
	Balance at 01/01/04	Additions or Provisions	Retirements	Transfers	Exclusion of Companies	Translation Differences	Balance at 12/31/04
Land and structures	14,736	72	(5,923)	-	(2,342)	(754)	5,789
Plant and machinery	15,163	589	(3,454)	(795)	-	(29)	11,474
Computer hardware	123,974	8,202	(12,383)	547	(9,581)	(597)	110,162
Furniture	12,241	312	(1,293)	(54)	(1,658)	(162)	9,386
Construction in progress	151	445	(69)	(98)	-	1	430
Other tangible fixed assets	3,045	343	(576)	(66)	-	(5)	2,741
Allowances	(17,042)	-	2,906	(89)		742	(13,483)
Accumulated depreciation	(113,967)	(25,502)	15,343	719	7,453	1,762	(114,192)
Total, net	**38,301**	**(15,539)**	**(5,449)**	**164**	**(6,128)**	**958**	**12,307**

	Thousands of Euros						
	Balance at 01/01/03	Additions or Provisions	Retirements	Transfers	Exclusion of Companies	Translation Differences	Balance at 12/31/03
Land and structures	18,312	203	(349)	108	-	(3,538)	14,736
Plant and machinery	8,782	2,196	(12)	4,447	(17)	(233)	15,163
Computer hardware	131,956	13,510	(8,655)	504	(150)	(13,191)	123,974
Furniture	14,120	316	(121)	46	(34)	(2,086)	12,241
Construction in progress	214	154	(49)	(146)	-	(22)	151
Other tangible fixed assets	8,147	70	(93)	(4,951)	(14)	(114)	3,045
Allowances	(29,233)	-	2,149	3,223	-	6,819	(17,042)
Accumulated depreciation	(97,539)	(34,777)	6,945	(323)	118	11,609	(113,967)
Total, net	**54,759**	**(18,328)**	**(185)**	**2,908**	**(97)**	**(756)**	**38,301**

The "Exclusion of Companies" column for 2004 relates mainly to the effect of the exclusion from consolidation of Lycos, Inc. (see Note 1).

In 2004 and 2003 the most significant investments in property and equipment related to those made by the Terra Group subsidiaries in Spain, Mexico, Brazil, and the U.S., mainly in computer hardware.

The "Translation Differences" column reflects the effect of exchange rate fluctuations on the beginning balances and the monetary adjustments that certain companies made to their balances to cater for the effect of inflation, in accordance with accounting practices in their respective countries.

(9) OTHER INVESTMENTS

The detail of the balances of the "Long-Term Investments – Other Investments" caption, of the related investment valuation allowances and of the variations therein in 2004 and 2003 is as follows:

Thousands of Euros	Other Investments	Allowances	Net
Balance at January 1, 2003	**93,785**	**(78,653)**	**15,132**
Additions or provisions	2,623	18,177	20,800
Retirements	(8,355)	8,405	50
Transfers	189,772	(41,326)	148,446
Translation differences	(13,729)	9,491	(4,238)
Balance at December 31, 2003	**264,096**	**(83,906)**	**180,190**
Additions or provisions	1,756	(2,817)	(1,061)
Retirements	(66,269)	37,977	(28,292)
Translation differences	2,000	(1,106)	894
Balance at December 31, 2004	**201,583**	**(49,852)**	**151,731**

The "Additions" in 2004 and 2003 relate mainly to additional investments in Inversis Networks, S.A. amounting to €1,601 thousand and €2,539 thousand, respectively.

The "Transfers" account in 2003 relates mainly to the reclassification of the full amount of the investment in Uno-e Bank, S.A. from the "Consolidation Goodwill" and "Investments Accounted for by the Equity Method" captions, for a net amount of €148,500 thousand.

The "Retirements" account in 2004 relates basically to the divestment of the minority interests owned by Lycos, Inc.

(10) STOCKHOLDERS' EQUITY

The variations in equity accounts in 2004 and 2003 were as follows:

	Thousands of Euros							
	Capital Stock	Additional Paid-in Capital	Reserves (1)	Accumulated Losses	Reserves at Consolidated Companies (2)	Translation Differences	Income (Loss) for the Year	Total
Balance at January 1, 2003	**1,216,321**	**5,491,533**	**28,075**	**111,320**	**(1,312,608)**	**(334,884)**	**(2,008,870)**	**3,190,887**
Allocation of loss	-	-	-	(804,072)	(1,204,798)	-	2,008,870	-
Capital reduction	(13,385)	(60,231)	-	-	-	-	-	(73,616)
Restricted reserve for retired capital	-	(13,385)	13,385	-	-	-	-	-
Treasury stock value adjustment	-	(165,521)	-	6,741	-	-	-	(158,780)
Restricted reserve for treasury stock	-	(126,262)	126,262	-	-	-	-	-
Variation in the scope of consolidation	-	-	-	(19,652)	19,652	-	-	-
Other transfers	-	-	(1,858)	1,722	-	136	-	-
Loss for the year	-	-	-	-	-	-	(172,710)	(172,710)
Consolidation of foreign subsidiaries	-	-	-	-	-	(65,240)	-	(65,240)
Balance at December 31, 2003	**1,202,936**	**5,126,134**	**165,864**	**(703,941)**	**(2,497,754)**	**(399,988)**	**(172,710)**	**2,720,541**
Allocation of loss	-	-	-	(44,075)	(128,635)	-	172,710	-
Capital reduction	(53,053)	(70,258)	-	-	-	-	-	(123,311)
Restricted reserve for retired capital	-	(53,053)	53,053	-	-	-	-	-
Dividend paid	-	(1,135,883)	13,760	-	-	-	-	(1,122,123)
Treasury stock value adjustment	-	(2,865)	-	-	-	-	-	(2,865)
Restricted reserve for treasury stock	-	111,143	(111,143)	-	-	-	-	-
Variation in the scope of consolidation	-	-	-	(966,144)	771,099	195,045	- -	-
Income for the year	-	-	-	-	-		163,972	163,972
Consolidation of foreign subsidiaries	-	-	-	-	-	(1,478)	-	(1,478)
Balance at December 31, 2004	**1,149,883**	**3,975,218**	**121,534**	**(1,714,160)**	**1,855,290**	**(206,421)**	**163,972**	**1,634,736**

(1) The "Reserves" column includes the balances of the "Unrestricted Reserves", "Reserves for Retired Capital" and "Reserves for Treasury Stock" captions in the accompanying consolidated balance sheet.

(2) The "Reserves at Consolidated Companies" column includes the balances of the "Reserves at Fully Consolidated Companies" and "Reserves at Companies Accounted for by the Equity Method" captions in the accompanying consolidated balance sheet.

a) Capital stock-

2004

The Parent Company's capital stock as of December 31, 2004, 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. Capital was reduced through 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. Substantially all of 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, 2003, 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 the Terra Group (see Note 1 and 4-l). These shares, which must be retired at the next Stockholders' Meeting, represent 1.217% of the capital stock, are valued at €2.16 each and amount to €15,120 thousand, and this amount is recorded under the "Treasury Stock" caption on the asset side of the accompanying consolidated balance sheet.

2003

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

On June 5, 2003, a capital reduction of €13,385 thousand was executed in a public deed. Capital was reduced through the retirement of 6,692,344 shares of treasury stock of €2 par value each, pursuant to a resolution adopted by the Stockholders' Meeting on April 2, 2003. These shares related to surplus shares left over from the Lycos, Inc. employee stock option plans. As of that date, these purchase options on Terra Networks, S.A. shares were recorded under the "Other Long-Term Investments" caption. The capital retirement reduced the balances of the "Capital Stock", "Additional Paid-in Capital", "Long-Term Investments" and "Consolidation Goodwill" captions by €13,385 thousand, €60,231 thousand, €71,400 thousand and €2,216 thousand, respectively.

As of December 31, 2003, the Company held 26,544,652 shares of treasury stock acquired by virtue of the resolution of the Board of Directors of December 16, 2003, using the powers granted to it by the Stockholders' Meetings of June 8, 2000 and April 2, 2003 (see Note 1). These shares were covering the stock option plan for employees of Lycos, Inc. In the first few months of 2004 employees of the Terra Group exercised options on 18,250 shares and the remainder, 26,526,402 shares of treasury stock, were retired in July 2004, thereby complying with the resolution adopted by the Stockholders' Meeting on June 22, 2004. As of December 31, 2003, these shares represented 4.41% of the capital stock and were valued at €4.76 each.

b) Additional paid-in capital-

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. 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 Parent Company incurred losses through December 31, 2003, to the balance of the legal reserve as of December 31, 2004, was zero.

d) Reserve for treasury stock-

As described in Note 10-a), in 2004 the Parent Company reduced capital through the retirement of 26,526,402 shares of treasury stock that it held as of December 31, 2003, and, consequently, it eliminated the reserve for treasury stock that it had recorded for this amount.

In accordance with Article 79.3 of the revised Spanish Corporations Law, as of December 31, 2004, the Parent Company had recorded a restricted reserve of €15,120 thousand for a total of 7,000,000 shares of treasury stock (see Note 10-a).

e) Reserve for retired capital-

Pursuant to Article 167 of the revised Corporations Law, the Parent Company recorded a restricted reserve of €92,649 thousand for the amount of the par value of the shares retired in 2004 and prior years in order to avoid its creditors having the right to contest the aforementioned capital reductions.

f) Reserves at consolidated companies-

In 2004 the holding in Lycos, Inc. was excluded from consolidation, as a result of which the reserves at fully consolidated companies and companies accounted for by the equity method were reduced by €771,099 thousand. This amount was reclassified to the accumulated losses of the Parent Company (see Note 10-g).

Additionally, the dissolution of Emplaza, S.A. and A Tu Hora , S.L. gave rise to a reduction in reserves of €10,310 thousand, and this amount was reclassified to the reserves of Terra Networks Asociadas, S.L., the company which owned these holdings.

g) Translation differences-

The translation differences relate to the effect of exchange rate fluctuations on the net assets of the companies located abroad and the effect of the adjustment for inflation on the assets contributed by the companies at which this accounting practice is applied. These effects reduced the accumulated assets by €206,421 thousand as of December 31, 2004, and by €399,988 thousand as of December 31, 2003, as a result of the consolidation of the various subsidiaries composing the Group.

Pursuant to Royal Decree 1815/1991, the exclusion from consolidation of Lycos, Inc. reduced the translation differences by €195,045 thousand, which was reclassified to the accumulated losses of the Parent Company.

The year-end exchange rate method was used to calculate the translation differences (see Note 4-d).

h) Contribution of the Group companies to consolidated reserves and results

The detail of the contribution of the Terra Group companies to consolidated reserves and results as of December 31, 2004 and 2003, is as follows:

	Thousands of Euros			
	Loss (Income)		Negative (Positive) Reserves	
	12/31/04	12/31/03	12/31/04	12/31/03
Terra Networks, S.A. (Parent Company)	(264,784)	44,075	1,606,386 (**)	538,077
Fully or proportionally consolidated companies:				
T.N. España, S.A.	(15,439)	831	235,368	232,985
Ordenamiento de Links Especializados, S.L.	-	-	-	1,552
Terra Lycos Intangibles, S.A.	68	95	5,213	5,118
Lycos, Inc.	44,327	48,678	-	692,830
T.N Guatemala, S.A.	1,742	1,930	12,250	10,320
T.N. Perú, S.A.	2,042	1,479	47,131	45,652
T.N. USA, Inc. and subsidiaries	10,969	-	230,010	230,010
T.N. Argentina, S.A.	986	1,540	51,706	50,166
T.N. México Holding, S.A. de C.V. and subsidiaries	11,940	24,303	404,948	380,645
Telefónica Interactiva Brasil, S.A. and subsidiaries	17,714	8,774	400,778	392,004
T.N. Chile Holding Ltda. and subsidiary	6,154	6,015	58,622	52,607
T.N. Venezuela, S.A.	249	859	17,901	17,042
T.N. Colombia Holding S.A. and subsidiary	273	2,662	47,261	44,599
Ifigenia Plus, S.L.	1,367	520	4,347	3,827
T.N. Caribe, S.A.	-	137	1,524	1,387
Maptel Networks, S.A.	642	803	1,334	531
Terra Networks Latam E.T.V.E., S.L.	(11,798)	(859)	(1,598)	(739)
Terra Networks Asociadas, S.L.	9,819	(7,467)	128,893	126,050
OneTravel.com, Inc.	4,213	2,689 (*)	5,765	3,076
Emplaza, S.A. (liquidated)	-	-	-	3,886
Terra Lycos, S.A.	(1)	-	-	-
Educaterra, S.L.	986	1,038	1,038	-
Companies accounted for by the equity method:				
Uno-e Bank, S.A.	-	2,383	2,383	-
Azeler Automoción, S.A.	21	546	4,608	4,062
A Tu Hora, S.A.	-	1,897	-	4,527
Rumbo S.A.	(284)	2,947	9,357	6,410
Centro de Investigación y Experimentación de la Realidad Virtual, S.L.	-	1,268	12,740	11,472
De remate.com, Inc.	-	-	8,036	8,036
Lycos Asia Limited	408	8,069	-	12,966
Lycos Europe N.V.	13,643	17,632	162,718	145,086
Lycos Ventures LP	168	71	-	8,129
Lycos Korea, Inc.	-	(1,213)	-	1,466
Sympatico Lycos, Inc.	-	-	-	103
Iniciativas Residenciales en Internet, S.A.	603	1,008	2,957	1,949
TOTAL	**(163,972)**	**172,710**	**3,461,676**	**3,035,831**

(*) Including €126 thousand in 2003, generated when the company was accounted for by the equity method.

(**) Including €966,144 thousand generated by Lycos, Inc. when it formed part of the Terra Group.

i) 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 consolidated balance sheet (see Note 4-l); 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.

Note 17-b shows a detail of the options under the Stock Option Plan for Lycos, Inc. employees.

(11) MINORITY INTERESTS

These relate to the equity of minority interests in the net worth and results for the year of the fully consolidated subsidiaries. Exhibit I contains a detail of the various Terra Group companies, including the percentages of direct and indirect ownership and their net worth at 2004 year-end.

The variations in 2004 and 2003 in this caption in the accompanying consolidated balance sheet were as follows:

	Thousands of Euros				
Company	Balance at 01/01/04	Loss for the Year	Capital Increases	Translation Differences	Balance at 12/31/04
One Travel.com, Inc.	2,961	(3,066)	-	105	-
Total	**2,961**	**(3,066)**	**-**	**105**	**-**

	Thousands of Euros				
Company	Balance at 01/01/03	Loss for the Year	Capital Increases	Translation Differences	Balance at 12/31/03
One Travel.com, Inc.	-	(536)	3,496	1	2,961
Total	**-**	**(536)**	**3,496**	**1**	**2,961**

(12) BALANCES WITH TELEFÓNICA GROUP COMPANIES

The detail as of December 31, 2004 and 2003, of the balances arising from transactions with Telefónica Group companies, which are broken down in Note 15 (“Revenues and Expenses”), is as follows:

	Thousands of Euros			
December 31, 2004	Short-Term Investments	Short-Term Receivables	Long-Term Payables	Short-Term Payables
Telefónica Finanzas, S.A.	519,795	-	-	-
Telefónica, S.A.	307,126 (*)	8,604	26,183	(140)
Telefónica Data España S.A.	-	288	-	7,757
Telefónica Investigación y Desarrollo, S.A.	-	-	-	732
Telefónica de España, S.A.	-	33,422	-	4,706
Telefónica Móviles, S.A.	-	2,104	-	255
Telefónica Procesos y Tecnología de la Información, S.A.	-	113	-	465
Atento España, S.A.	-	-	-	370
Zeleris España, S.A.	-	2	-	363
CTC Chile, S.A.	-	5,328	-	201
CTC Mundo, S.A.	-	144	-	323
Telefónica Móviles Chile, S.A.	-	315	-	11
Assist Telefónica, S.A.	-	2,501	-	-
Telecomunicaciones de Sao Paulo, S.A.	-	3,258	-	1,491
Telefónica Soluciones de Inf. y Teleco, S. L.	-	700	-	-
Telefónica Internacional, S.A.	-	2,530	-	-
Telefónica Publicidad e Información, S.A.	-	432	-	180
Fisatel, S.A. de C.V.	-	-	-	2,047
Telefónica Soluciones de Informática y Com. de España	-	-	-	888
Telefónica Móviles México	-	369	-	556
Telefónica Data Brasil	-	56	-	-
Atento Do Brasil Ltda.	-	-	-	860
Telefónica Data USA, Inc.	-	5	-	253
Telefónica Empresas Perú, S.A.	-	32	-	1,061
Telefónica del Perú, S.A.	-	2,046	-	-
Other Telefónica Group companies	-	2,195	-	4,361
Total	**826,921**	**64,444**	**26,183**	**26,740**

(*) see Note 14.

December 31, 2003	Thousands of Euros Short-Term Investments	Short-Term Receivables	Long-Term Payables	Short-Term Payables
Telefónica Finanzas, S.A.	1,365,307	-	-	1
Telefónica, S.A.	-	12,155	26,183	1,273
Telefónica Data España S.A.	-	904	-	14,336
Telefónica Investigación y Desarrollo, S.A.	-	7	-	2,094
Telefónica de España, S.A.	-	23,316	-	4,870
Telefónica Móviles España, S.A.	-	3,364	-	2,068
Telefónica Procesos y Tecnología de la Información, S.A.	-	-	-	998
Atento España, S.A.	-	1	-	959
Zeleris España, S.A.	-	-	-	771
CTC Chile, S.A.	-	5,056	-	1,302
CTC Mundo, S.A.	-	419	-	-
Telefónica Móviles Chile, S.A.	-	372	-	11
Assist Telefónica, S.A.	-	1,355	-	-
Telecomunicaciones de Sao Paulo, S.A.	-	1,927	-	476
Telefónica Soluciones de Inf. y Teleco, S. L.	-	164	-	-
Telefónica Internacional, S.A.	-	-	-	-
Telefónica Publicidad e Información, S.A.	-	79	-	180
Fisatel, S.A. de C.V.	124	-	-	-
Telefónica Soluciones de Informática y Com. de España	-	622	-	65
Telefónica Móviles México	-	895	-	5
Telefónica Data Brasil	-	-	-	1,561
Atento Do Brasil Ltda.	-	-	-	662
Telefónica Data USA, Inc.	-	2	-	457
Telefónica Empresas Perú, S.A.	-	-	-	969
Telefónica del Perú, S.A.	-	3,541	-	536
Other Telefónica Group companies	-	3,238	9	4,608
Total	**1,365,431**	**57,417**	**26,192**	**38,202**

The balances with Telefonica Finanzas, S.A. (Telfisa) relate to the current accounts held by various Spanish Terra Group companies at that entity. The current account balances earn interest at market rates (the average interest rates in 2004 and 2003 were 2.29% and 2.57%, respectively).

The balances included under the "Short-Term Receivables" and "Short-Term Payables" captions relate mainly to the outstanding balances arising from various transactions performed under the Framework Strategic Alliance Agreement entered into with Telefónica, S.A. (see Note 15).

(13) BALANCES WITH ASSOCIATED COMPANIES

The detail of the accounts receivable from and payable to associated companies as of December 31, 2004 and 2003, is as follows:

	Thousands of Euros		
December 31, 2004	Long-Term Loans	Short-Term Receivables	Short-Term Payables
Red Universal de Marketing y Bookings Online, S.A.	3,757	864	26
Lycos Europe, N.V.	-	19	126
Aremate.com, Inc.	-	505	-
Iniciativas Residenciales en Internet, S.A.	-	448	83
Uno-e Bank, S.A.	-	97	-
Other	-	43	34
Total	**3,757**	**1,976**	**269**

	Thousands of Euros		
December 31, 2003	Long-Term Loans	Short-Term Receivables	Short-Term Payables
Red Universal de Marketing y Bookings Online, S.A.	3,757	463	194
A Tu Hora, S.A.	-	-	2,877
Lycos Asia Limited	12,272	-	-
Lycos Europe, N.V.	-	-	32
Aremate.com, Inc.	-	884	-
Iniciativas Residenciales en Internet, S.A.	-	358	2
Other	-	132	-
Total	**16,029**	**1,837**	**3,105**

The loans granted to Red Universal de Marketing y Bookings Online, S.A. are participating loans (earning floating interest rates subject to fulfillment of the condition precedent that the company obtain certain results).

The long-term loans granted in 2003 to the associated company Lycos Asia Limited earn interest at market rates and had been fully provisioned as of December 31, 2003, under the "Other Investment Valuation Allowances" caption in the accompanying consolidated balance sheet. In 2004 this company was excluded from the scope of consolidation as a result of the divestment of Lycos, Inc.

(14) TAX MATTERS

a) Tax receivables and taxes payable-

The detail of the "Tax Receivables" and "Taxes Payable" captions in the accompanying consolidated balance sheets as of December 31, 2004 and 2003, is as follows:

	Thousands of Euros	
December 31, 2004	Long Term	Short Term
Tax receivables		
Tax loss carryforwards	233,839	-
Prepaid income taxes	55,839	-
VAT refundable	4,457	1,259
Tax withholdings and prepayments	-	6,739
Local taxes	-	-
Foreign taxes	5,697	2,333
Total	**299,832**	**10,331**
Taxes payable		
Long-term deferred taxes	2,292	-
Personal income tax withholdings	-	1,373
Withholdings from income from movable capital	-	2,240
Accrued social security taxes payable	-	605
VAT payable	-	303
Local taxes	-	53
Foreign taxes	12,699	4,701
Total	**14,991**	**9,275**

December 31, 2003	Thousands of Euros	
	Long Term	Short Term
Tax receivables		
Tax loss carryfowards	233,925	-
Prepaid income taxes	55,839	-
VAT refundable	4,457	2,935
Tax withholdings and prepayments	-	17,937
Local taxes	-	32
Foreign taxes	1,574	8,837
Total	**295,795**	**29,741**
Taxes payable		
Long-term deferred taxes	2,423	-
Personal income tax withholdings	-	1,433
Accrued social security taxes payable	-	771
VAT payable	-	1,090
Local taxes	-	2,209
Foreign taxes	597	8,731
Total	**3,020**	**14,497**

The years open for review by the tax inspection authorities for the main taxes applicable vary from one consolidated company to another, although they are generally the last four years. The Company's directors do not expect any material liabilities to arise for the Company in the event of a tax audit of the open years.

The variations, by company, in 2004 and 2003 in the tax assets recorded by the Terra Group under the "Tax Loss Carryforwards" caption in the consolidated balance sheet were as follows:

December 31, 2004	Thousands of Euros			
	Tax Losses Incurred in Prior Years	Reversal of 2004 Tax Losses	Translation Differences	Total
Terra Networks, S.A.	231,170	-	-	231,170
Ifigenia Plus, S.L.	66	(66)	-	-
Terra Networks Chile Holding, S.A. and subsidiary	2,689		(20)	2,669
	233,925	**(66)**	**(20)**	**233,839**

December 31, 2003	Thousands of Euros			
	Tax Losses Incurred in Prior Years	2003 Tax Losses	Translation Differences	Total
Terra Networks, S.A.	231,170	-	-	231,170
Ifigenia Plus, S.L.	66	-	-	66
Terra Networks Chile Holding, S.A. and subsidiary	2,689	-	-	2,689
	233,925	**-**	**-**	**233,925**

The prepaid income taxes and tax loss carryforwards recognized by the Company as of December 31, 2004, will be allocated to income as and when the companies that generated them obtain taxable income which, per the Terra Group's business plan, will occur in the next ten years, which, under the Spanish accounting legislation in force as of December 31, 2004, is the maximum period for recognizing tax assets for tax loss carryforwards. Similarly, the deferred tax liabilities will be reversed as and when Terra Networks, S.A. releases the investment valuation allowance as a result of the obtainment of income by its subsidiaries.

b) Corporate income tax-

The corporate income tax of each of the Terra Group companies 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.

The corporate income tax legislation in force in the countries in which the Terra Group companies are taxed provides that, in certain circumstances, tax losses incurred in prior years may be carried forward for offset against the taxable income obtained in subsequent years. Specifically, the last years offsetting the main tax losses incurred by the Terra Group are as follows:

1. Under the legislation currently in force in Spain, following the amendments introduced by Law 24/2001 on Tax, Administrative, Labor and Social Security Measures, the tax losses incurred in a given year may be carried forward for offset against the income obtained in the 15 years following the first year in which income is obtained.
2. In Mexico, tax losses may be carried forward for offset for a period of ten years from the year in which they are incurred.
3. In Brazil and Chile there is no deadline for the offset of tax losses, although in Brazil the amount of the losses to be offset may not exceed 30% of the total taxable income.

4. In Peru and Argentina, tax losses may be carried forward for offset for four and five years, respectively, from the year in which they were incurred.

5. In the U.S., tax losses can be carried forward for offset for 20 years from the year in which they were incurred.

The breakdown of the net balance of the "Corporate Income Tax" caption in the accompanying 2004 and 2003 consolidated statements of operations is as follows:

	Thousands of Euros	
	12/31/04	12/31/03
Tax asset earned in the sale of Lycos, Inc.	(271,733)	-
Tax asset for period losses of Tax Group companies	(55,280)	-
Permanent differences at Tax Group companies	19,889	-
Reversal of tax assets	66	-
Deferred income taxes	-	(28)
Reversal of deferred taxes in consolidation	-	-
Tax incurred abroad	597	290
Other items (net balance)	5	4
Corporate income tax expense (revenue)	**(306,456)**	**266**

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 consolidated financial statements no effect for accounting purposes was taken into account in this connection.

In 2004 and 2003, based on the annual study performed, it was concluded that the recoverability of the tax assets recognized was reasonably assured.

The aforementioned analysis of the recoverability of the tax assets focused on analyzing the impact on Terra Networks, S.A. (the Parent Company) of the future earnings expectations of the subsidiaries and, consequently, on the possible reversal of the investment valuation allowance recorded in the Parent Company's individual financial statements.

These future earnings expectations were obtained from the business plans of the subsidiaries, which were also used in the analysis of the recoverability of goodwill, as described in Note 1.

Since Terra Networks, S.A. and other Spanish Group companies have formed part, since January 1, 2004, of the consolidated Tax Group the Parent Company of which is Telefónica, S.A., it is considered that the tax asset associated with the tax losses incurred from this date and contributed to the Tax Group is recoverable.

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 for 2001 and subsequent years.

Accordingly, in the period from 2001 to December 31, 2003 (see Note 14-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

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.

The account receivable from Telefónica, S.A. arising in 2004 as a result of the filing of a corporate income tax return amounted to €307,126 thousand as of December 31, 2004, and this amount is recorded under the "Loans to Telefónica Group Companies" caption in the accompanying consolidated balance sheet (see Note 12).

(15) REVENUES AND EXPENSES

Revenues-

The operating revenues relate mainly to the following items:

1. *Internet service provider and communications revenues*. These relate to the revenues from subscriptions mainly to provide Internet access to the residential and SOHO markets and support services and technical assistance to users. They also include the revenues for induced traffic and interconnection received from telecommunications operators in certain countries and revenues from charges for technical assistance and user support. These revenues account for 44% of the total operating revenues. In 2004 13% of the revenues in this connection related to the Framework Strategic Alliance Agreement entered into with Telefónica, S.A.

2. *Portal advertising and e-commerce revenues*. The advertising revenues relate mostly to revenues received on the basis of a price based on the number of insertions, clicks or any advertising format in the Terra Group's portals, pursuant to the agreements to sponsor portal areas based on a fixed amount. They also include the revenues arising from e-commerce transactions made through the Terra Group's portals. These revenues account for 22% of the total operating revenues. In 2004 10% of the revenues in this connection related to the Framework Strategic Alliance Agreement entered into with Telefónica, S.A. The e-commerce revenues include the amount invoiced for on-line travel sales (mainly air fares, and hotel and cruise bookings). One Travel.com. Inc, which is an on-line travel agency, bills the end customer for

the total amount of the fare, including taxes, assumes the risk of credit or default on the part of the end customer, has a minimum purchase commitment to its supplier and is authorized to establish the definitive price to be paid by the end customer. In 2004 21.4% of the portal advertising and e-commerce revenues related to on-line travel sales.

3. *Communications services, portal and content sale revenues*. These include the revenues from subscriptions to value added and communications services and the sale of associated software package licenses. They also include revenues from subscriptions to portal services and content and from the sale of associated software package licenses. These services are provided directly to the end customer or through corporations which distribute them to such end customers. These revenues represent 23% of the total operating revenues. In 2004 57% of the revenues earned in this connection related to the Framework Strategic Alliance Agreement entered into with Telefónica, S.A.

4. *Corporate services revenues*. These relate to services rendered to companies such as connection services, development of applications, web developing, consulting projects, b2b e-commerce, and corporate financial information in the case of Terra Networks México, S.A. de C.V. These revenues account for 11% of the total operating revenues. In 2004 34% of the revenues in this connection related to the Framework Strategic Alliance Agreement entered into with Telefónica, S.A.

5. *Other services*. These relate to revenues from sales of modems and connection kits. These revenues do not account for a significant percentage of the total operating revenues, although 10% of revenues in this connection relate to the Framework Strategic Alliance Agreement entered into with Telefónica, S.A.

The detail, by geographical market (taken to be the country in which the Terra Group service provider is located), of the "Total Operating Revenues" caption in the accompanying consolidated statement of operations is as follows:

Country	Thousands of Euros	
	2004	2003
Spain	238,349	207,392
U.S.A.	86,315	126,296
Brazil	147,405	140,714
Mexico	29,242	35,005
Chile	28,125	26,441
Guatemala and the Caribbean	2,143	2,221
Peru	6,463	6,909
Colombia	1,030	713
Argentina	957	657
Venezuela	449	279
	540,478	**546,627**

Note: Terra intercompany sales were eliminated from the amounts contributed by each country to the total consolidated revenues.

Transactions with Telefónica Group companies-

The Terra Group's main transactions with the Telefónica Group are based on the Framework Strategic Alliance Agreement of February 12, 2003 (see Note 1). The main features of the Framework Agreement are as follows:

a) Strengthening of the Terra Group as:

- The exclusive provider of essential portal elements, brand user and aggregator of the broad and narrow band Internet content and services targeted at the residential, SOHO and, when so agreed, SME market segments, for the Telefónica Group companies' connectivity and ISP services.
- Preferential provider of audit, consulting, management and maintenance services for the country portals of the Telefónica Group companies.
- Exclusive provider of Telefónica Group employee on-line training services.
- Preferential provider of on-line integral marketing services to the Telefónica Group companies.

b) Guaranteed minimum volume of purchases of on-line advertising space of the Terra Group companies by the Telefónica Group companies.

c) Exclusive acquisition of connectivity and wholesale Internet access services by Terra Group companies from Telefónica Group companies under the legally permitted most-favored-customer conditions.

d) Outsourcing by Terra Group companies to Telefónica Group companies of all or part of the services and/or operation of the Internet access elements for the provision of ISP services to its residential, SOHO and, when so agreed, SME customers under the legally permitted most-favored-customer conditions.

e) Exclusive acquisition by Terra Group companies from Telefónica Group companies of the advanced broad and narrow band network and platform services required to construct the range of services to be offered to residential, SOHO and, when so agreed, SME customers under the legally permitted most-favored-customer conditions.

This Framework Agreement guarantees the generation for the Terra Group of a minimum value throughout the term of the Agreement of €78.5 million per year. This amount is the difference between the operating revenues arising from the services provided under the Framework Agreement and the costs and investments directly associated therewith. The Framework Agreement defines a new model for relations between the two companies which puts to better use their respective capabilities to promote their growth on the Internet. This Framework Agreement will run for six years through December 31, 2008, and will be automatically renewed annually, unless notice of termination is expressly given by the parties concerned.

In conformity with the provisions of the Framework Strategic Alliance Agreement, in 2004 and 2003 the aforementioned annual minimum value was generated for the Terra Group.

Following is a description of the main transactions with Telefónica Group companies in 2004 and 2003, included or otherwise in the scope of the Framework Strategic Alliance Agreement:

- Communications services from the Telefónica Data Group, relating mainly to the Spanish and international Internet traffic required to provide services to ISP customers and to make the portal more visible.

- Communications services from Telefónica de España, S.A., relating mainly to the narrow and broad band access infrastructures required to configure the ISP services marketed.

- Teleoperation and telemarketing services from the Atento Group.

- Sale of software package licenses and provision of the associated maintenance and support services to Telefónica de España, under an agreement between Terra Networks España, S.A. and Telefónica de España, S.A. The software packages consist of applications that enable Telefónica de España, S.A. to add more features to its narrow and broad band retail ISP services, and services for residential and business customers.

- Sale of software package licenses, including the sale of the access customer management program of Terra Networks Brasil to Assist Telefónica, S.A.

- Portal services between Terra Networks Brasil, S.A. and Assist Telefónica, S.A.

- On-line training services between Educaterra, S.L. and Telefónica Group companies.
- Consulting, management and maintenance of the Telefónica Group's corporate portals.
- Advertising services. These relate to the revenues received mainly on the basis of a price based on the number of insertions in Terra's portals, pursuant to the agreements to sponsor portal areas based on a fixed amount.

The Terra Group's transactions in 2004 and 2003 with Telefónica Group companies were as follows:

Revenues

Company	Thousands of Euros	
	2004	2003
Telefónica Data España, S.A.	298	600
Telefónica de España, S.A.	83,398	62,655
CTC Chile, S.A.	1,479	1,906
CTC Mundo, S.A.	100	222
Telefónica Empresas Chile, S.A.	574	903
Telefónica, S.A.	13,959	18,427
Telefónica Móviles España, S.A.	2,548	2,212
Telefónica de Argentina, S.A.	196	252
Telecomunicaciones de Sao Paulo, S.A.	11,831	7,783
Assist Telefónica, S.A.	13,095	27,244
Telefónica Solución de Informática y Comunicaciones de España, S.A.	18	827
Telefónica Internacional, S.A.	2,538	-
Telefónica de Perú, S.A.	4,268	4,143
Other Telefónica Group companies	4,939	3,441
Total net sales to Telefónica Group companies	**139,241**	**130,615**
Telefónica Móviles México, S.A. de C.V.	205	24
Other Telefónica Group companies	75	257
Total other operating revenues received from Telefónica Group companies	**280**	**281**
Subtotal of operating revenues received from Telefónica Group companies	**139,521**	**130,896**
Telefónica Finanzas, S.A.	23,238	34,569
Other Telefónica Group companies	70	452
Total financial revenues received from Telefónica Group companies	**23,308**	**35,021**

Expenses

Company	Thousands of Euros 2004	2003
Telefónica Data España, S.A.	26,250	13,315
Telefónica de España, S.A.	66,975	69,137
Telecomunicaciones de Sao Paulo, S.A.	23,251	1,157
Atento Teleservicios España, S.A.U.	4,032	3,565
Atento do Brasil, Ltda.	8,018	9,673
Telefónica Data Brasil, S.A.	3,834	23,125
CTC Chile, S.A.	1,725	2,362
CTC Mundo, S.A.	2,608	2,179
Telefónica Empresas Chile, S.A.	2,307	2,896
Telefónica Móviles España, S.A.	428	786
Teleatento del Perú, S.A.C.	591	382
Telefónica Centroamérica Guatemala Holding, S.A.	-	867
Telefónica empresas Perú, S.A.	1,092	573
Telefónica Data USA, Inc.	3,161	4,170
Other Telefónica Group companies	9,028	8,368
Total purchases from Telefónica Group companies	**153,300**	**142,555**
Telefónica Investigación y Desarrollo, S.A.	469	3
Telefónica de España, S.A.	7,241	6,302
Telefónica, S.A.	4,624	2,653
Telefónica Data España, S.A.	5,418	5,038
Atento Do Brasil, Ltda.	2,718	-
Zeleris España, S.A.U.	(197)	3,335
CTC Chile, S.A.	956	1,004
Atento Chile, S.A.	191	57
Telefónica Móviles España, S.A.	512	458
Telefónica de Argentina, S.A.	24	32
Telesp, S.A.	799	653
Atento México, S.A. de C.V.	1,546	1,488
Telefónica Móviles México, S.A. de C.V	1,722	2,760
Other Telefónica Group companies	3,719	2,789
Total outside services received from Telefónica Group companies	**29,742**	**26,572**
Total	**183,042**	**169,127**

Travel revenues-

The detail of the revenues from online travel sales of One Travel.com, Inc. recorded as of December 31, 2004 and 2003 is as follows (in thousands of euros):

	2004	2003
Air fares	19,394	25,902
Hotels	1,876	1,649
Cruises	2,401	1,644
Other	1,986	1,998
Total	**25,657**	**31,193**

In 2004 and 2003 One Travel.com, Inc. made gross sales (amount managed) amounting to US$ 93,105 thousand and US$ 106,083 thousand, respectively. The accounting method used to recognize the revenues and expenses of One Travel.com, Inc. is described in the "Valuation Standards" Note (see Note 4).

Personnel expenses-

The detail of the personnel expenses in the years ended December 31, 2004 and 2003, is as follows:

	Thousands of Euros	
	2004	2003
Wages and salaries	77,502	95,760
Social security costs	10,613	11,181
Other employee welfare expenses	7,670	12,712
Total	**95,785**	**119,653**

In 2004 the Group carried out significant labor force restructuring processes, mainly at companies in Spain, the U.S.A. and Mexico, giving rise to a significant reduction in personnel expenses and in the number of employees.

The "Other Employee Welfare Expenses" caption includes the contributions to the external pension fund, which are made on the basis of a percentage of each employee's total salary.

Average headcount-

The Terra Group had an average of 2,018 and 2,300 employees in the years ended December 31, 2004 and 2003, respectively, and the year-end headcounts in 2004 and 2003 were 1,606 and 2,255, respectively.

Outside services and other operating expenses-

The detail of this caption for the years ended December 31, 2004 and 2003, is as follows:

	Thousands of Euros	
	2004	2003
Advertising, publicity, public relations and outside marketing expenses	52,715	68,495
Independent professional services	21,897	23,191
Rent and royalties	12,005	26,803
Travel expenses	3,282	4,591
Taxes other than income tax	10,007	9,867
Other operating expenses	28,572	33,242
Total	**128,478**	**166,189**

Extraordinary revenues and income-

The detail of the "Gains on Long-Term Investment Disposals" caption in 2004 and 2003 is as follows:

	Thousands of Euros	
	2004	2003
Lycos, Inc. (Note 2)	26,171	-
Tecnología y S.V.A., S.A. (Note 2)	10,772	-
Terra Mobile, S.A. (Note 2)	-	10,526
Other gains on the disposal of long-term investments	862	382
Total	**37,805**	**10,908**

The detail of the "Other Extraordinary Revenues" caption in 2004 and 2003 is as follows:

	Thousands of Euros	
	2004	2003
Repayment of advances collected (Note 2)	2,875	-
Gain on shares of treasury stock sold in the tender offer launched by Telefónica, S.A. (Note 1)	-	10,985
Other	593	1,149
Total	3,468	12,134

As described in Note 1, on June 26, 2003, the Board of Directors announced its acceptance of the tender offer launched by Telefónica, S.A. for the 2,420,468 shares of Terra Networks, S.A. held by Lycos, Inc. (see Note 1). The gain on the sale of these shares amounted to €10,985 thousand.

Extraordinary expenses and losses-

The detail of the extraordinary expenses and losses in 2004 and 2003 is as follows

	Thousands of Euros	
	2004	2003
Write-down of goodwill (Note 5)	8.892	6.452
Early termination of contracts	23.751	2.177
Labor force and business restructuring costs	21.906	597
Prior years' expenses and losses	3.214	3.776
Other extraordinary expenses	4.144	4.562
Total	**61.907**	**17.564**

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 headcount at 2004 year-end to 1,606 persons, as compared with the headcount of 2,255 persons at 2003 year-end. The expenses incurred in this process were recorded under the "Early Termination of Contracts" and "Labor Force and Business Restructuring Costs" captions in 2004.

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

(16) DIRECTORS' COMPENSATION, OTHER BENEFITS AND OTHER DISCLOSURES ON THE BOARD OF DIRECTORS

In the years ended December 31, 2004 and 2003, the compensation and other benefits paid to the Board members and recorded in the accompanying consolidated statements of operations were as follows:

	Thousands of Euros	
	2004	2003
Salaries of executive directors	461	1,945
Indemnity payments to directors of Lycos, Inc.	511	-
Compensation of Board members	571	706
Fees for attending Committee meetings	32	40
Total	**1,575**	**2,691**

As described in Note 17, the executive members of the Board of Directors of the Terra Group did not hold any purchase options on Terra Networks, S.A. shares as of December 31, 2004. In 2003 the executive members of the Board of Directors of the Terra Group held 8,717,026 purchase options on Terra Networks, S.A. shares derived from the Stock Option Plans of Terra Networks, S.A. and Lycos, Inc. The weighted average exercise price was €18.40 as of December 31, 2003.

As of December 31, 2004 and 2003, 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 Wireline telecommunications Telecommunications Internet	Board Member Executive Chairman 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 contstitute 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.

(17) COMMITMENTS AND CONTINGENCIES

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 implemented by Board of Directors' resolutions adopted on October 18 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 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 call 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 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 consolidated financial statements, the Board of Directors had not implemented the extension of the duration of the options.

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, on February 25, 2002, the assignment of further options was approved by the Board of Directors.

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

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

As of December 31, 2003, the Terra Group's executives and directors held 1,185,252 stock options under the Terra Networks, S.A. Stock Option Plan, the weighted average exercise price being €19.03.

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. approved the partial modification of the resolution relating to the Stock Option Plan, that had been 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 continued to cover the Lycos Inc. employee Stock Option Plans outstanding at that date.

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

As of December 31, 2003, the executives and directors held stock option rights, derived from the Lycos, Inc. Stock Option Plans set up prior to the acquisition of Lycos, Inc. by Terra Networks, S.A., on 9,090,776 Terra Networks, S.A. shares, the weighted average exercise price of which is US$ 23.05.

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

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. 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, commitments, 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:

	Thousands of Euros	
	2004	2003
Lycos, Inc.	7,342	-
One Travel.com	596	-
Total	**7,938**	**-**

At the date of preparation of these consolidated 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 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 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 lack 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 Transactional Agreement 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 Transactional Agreement, 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, a 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 consolidated 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. <u>Universal Communications Systems, Inc.</u>

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.

(18) FEES PAID TO AUDITORS

The payments made in 2004 and 2003 to the various member firms of the Deloitte & Touche Worldwide Organization, to which Deloitte, S.L., the auditors of the consolidated Terra Group, belongs, amounted to €1,046 thousand and €1,390 thousand, respectively.

The detail of the foregoing amounts is as follows:

	Thousands of Euros	
	12/31/04	12/31/03
Audit of financial statements	832	823
Other audit services	184	429
Work additional to or other than audit services	30	138
Total	1,046	1,390

The payments made to other auditors of the Terra Group in 2004 and 2003 amounted to €863 thousand and €578 thousand, respectively, the detail being as follows:

	Thousands of Euros	
	12/31/04	12/31/03
Audit of financial statements	49	42
Other audit services	11	11
Work additional to or other than audit services	803	525
Total	863	578

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

(19) EVENTS SUBSEQUENT TO YEAR-END

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. and distribution of dividend

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.

c) Sale of One.Travel.com, Inc.

On February 11, 2005, 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.

d) Adoption of International Financial Reporting Standards - IFRSs

Under Regulation (EC) no. 1606/2002 of the European Parliament and of the Council of July 19, 2002, all companies governed by the law of an EU Member State and whose securities are admitted to trading on a regulated market of any Member State must prepare their consolidated financial statements for the years beginning on or after January 1, 2005, in conformity with the International Financial Reporting Standards (IFRSs) previously adopted by the European Union. In conformity with this Regulation, the Group will have to present its consolidated financial statements for 2005 in accordance with the IFRSs adopted by the European Union.

Under IFRS 1, First-Time Adoption of International Financial Reporting Standards, although the first consolidated financial statements prepared in accordance with IFRSs will, in the case of the Group, be those for the year ending December 31, 2005, it will be necessary to include, for comparison purposes, the figures for the preceding year (2004), prepared on a basis consistent with that used to calculate the figures for 2005. Accordingly, an opening balance sheet will have to be prepared as of the date of transition to IFRS accounting methods (January 1, 2004, in the case of the Group), also in accordance with the IFRSs in force as of December 31, 2005.

In order to meet the obligation imposed by Regulation (EC) no. 1606/2002, the Group has established a plan for the transition to IFRSs that includes, inter alia, the following steps:

1. Analysis of the differences between the methods provided for in the National Chart of Accounts in force in Spain and in IFRS.

2. Selection of the methods to be used in cases or areas in which IFRSs permit alternative accounting treatments to be applied.

3. Assessment and determination of the appropriate changes to or adaptations of the operating procedures and systems used for compiling and providing the information required in order to prepare the consolidated financial statements.

4. Preparation of the opening consolidated financial statements, as of the transition date, in accordance with IFRSs.

The Group started to implement the plan for the transition to IFRSs in 2003 and the stage of completion is currently as planned for the adaptation to be completed in 2005.

SUSTITUIR ESTA HOJA POR LA NOTA 20 CUADRO DE FINANCIACIÓN

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

Thousands of Euros	**2004**	**2003**
Net income (loss) for the year	163,972	(172,710)
Add:		
Start-up expense amortization expense	517	910
Intangible asset amortization expense	53,494	43,055
Property and equipment depreciation expense	25,502	34,777
Consolidation goodwill amortization expense	65,577	83,269
Write-down of consolidation goodwill	8,892	6,452
Share in losses of companies accounted for by the equity method	14,843	34,734
Extraordinary expenses and losses of companies accounted for by the equity method	1,877	-
Variation in investments	2,817	-
Write-down of tax asset	66	-
Less:		
Share in the income of companies accounted for by the equity method	(284)	-
Reversal of negative consolidation goodwill	(729)	(972)
Gains on long-term investment disposals	(36,943)	(10,525)
Variation in investments	-	(18,177)
Loss attributed to minority interests	(3,066)	(536)
Funds applied in (obtained from) operations	**296,535**	**277**

(21) EXPLANATION ADDED FOR TRANSLATION TO ENGLISH

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

EXHIBIT I: consolidated companies

Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	Net Worth at 12/31/04
Terra Lycos Intangibles, S.A. (formerly Terra Interactiva de Contenidos, S.A.) ISP Vía Dos Castillas, 33, Pozuelo de Alarcón - Madrid	100%	660	13,885
Terra Business Travel, S.A. (formerly Terra Lycos, S.A.) Intermediation in and/or organization of tourism services. Travel agency. Vía Dos Castillas, 33, Pozuelo de Alarcón - Madrid	100%	560	555
Terra Lycos Holding, B.V. Marketing of software licenses Koningslaan 34 1075 AD Amsterdam, the Netherlands	100%	18	18
Uno-e Bank, S.A. (***) On-line banking Julián Camarillo, 4, Edificio C, 28037 Madrid	33%	80,317	119,530
Terra Networks España, S.A. ISP Vía Dos Castillas, 7, Pozuelo de Alarcón, Madrid	100%	9,869	(374,082)
CIERV, S.L. Design of communications products Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	100%	6	(**)
Corporación Real Time Team, S.L. Design, advertising and consulting on the Internet Claudio Coello, 32, 1ext, Madrid	100% 12.04% indirectly through CIERV, S.L. and 87.96% through Terra Networks	18	(**)
Terra Networks USA, Inc. (1) Internet portal 1201 Brickell Avenue Suite 700 Miami, Florida 33131, USA	100%	(*)	(1,746)
Deremate.com, Inc. Internet content and e-commerce 1018 Centre Road, Wilmington, Delaware, USA	18% indirectly through Terra USA	(**)	(**)
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	32.1%	3,123	192,862
Terra Networks Latam E.T.V.E, S.L. (formerly Terra Networks Asociadas Extranjeras, S.L.) Foreign securities management Vía Dos Castillas, 33, Pozuelo de Alarcón - Madrid	100%	57,447	90,558

Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	Net Worth at 12/31/04
Telefónica Interactiva Brasil, Ltda (1) Portfolio company Rua de Consolaçao, 247, 6º Sao Paulo, Brazil	99.99% indirectly through TN Latam	534,510	81,590
Terra Networks Brasil, S.A. (1) ISP and portal Rua General João Manoel, 90, Porto Alegre, Rio Grande do Sul, Brazil	100% 59.16% indirectly through TI Brasil	248,656	7,856
Africanet Proveedora de Acesso e Informaçoes, Ltda. ISP Rua Timbiras, 138, loja 03 Belo Horizonte, Minas Gerais, Brazil	99.99% indirectly through TN Brasil	310	39
Mago Informaçoes e Dados, Ltda. ISP Rua Timbiras, 138 loja 03, Belo Horizonte, Mina Gerais, Brazil	99.99% indirectly through TN Brasil	1,939	(63)
Voyager Informática, Ltda. ISP Rua General João Manoel, 90, Porto Alegre, Rio Grande do Sul, Brazil	99.99% indirectly through TN Brasil	105	20
Manchester Informática, Ltda. ISP Rua Abiail do Amaral Carneiro, 191, loja 03/04, Vitoria, Espirito Santo, Brazil	99% indirectly through TN Brasil	746	209
Pensatron Informática, Ltda. ISP Rua Boulevard 28 setembro 389, sala 416/417, Rio de Janeiro, Brazil	99.99% indirectly through TN Brasil	10	108
Netmarket Informática, Ltda. ISP Rua General João Manoel, 90, Porto Alegre, Rio Grande do Sul, Brazil	99.99% indirectly through TN Brasil	73	9
Easyway Integradora Sistemas, Ltda. ISP Rua Alfonso Cavalcanti, 54, Porto Alegre, Rio Grande do Sul, Brazil	99.97% indirectly through TN Brasil	1,162	93
Missoes Informática, Ltda. ISP Rua General João Manoel, 90, 8º andar , Porto Alegre, Rio Grande do Sul, Brazil	99.99% indirectly through TN Brasil	234	31

(1) Consolidated data.

(*) Less than €1,000.
(**) Data not available as of the date of preparation of the consolidated financial statements.
(***) Provisional data as of the date of preparation of the consolidated financial statements.
TN: Terra Networks.
ISP: Internet service provider.

Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	 Net Worth at 12/31/04
DW Net Internet, Ltda. ISP Rod. Antonio Heil, 635, Brusque, Santa Catarina, Brazil	99.93% indirectly through TN Brasil	56	28
Terra Sorocaba, Ltda. ISP Rua Riachuelo, 290, Sorocaba, São Paulo, Brazil	100% indirectly through TN Brasil	480	12
Santa Helena Servicos de Informatica e Comunicaciones, Ltda. ISP Rua Luiz Viana Filho, s/nº, Salvador, Bahia, Brazil	99% indirectly through TN Brasil	2,647	209
Waves Networks e Prestaçao de Serviços de Internet, S/A. ISP Av. Das Nações Unidas, 12901 12º andar, São Paulo, Brazil	60% indirectly through TN Brasil	3	(690)
Fortaleza Networks e Prestaçao de Serviços de Internet, S/A. ISP Rua General João Manoel, 90, Porto Alegre, Rio Grande do Sul, Brazil	80% indirectly through TN Brasil	68	(1,057)
Terra Networks México Holding, S.A. de C.V. (formerly Terra Networks México, S.A. de C.V.) (1) Portfolio company Blvd. Díaz Ordaz Pte. Nº 123, Col. Santa María, Monterrey, Nuevo León, Mexico	100% indirectly through TN Latam	91,316	(28,796)
Terra Networks México, S.A. de C.V. (formerly Información Selectiva, S.A.) ISP and portal Blvd. Díaz Ordaz Pte. Nº 123, Col. Santa María, Monterrey, Nuevo León, Mexico	99.99% indirectly through TN México Holding	3,069	(13,096)
Terra Infosel, S.A. de C.V (formerly Guadalajara Teleport, S.A. de C.V.) ISP and Internet services Guadalajara, Mexico	100% indirectly through TN México Holding	198	17
Terra Negocios, S.A. de C.V. (formerly Interdata Infosel, S.A. de C.V.) e-commerce services Monterrey, Mexico	100% indirectly through TN México Holding	19	483

(1) Consolidated data.

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Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	Net Worth at 12/31/04
Terra de Compras S.A. (formerly Comunicación Internet, S.A. de C.V.) e-commerce services Monterrey, Mexico	99.99% indirectly through TN México	91	0
Infoshare Inc. Infosel Financiero Services New York, USA	100% indirectly through TN México	290	(294)
Internet Queretaro, S.A. Internet Services Queretaro, Mexico	99.99% indirectly through TN México Holding	52	52
Terra Networks Chile Holding Limitada, S.A. (1) Portfolio company Av.Vitacura, 2736, Las Condes, Santiago de Chile	99.99% indirectly through TN Latam	95,180	24,145
Terra Networks Chile, S.A. ISP and portal Av.Vitacura, 2736, Las Condes, Santiago de Chile	100% indirectly through TN Chile Holding	38,788	(1,249)
Terra Networks Colombia Holding, S.A. (1) Portfolio company Diagonal 97, nº 17-60, Oficina 402, Bogotá, Colombia	99.99% 81% Indirectly through TN Latam	248	(2,901)
Terra Networks Colombia, S.A. Portal and Internet in general Diagonal 97, nº 17-60, Oficina 402, Bogotá, Colombia	99.99% 94.99% indirectly through TN Colombia Holding 5% indirectly through TN Venezuela	2	311
Terra Networks Argentina, S.A. ISP and portal Av. Aleandro N. Alem, 712, Piso 11, Buenos Aires	99.99% indirectly through TN Latam	1,251	(166)
Terra Networks Perú, S.A. ISP and portal Los Sauces, 374, Piso 9 of. 902, Torre Roja, San Isidro, Lima, Peru	99.99% indirectly through TN Latam	2,540	1,308
Terra Networks Venezuela, S.A. ISP and portal Av. Francisco de Miranda, Cruce con Avda. el Parque, Torre Edicampo, Piso 2, Oficina 21, Campo Alegre, Caracas, Venezuela	100% indirectly through TN Latam	1,370	(1,691)

(1) Consolidated data.
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Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	Net Worth at 12/31/04
Terra Networks Guatemala, S.A. (1) ISP and portal Diagonal 6 nº 10-01 Zona 10 Nivel 10, Oficina 1002, Centro Gerencial, Edificio Las Margaritas II, Guatemala	100% indirectly through TN Latam	13,080	(1,430)
Terra Networks El Salvador, S.A. de C.V. Portal and Internet in general 63 Ave. Sur y Alameda Roosvelt, Centro Financ. Gigante Torre D, 2º Nivel, San Salvador	99.99% indirectly through TN Guatemala	1,606	77
Terra Networks Honduras, S.A. Portal and Internet in general Honduras	99.99% indirectly through TN Guatemala	1	(23)
Terra Networks Costa Rica, S.A. Portal and Internet in general Curridabat, Edificio Domus Plaza, 2ª Planta Ofician 1 2, San José, Costa Rica	99.99% indirectly through TN Guatemala	192	86
Terra Networks Nicaragua, S.A. Portal and Internet in general Nicaragua	99.99% indirectly through TN Guatemala	(*)	(*)
Terra Networks Panamá, S.A. Portal and Internet in general C/Harry Eno y Piloto, Posada Edificio El Educador, Coopeduc, Bethania, Panama	99.99% indirectly through TN Guatemala	(*)	(2,159)
Terra Networks Caribe, S.A. Internet portal Avenida Winston Churchill, Plaza Fernandez II, Local 18 B 3er. Nivel Ensanche Paraíso, Santo Domingo, Dominican Republic	99.98% indirectly through TN Guatemala	499	(291)
Terra Networks Serviços de Acceso a Internet e Trading, Lda. Av. Arriaga, 73, 2ºandar, sala 212, Freguería da Sé, Concelho de Funchal Portugal	100% indirectly through TN Latam	12	(**)
Terra Networks Maroc, S.A.R.L. 332, Boulevard Brahim Roudani, Casablanca Morocco	100% indirectly through TN Latam	31	(**)
Terra Networks Asociadas, S.L. Portfolio company Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	100%	6,114	(17,673)

(1) Consolidated data.
(*) Less than €1,000.
(**) Data not available as of the date of preparation of the consolidated financial statements.
(***) Provisional data as of the date of preparation of the consolidated financial statements.
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ISP: Internet service provider.

Company, Line of Business and Address	Percentage of Direct and Indirect Ownership	Thousands of Euros Capital at 12/31/04	Thousands of Euros Net Worth at 12/31/04
Ifigenia Plus, S.L. Education and culture portal Plaza Santa María Soledad Torres Acosta, 1 5ª Planta, Madrid	100% indirectly through TN Asociadas	144	(2,739)
Educaterra, S.L. Education portal Paseo de la Castellana 141, Edificio Cuzco IV – 5ª Planta, Madrid.	100% indirectly through TN Asociadas	686	1,859
Maptel Networks, S.A.U. Digital cartography design work Plaza Santa María Soledad Torres Acosta, 1 5ª Planta, Madrid	100% indirectly through TN Asociadas	2,543	422
Red Universal de Marketing y Bookings Online, S.A. (1) Travel booking portal Proción, 1-3, 28023 Madrid	50% indirectly through TN Asociadas	900	(5,810)
Azeler Automoción, S.A. (1) Motoring portal Vía Dos Castillas, 33, Pozuelo de Alarcón, Madrid	50% indirectly through TN Asociadas	1,804	1,139
Iniciativas Residenciales en Internet, S.A. Real estate portal Paseo de Recoletos, 10 Ala Norte 1ª Planta, Madrid	50% indirectly through TN Asociadas	1,424	577
OneTravel.com, Inc. (1) and subsidiaries Travel booking portal 258 Main Street, 3rd floor, East Greenville, USA	54.15% indirectly through TN Asociadas	10	(1,327)
Inversis Networks, S.A. IT and telematic systems and applications Calle Deyanira, 57. 28022 Madrid	10.68% Indirectly through TN Asociadas	44,027	30,264

The data on the capital and reserves of the subsidiaries that do not head their subgroups were translated to thousands of euros at the exchange rates ruling as of December 31, 2004. The 2004 results were translated to thousands of euros at the cumulative average exchange rates as of December 31, 2004 .

(1) Consolidated data.
(*) Less than €1,000.
(**) Data not available as of the date of preparation of the consolidated financial statements.
(***) Provisional data as of the date of preparation of the consolidated financial statements.
TN: Terra Networks.
ISP: Internet service provider.

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 products access and value added services at the same time.

Pay access subscribers totaled 1.8 million as of December 31, 2004, up 9% on the figure at 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 whom 68% relate to Brazil, 18% to Spain and 12% to Chile.

Customers for value-added services totaled 4.5 million as of December 31, 2004, an increase of 33%, of whom 3.2 million are customers arising from the Alliance with Telefónica.

Business performance and results

1.- Revenues

The Terra Group's total accumulated revenues as of December 31, 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 preceeding year.

Noteworthy as regards access was the increase in and improvement of broadband (ADSL) 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 the Antivirus service included.

In Brazil the pay access business performed particularly well and its position was consolidated in the latter part of the year, enabling the Group to continue to lead the market in 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 which it was decided to dispose of, and which in 2004 contributed revenues of €26 million.

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 to focus on providing integral marketing services giving advertisers access to a more segmented public and making 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 on 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 the form of 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 improved revenues for the Company.

III) Communications, portal and content sale services

This line of business contributed revenues of €122 million in 2004, 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 products and services in the communication and content areas. 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 viruses in PCs.
- 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 a 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 through 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 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 in 2003 to 2,018 in 2004. The headcount at 2004 year-end was 1,606, as compared with 2,255 at 2003 year-end.

3.- Net income

The 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 started 2005 by reinforcing its strategy of focusing on key products and seeking to reduce its cost structure and, to balance its revenues and to generate a high proportion of these revenues through pay services. To this end, in 2004 the Company acquired Tiscali 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" balances as of December 31, 2004, amounted to €529 million. The balance dropped in 2004 due 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 (€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 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, in its work towards the development of applications and services and in proposals for the Sixth European Union Framework Programme, which is addressing the possibility of creating virtual communities that will provide a new generation of real-time multimedia communications services. 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 Terra Group maintains a firm commitment to the monitoring of, active involvement in and promotion of open source development initiatives focused on the development of real-time communication services, through open cooperation 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 elements of the world economy.

In the multimedia and entertainment services fields, the development of advanced on-line games platforms, streaming and downloading of audiovisual content 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 at first call 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 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 the stockholders of the Company by cooptation 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 consolidated 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 to €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. with the U.S. company RCG Companies, aimed at the merger of the two companies. The value of the transaction in totals US$ 25.5 million.