SECURITIES AND EXCHANGE COMMISSION
FORM 20-F

☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2001

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 0-28011

TERRA NETWORKS, S.A.
(Exact name of registrant as specified in its charter)

TERRA NETWORKS, INC.
(Translation of registrant's name into English)

KINGDOM OF SPAIN

(Jurisdiction of incorporation of organization)

Calle Nicaragua, 54 **08029 Barcelona, Spain**	**Vía de las Dos Castillas, 33** **Complejo Atica** **Edificio 1** **Pozuelo de Alarcón** **28224 Madrid, Spain** **(Address of principal executive offices)**	**400-2 Totten Pond Road** **Waltham, MA 02451** **U.S.A.**

Securities registered or to be registered pursuant to Section 12(b) of the Act: None

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Securities registered or to be registered pursuant to Section 12(g) of the Act:

Ordinary shares, nominal value two euro each, listed on the Nasdaq National Market, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Nasdaq National Market.

American Depositary Shares, each representing the right to receive one ordinary share, listed on the Nasdaq National Market.

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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The number of issued shares of each class of stock of Terra Networks, S.A. at December 31, 2001 was:

Ordinary shares, nominal value two euro each: 621,265,845.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark which financial statement the registrant has elected to follow.

Item 17 ☐ Item 18 ☒

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FORWARD-LOOKING STATEMENTS

This annual report on Form 20-F contains forward-looking statements within the meaning of Section 21E of the U.S. Securities Exchange Act of 1934, as amended. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, levels of activity, performance or achievements to differ materially from those implied by the forward-looking statements. The forward-looking statements in this annual report can be identified, in some instances, by the use of words such as “expects”, “anticipates”, “intends”, “believes” and similar language. We cannot guarantee future results, levels of activity, performance or achievements.

Potential risks and uncertainties which may cause our actual results, levels of activity, performance or achievements to differ materially from those implied by the forward-looking statements include, but are not limited to:

- declining expenditures on portal and other web-based advertising;
- the failure to develop or expand our electronic commerce business;
- difficulties in developing and introducing new access methods and devices;
- the growth of free Internet access in many core markets that may increase competition;
- the introduction of certain types of flat-rate access regulatory models in some of our core markets;
- the need to establish and maintain strategic relationships with content providers, e-commerce merchants and technology providers;
- declining prices for our services;
- difficulties in integrating our acquired businesses;
- the effect of future acquisitions on our financial condition and results of operations;
- the effect of adverse economic trends on our principal markets;
- the effect of foreign exchange fluctuations on our results of operations;
- the potential lack of attractive investment targets;
- reliance on third-party content and service providers; and

other risks discussed under “Item 3—Risk Factors”, “Item 5—Operating and Financial Review and Prospects”, “Item 11—Quantitative and Qualitative Disclosures About Market Risk” and elsewhere in this annual report.

CERTAIN TERMS AND CONVENTIONS

Our ordinary shares, nominal value two euro each, are currently listed on the New Market segment of the Spanish stock exchanges under the symbol “TRR” and are quoted through the Automated Quotation System of the Spanish stock exchanges. Our American Depositary Shares, or ADSs, each representing the right to receive one ordinary share, are listed on the Nasdaq National Market under the symbol “TRLY”. ADSs are evidenced by American Depositary Receipts, or ADRs, issued under a deposit agreement with Citibank, N.A., as depositary.

As used in this annual report "Terra Lycos", "Terra Networks", "Terra", "we", "us", "our" and similar terms mean Terra Networks, S.A. and its consolidated subsidiaries unless the context requires otherwise. The term "Lycos" refers to Lycos, Inc. and its consolidated subsidiaries.

PRESENTATION OF CERTAIN FINANCIAL INFORMATION

We publish our financial statements in euro. References to "euro" or "€" are to the single currency of the participating member states in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time. In addition, for the convenience of the reader, this annual report contains translations of certain euro amounts into United States dollars at specified rates. These translations should not be construed as representations that the euro amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated. Unless otherwise stated, the translations of euro into dollars have been made at $0.8901 to €1.00, the noon buying rate in New York City for cable transfers in euro as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2001. In this annual report, references to "U.S.$", "dollars" or "$" are to United States dollars. See "Item 3—Exchange Rates".

PART I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

A. DIRECTORS AND SENIOR MANAGEMENT

Not applicable.

B. ADVISERS

Not applicable.

C. AUDITORS

On April 1, 2002, Arthur Andersen y Cia entered into an agreement with the French and Spanish national practices of Deloitte Touche Tohmatsu ("DTT") that provides for the association of Arthur Andersen y Cia with those national practices (and therefore with DTT), subject to regulatory approval which is currently under consideration. Until such time as this approval is granted and this relationship becomes final, Deloitte &Touche has agreed to perform the quality control procedures required for foreign associated firms that are embodied in the requirements of the SEC Practice Section of the American Institute of Certified Public Accountants. Deloitte & Touche has performed such quality control procedures with respect to Arthur Andersen y Cia's audit of the financial statements for the year ended December 31, 2001, included in this annual report on Form 20-F.

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

Item 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The selected consolidated financial data have been derived from our consolidated financial statements. The selected consolidated financial data set forth below should be read in conjunction with "Item 5 — Operating and

Financial Review and Prospects" and the consolidated financial statements and notes to those statements appearing elsewhere in this annual report.

In reading the information provided below, you should consider the following:

- Our historical financial results include the financial results of companies that were under the Telefónica group's control during some of the periods presented. These companies operated our residential and SOHO, or small office/home office, ISP business in Spain (but not our Spanish portal business), our businesses in Chile and our business in Peru and were transferred to us in April 1999, October 1999 and October 1999, respectively.

- We acquired our:

  - Spanish portal business in April 1999;

  - Brazilian ISP and portal business in June 1999;

  - Argentine portal business in September 1999;

  - Mexican ISP and portal business in October 1999;

  - Venezuelan portal business in April 2000; and

  - Colombian portal business in July 2000.

  In addition, we acquired Lycos, Inc. in October 2000.

  We have included the results of operations of these businesses in our consolidated results of operations from the dates that we acquired them for financial reporting purposes. Please see notes 2(b) and 2(d) to our consolidated financial statements appearing elsewhere in this annual report.

- Because of these acquisitions, the loss of advertising revenues from other Internet companies due to the adverse conditions affecting the sector, the introduction of free Internet access in Spain in June 1999, in Brazil in February 2000 (through June 2001), in Chile in March 2000 and in Mexico in February 2000 (through January 2002), and the introduction of limited flat rate access in Spain in July 2000, among other factors, our historical financial statements may not be a reliable indicator of our future performance.

- All information is presented in Spanish GAAP except as noted. The principal differences between Spanish GAAP and U.S. GAAP are explained in note 21 to our consolidated financial statements appearing elsewhere in this annual report.

- Financial data for periods prior to January 1, 1999 were restated from Spanish pesetas into euro using the irrevocably-fixed exchange rate at January 1, 1999 of €1.00 = Ptas 166.386. The comparative financial statements for periods prior to January 1, 1999 reported in euro depict the same trends that would have been presented had we continued to present such financial statements in Spanish pesetas. However, financial information for periods prior to January 1, 1999 is not comparable with that of other companies reporting in euro that restated these amounts from a currency other than the Spanish peseta.

	Year Ended December 31,				
	1997	1998	1999	2000	2001
	(thousands of euro, except share data)				
Consolidated Statement of Operations Data:					
Revenues:					
Advertising	72	1,115	5,123	132,447	405,789
Access	2,390	9,646	24,817	118,694	203,780
Corporate Services	—	—	10,710	29,306	46,130
E-Commerce	—	—	66	12,881	12,801
Other	88	1,384	9,515	14,201	25,012
Total revenues	2,550	12,145	50,231	307,529	693,512
Operating expenses:					
Goods purchased	(1,054)	(8,475)	(31,044)	(193,626)	(352,039)
Personnel expenses	(928)	(3,175)	(19,942)	(116,868)	(204,969)
Depreciation and amortization	(464)	(701)	(6,272)	(83,513)	(157,426)
Other	(2,144)	(5,555)	(83,904)	(356,281)	(396,522)
Total operating expenses before financial expenses	(4,590)	(17,906)	(141,162)	(750,288)	(1,110,956)
Operating loss	(2,040)	(5,761)	(90,931)	(442,759)	(417,444)
Financial income (expense), net	(81)	(90)	1,839	35,487	126,262
Amortization of goodwill (1)	(310)	(339)	(28,654)	(253,484)	(386,332)
Reversal of negative goodwill in consolidation	—	—	—	—	2,825
Equity share of affiliate losses, net	—	—	(60)	(54,721)	(181,732)
Loss from ordinary activities	(2,431)	(6,190)	(117,806)	(715,477)	(856,421)
Extraordinary income (expense)(2)	97	(562)	(1,425)	(89,710)	(74,847)
Corporate income tax credit	363	1,334	35,899	248,142	363,350
Minority interest	465	1,673	1,928	691	1,620
Net loss (Spanish GAAP)	(1,506)	(3,745)	(81,404)	(556,354)	(566,298)
Basic and diluted net loss per ordinary share	(0.01)	(0.02)	(0.40)	(1.61)	(0.91)
Net loss (U.S. GAAP)	(1,899)	(5,061)	(139,310)	(1,236,441)	(11,411,749)
Basic and diluted net loss per ordinary share (U.S. GAAP)	(0.01)	(0.03)	(0.68)	(3.59)	(18.37)
Weighted average ordinary shares outstanding	193,525,585	193,525,585	203,763,953	344,819,216	621,265,845
Dividends per share	—	—	—	—	—

(1) Under U.S. GAAP goodwill amortization is included in operating expenses.

(2) Extraordinary income (expense) items under Spanish GAAP would not qualify as extraordinary items under U.S. GAAP.

	At December 31,				
	1997	1998	1999	2000	2001
	(thousands of euro)				
Selected Consolidated Balance Sheet Data:					
Cash and cash equivalents	1,753	148	589,986	2,673,384	2,190,124
Working capital	(246)	(3,701)	501,266	2,467,155	1,980,947
Total assets (Spanish GAAP)	11,797	18,617	1,405,465	6,738,237	6,107,331
Total assets (U.S. GAAP)	11,390	16,884	1,301,359	16,958,819	4,743,246
Total long-term obligations (Spanish GAAP)	183	221	15,183	159,888	97,877
Shareholders' equity (Spanish GAAP)	2,998	3,593	1,233,527	6,126,833	5,556,792
Shareholders' equity (U.S. GAAP)	2,603	1,882	1,129,471	16,409,923	4,220,453

	At December 31,				
	1997	1998	1999	2000	2001
	(thousands of euro)				
Capital stock (excluding long-term debt and redeemable preferred stock)	1,332	5,589	560,000	1,242,532	1,242,532

Exchange Rates

The following table sets forth, for the periods indicated, the period-end, average, high and low noon buying rates, in each case for the purchase of U.S. dollars, all expressed in pesetas per U.S. dollar:

	Noon Buying Rate			
	PeriodEnd	Average(1)	High	Low
Year ended December 31, 1997	152.40	147.14	158.80	129.80
Year ended December 31, 1998	142.15	149.42	157.41	136.80

Source: Federal Reserve Bank of New York.

(1) The average of the noon buying rates on the last day of each full month during the relevant period.

Effective January 1, 1999, the following 11 European Union member states adopted the euro as a common currency: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. They also established fixed conversion rates between their respective sovereign currencies and the euro. The exchange rate at which the Spanish peseta has been irrevocably fixed against the euro is Ptas 166.386 = €1.00. On January 1, 2001, Greece joined the European Economic and Monetary Union. On January 1, 2002, the participating member states began issuing new euro-denominated bills and coins for use in cash transactions. As of March 1, 2002, the participating member states have withdrawn the bills and coins denominated in their respective sovereign currencies from circulation, and they are no longer legal tender for any transactions.

The Federal Reserve Bank of New York no longer quotes a noon buying rate for the former currencies of any of the participating member states, including Spain. The noon buying rate for the euro on June 17, 2002 was $0.9442=€1.00.

The following table describes, for the periods and dates indicated, information concerning the noon buying rate for the euro. Amounts are expressed in U.S. dollars per €1.00.

	Noon Buying Rate			
	Period End ($)	Average (1) ($)	High ($)	Low ($)
Year ended December 31, 1999	1.0070	1.0588	1.1812	1.0016
Year ended December 31, 2000	0.9388	0.9207	1.0335	0.8270
Year ended December 31, 2001	0.8901	0.8909	0.9535	0.8370
Month ended December 31, 2001	0.8901	0.8912	0.9044	0.8773
Month ended January 31, 2002	0.8594	0.8832	0.9031	0.8594
Month ended February 28, 2002	0.8658	0.8707	0.8778	0.8613
Month ended March 31, 2002	0.8717	0.8766	0.8836	0.8652
Month ended April 30, 2002	0.9002	0.8860	0.9028	0.8750
Month ended May 31, 2002	0.9339	0.9170	0.9373	0.9022
Month ended June 30, 2002 (through June 17, 2002)	0.9442	0.9437	0.9473	0.9390

Source: Federal Reserve Bank of New York.

(1) The average of the noon buying rates for euro on the last day of each month during the relevant period.

Monetary policy within the members of the euro zone is set by the European Central Bank. The European Central Bank has set itself the objective of containing inflation and will adjust interest rates in line with this policy without taking account of other economic variables such as the rate of unemployment. It has further declared that it will not set an exchange rate target for the euro.

Our ordinary shares are quoted on the New Market segment of the Spanish stock exchanges in euro. Currency fluctuations may affect the dollar equivalent of the euro price of our ordinary shares listed on the New Market segment of the Spanish stock exchanges and, as a result, the market price of our ADSs, which are quoted on the Nasdaq National Market.

Our results will continue to be affected by fluctuations between the euro and the currencies in which some of our revenues and expenses are denominated, principally the United States dollar, the Brazilian real, the Mexican peso and the Chilean peso.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Risks Related to Our Financial Condition

We have never been profitable and expect our losses to continue.

We have never been profitable. During the year ended December 31, 2001, we had negative earnings before interest, taxes, depreciation and amortization, or negative EBITDA, of €260.0 million, and during the year ended December 31, 2000, we had negative EBITDA of €359.2 million. During the year ended December 31, 2001, we recorded a net loss of €566.3 million under Spanish GAAP, and during the year ended December 31, 2000, we recorded a net loss of €556.4 million under Spanish GAAP. We expect to continue to incur significant losses. Based on our most recent business plan, goodwill related to acquisitions we have made and the experience of other Internet portal companies and ISPs, we envisage the obtainment of net income in 2005. However, because our business plan is necessarily based on future expectations, including those relating to the Internet industry, which is relatively new, rapidly evolving and intensely competitive, our actual results may be significantly better or worse than our projected results.

You should not rely on our historical operating results for periods prior to 2001 as an indication of our future results because they do not fully reflect the current scope of our activities, and they are subject to significant fluctuations.

We have acquired many companies since our incorporation, particularly in 1999 and 2000. However, only our historical results of operations are reflected in the consolidated financial statements appearing elsewhere in this annual report. As a result, our consolidated financial statements for periods prior to 2001 do not provide a complete view of the current scope of our activities. Accordingly, you should not rely on year-to-year comparisons of our results of operations as an indication of our future performance. In addition, although we experienced strong revenue growth during 2000 and 2001, we believe that it may be difficult to achieve the same level of revenue growth in 2002 or in future periods.

Our future revenues and results of operations may fluctuate significantly due to a combination of factors, including:

- the rapidly evolving nature of our business, which means we have not begun to achieve consistency in revenue and expense growth;

- our acquisition and growth strategy through which we may add new activities to our business, thereby leading to increased revenues and expenses;

- fluctuations in the prices we pay for content and technology we obtain from third parties;

- currency fluctuations that affect reported revenues and expenses from our U.S. and Latin American operations;

- heavier spending by advertisers in some periods compared to others, which would contribute to fluctuating advertising revenues;

- the substantial reduction in advertising spending by other Internet and technology companies as a result of the adverse economic conditions that have and may continue to affect these sectors;

- heavier retail purchasing activity in some periods compared to others, which would contribute to fluctuating e-commerce revenues; and

- our ability to identify and take advantage of new revenue streams.

Risks Related to Internet Companies Generally, Including Us

Risks Related to Stock Prices

Terrorist attacks have contributed to general economic instability in the United States. Additional terrorist attacks, war or other civil disturbances could lead to further economic instability and depress our stock price.

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope. These attacks have caused instability in the global financial markets and have contributed to volatility in the stock prices of publicly-traded companies around the world. Additional terrorist attacks, acts of war or civil disturbances in the United States or elsewhere could lead to further economic instability and increased volatility in our stock price, and could have a material adverse effect on our business, financial condition and results of operations.

Our stock price is volatile and is affected by factors relating to the Internet industry.

The market prices of our ordinary shares and ADSs have been and may continue to be subject to wide fluctuations. During 2001, the closing sale prices for our ADSs on the Nasdaq National Market ranged from approximately U.S.$16.88 to approximately U.S.$4.64. The sale price of our ADSs closed at U.S.$4.12 on June 24, 2002. The market prices of our ordinary shares and ADSs may fluctuate in response to any of the following events:

- quarterly variations in our results of operations;

- announcements of technological innovations or new products and media properties by us or our competitors;

- changes in financial estimates and recommendations by securities analysts;

- the operating and stock price performance of other companies that investors may deem comparable to us; and

- news relating to trends in our markets.

Also, the stock market in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the price of our ordinary shares and ADSs, regardless of our operating performance. Additionally, fluctuations in the market price of our ordinary shares and ADSs could result in stockholder lawsuits or affect our ability to retain key employees who hold stock options, either or both of which potentially could impair our business.

Risks Related to Advertising

We rely heavily on revenues derived from Internet advertising, which are subject to uncertain demand from our current and potential clients and are difficult to forecast accurately.

A substantial portion of our revenues comes from advertisements displayed on our portals and network of sites. Our ability to continue to achieve substantial advertising revenue depends upon:

- our ability to transition and expand into other forms of advertising in light of reductions in advertising prices and increased competition;
- growth of our user base;
- our user base being attractive to advertisers;
- our ability to derive better demographic and other information from our users;
- our ability to deliver or measure the delivery of advertisements reliably; and
- acceptance by advertisers of the Internet as an advertising medium.

In addition, many Internet companies have failed and other Internet companies have substantially reduced their spending on advertising, and companies in more traditional lines of business are not spending money on advertising as quickly as we anticipated as a result of the economic slowdown. These conditions could have a material adverse effect on our business, financial condition and results of operations. Furthermore, potential advertisers that have relied on traditional advertising media may be reluctant to advertise on the Internet.

A general economic downturn could harm our ability to generate advertising revenue.

Expenditures by advertisers tend to be cyclical, reflecting overall economic conditions as well as budgeting and buying patterns. The advertising market generally, and the Internet advertising market specifically, has been generally characterized in recent quarters by softness of demand. As a result, spending on Internet advertising has decreased. Additionally, the September 11, 2001 terrorist attacks have contributed to continued general economic weakness and further reductions in advertising spending. Any additional terrorist attacks or military campaigns may exacerbate the current economic weakness, and result in further reductions in Internet advertising. Even if general economic conditions do improve, marketing budgets and advertising spending may not increase from current levels.

Risks Related to E-Commerce

We are exposed to some direct sales risks, including fulfillment risk and product liability risk.

We are exposed to direct sales risks in connection with our activities as a retailer and fulfillment manager. If we do not successfully operate our fulfillment centers, it could significantly limit our ability to meet customer demand and harm our business. In addition, some of the products we sell such as toys, tools, hardware, computers, and kitchen and housewares products may expose us to product liability claims relating to personal injury, death or property damage caused by such products and may require us to take actions such as product recalls. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. Companies with which we have formed strategic alliances and the network of retailers with whom we have relationships also may sell products that may indirectly increase our exposure to product liability claims.

Risks Related to Competition

We may not be able to compete effectively, which would harm our business.

We compete with a wide range of companies in our Internet access, advertising and electronic commerce businesses, including companies that focus on the Internet, more traditional companies that also have Internet operations and companies in more traditional lines of business, such as publishing and television. There are many companies that provide Internet-related services and target the same markets that we do. We compete with large established U.S. Internet companies like Yahoo!, AOL Time Warner and Microsoft and more regional competitors such as Eresmas and Ya.com in Spain, El Sitio, Universo Online and T1msn in Latin America, and SINA, SOHU, NetEase and Dawn in Asia. Competition in each of our businesses and markets is intense. Increased competition could result in:

- loss of ISP subscription fees;
- lower advertising revenues;
- price reductions and lower revenues;
- higher prices for content from third-party providers;
- loss of customers;
- loss of brand recognition;
- change in brand perception;
- reduced page views;
- loss of market share; or
- loss of e-commerce revenues.

Any one of these could materially and adversely affect our business, financial condition and results of operations.

As we expand the scope of our Internet services, we will compete directly with a greater number of Internet sites, media companies and companies providing business services across a wide range of different online services, including:

- companies offering communications services either on a stand alone basis or integrated into other products and media properties;
- vertical markets where competitors may have advantages in expertise, brand recognition and other factors;
- manufacturers of personal computers who may develop their own Internet portals to which they would direct their customers;
- online employment recruiting companies; and

- online merchant hosting companies.

A loss of users to our competitors may have a material adverse effect on our business, financial condition and results of operations.

We will not be able to remain competitive if we do not continually enhance and develop the content and features of our Internet services.

To remain competitive, we must enhance and improve our content. In addition, we must:

- continually improve the responsiveness, functionality and features of our portals and sites;
- develop products and services that are attractive to visitors, advertisers and subscribers;
- establish a strong relationship with our users; and
- increase the download speed of our content through broadband access methods such as ADSL and cable.

We may not succeed in developing or introducing in a timely manner features, functions, products and services that users and advertisers find attractive. This would likely reduce our user traffic and materially and adversely affect our business, financial condition and results of operations.

If we fail to establish and maintain strategic relationships with content providers, e-commerce merchants and technology providers, we may not be able to attract and retain users and customers.

We supplement our proprietary content with third-party content. Accordingly, we have focused on establishing relationships with leading content providers, e-commerce merchants and technology and infrastructure providers such as Banco Bilbao Vizcaya Argentaria, Logista, Bertelsmann, Disney, Agencia EFE, Grupo Reforma, Healtheon/Web MD, Reuters, Associated Press, Business Week, Motor Press, Fox Sports, eBay, Vitaminic, TravelNet and Telefónica Data. Our business depends in part on these relationships. Because some of our agreements with these and other third parties are not exclusive, our competitors use some of the same partners as we do and may attempt to adversely impact our relationships with our partners. We might not be able to maintain these relationships or replace them on financially attractive terms. If the parties with whom we have these relationships do not adequately perform their obligations, reduce their activities with us, choose to compete with us or provide their services to a competitor, we may have more difficulty attracting and maintaining users and our business, financial condition and results of operations could be materially and adversely affected. Also, we intend to establish new relationships in the future. Although our efforts in this regard generally have been successful in the past, they may not be successful in the future.

Risks Related to the Internet, Technology and Technological Development

Unexpected network interruptions caused by local or global system failures may result in reduced user traffic, reduced revenue and harm to our reputation.

A key element of our strategy is to generate a high volume of user traffic. Our ability to attract advertisers and users as well as our reputation depend significantly upon the performance of our network infrastructure, including our servers, hardware and software. Any system failure, including network, hardware or software failure, that causes an interruption in our service or a decrease in responsiveness of our websites could result in reduced traffic and reduced revenue, and could impair our reputation. In addition, computer viruses or other factors could result in a catastrophic failure of the Internet, which would have a material adverse effect on our business, financial condition and results of operations. Although we carry business interruption insurance, this policy does not cover damages caused by computer viruses, hackers, software corruption or third-party network failure and may not be in amounts sufficient to compensate us for any losses we incur.

Concerns about security of e-commerce transactions and confidentiality of information on the Internet may reduce the use of our network and impede our growth.

A significant barrier to e-commerce and confidential communications over the Internet has been the need for security. Internet usage could decline if any well-publicized breach of security occurred. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by these breaches. Unauthorized persons could attempt to penetrate our network security. If successful, they could misappropriate proprietary information or cause interruptions in our services. As a result, we may be required to expend capital and resources to protect against or to alleviate these problems. Security breaches could have a material adverse effect on our business, financial condition and results of operations.

Computer viruses, denial of service (DOS) attacks and other types of attacks may cause our systems to incur delays or interruptions and may adversely affect our business.

Computer viruses, denial of service (DOS) attacks and other types of attacks may cause our systems to incur delays or other service interruptions. In addition, the inadvertent transmission of computer viruses could expose us to a material risk of loss or litigation and possible liability. Moreover, if a computer virus affecting our system is highly publicized, our reputation could be materially damaged and our user traffic may decrease.

We may fail to develop or introduce on a timely basis new access methods and devices.

We believe that the use of new Internet access methods, such as wireless, broadband and satellite, and new access devices, such as Internet television and personal digital assistants, will become increasingly widespread in coming years. If we are not able to develop or introduce on a timely basis new access methods with partners or on our own, or if we are not able to develop or obtain desired content for these devices, our business, financial condition and results of operations could suffer.

Risks Related to Legal and Regulatory Matters

We may become subject to burdensome government regulations affecting the Internet which could adversely affect our business.

To date, governmental regulations have not materially restricted use of the Internet in our markets. However, the legal and regulatory environment that pertains to the Internet may change along with the development of the Internet. Changes in laws or regulation could increase our costs of doing business (including significant expenses necessary to comply with such laws or regulation), expose us to substantial liability and prevent us from delivering our products and services over the Internet. The growth of the Internet may also be significantly slowed. This could delay growth in demand for our services and limit the growth of our revenues.

In addition to the adoption of new laws and regulations, existing laws may be applied to the Internet. New and existing laws may cover issues that include:

- sales and other taxes;
- user privacy;
- pricing controls;
- characteristics and quality of products and services;
- consumer protection;
- cross-border commerce;

- libel and defamation;
- copyright, trademark and patent infringement;
- pornography;
- other claims based on the nature and content of Internet materials;
- antitrust and competition law;
- news and audiovisual services;
- telecommunication laws;
- gambling; and
- childhood protection.

Depending on the nature of new laws and regulations, and depending upon the way existing laws are applied to the Internet, our growth could be constrained and our ability to generate revenues diminished.

We may be subject to claims based on the content we provide over our network.

The law in our core markets relating to the liability of online service providers, like us, for activities of their users is currently unsettled. Claims have been made against online service providers and networks in the past for defamation, negligence, copyright or trademark infringement, obscenity, child pornography, illegal gambling, personal injury or other theories based on the nature and content of information that was posted online by their users or by the online service provider itself. We could be subject to similar claims and incur significant costs in their defense. In addition, we could be exposed to liability for the selection of listings or links that may be accessible through our network or search services or for content and materials that our users may post in classifieds, message boards, chat rooms or other interactive services that we provide. It is also possible that if any information provided through our services contains errors, third parties could make claims against us for losses incurred in reliance on the information, including financial losses arising from investment decisions based on financial information provided on our websites such as Invertia.com and Quote.com. We offer web-based e-mail services, which expose us to potential liabilities or claims resulting from:

- unsolicited e-mail;
- lost or misdirected messages;
- illegal or fraudulent use of e-mail; or
- interruptions or delays in e-mail service.

Investigating and defending these claims is expensive, even if they do not result in liability.

We may be subject to claims relating to products and services sold or offered on our network.

We have entered into arrangements to offer third-party products and services on our network under which we may be entitled to receive a share of revenues generated from these transactions and, under certain circumstances, “slotting fees”. These arrangements may subject us to additional claims including product liability or personal injury from the products and services, even though we do not ourselves provide the products or services. These claims may require us to incur significant expenses in their defense or satisfaction. While our agreements with these parties often provide that we will be indemnified against such liabilities, such indemnification may not be adequate due to the size of the claim or if the indemnifying party is unable to pay us due to insolvency or otherwise. We may also suffer losses as a result of orders placed with fraudulent credit card data, even though the consumer's payment for these orders has been authorized by the associated financial institution. In addition, we are aware that governmental agencies are currently investigating the conduct of online auctions, which could require changes in the way we conduct our online auctions business.

Although we carry insurance, our insurance may not cover all potential claims to which we are exposed or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of insurance coverage could have a material adverse effect on our business, financial condition and results of operations. In addition, the increased attention focused on liability issues as a result of any lawsuits or legislative proposals could impact the overall growth of Internet use.

We may become involved in intellectual property litigation which could impair our ability to conduct our business.

There has been substantial litigation in the computer industry regarding intellectual property rights. Although we have not been subject to these types of claims as of the date of this annual report, we may become involved in claims and counterclaims with third parties regarding infringement with respect to current or future products or trademarks or other proprietary rights. Any infringement or other claims or counterclaims could impair our business because they could:

- be time-consuming;
- result in costly litigation;
- divert management's attention;
- cause product release delays;
- require us to redesign our products or require us to enter into royalty or licensing agreements which may not be available on terms acceptable to us, or at all; or
- result in substantial monetary liability

Our ability to collect personal data relating to our users may be restricted and may limit our ability to generate advertising and e-commerce revenue.

We must comply with applicable data protection legislation, including European Union directives that limit our ability to collect and use personal information relating to our users. Spain has adopted legislation implementing the standards required by this directive and some Latin American countries have modeled their legislation on this directive. Increased awareness on the part of the public of privacy issues and changes to legislation with which we may have to comply could impact our ability to use such personal information to attract advertisers and e-commerce partners, which could materially and adversely affect our business, financial condition and results of operations. Additionally, the United States prohibits the collection of personal data of children under the age of 13 without the consent of a parent or legal guardian, and most other countries have similar prohibitions. We may have difficulty in verifying the personal data we collect, including the identity of those persons who claim to be the parent or legal guardian of any of our users who are under the age of 13.

Other Risks

We depend substantially on highly-qualified managerial, sales and technical personnel who may not continue to work for us.

Our success is largely dependent on our ability to hire highly-qualified managerial, sales and technical personnel. The execution of our multi-local/global content approach requires us to find and employ personnel who excel at anticipating consumer tastes and interests. The loss of the services of any of our key management, sales or technical personnel could have a material adverse effect on our business, financial condition and results of operations. These individuals are in high demand, and we may not be able to attract the staff we need. The difficulties and costs in connection with our personnel growth are compounded by the fact that many of our operations are internationally based.

Risks Related to our Business and Strategy

Risks Related to our Internet Access Business

If we are not able to migrate users successfully from free Internet access services to pay Internet access services, we will not be able to increase our revenues as planned, which could affect our business, financial condition and results of operations.

As part of our new business strategy we seek to migrate users from free Internet access services to pay Internet access services such as subscription-based services and pay-per-view or pay-per-use arrangements. Accordingly, we have discontinued providing free Internet access services in Brazil and Mexico and may discontinue such services in other markets. Some of our competitors continue to provide free or low-price Internet access services in these markets. At March 31, 2002, we had 1.3 million pay Internet access subscribers. If we are unable to migrate our current free Internet access users successfully or at the rate we anticipate to pay Internet access services, or if we are unable to attract and retain new paying customers, our business, financial condition and results of operations could be negatively affected. In addition, if our portal user base declines because our customers switch to free Internet access providers because they are unable to gain free access to our services, our advertising and e-commerce revenues may decrease, and we could therefore face difficulties attracting and retaining advertisers. Further, market circumstances may force us to provide pay Internet access services with low, or even negative, margins for us or to relaunch free Internet access services.

The introduction of flat-rate Internet access in Spain has negatively affected us, and the introduction by regulatory authorities of certain types of flat-rate Internet access regulatory models in other markets could have a further negative effect.

Since mid-2000, we have been adversely affected by the introduction in Spain of flat rates for telephone calls to connect to the Internet. Flat rates allow our Internet access users to pay a pre-set amount for unlimited telephone calls to connect to our Internet access service during specified times, instead of paying for each call at the metered local rate based on the length of the call. However, our aggregate costs in connection with providing free Internet access services are related to the level of usage by our users. As a result, our costs of providing free Internet access to flat rate users have exceeded the revenues we receive relating to such flat rate access users. As a result of the foregoing, we are seeking to migrate users from free Internet access services to pay Internet access services. The introduction by regulatory authorities of certain types of flat-rate Internet access regulatory models in our other markets such as Peru could have a further adverse effect on our business, financial condition and results of operations, depending on the terms and conditions of such plans, including among others, the cost of such plans and the amounts (if any) received by us in connection with such plans.

If broadband access does not develop in some of our markets at the rate we anticipate, we may not be able to increase our revenues as planned, which could adversely affect our business, financial condition and results of operations.

As part of our strategy to shift customers towards value-added pay services and to attract new paying customers, we are focusing on the development of broadband products and services. We expect that broadband access will become more widely available in Spain and Latin America in the near future in part as a result of the wide-scale deployment of asymmetric digital subscriber lines (ADSL) by the Telefónica group in some of these markets. If broadband access does not develop at the rate we anticipate, we may not be able to offer value-added services, which could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to our Media Business

If we are not able to increase the number of users of our value-added pay services, we will not be able to increase our revenues as planned.

In connection with our new business strategy, we are seeking to transition our users from free services to higher value-added pay services and to create additional revenue streams by introducing new value-added pay services, including those that take advantage of broadband technologies that permit access to expanded multimedia content. At March 31, 2002, we had 1.8 million subscribers of value-added pay services, including our 1.3 million pay Internet access subscribers. In accordance with this strategy, we have launched, among others, new subscription-based services on our Angelfire and Tripod sites that include more options and features than the traditional services that we provide free of charge. We also introduced in March 2002 a subscription-based gaming platform that allows broadband users to play PC games on demand over the Internet. We may offer these and other premium services with our Internet access services on an integrated basis. If we are unable to transition our users successfully to our value-added pay services, or if we are unable to attract new users, it could have a material adverse effect on our business, financial condition and results of operations. In addition, these services may not generate significant revenues for us.

We must develop flexible payment systems in order to collect revenues from value-added pay services.

As we expand our portfolio of value-added pay services, we may seek to offer services for which we may charge low fees per use. Because potential users of these services may not have a pre-existing billing relationship or account with us, we must develop micropayment platforms that enable us to collect small payments that are below the required minimum charge for credit card use in individual transactions in order to be able to collect revenues from these services. If we are unable to develop flexible forms of payment, we may not be able to expand our value-added services and grow our revenues as planned.

We may not be successful in expanding the number of users of our electronic commerce services, and our ability to provide electronic commerce services such as online shopping effectively is limited.

We have focused, and intend to continue to focus, significant resources on the development and enhancement of our electronic commerce properties. These properties, such as Lycos Shop and Terra Compras/Terra Shopping, link users with a network of retailers with whom we have relationships. However, in order to support our electronic commerce initiative, we must rely in most cases on our third-party suppliers. The failure of our network of retailers to provide quality service to users of our websites, to deliver to our users on a timely basis the products purchased on our websites or to deliver satisfactory products may result in user dissatisfaction, which may, in turn, cause users to stop visiting our websites or using our services. Competing providers of online shopping, including merchants with whom we have relationships, may be able to provide a more convenient and comprehensive online shopping experience due to their singular focus on electronic commerce. As a result, we may have difficulty competing with those merchants for users of electronic commerce services. The inability of our electronic commerce properties to generate significant revenues could have a material adverse effect on our business, financial condition and results of operations.

General Risks Related to our Business and Strategy

We face risks associated with brand development.

We believe that establishing, maintaining and developing our Terra and Lycos network brands and brands relating to our strategic alliances is critical to our ability to expand our user base and our revenues. We believe that the importance of brand recognition will increase in the future. In order to attract and retain Internet users, advertisers and e-commerce partners, we intend to focus on creating and maintaining brand loyalty.

Promotion and enhancement of our Terra and Lycos network brands will depend largely on our ability to provide consistently high-quality products and services. Failure to promote and enhance our Terra and Lycos network brands in a cost-effective manner could have a material adverse effect on our business, financial condition and results of operations. In addition, our Terra and Lycos network brands could be impaired if:

- we do not provide consistently high-quality products and services or consumers do not perceive the quality of our products and services; or

- consumers do not use or favorably receive the new products and services which we introduce.

Risks Related to Our Acquisition Strategy and Investments

We may not be able to manage our expanding operations effectively .

Our rapid growth has from time to time placed significant strain on our managerial and operational resources. To accommodate this growth, we must continue to implement new or upgraded operating and financial systems, procedures and controls throughout many different locations. We may not succeed with these efforts. Our failure to expand and integrate these areas in an efficient manner could cause our expenses to grow and our revenues to decline or grow more slowly than expected, and could otherwise have a material adverse effect on our business, financial condition and results of operations.

We may not be able to integrate our acquired businesses successfully.

Although we did not make any significant acquisitions in 2001, we may make significant acquisitions in the future or we may form joint ventures with other companies and will therefore need to integrate their operations, personnel and products with ours. If we are not able to integrate these businesses successfully, the quality of our service may suffer and customers may be less likely to use our services. This could have a material adverse effect on our business, financial condition and results of operations.

We may not realize the anticipated benefits of our acquisitions.

Our operations have grown largely due to our acquisition of local Internet-based businesses and, most importantly, Lycos. If we are not able to develop strategies and implement business plans that take advantage of synergies with these acquired businesses, we may not be able to realize the anticipated benefits and growth opportunities from such acquisitions, which could have a material adverse effect on our business, financial condition and results of operations. In addition, as a result of our acquisitions, we currently offer more than 50 different categories of products and services. We will not be able to extract value from our acquisitions if we do not effectively manage this diverse range of products and services.

Our significant investments in other technology companies may never be recovered.

We have made significant investments in order to acquire minority interests in other technology companies. The value of such investments declined significantly in 2001, and may decline further in the future. We may never be able to recover our investments in such companies, which could have a material adverse effect on our results of operations and financial condition. During the year ended December 31, 2001, we recognized losses of $12.2 million related to declines in values of equity securities deemed to be other than temporary. These losses have been classified as a realized loss on investments in the accompanying consolidated statements of operations.

We have recorded an impairment charge to goodwill and may be required to write off additional goodwill in the future.

Goodwill represents the purchase price of an acquisition in excess of the fair value of the assets acquired less liabilities assumed. We generated substantial amounts of goodwill from our acquisitions, most importantly our acquisition of Lycos. Part of our strategy involves making significant acquisitions. Because Internet businesses of the type we target often do not have substantial tangible assets, any acquisition of these businesses may generate significant amounts of goodwill.

At December 31, 2001, under Spanish GAAP we had goodwill of €1,819.2 million, equal to 29.8% of our total assets and 32.7% of our shareholders' equity at that date, and at December 31, 2000, we had goodwill of €2,266 million, equal to 33.6% of our total assets and 39.5% of our shareholders' equity at that date. At December 31, 2001, under U.S. GAAP we had goodwill of €1,732.6 million, equal to 36.5% of our total assets and 41.1% of our shareholders' equity at that date, and at December 31, 2000, we had goodwill of €13,451.2 million, equal to 79.3% of our total assets and 82.0% of our shareholders' equity at that date. The significant differences in the amount of goodwill at each of these dates under Spanish GAAP compared with the amount under U.S. GAAP relate principally to the amount of goodwill recorded for Spanish GAAP purposes and for U.S. GAAP purposes, respectively, in connection with our acquisition of Lycos. In 2001, we conducted a study of the evolution of the business plans of our acquired companies, as a result of which we wrote down goodwill related to our prior acquisitions by €35.0 million under Spanish GAAP and U.S. GAAP. We also adjusted our goodwill amortization period to our new estimates of anticipated revenues in order to better match future revenues and expenses based on our actual rate of development and that of the industry in which we operate. In general, we extended the goodwill amortization period to ten years, as from July 1, 2001, except for the portion of goodwill in the amount of €400 million relating to our agreement with Bertelsmann, which we expect to recover in proportion to the revenues generated by the agreement over its five-year term.

In addition, in the fourth quarter of 2001, we performed an analysis of projected discounted cash flows from Lycos, Terra Networks USA and our Spanish portal business as a result of which we determined that such projected cash flows were not adequate to support the value of goodwill related to these companies under U.S. GAAP. Accordingly, we determined under U.S. GAAP that goodwill related to these companies was impaired, and we recorded a goodwill impairment charge in an aggregate amount of approximately €8,790 million in 2001, which reduced shareholders' equity at December 31, 2001 by that amount under U.S. GAAP.

We cannot be certain that we will be able to recover all of the goodwill that we now carry as an asset or that we will not have to write off additional goodwill in the future under U.S. GAAP or Spanish GAAP. We could be forced to write off goodwill because of rapid technological change, intense competition, significant declines in sales, earnings or cash flows and other factors that in the future indicate that the fair value of our acquisitions is not worth their carrying value.

We may not be able to identify or finance acquisitions or joint ventures in the future.

As part of our business strategy, we continually review acquisition prospects, joint ventures and strategic alliances that we expect to complement our existing business, increase our traffic, enhance our content offerings or increase advertising and e-commerce revenues. Most importantly, in October 2000, we acquired Lycos, one of the Internet's leading networks of separately-branded sites. We do not know if we will be able to identify any future joint ventures, acquisitions or alliances or that we will be able to agree to terms or to finance these transactions successfully. Any failure to do so may impair our growth.

Our acquisitions and joint ventures involve risks and uncertainties that may harm our business or cause it not to perform as expected.

Our acquisitions and joint ventures could result in numerous risks and uncertainties, including:

- difficulties in assimilating and managing effectively the operations, personnel, technologies and products of the acquired companies;
- the diversion of management's attention from other business concerns;
- the risk that an acquired business will not perform as expected or that it will carry unforeseen liabilities; and
- the risk of adverse changes in the business and financial condition of our joint venture partners, particularly those in the technology sector.

Risks Related to Some of Our Markets

If Internet usage does not continue to grow at a strong pace, our business may not be successful.

Some of the Internet markets outside the United States, Europe and certain countries in Asia in which we operate are in an early stage of development. Our business, financial condition and results of operations will be materially and adversely affected if Internet usage in such markets does not continue to grow or grows more slowly than we anticipate. We develop our expectations for Internet-industry growth on the basis of publicly-available projections such as those cited in this annual report. Any of these projections may turn out to be overly optimistic.

Growth in the number of people online and the number of hours spent online may be inhibited for a number of reasons, including:

- the cost of Internet access;
- the price and availability of Internet access devices;
- concerns about security and privacy;
- ease of use;
- quality of service;
- economic events;
- availability of telephone lines or other access methods, including broadband access; and
- the rate of development of telecommunications network infrastructure.

The high cost of Internet use may limit the growth of the Internet and slow our growth.

Unlike telecommunications companies in the United States, telecommunications companies in Latin America and certain of our other core non-U.S. markets generally do not provide customers with unlimited local telephone service for a fixed fee. Accordingly, Internet users in these markets have historically been charged fees by telecommunications companies based on the length of time they use telephone lines to access the Internet. Unfavorable rate developments in Latin America or other core non-U.S. markets could decrease our visitor traffic and our ability to derive revenues from transactions over the Internet. This could have a material adverse effect on our business, financial condition and results of operations.

Our ability to generate revenues would be adversely affected if e-commerce fails to gain acceptance as a viable means for transacting business in Latin America.

Numerous factors could delay or prevent the emergence of e-commerce in Latin America, which would impair our ability to generate e-commerce revenues and adversely impact our business. Reasons why e-commerce in Latin America may not gain acceptance among consumers and merchants include:

- the absence of a tradition in Latin America of consumers making purchases from non-“bricks and mortar” retailers, such as catalog retailers;
- the small percentage of consumers holding credit cards, which are the primary method of payment for e-commerce transactions in the United States;
- the lack of widespread acceptance of electronic payment methods;
- low levels of credit card use;
- concerns about security of commercial data, such as credit card numbers;
- concerns over privacy of consumers’ personal data; and
- lack of adequate distribution and fulfillment operations for goods purchased.

Moreover, unlike in the United States, consumers and merchants in Latin America can be held fully liable for credit card and other losses due to third-party fraud. The incidence of fraud in connection with credit cards and other methods of payment is higher in Latin America than in the United States. Because secure methods of payment for e-commerce transactions have not been widely adopted in Latin America, both consumers and merchants have a relatively low confidence level in the integrity of e-commerce transactions. Also, many banks and other financial institutions have generally been reluctant to give merchants the right to process online transactions due to concerns about third-party fraud. If concerns about third-party fraud persist, our ability to generate revenues from e-commerce may be limited, which could have an adverse effect on our business.

Additionally, customs duties and taxes are imposed on deliveries of international parcels in many countries in Latin America, making international e-commerce transactions more costly. Many countries also do not have systems in place to ensure speedy and reliable delivery of parcels once they have cleared customs. These problems may deter merchants and consumers from engaging in e-commerce transactions.

Social, political and economic conditions in our Latin American markets may cause volatility in our operations and adversely affect our business.

We derive and expect to continue to derive a portion of our revenues from the Latin American markets. Social and political conditions in Latin America are volatile and may cause our operations to fluctuate. This volatility could make it difficult for us to sustain our expected growth in revenues, which could have an adverse effect on our stock price. Historically, volatility in Latin American countries has been caused by:

- significant governmental influence over many aspects of local economies;
- political and economic instability;
- changes in regulatory requirements;
- fluctuations in exchange rates;
- social unrest;
- slow or negative economic growth;
- imposition of trade barriers; and
- wage and price controls.

Most or all of these factors have occurred at various times in the last two decades in our most important Latin American markets of Brazil, Mexico, Argentina, Peru, Venezuela and Chile.

We have no control over these matters. Poor social, political and economic conditions may inhibit Internet usage, create uncertainty regarding our operating climate and cause advertisers to reduce their advertising spending, all of which may adversely impact our business.

Latin American currencies have in the past been volatile, and any volatility in the future will impact the results of operations we report from our Latin American operations.

Although our reporting currency is the euro, revenues earned and expenses relating to our Latin American operations are denominated in local currencies. The currencies of many Latin American countries, including Argentina, Brazil and Mexico, have experienced substantial depreciation and volatility in the past. Most recently, in January 2002, Argentina devalued its currency, whose value had previously been pegged to the U.S. dollar. Fluctuations in exchange rates of Latin American currencies may impact our results of operations. In addition, the imposition of foreign currency exchange restrictions by Latin American governments may limit the ability of our Latin American subsidiaries to pay us dividends or other amounts owed to us, which could have a material adverse effect on our business, financial condition and results of operations.

Any spread of the macroeconomic crisis in Argentina to other countries in which we operate may adversely affect our business, financial condition and results of operations.

In late 2001 and early 2002, the Argentine government declared the official default on Argentina's foreign debt payments and removed the peg of the Argentine peso to the U.S. dollar, thereby resulting in the significant devaluation of the Argentine peso. Argentina's macroeconomic crisis has been accompanied by significant social and political turmoil. The Argentine economic crisis could spread to other Latin American countries. If the Argentine economic crisis has a negative impact on the economies of other Latin American countries in which we operate, it could have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to Competition within the Telefónica Group

A member of the Telefónica group currently competes with us with respect to certain services that we provide in Spain and other companies in the Telefónica group could in the future compete with us in other services and markets.

We provide services and content to members of the Telefónica group and may offer co-branded products with them in the future. We also compete with members of the Telefónica group. We currently compete directly with a member of the Telefónica group with respect to the provision of narrow band (i.e., dial-up Internet access services) and ADSL services to retail customers in Spain and may in the future compete in the provision of ADSL services in Brazil. In addition, many companies in the Telefónica group operate portals, and some of such companies offer services related to or that may compete with services that we offer. Other companies in the Telefónica group could in the future compete with us, and they may also pursue their own Internet-related business or operational strategies, including:

- offering ISP and access products (narrow and broadband) in some of our markets;
- further developing their existing portals or launching new portals;
- offering services through new platforms and devices (e.g., personal digital assistants, wireless access devices, etc.); and
- offering Internet-based services from new media platforms operated by them.

Because most Telefónica group companies operate in the telecommunications or media industries, there could be additional situations in which we and these other companies find ourselves with related, or even competing activities. Regulatory requirements in some countries may also necessitate that Telefónica group companies make their services such as Internet-based technology infrastructure available to our competitors. Telefónica is able to exercise significant influence over all matters requiring approval by our shareholders and board of directors, including approvals of mergers and other business combinations as a result of its approximately 37% interest in us and its effective ability to appoint a majority of our directors. It may also influence our operations and business strategies, including by limiting or restricting our ability to pursue certain strategies.

Contracts between us and members of the Telefónica group were negotiated between parties under common control.

We have entered into a number of contracts with members of the Telefónica group. These contracts were negotiated between parties under common control. We have a reasonable basis to believe that these contracts have terms and conditions similar to those available from third parties and are fair to us in all material respects. The most important of these contracts are our agreements with Telefónica de España, S.A. relating to network connection ports we lease from Telefónica de España, S.A. both for narrow band and ADSL services. Other relevant contracts include our agreement with Telefónica de España, S.A. relating to the traffic-inducement fees that Telefónica de España, S.A. pays us and our agreement with Telefónica Data, S.A. relating to IP connectivity. Telefónica de España, S.A. pays traffic-inducement fees to other ISPs at rates negotiated between Telefónica de España and the individual ISPs.

Regulations may affect our relationship with the Telefónica group.

Our relationship with the Telefónica group is a competitive strength that could be reviewed by Spanish, European Union or Latin American competition authorities. These regulatory bodies could limit the extent to which we can cooperate with members of the Telefónica group in providing Internet services.

Risks Related to our Technology Infrastructure and Technological Development

We may not be able to optimize the interconnection of our networks, which would hurt our ability to improve the level of service we provide.

We are in the process of interconnecting our network infrastructures, except for certain of our joint ventures, in the different countries in which we operate. With an optimally-interconnected network, we expect to be able to improve the level of service we can provide to our Internet access customers. For example, we believe that such a network would enable us to diagnose and correct problems remotely, and therefore more quickly. In the event we fail to interconnect our networks optimally, our ability to improve the level of service we provide to our customers will be limited. This could lead to decreased usage of our network, which in turn could have a material adverse effect on our business, financial condition and results of operations.

We may fail to develop and introduce new communication services and bundle them with Internet access products.

We believe that communication services such as e-mail, chat, voice over IP, instant messaging and forums will be a new profitable business stream, both independently and through bundling with different access products. Our strategy to monetize such services is based on the development of new pay services as well as defining a new portfolio of structured services (open, basic and premium) for upstream sales of increases in capacity and functionality. This strategy substantially depends on the development of our technological platform as well as our ability to enter into alliances and agreements with leading companies in the technology field. If we are not able to develop our platform or partner with other companies, our business, financial condition and results of operations may be adversely affected.

We are dependent upon the supply of critical elements by a few third parties.

We are substantially dependent upon a few third parties, including members of the Telefónica group, for several critical elements of our business, such as hosting services, ad serving, network services and data storage services. If these third parties fail to provide their services with a high degree of quality, reliability and performance, it could adversely impact our relationship with users and our advertising customers. In addition, some of these third parties have recently experienced financial problems. If we are no longer able to obtain services from these third parties, as a result of their financial troubles or otherwise, and are unable to find substitute service providers, it could have a material adverse effect on our business, financial condition and results of operations.

We may fail to build out our network cost-effectively.

As our global network grows, the risks associated with the development and deployment of technology increase and our ability to develop or acquire and implement usable solutions across our network may become more challenging. Our ability to build out and operate our network in a cost-effective manner depends upon our ability to develop individual products that may be deployed multiple times across all of the countries in which we operate. Our new subscription-based business model presents significant technological challenges because of the increased volume of transactions as well as the need for each product to interface with the different billing structures in various countries as a result of different tax regimes and payment methods. If we are unable to build products that may be used globally, we will not be able to operate our network cost-effectively, which could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Legal and Regulatory Matters

Regulatory changes in some of the jurisdictions in which we operate may affect our business models.

Government regulation in some of the jurisdictions in which we operate has a significant impact on our business models. Government regulations may determine, among other things, the services that we or our competitors may offer, the prices that we may charge for them and the relationship between us and our communications services providers. As a result, adverse changes in government regulations may prevent us from implementing our business plans or achieving our financial and operating goals, which could have a material adverse effect on our business, financial condition and results of operations.

Several U.S. federal laws could have an impact on our business.

The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances. This legislation may impose significant additional costs on our business or subject us to additional liabilities.

We post our privacy policy and practices concerning the use and disclosure of our user data on our websites. Currently, there are a large number of legislative proposals before the United States Congress and various state legislative bodies regarding privacy issues relating to our business. For example, the United States Congress and various state legislatures are considering initiatives concerning database protection, unsolicited commercial e-mail (commonly referred to as "spam"), electronic security and Internet gambling. We cannot predict the effect of such legislation should it be adopted, and certain proposals, if adopted, could materially adversely affect our business, financial condition and results of operations.

Our brand names are difficult to protect and may infringe on the intellectual property rights of third parties.

We rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary rights. We generally enter into confidentiality agreements with our employees, consultants and partners. We have registered and applied for registration of certain service marks and trademarks, and will continue to evaluate the registration of additional service marks and trademarks, as appropriate.

With respect to the Terra trademark, we have applied to register the Terra trademark in all countries in which we have an interest, as well as in many others. The registration of the Terra trademark has been obtained in different classes in almost all of our priority countries, and we are in the process of registering the trademark in the remaining countries. We are currently appealing an administrative ruling in Peru, with effect in Peru and other Andean Pact countries, that Terra Networks, S.A. infringed the trademark of Santillana S.A. and prohibiting Terra Networks, S.A. from using the "Terra" name in connection with the marketing of certain goods and services. We are negotiating with Santillana S.A. with the hope of a successful resolution of the issue, while we pursue annulment of the ruling in court. We are aware of other companies using the Terra trademark or variations of that trademark; however, none of these uses is within our specific business or commercial area. If we are required to discontinue the use of any of our trademarks with respect to our current activities, we could lose the goodwill that we have established and may be held liable for damages.

In addition, Carnegie Mellon University has licensed a patent issued in the United States relating to our search and indexing technology to us on a perpetual basis. Although it has not occurred in the past five years, other parties may challenge this patent. If challenges are brought and are successful, the patent may be invalidated. Also, we cannot assure you that we will develop proprietary products or technologies that are patentable, that any issued patent will provide us with any competitive advantages or will not be challenged by third parties, or that the patents of others will not impair our ability to do business. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or services or obtain and use information that we regard as proprietary. The laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the United States. In addition, our means of protecting our proprietary rights may not be adequate. Further, our competitors may independently develop similar technology, duplicate our products or design around our intellectual property rights.

Our ability to use the Lycos trademark is restricted.

Lycos, Inc., our wholly-owned subsidiary, holds a perpetual, worldwide right to use and sub-license the Lycos trademark. Prior to our acquisition of Lycos, it sub-licensed the Lycos trademark to certain of its joint venture partners, including Lycos Europe. As a result, we are unable to use the Lycos trademark in Spain and in other countries where the sub-license has been granted on an exclusive basis without the authorization of such licensee. Lycos Europe currently uses the Lycos trademark in Spain and competes directly with us. In addition, licensees of the Lycos trademark could take actions that diminish the value of our proprietary rights or harm our reputation.

We face risks associated with litigation.

We are party to lawsuits and other legal proceedings in the ordinary course of our business. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs to us. In addition, our senior management may be required to devote substantial time to these lawsuits which they could otherwise devote to our business. For a more detailed description of these lawsuits, see “Item 8.A.—Legal Proceedings”

U.S. investors may be subject to unfavorable tax consequences if we are a passive foreign investment company.

U.S. investors may be subject to unfavorable tax consequences if we are a passive foreign investment company (a “PFIC”). PFIC status depends, as determined periodically, on the composition of a company’s income and assets and the fair market value of its assets (including, among others, goodwill and equity investments in less than 25% percent owned entities). Because our market capitalization did not increase during the year ended December 31, 2001 and a substantial amount of our assets was invested in cash and cash equivalents, including short-term financial instruments, we cannot provide any assurance that we were not a PFIC for that year. If we were a PFIC for that year, we are and will continue to be considered a PFIC with respect to any U.S. investors that owned our shares or ADSs in that year. If you are such a U.S. investor, you are subject to special U.S. federal income tax rules that may have negative consequences and require annual reporting. See “Item 10 —Additional Information—Taxation—United States tax considerations—Passive Foreign Investment Company rules.”

Item 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Overview

We are one of the most popular Internet networks in the United States, Europe and Asia and the leading portal to Spanish- and Portuguese-speaking markets. We are the result of the combination in October 2000 of Terra Networks, S.A., a global Internet company and the leading provider of Internet access and interactive content and services to the Spanish- and Portuguese-speaking world, and Lycos, Inc., the Internet’s leading multi-brand network. Through our unique platform, which combines the benefits of the convergence of Internet services and next-generation communications technologies with a broad and comprehensive array of popular products and services, we offer our users a compelling network of web brands and advertisers access to our large and diverse audience.

We offer a suite of Internet services in a variety of languages that provides our users throughout our core markets in Europe, Latin America, North America and Asia with:

- access to the Internet (in Spain and certain countries in Latin America);
- portal and network services that incorporate a wide variety of content individually-tailored for each market and featuring enhanced functionality;
- a range of online advertising, marketing and e-commerce opportunities; and
- multiple solutions for our customers’ Internet needs, such as web design and hosting and communication.

Our services complement each other, as customer growth in our Internet access business will benefit our portal and network services business, which in turn will benefit our online advertising and e-commerce businesses, which in turn will benefit our Internet solutions businesses.

Through our portals and network of separately-branded websites and joint venture partnerships, we have the largest global footprint of any Internet portal or network, with portals in 43 countries and more than 120 websites. We currently hold a leading position in the following markets: Spain, Latin America and the U.S. Hispanic market.

Through our joint ventures and other interests, we also hold a leading position in: Europe (Lycos Europe), Canada (Sympatico-Lycos), Asia (Lycos Asia) and Japan (Lycos Japan). We are also a leading interactive services provider in Spain and Latin America, offering Internet access and local-language interactive content and services to more than 4.3 million customers in Spain, Brazil, Mexico, Peru, Chile and Guatemala. In 2001, we were one of the leading broadband services and content providers in Spain, Brazil and Mexico.

Each network property offers distinct features and targets a specific web audience through unique programming and branding. Each of these leading properties also selectively integrates other key network services and technologies to best meet the needs of its constituency. Our network is composed of the following portals and websites, among others:

- Terra—a comprehensive portal offering Spanish- and Portuguese-speaking users a wide variety of local and global content and services.
- Lycos.com—a comprehensive portal which offers search and directory accompanied by deep vertical content.
- Angelfire.com—a personal publishing community, similar to Tripod, but with a focus on a younger age group.
- Bumeran.com—one of Latin America's leading job-search sites.
- Gamesville.com—an interactive gaming site featuring virtual card games, trivia quizzes and traditional games such as bingo which recently launched a games-on-demand service.
- Hotbot.com—a sophisticated search service that provides users the ability to perform advanced web searches.
- Invertia.com—a broad-based financial portal offering global solutions for personal finance with real-time information and tools.
- Lycos Finance—includes the portals Quote.com and Raging Bull which provide financial market data, news, research and discussion boards.
- LYCOS Zone—located at Lycoszone.com—a premier site offering children's educational and entertainment content.
- Matchmaker.com—an online dating service.
- Rumbo.com—a travel portal providing travelers the ability to research and purchase airline tickets and vacation packages and to book hotel accommodations and rental cars.
- Terra Mobile–a leading wireless Internet portal.
- Tripod.com—a personal publishing community, featuring quality user-generated content created through easy-to-use homepage building tools for beginners and experienced users.
- Webmonkey.com—a comprehensive site featuring information for professional and amateur web enthusiasts offering daily articles and technical updates.
- Wired News—located at wired.com—a daily news service offering reporting and analysis of technology trends.

Our unique multi-brand strategy recognizes that online demographics mirror society's demographics and therefore sites need to appeal to a broad variety of target audiences. Our multi-local/global approach to content distinguishes our services from most of the competing portal services in the market, and we believe this approach will be key to our success. Our content is presented in our users' local languages or idioms. In addition, we work closely with prominent local media and technology companies and integrate their knowledge and experience in the local market in order to broaden our offerings of localized versions of our products and services. We believe that our multi-local/global approach is a substantially more effective way to attract a large group of Internet portal users and to earn their repeat business. This will provide us with expanding opportunities to increase Internet access and portal traffic, and to offer superior online advertising solutions and build our e-commerce business.

We are a Spanish corporation (*sociedad anónima*) with our registered address at Calle Nicaragua, 54, 08029 Barcelona, Spain. Our principal executive offices are located at: Vía de las Dos Castillas, 33, Complejo Atica, Edificio 1, Pozuelo de Alarcón, 28224 Madrid, Spain; 400-2 Totten Pond Road, Waltham, MA 02451, U.S.A.; and Calle Nicaragua, 54, 08029 Barcelona, Spain. Our telephone numbers are (34) 91-452-3000, 1-781-370-2700 and (34) 93-493-2300; and our corporate Internet address is www.terralycos.com. Our agent for service of process in the United States is Lycos, Inc., which is located at 400-2 Totten Pond Road, Waltham, MA 02451.

History

We were incorporated in December 1998. The following timeline describes the significant milestones in the development of our Internet business:

April 1999	Telefónica, S.A. transferred to us its Spanish residential and SOHO Internet access business which it had conducted since December 1995. With this transfer, we took control of Telefónica's 72,000 residential and SOHO ISP customers in Spain.
April 1999	We acquired 100% of Ordenamientos de Links Especializados, S.L., known as Olé, from InfoSearch Holdings, S.A. Olé operated a portal in Spain.
June 1999	Through a series of transactions, we acquired 96% of Nutec Informática, S.A. We subsequently agreed to acquire the remaining 4% from its minority shareholders. With this acquisition, we acquired our Brazilian ISP and portal, including 200,000 residential and SOHO ISP customers.
October 1999	We agreed to acquire 100% of Información Selectiva, S.A. de C.V. through a series of transactions. With this acquisition, we acquired our Mexican ISP and portal, including 49,000 residential and SOHO ISP customers.
October 1999	We acquired 95% of the shares of Proveedora de Servicios de Conectividad, S.A., known as CTC Internet, the Internet subsidiary of Compañía de Teléfonos de Chile — Transmisiones Regionales S.A., known as CTC Mundo. As previously agreed, CTC Mundo delivered to us, at no additional cost, the remaining 5% of CTC Internet in December 1999. With this acquisition, we acquired our Chilean ISP and portal, including 74,000 residential and SOHO ISP customers.
November 1999	We completed our initial public offering of approximately 30% of our shares.
May 2000	We entered into strategic alliance agreements with Bertelsmann, one of the largest media companies in the world, pursuant to which Bertelsmann agreed to purchase content and services from us beginning in November 2000.
September 2000	We completed a €2.2 billion rights offering, substantially all of which was subscribed by Telefónica, S.A.

October 2000	We acquired 100% of Lycos, Inc. in a stock-for-stock exchange. Lycos, Inc. was formed in June 1995 by CMG@VENTURES, L.P., a wholly-owned subsidiary of CMGI, Inc. Lycos grew rapidly since its inception through a series of acquisitions of technology companies. With our acquisition of Lycos, Inc., we acquired the Internet's leading multi-brand network, transforming us into one of the most popular Internet networks in the United States, Europe and Asia.

Business Strategy

In 2001, we adopted our new business strategy and model in order to enhance our profitability. A key component of this strategy is to monetize our services by migrating customers from free services to value-added pay services such as multimedia content offerings through the implementation of the "Open, Basic and Premium" model across each of our businesses.

Access & Communication Services

We are progressively shifting away from free Internet access services to pay Internet access services such as subscription-based or pay-per-view and pay-per-use arrangements. In 2001, we discontinued providing free Internet access services in Brazil, and we discontinued providing free Internet access services in Mexico in January 2002. We intend to discontinue free Internet access services in other countries, as market conditions permit. As part of our strategy to migrate customers from free Internet access services to pay Internet access services, we are focusing on the provision of broadband services and content in Spain and Latin America, where the Telefónica group is engaging in the wide-scale deployment of asymmetric digital subscriber line (ADSL) technology. Broadband technologies, such as ADSL, offer high-speed connections to the Internet and allow users to access expanded multimedia content, including streaming music and other audio, full-motion video and interactive games. Together with our Media business, we are developing interactive content and services, including those adapted to the needs of ADSL users, that we may offer to our pay Internet access subscribers on an integrated basis. These products and services are offered to our customers on an "Open, Basic and Premium" basis pursuant to which all users may access the "Open" content and services for free, while customers must pay for "Basic" or "Premium" access products and services with differentiated or increased capacity and functionality. Thus, we seek to transform ourselves from simply an Internet access provider to a premium service provider.

Media

Our Media business unit is comprised of our advertising business, network properties and electronic commerce platforms. As part of our strategy to transition our customers from the use of free services to value-added pay services and to attract new paying customers, we have introduced and are continuing to develop new high-quality products and services, including premium services that take advantage of high-speed connections to the Internet. We seek to expand and improve our product and services portfolio to consolidate our position in certain market segments and to penetrate new segments. We intend to leverage our expanding user base to increase our advertising revenues. We also intend to focus on the provision of integrated marketing services to our advertising customers through the use of new advertising technologies, direct marketing and customer relationship management to enable us to deepen our relationships with our advertising customers and to leverage the strength and experience of our advertising sales force.

Terra Business

We created the Terra Business unit to focus on the creation of vertical value-added service channels through strategic alliances with leading companies across selected industries and product categories. We believe that participating along the entire e-commerce value-added chain will allow us to extract more value from these businesses than being solely an e-commerce platform provider and to leverage our user base and the know-how and infrastructure of our strategic partners.

B. BUSINESS OVERVIEW

OUR BUSINESS

In late 2001, we adopted a new organizational structure, consisting of the following three strategic business units: Access & Communication Services, Media and Terra Business. Although we have reorganized ourselves along these business units for administrative purposes, our management continues to analyze our revenues from operations by type of revenue, i.e., advertising revenues, access revenues, corporate services revenues, e-commerce revenues and other revenues. Each of these business units generates one or more of these different types of revenues.

ACCESS & COMMUNICATION SERVICES

At December 31, 2001, we provided Internet access services to over 4.3 million customers in Spain and Latin America. In addition, we hold an approximate 29.6% interest in Lycos Europe, which provided Internet access services to an additional 2.5 million customers throughout Europe at that date. We target residential and small office/home office, or SOHO, Internet users in Spain and Latin America. The SOHO market consists of businesses that use telephone lines to connect to the Internet, as opposed to dedicated lines, and is made up of small businesses (generally with fewer than 10 employees) and businesses conducted out of the home. Based on the number of subscribers in our target residential and SOHO markets, we believe we are currently one of the leading Internet access service provider, or ISP, in Spain, Chile, Peru and Central America and the second-ranking ISP in Brazil and Mexico. The table below sets forth the number of access subscribers we had in each country as of the dates indicated.

	At December 31,		
	1999	2000	2001
Spain	659,000	2,579,000	2,881,000
Brazil (1)	346,000	852,000	761,000
Mexico	82,000	375,000	383,000
Chile	118,000	233,000	226,000
United States (2)	44,000	N/A	N/A
Peru	62,000	58,000	80,000
Central America	6,000	7,000	16,000
Total	1,317,000	4,103,000	4,347,000

(1) Including customers under franchise agreement with local ISP providers.

(2) We no longer provide Internet access service in the United States.

We intend to leverage our ISP expertise by moving into new value-added services using the Internet protocol (IP). These value-added services may include, among others, voice and fax over IP and video streaming. In addition, we introduced ADSL access to the Internet in Spain and Brazil in 1999 and in Chile in December 2000. We also plan to offer ADSL access in other countries and seek to become a leading provider of broadband services and content.

Although we were created by Telefónica to focus on customers in the residential and SOHO markets, we have some customers in Brazil, Mexico, Chile and Guatemala who are part of the larger corporate market. Other Telefónica group members provide Internet access to corporate customers in Chile and Guatemala.

Product Line

We offer a broad range of Internet access products tailored to the needs of our customers and adapted to local market conditions. We continuously adapt our product line to market needs and competitive demands using data collected in our extensive market research efforts. We follow a strategy of market and client segmentation, and an active policy of migrating clients to higher levels of services. Each access product consists of an Internet connection service, using telephone dial-up or ADSL services and a set of communications services such as e-mail, personal web page and virtual hard disk. Our usual product configurations include:

Standard Access	This product usually consists of one e-mail account and between two and ten megabytes of disk space for a personal home page. In order to best satisfy customer needs and to adapt our standard access product to local market conditions, we offer different subscription methods for our standard access product, including, in most markets: • unlimited connection time for a fixed monthly subscription fee; • limited connection time (usually 5, 10 or 15 hours per month) for a fixed monthly subscription fee combined with a per-minute fee for time spent in excess of the limited connection time; • unlimited connection time for connections during certain hours of the day (typically from 8:00 P.M. to 8:00 A.M.) for a reduced monthly subscription fee; or • a per-minute fee without a fixed monthly subscription fee. We also offer in certain markets pre-paid access whereby customers pay in advance for a fixed number of minutes at a reduced rate.
Free Access	With this product, the customer pays no subscription fee, and is only charged by the telephone company for use of the phone line, plus fees for any value-added services the customer uses. We may receive traffic-inducement or traffic-related fees from the telephone company. The standard free access product usually includes one e-mail account and five megabytes of disk space for a typical personal home page. We currently offer free Internet access in Spain and Chile. As part of our shift towards pay Internet access services, we have discontinued providing this service in Brazil and Mexico. We may discontinue providing this service in other countries, as market conditions permit. In July 2000, limited flat rate access in Spain was introduced during the evening and on weekends and holidays. For a flat fee, users can make unlimited telephone calls to connect to our free access service during such specified times. In addition, in September 2000 limited flat rate access was introduced in Chile.
Professional and Family Access	We target SOHO customers with advanced features such as multiple e-mail accounts with large disk space capacity, multi-user access and higher file transfer speed. We also offer services to assist SOHO customers in creating their own e-commerce sites. The pricing for this product includes both subscription fees and value-added service fees. In some countries, we provide a special family access product. This product targets the family segment by offering specific features not included in other products such as a filtering service that blocks access to certain URL addresses. In addition, we plan to enable users of the family product to access some of our value-added sites without payment of an additional fee.

ADSL Access	In October 1999, we launched ADSL broadband Internet access in Spain. We also began to offer ADSL in Brazil in November 1999 on a limited basis and are currently offering it throughout Brazil wherever the local telephone company has the appropriate infrastructure available. We introduced this service in Chile in December 2000 and are planing to offer it in other countries. Our ADSL products consist of Internet access with speeds of 256 Kbps, 512 Kbps and 2 Mbps and a series of value-added services such as virtual private networks (not available in Spain), network storage and access to "walled garden" content. We plan to expand our broadband content offerings.

Access Revenues

Our Internet access products generate one or a combination of the following sources of revenue for us:

- subscription fees;
- traffic-inducement fees (we began earning traffic-inducement fees in Spain in October 1999, in Guatemala in May 2000 and in El Salvador in July 2000, and traffic-related fees in Chile and Mexico in the first quarter of 2000); and
- value-added service fees.

We have the opportunity to earn additional fees for features that can be added to our basic Internet access service, including:

- filtering capabilities, which allow businesses to block access to certain URL addresses, and are currently available in Chile and Mexico; and
- roaming, which allows a customer to access the Internet while in another country for the price of a local telephone call. We provide international roaming in Brazil, throughout more than 50 cities in Mexico, and through I-Pass, a roaming services provider, in Guatemala and in Chile.

We plan to extend most value-added services we offer and to increase the range of these value-added services to include:

- extended messaging capabilities and capacities (enhanced e-mail and unified messaging boxes, alert-enabled systems including short-message capabilities to mobile phones, etc.);
- voice, fax and video over IP services;
- enhanced online storage services; and
- video streaming for real-time events as well as on demand.

As part of our strategy to migrate our users to pay services, we plan to charge a subscription fee (or a per-use fee) for some of these services, or for some extended capabilities that they might have. In some cases this subscription fee might be included in an access-plus-services or services-only package, and in other cases it might be offered individually or as a premium service.

Infrastructure and Customer Support

Infrastructure

We provide our customers with advanced technology infrastructure to make our Internet access services reliable, secure and efficient. Customers connect to our Internet access services with dial-up (metered or flat rate) and ADSL connections through local telecommunications service providers in the countries in which we operate. Telefónica group companies operate local telecommunications service providers in Spain, Brazil, Peru and Chile, although customers can connect to our ISPs using competing local service providers. Through points of presence, or POPs, our customers connect to data centers that house our servers, which are connected via leased lines to the Internet. In Spain, Peru and Chile, we lease our data network, including POPs and Internet connectivity links, from members of the Telefónica group. In Mexico and El Salvador, we own POPs, and in Guatemala and Brazil we own and lease POPs from local technology partners. In both Brazil and Mexico, we lease Internet connectivity lines from local operators. In Spain, Peru and Chile, we share our leased POPs with other ISPs. We are the exclusive users of our owned POPs. With our extensive network of POPs, most of our customers can use our services to connect to the Internet with a local call.

We own all of our servers, which route user traffic to its final destination. Our servers are housed in data centers in major cities in the countries in which we operate. These data centers are owned and operated by local technology partners.

We believe the telephony infrastructure in the countries where we currently operate is sufficient to accommodate our business and our anticipated growth.

The following table summarizes the ownership of our technology infrastructure and the percentage of each country's population that can use our services to connect to the Internet with a local call at December 31, 2001.

	Connection to Data Network	Data Centers	Approximate Percentage of Population Covered by Local Call
Spain	160 leased POPs	1 data center located in Madrid and operated by Terra Networks, S.A.	100%
Brazil	78 owned POPs 385 leased POPs	2 data centers located in Porto Alegre and São Paulo and operated by Terra Networks, S.A.	75%
Mexico	44 owned POPs	2 data centers located in Monterrey and Mexico, D.F. operated by Terra Networks, S.A.	90%
Peru	24 leased POPs	1 data center located in Lima and operated by the Telefónica group	100%
Chile	60 leased POPs	1 data center located in Santiago and operated by the Telefónica group	90%
Guatemala	1 leased POPs 1 owned POPs	1 data center operated by Terra Networks, S.A.	20%

	Connection to Data Network	Data Centers	Approximate Percentage of Population Covered by Local Call
El Salvador	1 owned POPs	1 data center operated by Terra Networks, S.A.	40%

We monitor our network, services and applications at all times. We operate platforms in Brazil and Mexico in order to supervise our data networks, servers and systems that are used in connection with our Internet access services. In Spain, Peru, Guatemala and Chile we rely on members of the Telefónica group to supervise network operations and provide us with virtually constant feedback. Our close involvement in our infrastructure allows us to maintain a strong local presence and to better serve our customers. We rely on the operators of our data centers to ensure the physical integrity of our servers against fire, flood and, where appropriate, earthquakes, and each data center is equipped with backup electrical service provided by its own on-site generators. In addition, all of our data centers are equipped with access control systems.

Customer Support

We maintain customer support facilities in each country where we operate an ISP. Our customer support is available 24 hours a day, 7 days a week in Brazil, Mexico and Spain and during business hours in Central America and Peru. Our support facilities handle multiple account issues for our customers, ranging from initial sales and sign-up to technical support and account administration. Our facilities maintain databases that allow customer support staff to track purchase history, payment history, caller history and contact history, and report, analyze and solve technical issues in an efficient and organized manner. We maintain lists of frequently asked questions in order to respond to common queries.

We also offer Internet-based online self-help and e-mail management. Most questions come from new users, and an online list of frequently asked questions allows our customer service representatives to address a large number of new users' questions efficiently. In Brazil and Mexico, for example, our customers are able to access their accounts online and change their service plans. New customers can subscribe to our service online.

We outsource most of our customer support facilities related to our Internet access business to Atento Holdings, S.A., a member of the Telefónica group. We expect that this outsourcing will enable us to be cost-efficient without sacrificing quality of service.

Competition

The principal markets in which we currently offer Internet access services are Spain, Brazil and Mexico. We believe that our ability to compete successfully in the Internet access market in these countries depends on a number of factors including:

- developing new access means such as broadband and wireless;
- reducing acquisition costs through our portals and expanding our customer knowledge;
- leveraging the Telefónica group's market knowledge;
- our ability to use the Telefónica group as an infrastructure partner to guarantee the quality of our services; and
- the integration of Internet access and portal offerings; and
- developing our brand name.

In Spain, we compete primarily with full-service telecommunications operators that offer Internet access services. In Latin America, we compete with local and global ISPs as well as cable operators in some markets such as Brazil. In each of our markets, we also compete more broadly for subscription revenues and customer usage with cable, information, entertainment and media companies. Our principal competitors in our main markets include:

Country	Access Provider
Spain	Eresmas (Retevisión), Ya.com (Deutsche Telekom), Wanadoo (Uni2), Telefónica de España
Brazil	Universo Online, Brasil Telecom, IG, AOLA
Mexico	Prodigy (Telmex), IFX, PSI Net, AOLA

Terra Mobile

Terra Mobile was initially formed in July 2000 as a joint venture between us, with a 49% interest, and Telefónica Móviles, with a 51% interest, to create a major wireless Internet portal under the Terra brand name. A wireless Internet portal is an Internet portal created and configured specifically for access through different types of wireless handsets such as mobile phones and personal digital assistants. Using Terra Mobile's wireless Internet portal, we envision that users will be able to access a wide variety of m-commerce (i.e., e-commerce carried out through a handset), business, entertainment and information services. Customers will be able to send e-mail, schedule meetings, bank, pay bills, send and receive faxes, shop, play games, browse freely on the Internet, or be told where to find the nearest place to their current location to perform these tasks. Terra Mobile will also seek to develop location-based services, which are unique to wireless services, in which information about a customer's geographic location can be immediately accessed to provide directory assistance, nearby entertainment and dining alternatives and other applications.

Terra Mobile launched its initial portal in September 2000 in Spain. In October 2001, Terra Mobile transitioned from its initial business model to a new one focused on:

- offering products and services and developing applications that take greater advantage of synergies with wireless networks; and
- significantly reducing fixed costs.

In addition, Terra Mobile reorganized its global structure to concentrate its European operations on markets with larger customer bases and discontinued operations in certain smaller markets. It also reduced its headcount by 57%.

In view of Terra Mobile's new business model, which is more focused on technological development related to wireless networks, and Telefónica Móviles' efforts to develop new wireless Internet applications, we and Telefónica Móviles adjusted our relative ownership interests, as a result of which Telefónica Móviles currently holds an 80% interest in Terra Mobile while we hold a 20% interest. We also entered into a put/call arrangement with Telefónica Móviles pursuant to which we may elect or be required to increase our ownership interest in Terra Mobile to 49%. See "Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Contractual Obligations and Commercial Commitments".

MEDIA

Portal and Network Services

We currently operate portals and our network of separately-branded websites in 43 countries throughout Europe, Latin America, North America and Asia. In December 2001, our average daily page views for the Terra Networks group exceeded 500 million and the number of unique monthly visitors was 111 million.

We have built our portal and network services through strategic acquisitions in Spain, Brazil, Mexico, Argentina, Venezuela, Colombia and the United States, and have created our own portals in the other markets we serve. The table below shows the dates on which we acquired or launched our principal portals and network of sites.

Portal/Network of Sites	Date Acquired or Launched
Terra Spain	April 1999
Terra Brazil	June 1999
Terra Chile	October 1999
Terra Mexico	October 1999
Terra Peru	October 1999
Terra Argentina	September 1999
Terra United States	January 2000
Terra Central America(1)	March 2000
Terra Venezuela	April 2000
Terra Uruguay	June 2000
Terra Colombia	July 2000
Lycos Network of Sites	October 2000
Terra Caribbean(2)	May 2001

(1) Includes portals in Guatemala, El Salvador, Panama, Costa Rica, Nicaragua and Honduras.

(2) Includes portal in the Dominican Republic only.

Our multi-local/global model allows us to create an Internet "home" for our users and transforms our portals into the final Internet destination for many of our users. We believe that our multi-local/global model is instrumental in differentiating our portals from competitors. We complement our portals with our network of separately-branded websites.

Our Portals

Portal Content

We design each of our portals as a one-stop gateway where both content and advertising reflect the specific country's culture, languages and tastes. Our portals offer a broad range of functionality, which we believe is instrumental in enabling users to build online communities organized around topics or areas of interest. Being part of an online community encourages a user to contribute actively to the dialogue and content within the community, and therefore enriches the user's online experience. We believe that fostering online communities will encourage users to spend more time in our portals and to return to our portals repeatedly. This in turn will make our portals attractive to Internet advertisers. Our portals offer or we expect they will offer services such as:

Directories and yellow pages	We offer online directories and yellow pages to our users in partnership with Telefónica Publicidad e Información, a member of the Telefónica group.
Free e-mail	We offer free e-mail services to registered users.
Instant messaging	This service allows our users to quickly exchange messages with their online friends.
Online communities and chat	These services create online communities where users can interact in group or one-on-one discussions.

Personal pages	This service allows our users to build their own personal page.
Search engines	We provide our users with powerful and sophisticated search capabilities to carry out extensive searches in our portals.
Shopping	This service allows our users to research and purchase products and services online.
Software downloads	This service allows our users to search for and download computer software.
Unified messaging	This service handles voice messages and e-mail messages through a website.
Virtual disk	This free service gives our users storage space on the Internet that can be accessed anywhere, anytime.
Voice over IP	This service allows our users to make calls through the Internet rather than through a conventional telephone.
Web fax	This service allows our users to send messages from their personal computer to a fax machine.
Wireless alerts	This service provides content to devices such as wireless handsets.

In addition to these services, our portals also include a number of channels that feature content grouped around a common theme. A particular channel may feature local content, global content, or a mixture of the two. Some of the channels our portals typically feature include:

Art and Culture	News, books, releases and literary articles on art and culture.
Computing	Access to a large number of public domain and “shareware” software programs that users can transfer to their own disks, as well as links to hardware and software vendors.
Current events	Current events and other information as they occur.
Education	Information on courses, schools and new developments.
Employment	Information on opportunities in the job market.
Finance	Market news, research reports and an online investment portal.
Games	Downloadable and online games (including games on demand), tricks and batches of popular video games.
Home and family	News related to family issues, health and fashion, including a wide range of links to fashion websites.
Internet	News regarding Internet business and legal issues, and virtual communities for users interested in Internet-related topics.

Leisure	A wide range of news and articles related to music, television and tourism.
Media and Marketing	News and information about journalism, marketing and the media business.
Music	Music content and information, as well as downloadable music.
News and Media	Breaking news.
Sports	Local and global sport news and information including results, commentary and analysis.
Teens	Information and services targeted to the teenage audience, including jokes, chats and bulletin boards.
Tourism	Information and services regarding popular places to visit.

Content Partnerships

Our network of third-party content providers is a crucial element of our multi-local/global portal model. We have arrangements with leading local and international content providers in order to offer rich and varied content across our portal network.

Some of our content providers include:

Agencia EFE	News
AP	News
BMG	Music
Buena Vista (Disney Blast)	Entertainment
Business Week	Financial news
Copesa	News and lifestyle
Dow Jones	Financial information
Fox Sports	Sports news and information
France Presse	News and financial news
Grupo Reforma	Local news and information from Mexico
Healtheon/WebMD and Medicus Media (Medicina news)	Health-related information
Istoé	News and financial news
Reuters	News and financial news (executed for our Spanish and Latin American portals)

Standard & Poors	Financial information
TVN	News and lifestyle
Weather Channel	Weather

Community-Generated Content

In addition to content provided by third parties, all of our portals feature community-generated content through services such as Tripod, Angelfire, Almas Gemelas (personal ads in Brazil), LimaLimón (personal ads in Mexico), Comunidades Virtuales (online communities), Bolsas de Trabajo (job markets) and Encuestas (opinion polls). Community-generated content strengthens the local character of each of our portals and reinforces our strategy of providing information and services that are relevant to our users' daily lives.

Our Network

Our network attracts a broad demographic base of Internet users through independently-branded websites, each of which seeks to address different interests and needs. Although users typically access our network for specific content through one of our separately-branded sites, they are encouraged to remain in the network by the breadth of our offerings and the easy navigation among our sites.

We encourage users to remain within our network through the use of links, promotions, shared content and banner advertisements that feature our other network properties. For example, when a user conducts a search using the Lycos.com search service, we offer the user the opportunity to perform the same search using our HotBot service with one click. Through integration and cross-promotion of our network of websites, we intend to increase the frequency and length of user visits.

We believe that our network strategy enables us to appeal to a large and an increasingly diverse Internet audience. As a result, our network provides an attractive medium for advertisers who seek to perform broad or targeted advertising as well as for online merchants.

Products and Services

We offer a comprehensive suite of online products and services. Our principal offerings are described below.

Premier Navigation Functionality. We offer our users the ability to quickly and easily find and access text, audio, video and other rich media content on the web. Our primary navigation products include:

- *Search*—We offer two general search services–HotBot and Lycos Search. HotBot is designed for a sophisticated user while Lycos Search appeals to a mainstream user. Since many users enter the Internet through search services, Lycos and HotBot generate a significant portion of our network traffic. We also offer our users Lycos Rich Media Search, which enables them to find, download and listen to various music, audio and video formats such as MP3.

- *Guides and Directories*—We provide our users with an easy-to-use framework to efficiently explore the Internet through a series of guides and directories. Our topic-based WebGuides provide categorized areas of interest that enable users to browse through related information. We also offer a version of AOL's Open Directory, which is a collection of websites organized by volunteer editors who have significant interest and expertise in the topics to which they contribute. The Open Directory compiles highly relevant links in an easy to navigate database.

- *Reference Services*—We provide a suite of products for our users to locate other individuals, businesses, products and places. WhoWhere?, a home address, e-mail address and telephone number directory, assists users in locating individuals worldwide. Other principal reference services offered by us include a yellow pages product, which allows users to locate businesses throughout the United States by searching according to category, business name, business address or keyword; Lycos Classifieds, which gives users a convenient way to find where to buy and sell goods and services online; and Lycos RoadMaps, which allows users to obtain driving directions and maps to virtually any street address in the United States.

Online Community Products. We provide a number of services to allow our users to create and actively manage communities around topics that interest them. We believe that users who become involved with online community products and services are more likely to return to those sites in the future. Consequently, we seek to develop an active, loyal user base by building significant community features into our network through the following online products:

- *Personal Publishing*—Through our Angelfire and Tripod services, which together comprise one of the web's largest online communities, we offer users the online publishing tools necessary to create and publish their own personal homepages. The simplest pages can be created and published in minutes, yet the tools provided allow a user, without any programming skills, to create a "professional-looking" site that incorporates photos, images, graphics, audio and video files, and a guestbook. Through what are commonly known as "affiliate programs", users also can create links to e-commerce sites and earn credit towards purchases by referring visitors to those e-commerce sites.

- *Clubs*—Lycos Clubs (clubs.lycos.com) offers users the ability to create their own topic-based clubs enhanced by features such as instant messaging, e-mail, paging, chat and photo albums that are seamlessly integrated into each club. Instead of leaving a club to use these features, club members can instantly communicate from within the club. A creator of a club can open the club to the general public or can restrict access to a particular group of users by requiring a password.

- *E-mail/Instant Messaging*—Through our MailCity product, we offer users a free, personalized web-based e-mail account which can be accessed from any computer with an Internet connection. Since MailCity users do not need to change their e-mail addresses when they move or change Internet service providers, the same e-mail address can be used indefinitely. In addition, in an alliance with AOL Time Warner, we launched the Lycos Instant Messenger service (messenger.lycos.com), enabling our users to communicate instantly with each other and with AOL Time Warner members.

- *Chat and Bulletin Boards*—We offer users the opportunity to participate in online chat sessions, in which users can interact, in real time, with multiple users from all over the world. Lycos Chat (chat.lycos.com) regularly features hosted chats with celebrities and experts on topics of interest to our users. Lycos Bulletin Board (boards.lycos.com) allows users to post messages to existing message threads or create a new thread by posting a message on a topic or topics of the user's choice.

Portal and Network Joint Ventures

In connection with Lycos' international expansion prior to our acquisition of the company in October 2000, Lycos sought to broaden its offerings of localized versions of its products and services to users outside the United States by partnering with prominent local media and technology companies. Our international joint venture partnerships include the following.

Lycos Europe

In May 1997, Lycos entered into a joint venture agreement with Bertelsmann Internet Services to create localized versions of the Lycos search and navigation throughout Europe. Lycos subsequently licensed its Angelfire, Tripod, Hotbot, Sonique and MyLycos properties to Lycos Europe. This joint venture, named Lycos Europe, was approximately 29.6%-owned by us at December 31, 2001. At that date, Lycos' joint venture partners, who collectively own approximately 29.6% of Lycos Europe, are Bertelsmann Internet Holding GmbH, Christoph Mohn Internet Holding GmbH and Fireball Internet GmbH. Approximately 8.3% of Lycos Europe's shares were issued pursuant to an initial public offering completed in March 2000. Lycos Europe currently operates localized versions of the Lycos.com and Tripod sites in Belgium, Denmark, France, Germany, Italy, The Netherlands, Norway, Spain, Sweden, Switzerland and the United Kingdom. On May 16, 2000 Terra Networks entered into a letter of intent regarding Terra Networks' possible acquisition of Bertelsmann's approximately 20% interest in Lycos Europe after May 1, 2003.

On September 20, 2000, Lycos Europe signed an agreement to acquire all of the outstanding share capital of Spray Network N.V. in exchange for 84,300,000 shares of Lycos Europe. Spray Network N.V. operates an Internet new media company that offers a branded network of media, commerce and communications products and services throughout Europe.

In November 2000, Lycos Europe announced the acquisition of MultiMania, a leading French online community site, in exchange for 22 million shares of Lycos Europe. Following the consummation of this acquisition in January 2001, Lycos Europe held approximately 93.8% of MultiMania's share capital. Since February 2001, Lycos Europe has also been listed on the Nouveau Marché of the Paris Stock Exchange.

Lycos Japan

In March 1998, Lycos established Lycos Japan KK as the basis for a joint venture to promote and operate a Japanese version of the Tripod and MailCity website. Lycos' joint venture partners are Sumitomo Corporation, one of the largest companies in Japan, Internet Initiative Japan, one of Japan's largest Internet service providers, and Kadokawa, a major Japanese publisher. As of April 2002, we beneficially own approximately 45.8% of the joint venture.

Lycos Korea

In March 1999, Lycos established Lycos Korea to promote localized versions of the Lycos and Tripod websites. Lycos' joint venture partner is Mirae Corporation, a prominent South Korean high-technology company. In June 2002, we entered into an agreement to sell our stake in Lycos Korea.

Lycos Asia

In September 1999, Lycos established Lycos Asia to promote localized versions of the Lycos and Tripod website in more than 10 countries in Asia, including Singapore, China, Taiwan, Hong Kong, India, Malaysia, the Phillippines, Thailand and Indonesia . Lycos' joint venture partner is Singapore Telecommunications, and we each own 50% of the joint venture.

Sympatico-Lycos

In February 2000, Lycos launched Sympatico-Lycos, Inc., a Canadian company, to promote localized versions of the Lycos Network websites. Lycos' joint venture partner is Bell GlobeMedia, a prominent online communications company in Canada. We own 29% of the joint venture.

Strategic Alliance with Bertelsmann

Bertelsmann, one of the largest media companies in the world, owns literary, scientific and non-fiction publishers, book and music clubs, daily newspapers, general and special interest magazines, music and film companies, radio and television activities, print shops, service corporations and online services providers. Bertelsmann's brands include Random House, BMG and Arista.

In connection with our agreement in May 2000 to acquire Lycos, Terra Networks, Telefónica and Bertelsmann entered into strategic alliance agreements pursuant to which Bertelsmann agreed to pay $325 million for services (on terms no worse than terms provided to third parties) during the first and second years from the date of the combination of Terra Networks and Lycos. During the third, fourth and fifth years after the date of such combination, Bertelsmann has agreed to purchase up to $675 million of services from us. Telefónica has agreed to purchase, if necessary, any portion of those services that Bertelsmann does not buy, up to $675 million.

In 2001, Bertelsmann purchased €160 million in services from us, including advertising for Bertelsmann's different products and services and premier placement for Bertelsmann's e-commerce properties such as barnesandnoble.com. and CDNOW on our portals and network of sites. During 2001, Bertelsmann was our single largest advertiser, accounting for approximately 39% of our total advertising revenues. In addition, as part of our strategic alliance, we have collaborated on a variety of partnership initiatives, including, among others:

- the deployment of state-of-the-art next-generation HTML products;
- the use of Opinion Minders survey technology to better understand how our users respond to various Bertelsmann products and services;
- direct marketing in the United States, Spain and Latin America to promote Bertelsmann's book and music clubs;
- online campaigns to promote magazine subscriptions for Bertelsmann's Gruner + Jahr publications;
- the promotion of Bertelsmann's BMG music group's artists on our portals and network of sites, including the creation of featured artist pages;
- co-advertising on television;
- product and website development, including the development of "The Price is Right" online game show for Bertelsmann's affiliate, Fremantle Media, and the development of online magazines for Gruner + Jahr in Spain;
- the utilization of Lycos' usability laboratory to test the efficacy and appeal to consumers of certain BMG products; and
- sweepstakes offerings and other special promotions.

We also obtain content and services from Bertelsmann, including music content from Bertelsmann's BMG music division and digital rights management (DRM) technology which allows us to place restrictions on the use of downloadable music.

In addition to the strategic alliance agreements, in May 2000, we entered into a letter of intent with Bertelsmann regarding the possible acquisition by us of Bertelsmann's approximately 20% stake in Lycos Europe, N.V. after May 1, 2003.

Other Strategic and Commercial Alliances

To increase traffic on our portals and network of sites and to enhance the functionality of our products and services and to extend our brands, we seek to enter into selected strategic and commercial alliances with business partners who offer content, distribution and technology capabilities as well as marketing and cross-promotional opportunities. Some of the strategic and commercial alliances that we have entered into include the following areas.

Auction Services

In February 2001, we entered into a strategic alliance with eBay for it to be the premier provider of auction services to Lycos users in the United States. As part of the agreement, Lycos users will be able to list and bid on items for auction on eBay. In addition, Lycos Europe has entered into a strategic alliance with eBay to be the premier provider of auction services to Lycos Europe's users in Germany, France and Italy. We also hold a minority stake in Deremate.com, one of Latin America's leading online auction websites.

Career Management Services

Recognizing that online career management is one of the fastest growing uses of the web, we have aggressively positioned ourselves via multiple partnerships with the leading providers of key career management services. Multiple partnerships in this area make it possible for us to provide a well-rounded and complete consumer offering, while maximizing our ability to generate revenue. These strategic alliances include:

Headhunter – In September 2000, we formed a strategic alliance with Headhunter.net to provide full-time career management services for the Lycos Career Marketplace. Together with Headhunter, we have made co-branded full-time job search functionality as well as resume posting and listing services available to our network of users. Additionally, the relationship provides co-branded access to helpful career advice. We receive fees from Headhunter for access to the Lycos network user base and discounted use of Headhunter's services for our recruiting purposes.

Net-Temps – In October 2000, we entered into a strategic alliance with Net-Temps, a leading provider of temporary and part-time career management services, to provide online access to such services via the Lycos Career Marketplace. The relationship makes it possible for Lycos users seeking part-time or temporary work to search listings from companies across the United States. In addition to job search, the co-branded environment provides content that addresses the unique career management needs associated with part-time and temporary work.

Delivery of Merchandise

In November 2001, we launched *Compras en USA*, a new service designed to facilitate online purchases from U.S. merchants by consumers outside the United States. We have made this service available and are actively promoting it throughout Latin America and in Spain. This service enables Latin American and Spanish consumers to utilize a post office box in the United States in order to receive merchandise from U.S. retailers, including retailers who do not ship goods to consumers outside the United States. Our service will then forward the goods to the consumer. In connection with this service, we entered into an agreement with LanBox, a subsidiary of LanChile, S.A., a Chilean airline, which has experience in managing post office boxes and delivering goods throughout Latin America and Spain.

Featured Listing

In November 2000, we entered into a strategic alliance with GoTo.com (subsequently renamed Overture.com) to enhance and further monetize the Lycos and Hotbot search offering by featuring pay-for-placement listings. This relationship provides for featured listings from Overtures' search results to be displayed to Lycos users. As these results are especially successful and relevant to e-commerce search terms, access to an expanded list of Overture results is provided on these terms. The result is a complete offering of search options for Lycos Network users along with a more complete monetization of search traffic.

Secure Online Payments

In July 2001, we entered into a sponsorship and promotional agreement with Visa International Service Association to leverage our brands in order to promote the benefits of making online purchases. Under the terms of the agreement, Visa will receive special positioning on Terra Networks portals in Latin America and the Caribbean which will promote Visa as the preferred payment method for secure electronic transactions.

Sports

In January 2002, we entered into a content, sales and marketing alliance with FOXSports.com, one of the world's leading sports websites, pursuant to which we intend to develop jointly and sell integrated media sales and sponsorship packages, subscription services, direct marketing programs and special event promotions. FOXSports.com powered by Lycos (foxsports.lycos.com) was made the premier sports destination on the Lycos network, with positioning on the Lycos.com homepage and content integration throughout the Lycos network. Fox Sports television networks will, in turn, provide on-air marketing exposure for Lycos on the various Fox Sports television networks.

Yellow Pages

In May 2000, we entered into a strategic alliance with Verizon Super Pages for it to be the exclusive provider of online business yellow pages listings on the Lycos Network. This relationship makes a private-labeled Lycos Yellow Pages service available to users of the network to permit simple and detailed searches of business listings in every category of business by geography across the United States.

Strategic Investments

We have investments in various Internet businesses. These businesses represent a source for new opportunities for future growth and creation of shareholder value. We intend to apply our existing commercial and technological knowledge to maximize value creation in new ventures by actively participating in their operation, by contributing personnel and technology resources. In addition to our individual investments, we plan to partner with other leading venture capital firms in order to make certain other strategic investments.

Our investment philosophy is guided by our desire to identify Internet businesses that:

- provide us with competitive advantages;
- enable us to position ourselves as a leader in existing and new markets;
- offer the potential for attractive returns on our investments; and
- may be leveraged on our global presence, our strategic partners and our user base.

Portal and Network Services Revenues

Our portal and network services business earns revenues principally from advertisers. The global reach of our portals and network, combined with our ability to segment and target our audience, provides advertisers with an attractive platform to promote their goods and services in a measurable, targeted and cost-effective manner. We host and serve advertising, and also strategically direct Internet traffic to websites designed, maintained or promoted on our network. We strive to be more than a seller of advertising space. Instead, we position ourselves as a solution provider with global reach, but with a strong local focus. This allows us to attract advertisers with international and local advertising needs, as well as advertisers with purely local needs. In addition, the wide variety of content and services available on our network enables advertisers to focus their promotional efforts on our network sites most relevant to their product or service offerings. Our strategy is further reinforced by our global sales force with offices or representatives in every country in which we operate. All sales offices can book advertising for any of our portals or websites. For example, a Spanish advertiser interested in reaching the Mexican market can book advertising for our Mexican portal through our office in Madrid.

In addition, our portal and network services business has strong synergies with our Internet access, e-commerce, advertising and Internet solutions businesses. We encourage portal and network users to become

Internet access customers, and we drive portal and network traffic to our e-commerce sites. Our e-commerce activities in turn help us attract advertisers, who are able to reach consumers at the exact moment they are ready to buy. We believe success in our e-commerce and advertising businesses will attract companies that seek to use our Internet solution services, such as web design and hosting.

We derive advertising revenues principally from:

- advertising arrangements, under which we earn revenues mainly based on a cost-per-thousand-impressions basis, a guaranteed number of impressions or the number of days an advertisement is displayed;
- contracts targeted to a particular audience or user, either in connection with one of our topical WebGuides or in connection with specified word searches (for example, when "automobile" is searched, an automotive or car manufacturer advertisement appears); and
- sponsorship arrangements, under which we earn revenues based on the number of impressions delivered or days the sponsorship is displayed, plus exclusivity fees for displaying advertisements only from our sponsor in the particular product category. We may in addition earn revenues for helping the sponsor design and customize the campaign for our users.

We provide advertisers with a variety of different advertising options, including:

- traditional banner advertising;
- banner advertising with enhancements, such as audio and video;
- pop-up windows;
- contextual link advertising;
- sponsorship;
- integrated advertising;
- direct marketing;
- e-mail advertising;
- text links;
- keywords; and
- demographic targeting.

In January 2002, we entered into a five-year agreement with DoubleClick to use its ad serving tools, which enable us to serve advertising on our network. This agreement supersedes prior agreements entered with DoubleClick by Terra Networks and Lycos. In addition to this agreement, we also entered into a two-year agreement with DoubleClick for e-mail advertising services.

Although we attract advertisers by offering a variety of competitive products, we work to retain them with excellent service. In order to provide the best service to our advertising clients, we provide advertisers with detailed and timely information on their target markets and the effectiveness of their campaigns, and with recommendations on how to improve their campaigns. To facilitate these services, we provide advertisers with online reports showing impressions (an impression is a one-on-one view of an advertisement by the end user) and the number of times users "click through" an advertisement to visit the advertiser's site.

We have built a dedicated advertising client service team that focuses on maintaining close relationships with major advertisers and leading advertising agencies throughout our core markets. This team is focused solely on selling advertising on our portal and website network. We have hired a significant number of our sales force from the advertising industry because we believe that an experienced sales force is critical to initiate and maintain relationships with advertisers and advertising agencies. Our sales team is complemented by our telemarketing department, since many accounts can be more efficiently serviced by telephone and e-mail.

Our efforts have attracted local and global advertisers such as:

- ABN AMRO
- American Express
- Audi
- Banco Bilbao Vizcaya Argentaria
- Banco Santander Central Hispano
- Bankinter
- Bell Atlantic
- BMG Music
- BMG Music Club
- Bradesco
- Carrefour
- CDnow
- Chrysler
- Coca-Cola
- Compaq Computer
- Daimler Chrysler
- Dell Computer
- Ford
- General Motors
- Hewlett-Packard
- Iberia
- IBM
- Intel
- Johnson & Johnson
- Kodak
- MasterCard
- Melia Viajes
- Motorola
- Nestlé
- Nokia
- Oracle
- Patagon
- Petrobrás
- Random House
- Renault
- SAP
- Sears
- Siemens
- Sony
- Unibanco
- Visa
- Volkswagen

Marketing and Brand Awareness

Our marketing efforts are designed to help us increase our customer base and consolidate our leadership in our target markets. Our marketing campaigns principally target the residential and SOHO markets, as well as advertisers and vendors. Central to our marketing efforts are the following strategies:

- actively participate in the development of portal and ISP markets;
- continuously expand our network, portal and ISP customer base and achieve strong user loyalty;
- create large communities of users of our local portals and websites;
- aggressively build our brand names; and
- rapidly respond to market changes by introducing new products, services and content offerings.

Develop Portal and ISP Markets

We actively participate in developing portal and ISP markets in Latin America, Spain and the United States. We conduct extensive market research in order to understand the needs of users in particular markets. We believe that people will come to associate our brands with the Internet through our efforts.

Expand Our Portal, Network and ISP Customer Base and Achieve Strong User Loyalty

We design our local marketing efforts to introduce the use of the Internet into the everyday lives of our potential customers. We believe that our marketing campaigns, affordable pricing, dedicated customer service and strong local presence will help us attract new customers. In addition, we actively exploit synergies between our

Internet access business and our portal business by configuring our portals as the default web page in all of our ISP connection software.

We plan to continue to commit substantial resources to building strong user loyalty. In order to retain existing customers, we will work to ensure that our portal and network services are the most competitive in the market, and we will adapt our portal and website offerings according to our customers' demands. We are committed to ensuring that our customers receive every day the information that they need.

Create Large Communities of Users of our Local Portals and Websites

We are working to build large communities of local portal and website users within certain of our core markets, including Spain, Latin America and the United States. We believe that we will be able to attract new users to our portals and websites with our strong brand names, and will build on the strength of our brand names to help make the Terra and Lycos brands among the most recognized portal and network brands in the world. We seek to create strong communities by:

- encouraging a sense of community among users by allowing users to create and share their own content;
- creating brand loyalty; and
- improving our advertising and e-commerce offerings by using our data warehousing capabilities to profile the interest and habits of our users.

We also seek to develop an active, loyal user base by building significant community features into our network through our comprehensive suite of online services and products. We believe that users who become involved with our online community products and services are more likely to return to those sites in the future.

Aggressively Build Our Brands

We believe that building our brands is essential to attract, retain and obtain revenue from our potential Internet user base, and we plan to aggressively build our brand names. We use advertising and public relations to build our brands, including advertising on radio, newspapers, television, online and public billboards, direct marketing, public relations, interactive ads and special ads. Through our advertising efforts, we seek to:

- introduce potential customers to our brands;
- identify our brands with the highest quality products, services and customer support; and
- build a strong media presence.

Rapidly Respond to Market Changes

We believe that responding quickly to changes in the Internet market will keep our brands competitive. We plan to continue to enter into new strategic alliances with local and global content providers to introduce new products to market in the shortest amount of time. To this end, we seek to enter into alliances with global partners who can contribute state-of-the-art technologies to our operations.

Infrastructure and Customer Support

We support our portal and network services with our proprietary servers. Our scalable network architecture is redundant and fully-distributed, which enables several servers to support one service. In this way, we help ensure that our customers' page views will not be interrupted upon server failure. We employ high levels of security, including hardened servers and firewalls to protect against intrusion.

Our network architecture is structured with sets of front-end web servers and back-end data and content servers that handle high user traffic and large volumes of information. Our front-end servers employ load balancing systems to manage users' requests, enabling our systems to respond to user requests in less than one second. Back-end servers are grouped in high availability configuration clusters and provide critical support for information intensive applications, our content databases and storage. The following table summarizes the monthly capacity of our servers in our largest markets as of December 31, 2001:

	Maximum Monthly Visits	Maximum Monthly Page Views
	(millions)	
Terra Spain	40	900
Terra Brazil	70	1,400
Terra Mexico	75	500
Terra United States	12	600
Lycos Network	200	16,000

The various features on our portals are implemented using a combination of our proprietary software applications, software applications developed by our content providers, and software technologies developed by global leaders such as Microsoft, IBM, Netscape, Allaire and Oracle. We also integrate proprietary software and technology from industry leaders to provide us with the ability to monitor and track traffic on our portals, the demographic characteristics of our users and advertising reports. We believe that this combination of software components is more reliable and scalable than single-source solutions.

We provide online user support through e-mail as well as web pages with answers to frequently asked questions and general tips.

Limitation of Access to Certain Content

We actively take steps to limit access on our portals and through our network to websites offering certain types of content, such as child pornography. We use a variety of devices and means to protect children from accessing and persons from disseminating inappropriate or offensive content through our portals and network of sites, including, among others:

- user identification requirements;
- content filters;
- restricted channels; and
- notices and content warnings.

In addition to complying with applicable laws, we seek to cooperate with law enforcement and judicial authorities to counter and prevent illicit acts by providing relevant information to these and other authorities on a timely basis in accordance with applicable law. We also encourage our users to contact the relevant authorities if they discover illicit material or activities on the web. We further seek to ensure the security of our portals and network of sites in order to reduce the risk of unlawful access to private data.

Competition

We expect that the success of Internet companies in the long term will depend on:

- the effectiveness of strategic alliances in the online and offline market;

- awareness of the latest technological developments as well as the implementation thereof;
- having a global footprint that will harness the synergies between different business areas;
- offering high quality products and services; and
- access to financial resources to expand further.

Many of our competitors, as well as a number of potential new competitors, may have longer operating histories, greater name recognition and greater financial and technological resources than we do. These competitors may be able to undertake more extensive marketing campaigns for their brands and services, and make more attractive offers to other companies in order to enter into exclusive arrangements with them.

We believe that our ability to compete successfully in portal and network services depends on several factors, including:

- the ability to capture and manage critical mass to provide our customers (i.e., advertisers) with tailor-made products;
- capturing through our network of separately-branded sites a diverse audience in order to balance our mix of advertising customers;
- providing our users with quality products, including local content and frequent updates creating a sense of community;
- further positioning our brands as leading Internet brands worldwide; and
- providing a state-of-the-art technological platform.

We compete directly with a variety of interactive service providers, including, web-based portals, search engines, web directories and individual websites providing content, commerce, community and similar features. Our principal competitors in our main markets include:

Country	Portal
Spain	Ya.com (Deutsche Telekom), Yahoo! España, Eresmas Interactiva (Retevisión), MSN España, Lycos Europe
United States	AOL Time Warner, Overture.com (formerly Goto.com), Google.com, Ask Jeeves, CMGI Altavista, Yahoo!, MSN
United States Hispanic market	Starmedia, El Sitio, Univision.com
Brazil	Universo Online, Starmedia, Cade (Yahoo!), AOL
Mexico	El Sitio, Starmedia, AOL, T1msn, Todito

We also compete for advertising revenues with traditional media companies, such as newspapers, magazines, television and radio.

E-Commerce Activities

Our e-commerce activities include:

- promotional activities whereby we offer merchants the opportunity to promote their products and services on our network;

- online marketplaces through which our merchant partners are able to sell their goods and services;
- our online retail store through which we sell a variety of consumer goods in Mexico; and
- our e-commerce solutions for businesses and consumers.

With our network generating average daily page views exceeding 500 million in 2001, our network represents an attractive e-commerce platform. We provide opportunities for our users to purchase products and services throughout our network both by integrating commerce opportunities into contextually relevant placements on our portals and network of sites and through our online marketplaces, Lycos Shop and Terra Compras/Terra Shopping, and in Latin America through our online retail store, Decompras.com. We also develop e-commerce solutions for businesses to sell their products on the Internet.

In order to promote e-commerce activity in our portals and network of sites, we design our e-commerce solutions to make Internet shopping easier for our customers and to reduce their concerns about the security of web-based purchases. We have introduced a search tool that enables our customers to input desired criteria, such as type of product, price and other characteristics, in order to search the databases of participating e-commerce stores to find desired products. The tool has been introduced in the United States, Spain, Brazil, Mexico, Chile and Argentina, and we expect to introduce it in other markets throughout 2002. In addition, we assist our customers in making large purchases online by providing access to financing alternatives. We work closely with companies specializing in e-commerce security to provide our customers with state-of-the-art security measures on all of our e-commerce sites.

Promotional Activities

We believe that integrating e-commerce opportunities into our network search and navigation services provides an easy and useful shopping experience for our users. Specifically, we integrate the opportunity to purchase related products and services into the results of commerce-related searches performed by our users. In addition, we provide certain merchant partners with prominent positioning for their product or service offering in appropriate sites within our network. In return, we generally receive a fixed fee and a share of the related e-commerce revenue, depending on our agreement with the merchant.

Online Marketplaces

We generate electronic commerce revenues from “slotting fees” paid for selective positioning and promotion within our suite of products as well as royalties from the sale of goods and services from our websites. We have entered into agreements with select retailers in each of our markets in order to offer our users a wide selection of goods and services. We seek to promote online shopping through advertising and marketing activities throughout our portals and network of sites as well as through offline advertising and marketing efforts.

Lycos Shop

In October 1999, Lycos launched Lycos Shop, an online marketplace offering thousands of products and services from a wide variety of brand name retailers and small specialty stores, including: Barnes & Noble, CDnow and Spiegel. Lycos Shop provides its users with valuable services, including product reviews and search, easy-to-use navigation and community at each stage in the buying cycle so that shoppers can research their buying options, and compare product and price features prior to making a purchase. Lycos Shop does not support transaction processing between customers and merchants. Fees received for merchant’s presence in Lycos Shop are not material to our total revenues and are recorded as part of advertising revenues.

Terra Compras/Terra Shopping

In December 1999, Terra Compras/Terra Shopping was launched in Spain and some countries in Latin America. Terra Compras/Terra Shopping is an online marketplace offering thousands of products and services from a wide variety of brand name retailers, small specialty stores, banks, and global/local partners including: Kodak, Telefónica Móviles, Ingram Micro and Banco Bilbao Vizcaya Argentaria (with whom we have a strategic alliance to facilitate credit card payments for e-commerce purchases made through our Spanish portal). For participating merchants, Terra Compras/Terra Shopping features a sophisticated store-building product (Intershop Platform) that permits large and small retailers to create and maintain online stores and accept credit card purchases.

Online Retail Store

In October 2001, we acquired certain assets of Decompras.com (including its trademark), a leading e-commerce site in Mexico and Latin America, from El Sitio, a member of the Claxson Interactive Group. In 2000, Decompras.com had sales of approximately $7 million, offering a wide range of consumer goods for individual and corporate customers. Unlike our e-commerce platforms, Decompras.com is involved in the entire retail sales chain, directly purchasing products from vendors and holding them for sale to its customers. See “Item 3.D—Risk Factors—Risks Related to Internet Companies Generally, Including Us—Risks Related to E-Commerce”. This acquisition forms part of our strategy to create one of the largest e-commerce markets in Mexico and Latin America through acquisitions and strategic alliances with retailers and leading Internet companies.

E-Commerce Solutions

We are currently building a range of e-commerce applications that will allow us to compete across the entire spectrum of e-commerce.

Business-to-consumer platform for small- and medium-sized enterprises

We plan to develop a complete business-to-consumer e-commerce platform that will enable small- and medium-sized enterprises, or SMEs, to sell their products on the Internet. This platform will:

- provide vendors with e-commerce infrastructure, including hosting and web-design services;
- support the consumer’s purchase decisions through directories, search engines, advertising and product aggregation;
- assist in closing the transaction and arranging for payment and delivery of the product; and
- facilitate the vendor’s post-sale services and support.

Business-to-business e-commerce

Through our Terra Business strategic business unit, we are developing vertical e-commerce portals that provide business-to-consumer and business-to-business services. See “—Terra Business” below. We also plan to develop business-to-business e-commerce solutions through alliances with leaders in this category. We have identified business-to-business e-commerce services oriented to SMEs to be an area of growth. Therefore, we intend to offer these services to SMEs, including complete e-commerce platforms, corporate website development and electronic shopping mall creation.

Competition

We believe that our ability to compete successfully in the business-to-consumer, consumer-to-consumer and business-to-business e-commerce markets depends on several factors, including:

- customer confidence relating to the security of web-based purchases;
- developing a trusted brand name;
- our ability to capture e-commerce revenues from our Internet access services and portal and network services users through:
  - promotions;
  - loyalty programs; and
  - best commercial practices;
- quality and variety of our product offerings; and
- end-to-end services, from providing vendors with e-commerce infrastructure to providing post-sale service and support to vendors and consumers.

We face competition from a wide variety of current and potential competitors, including:

- "bricks and mortar" shops, catalog retailers, distributors and manufacturers selling the products that we or our network of retailers sell, some of whom currently sell, or may in the future, sell products or services online;
- online vendors;
- web portals and web search engines involved in online commerce, either directly or in collaboration with retailers; and
- companies providing e-commerce services, including website developers.

TERRA BUSINESS

As part of our new business strategy, we are developing new vertical value-added service channels together with our strategic alliance partners. We are developing these e-commerce solutions with global and local leaders in some product categories. We believe that this will enable us to extract more value from every part of the e-commerce chain than being solely an e-commerce platform provider. To this end, our goal is to continue to enter into strategic alliances and joint ventures with global and local leaders in selected product categories. Our strategic alliances and joint ventures in this area include the following.

Automobiles–Azeler (BBVA)

In March 2001, we and Banco Bilbao Vizcaya Argentaria formed a new company, Azeler, to develop and manage vertical portals designed to facilitate and improve the operations of participants in the automotive sector as well as offer to end users services and products related to the automotive sector. We have launched Azeler in Spain.

Banking–Uno-e (BBVA)

In February 2000, Telefónica and Banco Bilbao Vizcaya Argentaria, S.A. entered into a strategic alliance agreement, which, among other things, provided that the online bank, Uno-e, would be 49%-owned by Terra Networks and 51%-owned by Banco Bilbao Vizcaya Argentaria, S.A. Following receipt of necessary government approvals, we acquired a 49% stake in Uno-e from Banco Bilbao Vizcaya Argentaria, S.A. in August 2001 for €160 million. In February 2002, we subscribed for shares in connection with a capital increase for €29.4 million. At December 31, 2001, Uno-e had over 100,000 customers and managed assets of approximately €750 million.

On May 15, 2002, we and Banco Bilbao Vizcaya Argentaria, S.A. signed a Protocol of Intent, agreeing in principle to the merger of Uno-e Bank, S.A. and the private consumer finance activities operated by Finanzia Banco de Credito, S.A., a wholly-owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A. Our participation in Uno-e Bank, S.A. following the merger would be 33%.

The merger, as well as our participation, will be subject to completion of the corresponding business review being carried out, the execution of definitive agreements and the receipt of necessary authorizations. In connection with our investment in Uno-e Bank, S.A., we have the right to sell our interest in Uno-e Bank, S.A. to Banco Bilbao Vizcaya Argentaria, S.A. pursuant to a liquidity mechanism, which will be subject to adjustment upon completion of the merger. See "Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Contractual Obligations and Commercial Commitments".

Real Estate–Atrea (BBVA)

In October 2001, we and Banco Bilbao Vizcaya Argentaria, S.A. formed a new company under the trade name Atrea to develop and manage a vertical portal in the real estate sector which is designed to facilitate and improve the operations of real estate agents and developers. The website also features a variety of services and information useful to the consumer when leasing or purchasing a home, including financing, insurance and moving services. We launched Atrea in Spain in October 2001.

Human Resources–Emplaza (Meta4)

We have joined together with Meta4 to create Emplaza, a virtual business-to-employee marketplace which offers a comprehensive range of interactive services and products for the management of human resources within companies. The joint venture will design, develop and maintain customized corporate portals that include facilities for business-to-business and business-to-consumer transactions. We launched Emplaza in Spain in 2001.

Travel–Rumbo/One Travel (Amadeus)

In July 1999, we agreed to create a 50/50 joint venture with Amadeus Global Travel Distribution, S.A., a global leader in the travel industry that operates a travel reservation and distribution system, to develop a website for travel and related services targeted at the Spanish- and Portuguese-speaking world. In September 2000, we launched Rumbo in Spain. In November 2000, we agreed to expand our joint venture agreement to include the U.S. market, acquiring a majority stake in OneTravel, a top ten U.S. online travel website and one of the first value-oriented travel websites. In 2001, we launched Rumbo in Argentina, Brazil and Mexico, and in 2002, we launched the website in Chile.

Careers–Bumeran

In December 2000, we acquired a majority stake in Bumeran.com International Holdings, Ltd., one of the leading career sites in Latin America, with services for both individuals and corporate clients. Bumeran is present in Brazil, Mexico, Argentina, Chile, Venezuela, the United States and Spain (Direcciona) with over one million resumes posted at December 31, 2001.

Culture–Ifigenia

In July 2000 we increased our stake in Ifigenia, a Spanish company, from 10% to 100%. Ifigenia develops and provides digital content and tools on topics including Spanish education, culture, art, entertainment and tourism. At December 31, 2001, we had invested a total of €11.9 million in Ifigenia.

GOVERNMENT REGULATION

To date, regulations have not materially restricted use of the Internet in our markets. However, the legal and regulatory environment relating to the Internet is uncertain and may change. New laws and regulations may be adopted. Existing laws may be applied to the Internet and new forms of e-commerce. Uncertainty and new regulations could increase our costs and prevent us from delivering our products and services over the Internet. It could also slow the growth of the Internet significantly. This could delay growth in demand for our network and limit the growth of our revenues. New and existing laws may cover issues like:

- sales and other taxes;
- user privacy;
- pricing controls;
- characteristics and quality of products and services;
- consumer protection;
- cross-border commerce;
- libel and defamation;
- copyright, trademark and patent infringement;
- financial services;
- consumer banking;
- pornography;
- claims based on the nature and content of Internet materials;
- gambling;
- child protection;
- news;
- audiovisual services; and
- telecommunications.

Spanish Regulation

The main Spanish law governing telecommunication services (including the ISP business) is Law 11/1998, of April 24, on Telecommunications (“Law 11/1998”), as further developed by Royal Decree 1651/1998, of July 24, Royal Decree 1736/1998, of July 31, and licenses and authorizations and Ministerial Orders dated September 22,

1998. This regulatory framework governs licenses and authorizations for the provision of telecommunication services and the establishment and development of telecommunication networks.

Under Law 11/1998 and the related regulations, entities providing data transmission services to the public such as ISP services must provide notice to the Telecommunications Market Commission (*Comisión del Mercado de las Telecomunicaciones*, hereinafter "CMT") regarding the provision of these services and be registered as a holder of a "Type C General Authorization" in a special official registry maintained by the CMT. Ten years after registration, and every ten years after that date, any holder of a Type C General Authorization must notify the CMT whether or not it intends to continue providing the relevant authorized services. Failure to notify the CMT would cause the termination of the Type C General Authorization. As a general matter, Type C General Authorizations may be revoked if the holder ceases to render the relevant authorized services or if applicable regulations are breached by the holder of such license.

Holders of general authorizations, such as the Type C General Authorization we hold, are required to pay an annual tariff to the Spanish State based on the relevant licensee's gross operating income. Such annual tariff is determined on a yearly basis, with a cap of 0.2% of gross operating income. Since 1999, the rate has been fixed at 0.15% of gross operating income.

Consumer Protection

Spanish general laws and regulations on consumer protection, contract conditions, competition and advertising generally apply to portal and electronic commerce services, as well as to Internet content. The main Spanish consumer protection law is Act 26/1984 on General Protection of Consumers and Users. Act 26/1984 generally addresses consumer protection, misleading advertising and unfair contracts. Act 7/1998, on Standard Terms of Use, which provides additional protection to consumers, sets forth certain provisions that may not be included in Terms of Use agreements. These prohibited provisions are void under Spanish law. The expected growth and demand for online commerce has led the Spanish authorities to adopt Royal Decree 1906/1999 on the General Terms of Telephonic or Electronic Contracts. This Royal Decree established special duties for companies contracting electronically or by telephone. In particular, it permits users to cancel a contract within seven business days of its formation. This right is also afforded to consumers by Act 7/1996, of January 15, on retail commerce.

E-commerce

The Spanish authorities are developing legislation relating to e-commerce in two main areas: electronic signature and e-commerce activities. The Spanish government has approved Royal Decree 14/1999 on Electronic Signature, establishing the legal requirements for electronic signature and permitting the admissibility of electronic signature as evidence in legal proceedings. We believe Royal Decree 14/1999 may be superseded by a new law on electronic signature in 2002, as the Spanish government is currently developing a new draft to incorporate certain provisions on electronic identification cards. Additionally, a bill setting forth a proposed regulatory framework for e-commerce and the provision of information services, which will implement the EU Directive on E-Commerce, has been submitted to the Spanish parliament. We expect the Spanish Parliament to enact the new law during 2002.

Financial Services

A number of our portals enable our users to search for and contract with third parties offering financial services. Such services may be subject to regulation. We believe that such regulations may apply to the third-party financial service providers, but not to us. However, we cannot be certain that a regulator would not deem us subject to such regulation.

Privacy and Data Protection

Spain has adopted restrictive laws and regulations concerning privacy and data protection, the most significant of which is Act 15/1999 on Personal Data Protection, relating to the electronic processing of personal data. Act 15/1999 and related regulations require prior notice and consent to be given in connection with the electronic processing, use or transfer of personal data by a third party. Entities like us which process personal data must register their databases with the Spanish Data Protection Agency (*Agencia de Protección de Datos*) and are required to adopt certain security measures with respect to databases that store personal data. The Spanish Data Protection Agency is authorized to sanction entities that infringe data protection regulations. Spanish Data Protection laws restrict our ability to transfer the user data that we collect to countries outside the European Union, including the United States and Latin American countries, that do not provide the required level of protection, and require compliance with certain regulatory procedures in order to transfer our user data to entities in eligible countries. A new European Union Directive on Data Protection may be adopted in 2002 that would supersede the current European Union Directive and set forth a more comprehensive regulatory framework.

Tariffs

In general, consumers in Spain are required to pay their telecommunications operator or Internet access provider for telephone calls to connect to the Internet at the local rate based on the duration of the connection. As of November 2000, Telefónica de España, S.A., the Telefónica group's fixed-line telephony operator in Spain, is required to provide Internet access services through the public switched telephone network (PSTN) and the integrated services digital network (ISDN) during off-peak times at a fixed monthly rate. In addition, Telefónica de España, S.A. is required to provide other services such as asymmetrical digital subscriber line (ADSL), which we also provide, at regulated prices. The regulations applicable to Telefónica de España, S.A. have affected the prices at which other service providers, including us, are able to offer these services.

Taxes

Other than value added taxes, or VAT, there are no specific taxes levied on ISP, portal or electronic commerce services in Spain.

United States Regulation

The Electronic Communications Privacy Act and the USA PATRIOT Act regulate the circumstances under which an entity providing an electronic communications service must disclose or must withhold from disclosure to the government or other third parties the contents of electronic communications and user account information.

The Communications Decency Act ("CDA") is intended to protect an interactive computer service from liability for information that is originated by a third-party user of the service. In addition, the CDA is intended to protect an interactive computer service from liability if the service restricts access to or the availability of content that the service finds in good faith to be objectionable.

The Federal Trade Commission has issued a rule that governs the online collection of personal data from children under the age of 13, including a requirement to obtain parental consent to collect, disclose and use that information. The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

The U.S. Electronic Signatures in Global and National Commerce Act, which became effective in June 2000:

- removes some barriers to Internet commerce by providing that contracts formed online have the same force of law as pen and paper contracts;
- seeks to provide a single, national regulation of electronic signatures and transactions;
- protects consumers by requiring an express "opt-in" to the electronic delivery of information; and

- eliminates many traditional paper-based record-keeping requirements.

The Digital Millennium Copyright Act is intended to reduce the liability of online service providers for hosting content created by users, or referring or linking users to third-party websites that include materials that infringe copyrights of others.

Latin America Regulation

Discussed below is a brief summary of the laws and regulations applicable to our principal Latin American operations.

Brazil

The Brazilian House of Representatives is currently considering a law governing e-commerce that will, among other things, subject Internet service providers to civil and criminal sanctions if they knowingly provide services that allow illegal goods or services to be sold on the Internet. This bill would also require Internet service providers to keep confidential all non-public information that was transmitted or stored on its network, unless a court orders that such information may be disclosed. Furthermore, the main law governing telecommunications services, Act 9.472, of July 16, 1997, requires operators to be granted a license to provide telecommunications services, while the provision of value-added services can be carried out without licensing requirements. Award of new licenses using the public switched telephony network (PSTN) is currently not foreseen by Brazilian regulatory authorities until the end of 2002 or 2003, depending on fulfillment by current licensees of their obligations, although this may be moved forward. ANATEL, the Brazilian regulatory authority, has been considering a number of services as telecommunications services which prevents us from providing certain services in Brazil such as short messaging services, web-fax and voice over IP.

Mexico

The Federal Telecommunications Commission in Mexico requires that providers of value-added services must register these services with the Telecommunications Commission prior to offering them to the public. If a provider of value-added services does not register each service with the Commission, the Commission can impose a de minimis fine. We have registered the following services with the Commission: e-mail, voice-mail, fax, Internet access, electronic exchange of data and database long distance access. In addition, during 2001, we were registered as a service provider of audio text, remote data processing, videotext and videoconferencing.

Argentina

Under Argentine law, the Argentine National Government does not regulate or control the information available on the Internet, and does not intervene in the production, creation or transmission of the information available through the Internet. However, Argentine laws and regulations on consumer protection, contract, competition and advertising generally apply to portal and electronic commerce service providers in the same way as they would apply to any provider of services to consumers in Argentina. In addition, the Argentine Constitution and the Data Protection Act approved in 2000, subject to further development, protect a person's right to know the information that any public or private database contains about him or her, and grant that person the right to demand that information be changed or removed from the database if that information is false or discriminatory. Furthermore, the Data Protection Act prohibits the transfer outside Argentina of user information, without the user's consent, to destinations which do not provide an appropriate level of protection to such data.

Chile

Under Chilean law, Internet access services and information services are not considered telecommunications services and therefore there are no licensing requirements. However, the provision of Internet services is subject to compliance with applicable Chilean law, particularly Act no. 19,496 on Consumer Protection, Act no. 19,628 on

Privacy Protection, Act no. 17,336 on Intellectual Property, Act no. 19,039 on Industrial Property and certain telecommunications regulations.

Peru

As required by the Peruvian regulatory framework, we are registered with the Transport and Telecommunications Ministry (*Ministerio de Transportes y Telecomunicaciones*) to provide certain value-added services (such as Internet access, e-mail, news, voice mail, the transmission of electronic information, etc.). Value-added services are defined under Peruvian laws as services which use telecommunications or broadcasting services to add some additional capability or functionality to such underlying telecommunications or broadcasting services.

Colombia

Under Colombian law we are not required to obtain any licenses or authorizations for the services we currently provide. However, the provision of Internet access services is subject to the prior granting of the relevant license from Ministry of Communications (*Ministerio de Comunicaciones*). We do not currently provide Internet access services, but we intend to do so in the near future. We applied for, and were granted, the relevant license in December 2001.

INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS

We rely on patent, trademark and copyright law, trade secret protection and other applicable intellectual property law and confidentiality and/or license agreements with our employees, customers, content and service providers, partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property in Internet-related industries is uncertain and still evolving. The laws of some foreign countries do not protect intellectual property to the same extent as do the laws of the United States.

We pursue the registration of our trademarks on a global basis, with particular emphasis on our primary markets. We have registered the Terra brand in many of the countries where we operate under that brand name. The Terra trademark has been granted in countries including Spain, Brazil, Mexico, Chile, Nicaragua, Uruguay, Venezuela, Peru, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Panama, Paraguay and the Dominican Republic. We hold trademarks and registrations for these marks in many other countries as well. The granting of the trademark in some other countries in which it was applied for, including the United States, is still pending, although the processing of these trademark applications is following its normal course and our application has not been denied in any major country in respect of the categories of services and products that we provide. We expect that the Terra trademark will be granted in the United States around mid-2002. We have also applied for the registration of our other trademarks in many of the countries where we operate sites. These trademarks have been granted in some countries while in others they are in process.

Policing unauthorized use of our marks is also difficult and expensive. In addition, it is possible that our competitors will adopt product or service names similar to ours, thereby impeding our ability to build brand identity and possibly leading to customer confusion. We actively seek to protect our marks against similar and confusing marks of third parties by:

- using a watch service that identifies applications to register trademarks;
- filing oppositions to third parties' applications for trademarks;
- sending cease and desist letters to infringers; and
- bringing lawsuits against infringers.

Trademark infringement actions may be time-consuming and expensive. To date, we believe that we have effectively, protected our trademarks and service marks, and we believe that we will continue to do so in the future. Nevertheless, our inability to effectively protect our trademarks and service marks would have a material adverse effect on our business, financial condition and results of operations.

Many parties are actively developing chat, home page, search and related web technologies. We expect these developers to continue to take steps to protect these technologies, including seeking patent protection. There may be patents issued or pending that are held by others and that cover significant parts of our technology, business methods or services. For example, we are aware that a number of patents have been issued in the areas of e-commerce, web-based information indexing and retrieval and online direct marketing. Disputes over rights to these technologies are likely to arise in the future. We cannot be certain that our products do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. In the event that we determine that licensing this intellectual property is appropriate, we may not be able to obtain a license on reasonable terms or at all. We may also incur substantial expenses in defending against third-party infringement claims, regardless of the merit of these claims. Successful infringement claims against us may result in substantial monetary liability or may prevent us from conducting all or a part of our business.

We also intend to continue to license technology from third parties, including our web-server and encryption technology, search, directory services, advertisement serving, commerce transaction processing, online product reviews and value-based comparisons. The Lycos search and indexing technology was originally developed at Carnegie Mellon University. In June 1995, Lycos entered into a license agreement with Carnegie Mellon University pursuant to which Carnegie Mellon University granted Lycos a perpetual, worldwide right to use and sub-license the Lycos search and indexing technology and other intellectual property rights, including the “Lycos” trademark and the domain name lycos.com. We have sublicensed the “Lycos” trademark to certain of our joint venture partners, including Lycos Europe, and as a result, we are not able to use this trademark in the jurisdictions in which these joint venture partners operate. Carnegie Mellon University has been issued a patent in the United States relating to Lycos’ search and indexing technology.

The market is evolving and we may need to license additional technologies to remain competitive. We may not be able to license these technologies on commercially reasonable terms or at all. In addition, we may fail to successfully integrate any licensed technology into our services. Our inability to obtain any of these licenses could delay product and service development until alternative technologies can be identified, licensed and integrated.

C. ORGANIZATIONAL STRUCTURE

Our Relationship with the Telefónica group

Telefónica, S.A., a leading diversified telecommunications and multimedia group, owned approximately 37.03% of our equity interest at December 31, 2001.

The Telefónica group serves approximately 78.4 million customers in Spain and Latin America across a wide range of distribution platforms, including at December 31, 2001:

- 45.0 million fixed-line telephone customers;
- 32.3 million wireless and mobile communications customers; and
- 1.1 million pay-TV customers.

The Telefónica group’s principal telecommunications and infrastructure interests in Spain and Latin America include:

Company	Principal Countries of Operation	Principal Services Provided
Telefónica de España, S.A.	Spain	Fixed-line telecommunications services, including access lines and local and long-distance services
Telefónica Móviles, S.A.	Spain, Brazil, Argentina, Peru and Mexico	Wireless communications services
Telefónica DataCorp, S.A.	Spain, Brazil, Argentina, Peru, Mexico and United States	Data transmission services
Grupo Admira Media, S.A.	Spain, Argentina and the Netherlands	Free-to-air television and radio, audiovisual content and pay television
Telefónica Internacional, S.A.	Brazil, Chile, Argentina and Peru	Fixed-line telecommunications services, including access lines and local and long-distance services
Telefónica Publicidad e Información, S.A.	Spain and Brazil	Directory publishing and advertising
Atento Holding Telecomunicaciones, S.A.	Spain and Brazil	Call center services
Katalyx, S.A.	Spain, Argentina, Brazil and Mexico	B2B e-commerce
Emergia, S.A.	Uruguay, Argentina, Brazil and Peru	Broadband communications through submarine fiber optic cable

Subsidiaries

The following chart summarizes our interest in our principal subsidiaries at December 31, 2001.

Company	Country of Incorporation	Terra Networks' Ownership Interest	Terra Networks' Voting Power
Lycos Inc.	United States	100.0%	100.0%
Terra Networks Argentina, S.A.	Argentina	100.0%	99.9%
Ifigenia Plus, S.L.	Spain	100.0%	100.0%
Terra Networks España, S.A.	Spain	100.0%	100.0%
Terra Networks Brasil, S.A.	Brazil	100.0%	100.0%
Terra Networks Operations, Inc	United States	100.0%	100.0%
Terra Networks Guatemala, S.A.	Guatemala	100.0%	100.0%
Terra Networks Perú, S.A.	Peru	100.0%	99.9%
Terra Networks México, S.A. de C.V.	Mexico	100.0%	100.0%
Terra Networks Chile, S.A.	Chile	100.0%	100.0%
Terra Networks Venezuela, S.A.	Venezuela	100.0%	100.0%

Company	Country of Incorporation	Terra Networks' Ownership Interest	Terra Networks' Voting Power
Terra Networks Colombia, S.A.	Colombia	65.0%	65.0%
Terra Networks Uruguay, S.A.	Uruguay	100.0%	100.0%
Lycos Europe, N.V.	Netherlands	29.6%	29.6%
Terra Mobile, S.A.	Spain	20.0%	20.0%
Uno-e Bank, S.A.	Spain	49.0%	49.0%

D. PROPERTY, PLANT AND EQUIPMENT

Our principal executive offices are located in Madrid (Spain), Waltham (Massachusetts, USA) and Barcelona (Spain). We also lease office space in many cities around the world, including:

- São Paulo, Porto Alegre and more than 40 other locations throughout Brazil;
- Monterrey, Mexico City, Guadalajara and more than 15 other locations throughout Mexico;
- Santiago and Concepción, Chile;
- Buenos Aires and Córdoba, Argentina; and
- New York, New York; Miami, Florida; Los Angeles, California; Dallas, Texas; San Francisco and Mountain View, California; and Chicago, Illinois.

See "Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources" for a discussion of our historical and planned capital expenditures.

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

Overview

We are one of the most popular Internet networks in the United States, Europe and Asia and the leading portal to Spanish and Portuguese-speaking markets. We are the result of the combination in October 2000 of Terra Networks, a global Internet company and the leading provider of Internet access and interactive content and services to the Spanish and Portuguese-speaking world, and Lycos, the Internet's leading multi-brand network.

We have a limited operating history for you to use as a basis for evaluating our business. You must consider the risks and difficulties frequently encountered by early stage companies like ours in new, rapidly evolving and intensely competitive markets.

We have incurred significant net losses and negative cash flows since our inception. Our losses have been funded primarily through shareholder contributions, our initial public offering of our ordinary shares and our rights offering completed in September 2000.

We expect these losses to continue. Based on our most recent business plan, we envisage the obtainment of net income in 2005. However, because our business plan is necessarily based on future expectations, including those relating to the Internet industry, which is relatively new, rapidly evolving and intensely competitive, significant differences may arise between our projected and actual results. For a discussion of some of the factors that may cause our actual results to differ from our anticipated results, see "Item 3.D—Risk Factors".

Changes in the Composition of the Group

Year Ended December 31, 2000

During 2000 we undertook a series of acquisitions of unrelated companies. The most significant of these were our acquisition of:

- the Venezuelan portal Chévere, which we acquired in April 2000 for financial reporting purposes;
- the Colombian portal laciudad.com, which we acquired in July 2000 for financial reporting purposes; and
- Lycos, Inc., which we acquired in November 2000 for financial reporting purposes.

Year Ended December 31, 2001

We also made several acquisitions in 2001. The most significant of these were our acquisition of:

- Bumeran Participaciones, S.L., which we acquired in January 2001 for financial reporting purposes;
- Maptel Networks, S.A., which we acquired in February 2001 for financial reporting purposes; and
- Uno-e Bank, S.A., which we acquired in August 2001 for financial reporting purposes.

As a result of these acquisitions, our results of operations for 1999, 2000 and 2001 may not be comparable with one another or our results of operations for future periods. See "Item 3—Risk Factors—Risks Related to Our Financial Condition".

Please see "Item 4A—History" for a more complete description of some of these acquisitions.

Change in Accounting Estimate

In 2001, we conducted a study of the evolution of the business plans of our acquired companies, as a result of which we wrote down goodwill related to our prior acquisitions by €35.0 million. We also adjusted our goodwill amortization period to our new estimates of anticipated revenues in order to better match future revenues and expenses based on our actual rate of development and that of the industry in which we operate. In general, we extended the goodwill amortization period to ten years, as from July 1, 2001, except for the portion of goodwill in the amount of €400 million relating to our agreement with Bertelsmann, which we expect to recover in proportion to the revenues generated by the agreement over its five-year term. Our goodwill amortization expense in 2001 would have been approximately €163.4 million higher had we amortized goodwill on a straight-line basis over five years throughout 2001, as we had done in prior periods, rather than 10 years.

Revenues

We generate advertising revenues, access revenues, corporate services revenues, e-commerce revenues and other revenues.

The following table summarizes our total revenues for the three years ended December 31, 2001 by type of revenue in each of our principal geographic markets:

	Year Ended December 31,		
	1999	2000	2001
	(thousands of euro)		
Europe			
Advertising	2,400	24,324	26,834

	Year Ended December 31,		
	1999	2000	2001
	(thousands of euro)		
Access(1)	4,033	31,300	84,271
Corporate Services	—	—	5,179
E-commerce	60	1,793	2,227
Other	4,722	9,425	20,279
Total	11,215	66,842	138,790
Latin America			
Advertising	2,663	24,776	25,717
Access(1)	18,561	79,829	119,509
Corporate Services	10,710	29,306	40,951
E-commerce	—	10,757	9,877
Other	4,878	4,096	3,051
Total	36,812	148,764	199,105
United States			
Advertising	—	83,347	353,238
Access	2,224	7,566	—
E-commerce	—	331	697
Other	—	679	1,682
Total	2,224	91,923	355,617

(1) Includes subscription fees, traffic-inducement fees and fees for value-added services.

Advertising Revenues

We derive revenues from our portals and network of sites chiefly from advertising. Advertising revenues are derived principally from:

- advertising arrangements under which we receive revenues, generally based on cost per-thousand impressions;
- sponsorship arrangements that allow advertisers to sponsor an area on one of our portals or websites in exchange for a fixed payment; and
- fees for design, coordination and integration of advertising campaigns and sponsorships to be placed on one of our portals or websites.

Advertising and sponsorship rates generally depend on:

- whether the page views are for general or targeted audiences;
- which of the specific channels on our portals or which website displays the advertising; and
- the number of guaranteed page views, if any.

Advertising revenues are recognized ratably in the period in which the advertisement is displayed, provided that no significant obligations remain and collection of the resulting receivable is probable. To the extent minimum guaranteed page view levels are not met, we defer recognition of the corresponding revenues until guaranteed levels are achieved. Payments received from advertisers prior to displaying advertisements on our portals or websites are recorded as deferred revenues. Revenues from sponsorship arrangements are recognized ratably over the contract term, provided that no significant obligations remain and collection of the resulting receivable is probable.

Although we expect advertising revenues to grow over the next few years, we anticipate advertising revenues will decline as a percentage of total revenues, primarily as a result of a weaker advertising market.

Access Revenues

We derive access revenues primarily from (i) subscription fees paid by our customers for dial-up and ADSL access to our ISPs, (ii) value-added service fees and (iii) traffic-inducement fees paid to us for traffic we induce over certain telecommunications networks. In addition, in Spain we derive access revenues from fees for flat rate telephone plans sold by us as well as specified amounts received from the telecommunications network operator relating to such plans. Access revenues are recognized as service is rendered, provided that collection of the resulting receivable is probable.

Access revenues represented 29% of our total consolidated revenues for 2001 and 39% for 2000. We expect access revenues to continue to account for a significant percentage of our total revenues, particularly as we evolve from being principally a pure Internet access provider to a provider of bundled services, including access, communications services and content.

Spain

The following charts provide certain information with respect to our pay Internet access model and our free Internet access model in Spain.

PAY INTERNET ACCESS MODEL

	Metered rate	**ADSL**
General	User pays (i) for each telephone call at the local rate based on connection time to connect to our pay Internet access service and (ii) a monthly subscription fee (plus any additional fees for value-added services)	User pays (i) a monthly subscription fee (plus any additional fees for value-added services), (ii) a one-time installation charge (if applicable) and (iii) the cost of a modem (if applicable)
Amount paid by user	Variable charge for telephone calls based on the number of calls and connection time, plus applicable subscription fee and applicable charges for value-added services (if any) purchased by user	Installation charge (if applicable), cost of modem (if applicable), applicable subscription fee and applicable charges for value-added services (if any) purchased by user
Recipient of amount paid by user	*Telephone charges*: Telefónica de España *Subscription fees and value-added services*: Terra Networks	Terra Networks

	Metered rate	ADSL
Access revenues recorded by Terra	Fees from Telefónica de España based on scheduled rates and variable amounts of subscription fees and charges for any value-added services, depending on plans subscribed and value-added services purchased by customers	Installation charges and variable amounts of subscription fees and charges for any value-added services, depending on plans subscribed and value-added services purchased by customers. Revenues from sales of modems are recorded as "other revenues".
Approximate number of customers at December 31, 2001	81,000	109,000

FREE INTERNET ACCESS MODEL

	Flat rate	Metered rate
General	User pays a fixed rate for unlimited telephone calls during specified periods to connect to our free Internet access service	User pays for each telephone call at the local rate based on connection time to connect to our free Internet access service
Amount paid by user	€16.50 per month for telephone calls, no charge for Internet access	Variable charge for telephone call based on the number of calls and connection time, no charge for Internet access
Recipient of amount paid by user	Terra Networks, if user subscribes for flat rate plan through Terra Networks, otherwise Telefónica de España	Telefónica de España
Access revenues recorded by Terra Networks	*Terra Networks Flat Rate Plan:* €16.50 per month per user paid to Terra Networks by user, if user subscribes for flat rate plan through Terra Networks, and €2.10 per month per such user paid to Terra Networks by Telefónica de España *Telefónica de España Flat Rate Plan:* €2.10 per month per user paid to Terra Networks by Telefónica de España	Fees from Telefónica de España based on scheduled rates
Approximate number of customers at December 31, 2001	142,000 (1)	2,550,000

(1) Includes only customers who subscribe for flat rate plans directly through Terra Networks.

We derive revenues from our pay Internet access services from subscription fees paid by our customers for dial-up and ADSL access to our ISPs and from additional fees paid by our customers for features that can be added to our basic Internet access service (i.e., value-added services) such as enhanced online services and video streaming. We charge different prices for Internet access products depending on the product selected by our customer.

In June 1999, we introduced free Internet access in Spain, launching an extensive advertising campaign to promote this service. Users of our free Internet access service pay the telecommunications network operator applicable charges for telephone calls made to connect to our free Internet access service but do not pay us subscription fees. As a result, while our efforts to promote our free Internet access service produced a significant increase in our number of subscribers, our subscription fees did not grow at the same rate. During the first half of 1999, subscription fees in Spain accounted for approximately 44% of our access revenues and approximately 27% of our consolidated revenues. During the whole year, they accounted for approximately 10% of our access revenues and approximately 5% of our consolidated revenues.

In order to offset in part the absence of subscriber fees in connection with free Internet access services, in October 1999 we entered into an agreement with Telefónica Data España under which Telefónica Data España paid us traffic-inducement fees for usage of its network by our free and pay Internet access customers. In accordance with this agreement, traffic-inducement fees earned by us were calculated according to a graduated fee schedule based on the total number of monthly minutes consumed by our Internet access customers. See "Item 7B–-Ongoing Relationships with Members of the Telefónica Group –Related Party Transactions–Traffic-Inducement Fees". In January 2001, we entered into a new agreement with Telefónica Data España, which eliminated the graduated fee schedule and established a factor of Ptas 0.38 (approximately €0.00228) per minute of induced traffic. In September 2001, we entered into a new agreement with Telefónica de España which replaced our existing agreement with Telefónica Data España, as a result of which fees are currently paid to us by Telefónica de España. See "Item 7.B —Related Party Transactions—Ongoing Relationships with Members of the Telefónica Group—Traffic-Inducement Fees". We record traffic-inducement fees as minutes of usage are incurred. Traffic-inducement fees, which we began earning in the fourth quarter of 1999, accounted for approximately 13% of our access revenues in Spain and approximately 3% of our consolidated revenues in 1999. For 2000, they accounted for approximately 43% of our access revenues in Spain and approximately 4% of our consolidated revenues.

Since mid-2000, however, our traffic-inducement fees in Spain have been adversely affected by the introduction of flat rates for telephone calls to connect to the Internet because we do not receive traffic-inducement fees for such calls. Flat rate plans are governed by Royal Decree 7/2000 of June 23 which provides that:

- flat rate access shall be available from 6:00 p.m. to 8:00 a.m. weekdays and during weekends and national holidays; and
- the price offered by the dominant operator may not exceed Ptas 2,750 (approximately €16.53) per month.

As a result, for 2001 traffic-inducement fees in Spain accounted for approximately 9.9% of our access revenues in Spain and approximately 1.2% of our total consolidated revenues.

With respect to the flat rate plans that we sell and for which we bill directly, we record as revenues the flat rate plan fees received from these flat rate customers on a monthly basis (€16.50 per month per customer) as well as €2.10 per existing plan that we receive monthly from Telefónica de España in connection with our sale of such plans. Correspondingly, we record as communication costs, which are payable to Telefónica de España, an amount equal to the full amount of fees received from our flat rate customers (€16.50 per month per customer). The receipt of revenues in connection with these flat rate plans has offset in part the adverse effects of free Internet access on our total access revenues.

Although the introduction of flat rate Internet access in Spain has had an adverse effect on our business, we expect that this effect will be offset over time if we are able to migrate these users to pay broadband services. In addition, the lower marginal cost of Internet usage should have a beneficial effect on revenues from our communications services (such as enhanced online storage services and video streaming), advertising revenues and e-commerce revenues.

Other Countries

We currently offer pay Internet access services in Brazil, Mexico, Peru, Chile and Guatemala and free Internet access services in Chile, where we introduced such services in March 2000. As part of our new business strategy to migrate users from free Internet access services to pay Internet access services, in June 2001 we discontinued providing free Internet access in Brazil, where we had offered such services since February 2000, and in January 2002, we discontinued providing free access in Mexico, where we had offered such services since March 2000.

We derive access revenues from our pay Internet access services from subscription fees paid by our customers for dial-up and ADSL access to our ISPs and from additional fees paid for value-added services. In accordance with local regulation, we also receive traffic-related fees in Chile, which we account for as traffic-inducement fees. According to such regulation, the telephone network operator receives 43% of the cost of the standard metered call to connect to the Internet, and we receive the remaining 57%, plus any premiums or less any discounts that we may apply to calls to our Internet access lines. Therefore under existing regulations in Chile we derive a significant amount of revenue from our free Internet access customers, even though they do not pay us subscription fees. Because we were unable to reach an agreement on traffic-inducement fees with the local telephone network operators in Brazil, we did not receive traffic-inducement or traffic-related fees during the time that we provided free Internet access services in Brazil. The introduction by regulatory authorities of certain types of flat-rate Internet access regulatory models in our Latin American markets could have an adverse effect on our business, financial condition and results of operations, depending on the terms and conditions of such plans, including among others, the cost of such plans and the amounts (if any) received by us in connection with such plans.

Corporate Services Revenues

We derive corporate services revenues from services such as financial information services in Mexico and web hosting services and web design and maintenance in some of the countries in which we operate such as Spain, Brazil, Mexico, Chile, Peru, Columbia and Guatemala. In Mexico, Infosel Financiero, launched in 1990, provides real-time stock prices, stock indexes, financial news and trend analysis to market professionals in Mexico and New York, competing with services such as Reuters and Bloomberg. This service accounted for 20.0% of Terra Mexico's 2001 revenues.

E-Commerce Revenues

Electronic commerce revenues are derived principally from "slotting fees" paid for selective positioning and promotion within our suite of products, royalties from the sale of goods and services from our websites and sales of goods and services sold directly by us. Electronic commerce revenues are generally recognized upon delivery provided that no significant obligations remain on our part, and collection of the receivable is probable. In cases where there are significant remaining obligations we defer such revenue until those obligations are satisfied. As the e-commerce market place develops, we expect e-commerce revenues to comprise an increasingly greater portion of the revenue base of our portals and network of sites primarily because of our:

- plans to develop this part of our business actively, for example by continuing to enter into strategic alliances with product and service providers;
- expectation that consumers will spend increasing amounts of money on e-commerce transactions; and
- expectation that increasing competition from other Internet access providers and portal operators will put increased pressure on our ability to earn access and advertising revenues, which today account for the bulk of our revenues.

Other Revenues

We derive other revenues from the sale of modems and customer connection kits and fees related to maintenance and support of our product offerings. These maintenance and support fees are deferred and recognized over the period in which such services are required to be provided. We expect our other revenues to decline as a percentage of our total revenues over the next few years.

Operating Expenses

Goods Purchased

Expenses relating to goods purchased include telecommunication expenses, expenses recorded for the purchase of customer connection kits and modems, technical help desk expenses and expenses relating to the purchase of advertising space.

Personnel Expenses

Personnel expenses include all expenses associated with salaries and other employee benefits, regardless of the job classification of the employee.

We have established an employee stock option plan. We have deposited at book value with three banks the shares that are the subject of the plan. The banks have in turn granted options to us to purchase these plan shares at book value. Under both Spanish GAAP and U.S. GAAP, no deferred compensation is booked if the exercise price of the options is equivalent to the market value of our shares on the date of grant. Please see "Item 6.E—Share Ownership—Employee Stock Options".

Depreciation and Amortization

Depreciation and amortization expenses include depreciation charges relating to our tangible assets, such as points of presence (POPs) in our ISP business, and amortization charges relating to our intangible assets, principally software. Under Spanish GAAP, amortization of goodwill is recorded separately, and does not appear as an operating expense.

Other Operating Expenses

Other operating expenses principally include:

- marketing expenses;
- professional services, including consulting fees and auditors' fees; and
- rental expenses and royalties.

Financial Income (Expense), Net

Our financial income (expense), net consists principally of income from interest bearing accounts and investment securities and other instruments, net of interest expenses.

Goodwill

We generated substantial amounts of goodwill from our acquisitions, most importantly our acquisitions of Lycos, ZAZ, Infosel and Olé. In 2001, we conducted a study of the evolution of the business plans of our acquired companies, as a result of which we wrote down goodwill related to our prior acquisitions by €35.0 million. At December 31, 2001, we had goodwill of €1,819 million, equal to 29.8% of our total assets at that date.

Whereas the business models of our acquired companies were based on free Internet access and advertising revenues, we have evolved towards a new business model based on pay-per-access, pay-per-content and customized advertising. Therefore following our study of the evolution of the business plans of our acquired companies and the write down of goodwill related to these acquisitions, we adjusted our goodwill amortization period to our new estimates of anticipated revenues in order to better match future revenues and expenses based on our actual rate of development and that of the industry in which we operate. As a result, as from July 1, 2001, we now amortize goodwill related to our acquired businesses on a straight-line basis over 10 years. Previously, we amortized goodwill over a five-year period. See "—Change in Accounting Estimate" above. Our goodwill amortization expense in 2001 would have been approximately €163.4 million higher under Spanish GAAP had we amortized goodwill on a straight-line basis over five years throughout 2001, as we had done in prior periods, rather than 10 years. If we acquire more businesses and generate more goodwill in the future, our goodwill amortization expense may grow under Spanish GAAP.

For a discussion relating to an impairment charge to goodwill in 2001 under U.S. GAAP, see "—U.S. GAAP Reconciliation".

Critical Accounting Policies

The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Consequently, our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our financial statements. The profile of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors you should consider in connection with your review of our financial statements and the discussion of our financial condition and results of operations below. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our financial statements and the uncertainties that could impact our financial condition, results of operations and cash flows.

Contingencies

We are subject to various legal proceedings and claims. Spanish GAAP requires that an estimated loss from a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial condition or results of operations.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or creditable for the current year and deferred tax liabilities and assets for future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns and in assessing the recoverability of deferred tax assets regarding tax loss carryforwards. Variations in the actual outcome of these future tax consequences could materially impact our financial condition or results of operations.

Long-Lived Assets

We evaluate the impairment of our long-lived assets based on the projection of discounted cash flows. Estimates of future cash flows used to test the recoverability of specific long-lived assets are based on expected cash flows from the use and eventual disposition of the assets. A significant reduction in actual cash flows and estimated cash flows may have a material adverse impact on our financial condition and results of operations.

Results of Operations

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Revenues

Our revenues for 2001 and 2000 were principally derived from advertising on our portals and network of sites and our Internet access businesses in Spain, Brazil and Mexico. In 2001, we derived 29% of our revenues in Latin America, compared with 48% in 2000.

Total Revenues. Our total revenues increased 126% to €693.5 million for 2001 from €307.5 million for 2000, primarily for the reasons discussed below.

Advertising Revenues. Advertising revenues increased 206.4% to €405.8 million for 2001 from €132.4 million for 2000, principally as a result of a full twelve months of advertising revenues of Lycos, which we acquired in October 2000. Our advertising revenues in 2001 were adversely affected by a general slowdown in the growth rate of online advertising. Advertising revenues from Latin America accounted for 6.3% of our total advertising revenues in 2001 compared to 18.7% in 2000. Advertising revenues represented approximately 58.5% and 43.1% of our total revenues for 2001 and 2000, respectively.

Access Revenues. Our access revenues increased 71.7% to €203.8 million for 2001 from €118.7 million for 2000, primarily due to:

- a 58% increase in the average number of subscribers to 4.4 million in 2001 from 2.8 million in 2000 due in part to greater market penetration as a result of the increase in online users in the countries where we offer Internet access services and the increase in the average number of ADSL subscribers to approximately 127,000 in 2001 from approximately 11,000 in 2000 as a result of the expansion of our ADSL service offerings in Spain and Brazil; and

- a 40.0% increase in revenue per pay Internet access subscriber due to an increase in the number of ADSL subscribers who have a tendency to consume higher-priced premium services and the bundling of value-added services with our broadband access products which enables us to charge higher subscription fees.

Access revenues represented approximately 29.4% and 38.6% of our total revenues for 2001 and 2000, respectively.

Access revenues experienced strong growth in Spain and Brazil. Access revenues in Spain grew principally due to a 97% increase in the average number of total subscribers to approximately 2.8 million in 2001 from approximately 1.4 million in 2000, including a significant increase in the average number of ADSL subscribers in Spain to 68,000 in 2001 from approximately 6,000 in 2000. Access revenues in Brazil increased primarily due to a 21% increase in the average number of dial-up subscribers to approximately 578,000 in 2001 from approximately 478,000 in 2000, a significant increase in the average number of ADSL subscribers to 58,000 for 2001 from approximately 5,000 for 2000 and price increases for certain services such as dial-up Internet access services. The number of pay subscribers in Brazil increased in part because we discontinued providing free Internet access services in June 2001 as a result of which some of our free access customers became pay subscribers.

The table below provides comparative information regarding our ISP subscriber base for the periods indicated.

Business	Number of Subscribers at December 31, 2000	2001	
Spanish ISP	2,579,000	2,881,000	
Brazilian ISP	852,000	761,000	(1)
Mexican ISP	375,000	383,000	
Chilean ISP	233,000	226,000	
Peruvian ISP	58,000	80,000	
U.S. ISP(2)	—	—	
Guatemalan ISP	7,000	16,000	
Total(3)	4,103,000	4,347,000	

(1) The decrease in the number of subscribers in Brazil at year-end 2001 was mainly due to the discontinuation of free Internet access services in Brazil in 2001.

(2) We no longer provide Internet access service in the United States.

(3) Includes pay Internet access subscribers and free Internet access subscribers. Our number of pay Internet access subscribers increased to 1,310,000 at December 31, 2001 from 998,000 subscribers at December 31, 2000.

We believe that further penetration of free ISP services due to the entry into the market of telecommunications operators as a result of market deregulation in some of the countries in which we provide Internet access services will continue to reduce our access revenue from basic Internet access services. However, we expect part of that decline to be offset by other revenues from premium ADSL Internet access, communications services such as video streaming, unified messaging and virtual hard disk and other value-added services we expect to introduce.

Corporate Services Revenues. Corporate services revenues increased 57.4% to €46.1 million in 2001 from €29.3 million in 2000, principally as a result of the increase in access-related corporate services in Brazil and corporate services revenues earned in markets where we did not previously earn corporate service revenues, including Columbia, Peru and Spain. Corporate services revenues accounted for approximately 6.7% and 9.5% of our total revenues for 2001 and 2000, respectively.

Electronic Commerce Revenues. Electronic commerce revenues remained virtually unchanged, amounting to €12.8 million in 2001 and €12.9 million in 2000, as a result of the decrease in e-commerce revenues in Mexico to €3.9 million in 2001 from €7.8 million in 2000, offset in part by an increase in e-commerce revenues in other countries in which we operate, particularly Brazil, Spain and Venezuela which together accounted for approximately 58.0% of our total e-commerce revenues in 2001. Electronic commerce revenues accounted for approximately 1.8% and 4.2% of our total revenues for 2001 and 2000, respectively.

Other Revenues. Other revenues increased 76.1% to €25.0 million for 2001 from €14.2 million for 2000, principally due to the increase in other revenues in Spain. Other revenues in Spain increased 115.2% in 2001, principally because of the increase in sales of ADSL modems as a result of the significant increase in the number of ADSL subscribers. Other revenues accounted for approximately 3.6% and 4.6% of our total revenues for 2001 and 2000, respectively.

Operating Expenses

Total Operating Expenses. Our total operating expenses for 2001 increased 48.1% to €1,111.0 million for 2001 from €750.3 million for 2000 for the reasons discussed below.

Goods Purchased. Goods purchased increased 81.8% to €352.0 million for 2001 from €193.6 million for 2000. This increase was principally due to the inclusion of Lycos, which we acquired in October 2000, and an increase in communications costs in Spain to €108.6 million in 2001 from €29.0 million in 2000, principally due to the increase in our average number of access subscribers. See "—Access Revenues—Spain" above. As a percentage of net revenues from operations, goods purchased decreased to 50.8% for 2001 from 63.0% for 2000.

Personnel Expenses. Personnel expenses increased 75.4% to €205.0 million for 2001 from €116.9 million for 2000. This increase was principally due to a full year of personnel expenses of Lycos, offset in part by workforce reductions in 2001. Personnel expenses from Lycos accounted for 46.2% of our total personnel expenses for 2001. As a percentage of net revenues from operations, personnel expenses decreased to 29.6% for 2001 from 38.0% for 2000.

Depreciation and Amortization. Depreciation and amortization expense increased 88.5% to €157.4 million for 2001 from €83.5 million for 2000. This increase was principally due to POPs, software and hardware added in 2000 as a result of our acquisition of Lycos in October 2000, which were depreciated over a full twelve-month period during 2001. As a percentage of net revenues from operations, depreciation and amortization decreased to 22.7% for 2001 from 27.2% for 2000.

Other Operating Expenses. Other operating expenses increased 11.3% to €396.5 million for 2001 from €356.3 million for 2000. This increase was principally due to a 55.2% increase in professional services costs (including consulting fees, auditors' fees and advisory fees) to €62.4 million in 2001 from €40.2 million in 2000, mainly as a result of the inclusion of a full year of operating expenses of Lycos, offset in part by significant costs control policies implemented in each of the countries where we operate and a 12.0% decrease in marketing expenses to €186.0 million in 2001 from €211.4 million in 2000. The decrease in marketing expenses was due in part to the consolidation of Terra's brand name in the markets in which we operate. Marketing expenses relating to our Mexican, Spanish and U.S. businesses represented 19%, 19% and 32%, respectively, of our total marketing expenses in 2001. As a percentage of net revenues from operations, other operating expenses decreased to 57.2% for 2001 from 115.9% for 2000.

Financial Income (Expense), Net. Net financial income was €126.3 million for 2001 compared with net financial income of €35.5 million for 2000, mainly due to income we received from short-term financing we provided to related Telefónica group companies and an increase in interest earned on cash deposits by Lycos at financial entities.

Amortization of Goodwill. Amortization of goodwill increased 52.4% to €386.3 million for 2001 from €253.5 million for 2000 principally as a result of a full twelve months of amortization expense associated with the acquisition of Lycos, offset in part by the change in the amortization period for goodwill. See "—Change in Accounting Estimate" above. The amortization of the goodwill generated in the acquisition of Lycos amounted to €91.8 million for 2001.

Equity Share of Affiliate Losses, Net. Net equity share of losses of our affiliates was €181.7 million for 2001 compared with €54.7 million for 2000 primarily as a result of the inclusion of a full year of losses of affiliates of Lycos, which are included as of the date of our acquisition of Lycos in October 2000, and an increase in losses of Terra Mobile, which is included in our financial statements as of the date of its incorporation in June 2000.

Extraordinary Income (Expense), Net. Net extraordinary expense was €74.8 million for 2001 compared to net extraordinary expense of €89.7 million for 2000. This extraordinary expense resulted principally from the early termination of commercial contracts, workforce restructuring provisions in Mexico and Spain and a provision for our potential liability in connection with a legal proceeding. Some of these items would not meet the criteria of extraordinary items under U.S. GAAP., although the majority of them would not be considered extraordinary items under U.S. GAAP.

Corporate Income Tax Credit. Because we had operating losses, we were able to deduct these losses from our consolidated corporate income tax obligation. In 2001, we booked an account receivable in the form of a tax credit amounting to €344.7 million for 2001, reversed a long-term deferred tax liability of €73.3 million and made consolidation adjustments of €63.5 million relating to the tax effect of various transactions carried out by Lycos

Europe, N.V. that were effective for accounting purposes prior to the date on which we acquired Lycos. We also recorded an account receivable for prepaid income taxes in the amount of €8.2 million. The net effect of these entries and certain other adjustments is that we recorded in our consolidated statement of operations a corporate income tax credit of €363.3 million. The corporate income tax legislation in effect in the countries in which we are taxed provides that, in certain circumstances, tax losses incurred in prior years may be carried forward to offset against taxable income in subsequent years. Specifically, the last years for offset of the main tax losses incurred by us are as follows:

- In Spain, in accordance with changes in the tax law introduced in 2001, tax losses may now be carried forward to offset against taxable income during a period of 15 years, which period commences in the first year in which such company begins to generate income.

- In Mexico, tax losses may be carried forward to offset against taxable income during a period of 10 years from the year in which they were incurred.

- In Brazil and Chile, there is no deadline for the offset of tax losses, although in Brazil the amount that the losses offset may not exceed 30% of total taxable income.

- In Peru and Argentina, tax losses may be carried forward to offset taxable income during a period of four and five years, respectively, from the year in which they were incurred.

- In the United States, net operating losses (NOLs) may be carried forward for offset in a period of twenty years from the year in which they were incurred, with an additional carryback of two years.

Minority Interest. Minority interest increased by 134.4% to €1.6 million for 2001 from €691 thousand for 2000 principally due to increased deductions for minority interests in the losses incurred by Terra Networks Colombia, S.A. in 2001.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Revenues

Our revenues for 2000 and 1999 were principally derived from our Internet access businesses in Brazil, Spain and Mexico and advertising on our portals.

Total Revenues. Our total revenues increased 512% to €307.5 million for 2000 from €50.2 million for 1999, primarily for the reasons discussed below.

Access Revenues. Our access revenues increased 379% to €118.7 million for 2000 from €24.8 million for 1999, primarily because of our acquisitions of our Brazilian and the Mexican ISP businesses. Our Brazilian and Mexican ISP businesses accounted for 41% and 14%, respectively, of our total access revenues for 2000. Access revenues represented approximately 39% and 29% of our total revenues for 2000 and 1999, respectively.

The growth of our ISP businesses in Spain and Chile was also significant. Access revenues from our ISP business in Spain increased 683% to €31.3 million for 2000 from €4 million for 1999, primarily due to an increase of 512% in the average number of subscribers. Access revenues from our Chilean ISP increased 98% to €11.7 million for 2000 from €5.9 million for 1999, primarily due to a 198% increase in the average number of subscribers. Because we introduced free ISP access in Chile in March 2000, our number of total customers increased at a greater rate than our access revenues.

The table below provides comparative information regarding our ISP subscriber base for the periods indicated. In addition, we currently hold approximately 29.6% of Lycos Europe, which provided Internet access services to an additional 2 million customers at December 31, 2000.

Business	Number of Subscribers at December 31, 1999	Number of Subscribers at December 31, 2000
Spanish ISP	659,000	2,579,000
Brazilian ISP	346,000	852,000
Mexican ISP	82,000	375,000
Chilean ISP	118,000	233,000
Peruvian ISP	62,000	58,000
U.S. ISP(1)	44,000	—
Guatemalan ISP	6,000	7,000
Total	1,317,000	4,103,000

(1) We no longer provide Internet access service in the United States.

Advertising Revenues. Advertising revenues increased significantly to €132.4 million for 2000 from €5.1 million for 1999, principally as a result of our acquisition of Lycos in October 2000 and a full twelve months of advertising revenues of our Brazilian and Mexican operations acquired in 1999. Advertising revenues in Spain increased 913% to €24.3 million for 2000 from €2.4 million for 1999, principally as a result of a 408% increase in the number page views due to the introduction of new services, such as messages to mobile telephones, financial services and personal web pages, among others. Advertising revenues represented approximately 43% and 10% of our total revenues for 2000 and 1999, respectively.

Corporate Services Revenues. Corporate services revenues increased 173.8% to €29.3 million in 2000 from €10.7 million in 1999. This increase was due primarily to the inclusion of a full year of results from our acquisitions in Brazil and Mexico. Revenues from corporate services in Brazil and Mexico accounted for approximately 89% of our total corporate services revenues in 2000. Corporate services revenues accounted for approximately 9.5% and 21.3% of our total revenues for 2000 and 1999, respectively.

Electronic Commerce Revenues. Electronic commerce revenues increased significantly to €12.9 million in 2000 from €0.1 million in 1999. This increase was mainly attributable to our operations in Latin America which began generating e-commerce revenues in 2000, particularly our operations in Brazil and Mexico which accounted for 81% of our total e-commerce revenues in 2000. Electronic commerce revenues accounted for approximately 4% of our total revenues for 2000.

Other Revenues. Other revenues increased 49.3% to €14.2 million for 2000 from €9.5 million for 1999, principally due to the significant increase in sales of modems and web-enabled phones in Spain. Other revenues accounted for approximately 4.6% and 40.2% of our total revenues for 2000 and 1999, respectively.

Operating Expenses

Total Operating Expenses. Our total operating expenses for 2000 increased 431% to €750.3 million from €141.2 million for 1999 for the reasons discussed below.

Goods Purchased. Goods purchased increased 524% to €193.6 million for 2000 from €31.0 million for 1999. This increase was driven primarily by our Spanish and Brazilian operations, which accounted for 33% and 30% of our total goods purchased expense during 2000 and 1999, respectively.

Goods purchased relating to our ISP business in Spain increased 179% to €47.1 million for 2000 from €16.9 million for 1999. This increase was principally due to an increase in network communications expenses and technical help desk expenses to support the growth in the number of subscribers.

Personnel Expenses. Personnel expenses increased 487% to €116.9 million for 2000 from €19.9 million for 1999. This increase was principally due to an increase in the total number of employees, as a result of our acquisitions during 1999 and 2000, our expansion in Spain and Latin America and our acquisition of Lycos. Personnel expenses from our Brazilian and Mexican businesses accounted for 16% and 24%, respectively, of our total personnel expenses for 2000. Personnel expenses from Lycos accounted for 18% of our total personnel expenses for 2000.

Depreciation and Amortization. Depreciation and amortization expense increased approximately 1,225% to €83.5 million for 2000 from €6.3 million for 1999. This increase was principally due to POPs, software and hardware added in 1999 relating to our acquisitions during the last quarter of 1999 and which were depreciated over a full twelve month period during 2000, as well as amortization of start-up expenses, including expenses associated with our global initial public offering and the launching of the Terra brand in new markets.

Other Operating Expenses. Other operating expenses increased 325% to €356.3 million for 2000 from €83.9 million for 1999. This increase was principally due to:

- a significant increase in our marketing expenses to €211.4 million in 2000 from €48.1 million in 1999, primarily as a result of the launch of the Terra brand in new markets (including the United States) and our free ISP access marketing campaign in Brazil and Mexico. Specifically, marketing expenses relating to our Brazilian, Mexican and U.S. businesses represented 20%, 26% and 19%, respectively, of our total marketing expenses for 2000. In addition, marketing expenses related to our business in Spain increased 60% to €34.4 million from €21.5 million, principally as a result of a significant campaign to advertise new content offered on our portal and our access service, and to build global brand awareness. These expenses represented 16% of our total marketing expenses for 2000; and

- professional services costs, including consulting fees, advisory fees and costs associated with market research, which increased 290% to €40.2 million for 2000 from €10.3 million for 1999, primarily due to increased consulting fees.

Financial Income (Expense), Net. Net financial income was €35.5 million for 2000 compared with a net financial income of €1.8 million for 1999, principally due to income we received from short-term financing we provided to related Telefónica group companies.

Amortization of Goodwill. Amortization of goodwill increased 783% to €253.5 million for 2000 from €28.7 million for 1999, principally as a result of the acquisition of Lycos in 2000 and a full twelve months of goodwill amortization expense associated with the acquisitions we made during 1999. The amortization of the goodwill generated in the acquisition of Lycos and the acquisitions of our Brazilian and Mexican businesses amounted to €32.1 million, €52.9 million and €47.6 million, respectively, for 2000.

Equity Share of Affiliate Losses, Net. Net equity share of losses of our affiliates was €54.7 million for 2000 compared with €60 thousand for 1999 primarily as a result of our share of the loss of Terra Mobile, S.A., Lycos Europe N.V. and Aremate.com.

Extraordinary Income (Expense), Net. Net extraordinary expense was €89.7 million for 2000 compared to net extraordinary expense of €1.4 million for 1999, principally as a result of expenses arising from the disposition of fixed assets and the recording of a provision in the amount of €23.4 million for the estimated payment by us to former Lycos executives in order to offset taxes arising from the accelerated vesting of their stock options pursuant to agreements entered into in connection with our acquisition of Lycos. However, some of these items would not meet the criteria of extraordinary items.

Corporate Income Tax Credit. Because we had operating losses, we were able to deduct these losses from our consolidated corporate income tax obligation. We booked an account receivable in the form of a tax credit amounting to €226.8 million for 2000, as well as a long-term deferred tax liability of €35.4 million in order to eliminate from the accounts the duplication arising from aggregating the individual tax assets taken into account in the investment portfolio provision recorded by us. We also recorded an account receivable for prepaid income taxes in the amount of €47.5 million. The net effect of these entries and certain other adjustments is that we recorded in our consolidated statement of operations a corporate income tax credit of €248.1 million. The corporate income tax legislation in effect in the countries in which we are taxed provides that, in certain circumstances, tax losses incurred in prior years may be carried forward to offset against taxable income in subsequent years. See "Year Ended December 31, 2001 Compared to Year Ended December 31, 2000—Corporate Income Tax".

Minority Interest. Minority interest decreased by 64% to €691 thousand for 2000 from €1.9 million in 1999. However, the composition of this balance is different for each period as a result of the acquisitions we have made during 2000 and the second half of 1999.

The Introduction of the Euro

Eleven of the 15 member countries of the European Union, including Spain, established as of January 1, 1999 fixed conversion rates between their existing sovereign currencies and the euro. The participating countries adopted the euro as their common currency on the same day. On January 1, 2001, Greece became the twelfth member country to adopt the euro. The euro was available for non-cash transactions during the transition period between January 1, 1999 and January 1, 2002. Euro banknotes and coins were first put into circulation on January 1, 2002, in all twelve member states. National banknotes and coins of the twelve member states were withdrawn from circulation as of March 1, 2002. During the transition period, the existing currencies remained legal tender in the participating countries as denominations of the euro and public and private parties were able to pay for goods and services using either the euro or existing currencies.

During the transition period, we and our suppliers and customers were required to manage transactions in both the euro and the participating countries' respective individual currencies. As a result, we incurred some operational costs to modify or upgrade our information systems in order to:

- convert individual currencies to euro;

- execute conversion calculations utilizing six-digit exchange rates and other prescribed requirements; and

- accommodate the euro currency symbol.

We selected our computer and operational systems in an attempt to ensure that our ability to transact business would not be impaired by complications resulting from the introduction of the euro. We believe that our systems were not adversely impacted by the euro conversion. Thus far, we have not experienced any significant problems with third parties (e.g., customers or suppliers) as a result of the introduction of the euro.

We have not made significant expenditures in connection with the introduction of the euro.

Foreign Currency Fluctuation

We publish our financial statements in euro, while a substantial portion of our revenues and expenses are denominated in other currencies, principally the United States dollar, the Brazilian real and the Mexican peso. Our results of operations are affected by fluctuations in exchange rates between the euro and such currencies or between the dollar and such other currencies in cases where there is no direct rate of exchange between the euro and such other currencies. In 2001, fluctuations in the exchange rates had a €0.9 million positive impact on our results of operations, principally due to the appreciation of the dollar against the euro, offset in part by the devaluation of the Latin American currencies relative to the euro.

Transactions which have the purpose and effect of eliminating or significantly reducing exchange, interest rate or market risk in asset/liability positions or in other transactions are deemed to be hedging transactions. The gains or losses arising over the term of these derivatives are allocated to income using the same method as that used for the recognition of gains or losses arising from the underlying instrument and the main transaction. At December 31, 2001, there were no derivatives.

Accounting Treatment Relating to Former Lycos Options

In connection with our acquisition of Lycos, we issued 62,540,249 new Terra Networks shares with a book value of €11.00 per share to cover options to acquire Terra Networks ADSs delivered to Lycos employees, officers and directors in exchange for options to acquire Lycos shares held by them at the time of the acquisition. The Terra Networks shares are held by Citibank, N.A., subject to delivery to the optionholder in the form of ADSs, upon exercise. For accounting purposes, we have drawn a distinction between shares that cover options with an exercise price equal to or greater than €11.00 and shares that cover options with an exercise price less than €11.00.

In connection with the exercise of those options with an exercise price equal to or greater than €11.00, the positive difference between the exercise price paid by the employee and €11.00 was recorded in our consolidated financial statements under the “Negative Goodwill in Consolidation” caption on the liability side of our balance sheet. This amount will then be allocated to income as “Reversal of Negative Goodwill in Consolidation” throughout the remaining period over which the goodwill that initially arose in connection with the Lycos acquisition is being amortized, i.e., up to a maximum of 10 years from the acquisition date of October 27, 2000. The reversal of negative goodwill in consolidation had a €2.8 million positive impact on our results of operations for 2001 and no effect in 2000.

In connection with the exercise of those options with an exercise price of less than €11.00, the difference between €11.00 and the exercise price was recorded as additional goodwill on our balance sheet. This goodwill is being amortized on a straight-line basis over a maximum period of 10 years from the date of the acquisition.

Pursuant to the resolutions adopted by the annual general shareholders’ meeting of June 7, 2001, Terra Networks may acquire, during a period of 18 months from the date of the resolution, its shares that are held by Citibank, N.A., as described above, in respect of options that have gone unexercised and which are no longer exercisable. Any shares acquired by us pursuant to this shareholders’ resolution must be presented by our board of directors to our shareholders' at a general meeting in order to approve their cancellation. In accordance with this resolution, our general shareholders' meeting of April 9, 2002 approved the cancellation of 13,105,586 shares, resulting in a €26.2 million reduction in "Capital Stock", a €117.9 million reduction in "Additional Paid-in Capital", a €138.9 million reduction in "Long-Term Financial Investments" and a €5.2 million reduction in "Goodwill in Consolidation".

Following the cancellation of these shares, at April 30, 2002, there was a total of 1,466,286 shares with an exercise price of at least €11.00 which will not be exercised and which currently form part of our capital stock and additional paid-in capital. In addition, at that date, there was a total of 224,944 shares with an exercise price of less than €11.00 which will not be exercised and which currently form part of "Capital Stock and Additional Paid-in Capital". We will have to acquire these shares and cancel them, subject to the approval of our shareholders. As a result, our "Capital Stock" and "Additional Paid-in Capital" may be reduced by up to approximately €3.4 million and approximately €15.2 million, respectively.

U.S. GAAP Reconciliation

The principal differences between U.S. GAAP and Spanish GAAP relevant to us are the capitalization of start up costs, the amortization and impairment of goodwill, tax deductions for stock options, the recognition of deferred taxes, the accounting treatment applied to certain business combinations and the application of FASB 115 to certain equity investments. See note 21 to our consolidated financial statements. These differences are as follows:

- Under Spanish GAAP an impairment loss on goodwill is recognized for the difference between the estimated fair value based on our business plan and the carrying value of the goodwill. For U.S. GAAP purposes we review events and changes in circumstances to determine whether the recoverability of the carrying value of goodwill should be reassessed. When events or circumstances indicate that the carrying value may not be recoverable based on discounted future cash flows, an impairment loss measured by the difference between the discounted future cash flows and the carrying value of goodwill is recognized by us. In the fourth quarter of 2001, we performed an analysis of projected discounted cash flows from Lycos, Terra Networks USA, Inc. and our Spanish portal business as a result of which we determined that such projected cash flows were not adequate to support the value of goodwill related to these companies under U.S. GAAP. Accordingly, we determined under U.S. GAAP that goodwill related to these companies was impaired and recorded a goodwill impairment charge in an aggregate amount of approximately €8,790 million in 2001, which reduced shareholders' equity at December 31, 2001 by that amount under U.S. GAAP.

- Under Spanish GAAP, expenses incurred during the start-up of a business which will contribute to future revenues may be deferred and amortized over five years. For purposes of U.S. GAAP, start-up expenses must be expensed as incurred.

- Under Spanish GAAP, deferred tax assets, including those related to net operating loss carryforwards, are recognized if it can be demonstrated that the deferred tax assets can be realized within a ten-year period from the date on which the assets were generated. For 1999, 2000 and 2001, we recognized such tax assets under Spanish GAAP because our business plan indicates that these assets will be realized within a ten-year period, even in worst case scenarios. Under U.S. GAAP, based on relevant considerations, a valuation allowance would be provided in full against the deferred tax assets related to our net operating losses under U.S. GAAP.

- Under U.S. GAAP, equity investments constituting between 20% and 50% of a company's share capital should be accounted for under the equity method. Investments constituting less than 20% of a company's share capital should be accounted for pursuant to FASB 115 ("Accounting for Certain Investments in Debt and Equity Securities"). Our subsidiary, Lycos, Inc., has several equity investments and pursuant to FASB 115, it has concluded that all of its equity investments constituting less than 20% of a company's share capital should be considered "available for sale" and accordingly these investments are marked to market at each balance sheet date and any unrealized gains or losses are recorded in the balance sheet (comprehensive income) and not in the statement of operations. Under Spanish GAAP, all unrealized losses are recorded in the statement of operations and a reserve for those investments whose value has declined is registered. However, under Spanish GAAP, the historical cost basis of those investments that have increased in value is not adjusted and all unrealized gains are not recognized as income until they are realized.

- Under Spanish GAAP, the translation of financial statements from the functional currency to the reporting currency involves multiplying all assets and liabilities, except for goodwill in certain cases, by the current exchange rate on the balance sheet date. Goodwill is translated using the historical exchange rate on the date the acquisition was consummated. Under U.S. GAAP, all assets, including

- goodwill and other intangible assets, are translated using the current rate of exchange as of the balance sheet date.

Under U.S. GAAP shareholders' equity was €4,220 million at December 31, 2001 compared with €5,557 million under Spanish GAAP. Under U.S. GAAP, shareholders' equity was €16,410 million at December 31, 2000 compared with €6,127 million under Spanish GAAP.

Under U.S. GAAP net loss was €11,412 million compared to €566 million under Spanish GAAP for the year ended December 31, 2001. We had a net loss of €1,236 million for 2000 under U.S. GAAP compared with a net loss of €556 million under Spanish GAAP during such period. Please see note 21 to our consolidated financial statements.

Goodwill represented approximately 29.8% of our assets at December 31, 2001 and 33.6% of assets at December 31, 2000 under Spanish GAAP. As of July 1, 2001, we began amortizing goodwill over a 10-year period. During prior years, goodwill was amortized over a five-year period. See "—Change in Accounting Principles" above.

New U.S. Accounting Pronouncements

Accounting for Business Combinations, Goodwill and Other Intangible Assets

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets". SFAS No. 141 replaces Accounting Principles Board Opinion No. 16 (APB 16) "Business Combinations" and requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangible assets will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations in the periods in which the recorded value of goodwill and certain intangibles exceeds its fair values. The provisions of SFAS No. 141 and SFAS No. 142, which apply to goodwill and intangible assets acquired prior to June 30, 2001, will be adopted by us on January 1, 2002. We are currently assessing the potential impact of these standards on our financial position and results of operations. In addition, goodwill relating to prior business combinations will cease to be amortized for U.S. GAAP reporting purposes.

Accounting for Asset Retirement Obligations

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 143 "Accounting for Asset Retirement Obligations". SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as an operating item in the statement of income. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. We do not anticipate that adoption of SFAS No. 143 will have a material impact on our financial position or results of operations.

Accounting for Impairment and Disposal of Certain Assets

In October 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144 "Accounting for the Impairment and Disposal of Long-Lived Assets", which supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and certain provisions of Accounting Principles Board Opinion No. 30 (APB 30) "Reporting Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". SFAS No. 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The provisions of SFAS No. 144, which are effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with early adoption permitted, will be adopted by us on January 1, 2002. We do not expect the adoption of SFAS No. 144 to have a material impact on our financial position or results of operations.

SFAS No. 145

In April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement rescinds SFAS No. 4 "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that statement, SFAS No. 64 "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements". This statement also rescinds SFAS No. 44 "Accounting for Intangible Assets of Motor Carriers". This statement amends SFAS No. 13 "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this statement related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. The provisions in paragraphs 8 and 9(c) of this statement related to Statement 13 shall be effective for transactions occurring after May 15, 2002, with early application encouraged. All other provisions of this statement shall be effective for financial statements issued on or after May 15, 2002, with early application encouraged. We have not yet assessed what effect, if any, application of this statement will have on our financial position or results of operations.

B. LIQUIDITY AND CAPITAL RESOURCES

To date, we have primarily financed our operations from:

- funds raised in our global initial public offering completed in November 1999;
- capital contributions and short-term debt financing from members of the Telefónica group;
- a rights offering in September 2000 pursuant to which we raised approximately €2.2 billion; and
- cash generated from operations.

Substantially all of the shares offered in the rights offering were subscribed for by Telefónica, S.A.

As of December 31, 2001, based on our existing business plan, we expect that these sources will enable us to meet our operational funding needs and budgeted capital expenditures for approximately the next several years. However, any significant acquisition for cash that we make during or after this period may require additional financing. We cannot assure you that we will be able to obtain sufficient funds to finance our operating losses, make necessary capital expenditures and continue to execute our business plan.

We expect to fund our future operations, acquisitions, joint ventures and infrastructure improvements to support our strategic plan through a combination of:

- proceeds from our September 2000 rights offering;
- operating cash flow; and
- to the extent necessary, additional equity offerings and debt offerings.

Amortization of goodwill expense, which affects our results of operations, is not a cash item and therefore does not affect our ability to generate cash or our cash needs.

Capital Expenditures

The table below shows our capital expenditures for hardware and software during each of the past three years.

	Year Ended December 31,		
	1999	**2000**	**2001**
	(thousands of euro)		
Hardware	18,926	75,367	30,357
Software	6,930	46,434	19,948
Total	25,856	121,801	50,305

We expect our capital expenditures during 2002, 2003 and 2004 relating to computer hardware to be as set forth in the table below.

	Year Ended December 31,		
	2002	**2003**	**2004**
	(millions of euro)		
Spain	19	12	12
Brazil	8	6	5
Mexico	5	5	4
United States	2	2	2
Other	9	10	10
Total	43	35	33

In addition, we expect our capital expenditures during 2002, 2003 and 2004 relating to the acquisition of software to be as set forth in the table below.

	Year Ended December 31,		
	2002	**2003**	**2004**
	(millions of euro)		
Spain	6	9	9
Brazil	6	5	5

	Year Ended December 31,		
	2002	2003	2004
	(millions of euro)		
Mexico	6	6	5
United States	10	9	8
Other	21	20	20
Total	49	49	47

The foregoing amounts are estimates only and our actual capital expenditures may be less than or exceed these amounts. In particular, our capital expenditures will increase significantly in the future to the extent we acquire significant additional businesses.

Cash Flows

The following analysis of cash flows is based on our consolidated financial statements. To date, we have experienced significant negative cash flows from operating activities resulting from our net operating losses. Net cash used in operating activities was €167.0 million for 2001 compared to net cash used in operating activities of €274.6 million for 2000 and net cash provided by operating activities of €1.6 million for 1999.

Net cash used in by investing activities was €366.9 million for 2001 compared to net cash provided by investing activities of €101.4 million for 2000 and net cash used in investing activities of €730.4 million for 1999. Net cash used in investing activities in 2001 primarily related to acquisitions and capital expenditures.

Net cash provided by financing activities consisted of €25.9 million for 2001, €2,272.5 million for 2000 and €1,316.4 million for 1999. Net cash provided by financing activities in 2001 mainly related to proceeds from capital contributions in connection with the exercise of options granted under our employee stock option plans. Substantially all of the net cash provided by financing activities in 2000 related to our September 2000 rights offering. Approximately 65% of the net cash provided by financing activities for 1999 was generated by our initial public offering and the remaining part of this financing was provided by members of the Telefónica group in the form of short-term loans and capital contributions.

Debt

We capitalized in September 1999 €266.8 million in short-term liabilities owed to members of the Telefónica group, in exchange for which Telefónica received 133.4 million of our ordinary shares. At December 31, 2001 we had approximately €16.1 million in long-term liabilities, mainly attributable to long-term trade accounts payable by Terra Networks Colombia, S.A.

At December 31, 2001, there were no derivatives. The “Financial income (expense), net” caption in the accompanying consolidated statement of operations reflects the effect of the transactions carried out in 1999. This effect was not material.

Contractual Obligations and Commercial Commitments

Our principal contractual obligations as of December 31, 2001 to make future payments are described below.

Our subsidiary, Terra Networks Colombia Holding, S.A., has entered into four separate content agreements with Casa Editorial El Tiempo, S.A., Comercializadora La Semana, S.A., El Colombiano Ltda y Cía, S.C.A. and El Pais, S.A. and a trademark purchase agreement with all of the above-mentioned parties dated July 14, 2000. Pursuant to these agreements, we are obligated to pay an aggregate amount of U.S.$15 million, U.S.$11.5 million of which relates to the trademark agreement and U.S.$3.5 million of which relates to the content agreements.

In connection with our acquisition of Laciudad.com in Colombia, Terra Networks, S.A. granted a put option to the founders of Laciudad.com pursuant to which they have the right to require us to purchase their 35% stake in Terra Networks Colombia, S.A. for a maximum aggregate amount of U.S.$5,833,672, subject to certain adjustments. This put right may be exercised between July 15, 2002 and July 15, 2004.

We also entered into a put/call arrangement with Telefónica Móviles, S.A. pursuant to which we have a call right and a put right with respect to Terra Mobile. Under this agreement, we have the right to acquire up to a 49% stake in Terra Mobile for the lower of (i) fair market value or (ii) the value of our investment in Terra Mobile, as adjusted to cost of carry. This option may be exercised once between January 1, 2003 and January 1, 2006. We also have the right to require Telefónica Móviles, S.A. to purchase our 20% stake in Terra Mobile for the lower of (i) fair market value or (ii) the value of our investment in Terra Mobile, as adjusted to the cost of carry, if we disagree with any decisions to (i) effect capital increases or debt issuances or (ii) adopt measures that may affect our strategic position. This option may be exercised between January 1, 2003 and the termination of the shareholders' agreement between us and Telefónica Móviles, S.A. in connection with our investment in Terra Mobile, which agreement shall be in effect so long as we own an interest in Terra Mobile. Because the amounts payable by either party are based on appraised fair market value and Terra Mobile is not publicly traded, the determination of the fair market value of Terra Mobile at the time of exercise of such options is not practicable as of the date of this annual report. See "Item 4—Information on the Company—Access & Communication Services —Terra Mobile".

In connection with our acquisition of Bumeran Participaciones, S.L., we agreed to subscribe to two capital increases in an aggregate amount of €3,408,608 prior to December 31, 2003. In addition, we granted a put option to the founders of Bumeran Participaciones, S.L. pursuant to which they have the right to require us to purchase their 16% stake in Bumeran Participaciones, S.L. for the greater of (i) €4,923,919 or (ii) 60% of the fair market value of such interest (as determined by certain specified auditing firms), if Bumeran Participaciones, S.L. does not conduct a public offering of its securities prior to December 31, 2003. In addition, we have the right to purchase the founders' 16% stake in Bumeran Participaciones, S.L. in the event of a breach of certain employment contracts entered into between the founders and Bumeran Participaciones, S.L. The exercise price for such option is the lower of (i) €4,923,919 or (ii) 60% of the fair market value of such interest (as determined by certain specified auditing firms). We also have a right to purchase the founders' 16% stake in Bumeran Participaciones, S.L., beginning December 12, 2003, for the greater of (i) €4,923,919 or (ii) 60% of the fair market value of such interest (as determined by certain specified auditing firms). The determination of the fair market value of the founders' interest in Bumeran Participaciones, S.L. at the time exercise of such options is not practicable as of the date of this annual report.

With respect to our investment in Uno-e Bank, S.A., we have entered into an agreement to provide for a liquidity mechanism, which is subject to adjustment upon completion of the merger agreed to in principle between Uno-e Bank, S.A. and the private consumer finance activities operated by Finanzia Banco de Credito, S.A. We have the right to sell our stake in Uno-e Bank, S.A. to Banco Bilbao Vizcaya Argentaria, S.A. between May 15, 2004 and May 15, 2006 at fair market value (as determined by an investment bank). If the merger agreed to in principle is not consummated, the purchase price paid by Banco Bilbao Vizcaya Argentaria, S.A. for our stake in Uno-e Bank, S.A. in accordance with such right shall be the greater of (i) fair market value (as determined by an investment bank) and (ii) the amount paid by us for our stake in Uno-e Bank, S.A. (€189.4 million).

Additionally, Banco Bilbao Vizcaya Argentaria,S.A. has the right to purchase our stake in Uno-e Bank, S.A. between May 15, 2004 and May 15, 2006 at a purchase price equal to the greater of (i) fair market value (as determined by an investment bank) and (ii) the amount paid by us for our stake in Uno-e Bank, S.A. (€189.4 million) plus accrued interest at an annual interest rate of 4.70%. If a definitive agreement relating to the merger agreed to in principle is reached by the parties, the above-referenced liquidity mechanism will be modified, as a result of which Banco Bilbao Vizcaya Argentaria, S.A. will no longer have the right to purchase our shares, and the exercise price in connection with our right to require Banco Bilbao Vizcaya Argentaria, S.A. to purchase our interest in Uno-e Bank, S.A. will be equal to fair market value (as determined by an investment bank).

The following table discloses aggregate information about our contractual obligations and the periods in which payments are due.

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years
	(thousands of euro)				
Contractual Obligations					
Bumeran capital increases	3,409	—	3,409	—	—
Unconditional purchase obligations (1)	15,000	5,333	9,667	—	—
Total contractual cash obligations	18,409	5,333	13,076	—	—

(1) Includes amounts payable in accordance with content agreements and trademark purchase agreements entered into by Terra Networks Colombia Holding, S.A. Certain of these obligations are denominated in dollars. We have translated these amounts into euro at U.S.$0.8901=€1.00, the noon buying rate for euro on December 31, 2001. Actual amounts paid in dollars may differ at the payment date.

The following table discloses aggregate information about our commercial commitments. Commercial commitments are items that we could be obligated to pay in the future. They are not included in our consolidated balance sheet.

	Amount of Commitment Expiration Per Period						
	Total amounts Committed		**Less than 1 Year**	**1 - 3 years**		**4 - 5 years**	**After 5 years**
	(thousands of euro)						
Commercial Commitments							
Colombia put agreement	5,193		—	5,193	(1)	—	—
Bumeran put right	n.a.	(2)	—	n.a.	(2)	—	—
Total commercial commitments	5,193		—	5,193		—	—

(1) Subject to certain adjustments. In addition, the purchase price is denominated in dollars. We have translated these amounts into euro at U.S.$0.8901=€1.00, the noon buying rate for euro on December 31, 2001. Actual amounts paid in dollars may differ at the payment date.

(2) The total amount that could be paid under the agreement is based on appraised fair market value. This entity is not publicly traded and therefore a determination of fair market value is not practicable as of the date of the filing of this annual report.

C. RESEARCH AND DEVELOPMENT

We continuously seek to improve our existing services and systems as well as to develop new services that add more value and broaden our portfolio of products and services. We implement an active policy of creating and introducing new services and systems in conjunction with the main suppliers in the market. We also maintain a close relationship with Telefónica Investigación y Desarrollo, S.A., the main supplier of research and development services to us and other members of the Telefónica group, in connection with research and development activities with respect to new technological solutions.

Our research and development projects are executed in phases, beginning with the identification of the service to be developed through the testing and implementation phase. The time frame for the development and introduction of new services to the market depends on the nature and complexity of the service. As a general policy, we develop projects on a global basis, subject to modifications necessary for their implementation in local markets.

In 2000 and 2001, we had research and development expenditures of approximately €137.4 million and approximately €127.6 million, respectively. The increase in research and development expenses in 2001 was primarily due to efforts to develop and enhance our product offerings. We did not have material research and development expenditures in 1999. All research and development costs are expensed as incurred, except for the costs of acquired technology.

Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

Under Spanish corporate law, the board of directors is responsible for the management, administration and representation in all matters concerning our business, subject to the provisions of the by-laws (*estatutos sociales*) and resolutions adopted at general shareholders' meetings. We will endeavor to appoint a majority of the members of the board of directors from outside of the company, including representatives of the significant shareholders and independent directors. Under the *Código de Buen Gobierno* (Code of Good Corporate Governance) of the *Comisión*

Nacional del Mercado de Valores (the Spanish Securities Commission, or CNMV) the following persons would not be considered independent directors: persons who have had a significant commercial or business relationship with the company or have been officers of the company during the two years prior to the date of appointment or have family links with the company or with the members of the board of directors.

Directors are elected by our shareholders to serve a five-year term. A director may be elected to serve for an unlimited number of terms. If a director does not serve out his or her entire term, the board of directors may fill the vacancy by appointing a shareholder as a replacement director to serve until the next general shareholders' meeting, when the appointment may be ratified or a new director to fill the vacancy is elected or replaced. A director may resign or be removed from office by the shareholders at the general shareholders' meeting. Our by-laws provide that a majority of the members of the board (represented in person or by proxy) constitute a quorum. Resolutions of the board of directors are passed by a simple majority of the directors present or represented at a board meeting.

Under Spanish corporate law, the board of directors may delegate its powers to an executive committee or delegate committee or to one or more managing directors (*consejeros delegados*). Spanish corporate law provides that resolutions appointing an executive committee or any managing director or authorizing the permanent delegation of all, or part of, the board's power require a two-thirds majority of the members of the board of directors. Certain powers provided in Spanish corporate law may not be delegated.

At May 31, 2002, the members of our board and their respective positions are as follows:

Name	Position	Current Term Expires	Age
Joaquim Agut Bonsfills	Executive Chairman	2006	48
Angel Vilá Boix	Director	2006	38
Francisco Moreno de Alborán y de Vierna	Director	2004	57
Luis Ramón Arrieta Durana	Director	2006	45
Alejandro Junco de la Vega Elizondo	Director	2005	27
John de Mol	Director	2005	46
Enrique Used Aznar	Director	2006	61
Telefónica DataCorp, S.A.(1)	Director	2005	44
Robert J. Davis	Vice Chairman	2005	45
Edward M. Philip	Director	2005	37
Jesús María Zabalza Lotina	Director	2007	44
Carlos Fernández-Prida Méndez-Nuñez	Director	2007	58
José F. Mateu Isturiz	Secretary; Non-Director	2006	47

(1) Represented by Antonia Viana-Baptista

None of our directors serve on our board pursuant to any service contract. However, Messrs. Davis and Philip were elected to serve on our board of directors pursuant to the terms of our merger agreement with Lycos.

Biographies of Directors

Joaquim Agut Bonsfills serves as Executive Chairman of our Board of Directors. From 1997 to August 2000, Mr. Agut served as president and chief executive officer of GE Power Controls. Prior to that time, he served as vice president and general manager of marketing and sales of GE Power Controls. Mr. Agut was also the GE national executive for Spain and Portugal and chairman of the Pan European GE Quality Council. In December 1999, he was named leader of the European Corporate Executive Council of General Electric, becoming General Electric's first executive in Europe.

Angel Vilá Boix serves as a Director. Mr. Vilá Boix is the general manager of corporate development and a member of the executive committee at Telefónica, S.A. He joined the Telefónica group in 1997 as a controller and was subsequently promoted to the position of general manager of finance and control at Telefónica Internacional, S.A. and later to the position of general manager of control and corporate development at Telefónica, S.A. Mr. Vilá Boix left the Telefónica group during 1999, serving as general manager of business at the Planeta Group prior to rejoining Telefónica, S.A. in his current position in May 2000. Mr. Vilá Boix began his career as a financial analyst at Citibank, N.A. and has served as a consultant at McKinsey & Co. and worked at the Spanish construction companies, Ferrovial and Paesa. Mr. Vilá Boix currently serves on the board of directors of Banco Bilbao Vizcaya Argentaria, S.A. and Catalana d'Iniciatives CR, S.A. Mr. Vilá Boix has a degree in industrial engineering from the Universidad Politécnica de Cataluña and a master's degree in business administration from Columbia University.

Francisco Moreno de Alborán y de Vierna serves as a Director. Mr. Alborán has served in various positions at McKinsey & Co., including as president of McKinsey's Spanish organization and a member of its board of directors.

Luis Ramón Arrieta Durana serves as a Director. Mr Arrieta is deputy executive vice president of Banco Bilbao Vizcaya Argentaria, S.A. and chief executive officer of BBVA E-Commerce. Previously, he served as chief executive officer of BBVA Finanzia.

Alejandro Junco de la Vega Elizondo serves as a Director. Mr. Junco de la Vega Elizondo is the director of the Internet division of Grupo Reforma. From 1997 until 1999 he served in the executive development program of CEMEX (Cementos Mexicanos).

John de Mol serves as a Director. Since 1998, Mr. de Mol has served as the chairman of the executive board of Endemol Entertainment. He formed John de Mol Productions in 1979, which merged in 1994 with Joop van den Ende Productions to create Endemol Entertainment.

Enrique Used Aznar serves as a Director. Mr. Used is the chairman of Amper, S.A. and AmperProgramas and the deputy chairman of Medidata (Brazil). Previously, he held the position of chairman of Telefónica Internacional, S.A., Telefónica Móviles, S.A., Estratel and Telefónica Investigación y Desarrollo, S.A. He has also served as deputy chairman and chief executive officer of Telefónica Publicidad e Información and Compañía de Telecomunicaciones de Chile. He has also served as a member of the board of directors of Telefónica de Argentina, ATT Network System International and Ericsson (Spain).

Antonio Viana-Baptista serves as the representative of Telefónica DataCorp, S.A. on our Board of Directors. Mr. Viana-Baptista is president of Telefónica Internacional, S.A. and a member of the standing committee and executive committee of Telefónica, S.A. He is also executive president of Telefónica DataCorp, S.A. and Emergia, S.A. Previously, he held the position of executive board member of Banco Portugues de Investimentos SGPS and principal partner of McKinsey & Co.

Robert J. Davis serves as Vice Chairman of our Board of Directors. From the combination of Terra Networks and Lycos in October 2000 to January 2001, Mr. Davis served as Chief Executive Officer of Terra Networks. Previously, he served as president and chief executive officer of Lycos from its inception in June 1995 until October 2000. From January 1993 to June 1995, Mr. Davis served as vice president of sales at Cambex Corporation, a manufacturer of computer-related products. From January 1982 to January 1993, Mr. Davis was employed by Wang Laboratories, a computer manufacturer, in various sales and marketing positions, including director of United States commercial sales and marketing and director of worldwide marketing.

Edward M. Philip serves as a Director and Senior Vice President of Special Projects. From the combination of Terra Networks and Lycos in October 2000 to January 2001, Mr. Philip served as Chief Financial Officer of Terra Networks. Prior to the combination of Terra Networks and Lycos, Mr. Philip served as chief financial officer and secretary of Lycos since December 1995 and chief operating officer since December 1996. From July 1991 to December 1995, Mr. Philip was employed by The Walt Disney Company where he served in various finance positions, most recently as vice president and assistant treasurer. From September 1989 to May 1991, Mr. Philip attended Harvard Business School. From August 1987 to June 1989, Mr. Philip was an investment banker at Salomon Brothers Inc.

Jesús María Zabalza Lotina serves as Director. Mr. Zabalza was born in 1958 in Baracaldo (Vizcaya). He graduated from the University of Bilbao with a degree in electrical engineering. In 1982, he joined Banco Vizcaya, S.A. and, in 1988, he became regional manager of Burgos at Banco Bilbao Vizcaya, S.A. (successor to Banco Vizcaya, S.A.). In 1989-1990, he was the head of the "managing schemes" department, and during 1990-1992, he was the marketing manager of Banco Bilbao Vizcaya, S.A. in Madrid. He joined Caja Postal (Argentaria) in 1992 as deputy general manager, and in 1994, he became the general manager of Banco Hipotecario, where he remained until 1996, when he became the general manager of Caja Postal (Argentaria), leading its network of branches. In December 1996, he joined Caja de Ahorros y Pensiones de Barcelona, S.A. ("la Caixa") as territorial manager. Mr. Zalbaza is currently an executive vice president of la Caixa, a member of the board of directors of la Caixa and a member of the boards of directors of e-la Caixa, S.A., Telefónica Factoring, S.A., Telefónica Factoring Brasil S.A. and Adeslas, S.A. He is also vice president of the *Asociación Española de Ejecutivos de Finanzas* (AEEF) and of the *Club Financiero Génova*.

Carlos Fernández-Prida Méndez-Nuñez serves as Director. Mr. Fernández-Prida received a degree in engineering from the Universidad Politécnica de Madrid and is licensed in chemical sciences by UNED. He received an executive business degree in general management and corporate management from the Escuela Superior de Administración de Empresas de Madrid. He completed post-graduate work at the University of Indiana (United States). Since 1992, he has served on the boards of directors of various companies in Spain and England, particularly in the chemical, forestry and real estate sectors. Between 1968 and 1981, he was a professor at the Universidad Politécnica de Madrid. He served in management positions at various companies between 1981 and 1992. He served as president of the *Asociación Española para la Investigación de la Industria de la Madera* between 1992 and 1996. In May 1997, he was appointed as president of Telefónica de Argentina, a position which he occupied until February 2002. He is the vice president of MEBF and a member of the executive board of the Argentine Chamber of Commerce. He has served on the board of directors of Atlántida de Comunicaciones, Cablevisión, S.A. and *Asociación de Empresas de Servicios Publicos Argentina*. He is currently a member of the board of directors of Telefónica Media de Argentina S.A. and *Instituto para el Desarrollo Empresarial de la Argentina*, among others.

José F. Mateu Isturiz serves as Secretary to the Board of Directors and General Counsel. Prior to joining Terra Networks in 2001, Mr. Mateu was senior counsel and vice secretary of the board of Repsol YPF, S.A., where he held various positions since joining the company in 1988. Mr. Mateu started his career as a state attorney in several ministries of the Spanish government. Mr. Mateu also worked as a government expert to the legal service of the EEC Commission. Mr. Mateu holds a law degree from the Complutense University of Madrid and conducted post graduate studies to become a state attorney and finance and tax inspector. Mr. Mateu is a member of the Madrid Bar and the SERL of the International Bar Association and is the chief legal officer of Roundtable Europe. He is a frequent lecturer in European, corporate and tax law and a member of the editorial board of Global Counsel.

Executive Officers and Senior Management

Our executive officers and senior management and their respective positions at May 31, 2002 are as follows:

Name	Position	Age	Year of Appointment
Joaquim Agut Bonsfills	President and Executive Chairman	48	2000
Stephen J. Killeen	Executive Vice President of U.S. Operations	38	2001
Juan Antonio García-Urgelés Capdevilla	Executive Vice President of Global Operations	41	2000
Elías Rodríguez-Viña Cancio	Chief Financial Officer	42	2001
Juan Rovira de Osso	Executive Vice President – Planning, Strategic Marketing and International Joint Ventures	46	2001
Javier Martínez Díaz	Executive Vice President – Spanish and Latin American Operations	38	2001

Name	Position	Age	Year of Appointment
Antonio de Esteban Quintana	Executive Vice President – Audit	40	1999
Antonio Botas Bañuelos	Executive Vice President for Vertical and Transactional Joint Ventures	38	1999
José F. Mateu Isturiz	General Counsel	47	2001
John McMahon	Executive Vice President – Human Resources	49	2001

All of our executive officers and senior management serve at the discretion of the Board of Directors.

Biographies of Executive Officers and Senior Management

Stephen J. Killeen serves as Executive Vice President of U.S. Operations. Prior to joining Terra Networks, Mr. Killeen was president and director of MKTG Services, Inc. (MKTG), formerly MSG, a leading provider of integrated marketing solutions, and chairman of MKTG's Internet Group. Previously, Mr. Killeen was president and chief executive officer of Raging Bull, joining the company when it had four employees, and orchestrating its acquisition by AltaVista. Before leading Raging Bull, Mr. Killeen was senior vice president at Fidelity Investments, the second largest discount brokerage firm in the world, where he led the organization responsible for Fidelity's dramatic online growth. Prior to his tenure at Fidelity, Mr. Killeen served as senior vice president at DLJ Direct (now called CSFB Direct). At DLJ Direct, Mr. Killeen pioneered the online brokerage industry in the early 1990s and dramatically grew the company's online account base and transactions. Mr. Killeen received a bachelor of arts degree in political science from Union College. He is a member of The Industry Standard's Leaders of the Internet Economy Network, the Interactive Services Association, the Securities Industry Association and the Interactive Industry Association.

Juan Antonio García-Urgelés Capdevilla serves as Executive Vice President of Global Operations. Prior to the combination of Terra Networks and Lycos in October 2000, he served as Chief Operating Officer of Terra Networks. Mr. García-Urgelés has served in different positions at Microsoft Ibérica, among them as technical director for five years, marketing director for four years and corporate customer division general manager.

Elías Rodríguez-Viña Cancio serves as Chief Financial Officer. Prior to joining Terra Networks in early 2001, Mr. Rodríguez-Viña served as business development director for GE Capital Europe for Spain and Portugal and director of mergers and acquisitions for UBS. Mr. Rodríguez-Viña began his career in auditing at Arthur Andersen.

Juan Rovira de Osso serves as Executive Vice President of Planning, Strategic Marketing and International Joint Ventures. Prior to joining Terra Lycos, Mr. Rovira worked at the Telefónica group, which he joined in 1997 as deputy general manager for business development of Telefónica Internacional. At Telefónica Internacional, he was involved in the expansion of the Telefónica group in certain Latin American countries and served as a board member of Telefónica Centroamérica. Mr. Rovira served as sr. vice president of Telefónica Internacional USA, Inc. in Miami and in 1999, he was appointed sr. vice president for corporate development and strategy of Atento Holding USA, part of the call center business of the Telefónica group. Before joining the Telefónica group, Mr. Rovira was managing director of electronic banking and cash management services at Banco Santander. He started up and consolidated this line of business for Banco Santander in Spain and initiated the international expansion of Banco Santander's electronic banking business in Latin America. Mr. Rovira began his career as an international legal counsel for Banco de Vizcaya, S.A. (the predecessor to Banco Bilbao Vizcaya Argentaria, S.A.) where he acquired extensive experience in international capital markets transactions. Mr. Rovira holds a law degree from the University of Barcelona and an executive management degree from IESE Business School, University of Navarra.

Javier Martínez Díaz serves as Executive Vice President of Spanish and Latin American Operations. Prior to the combination of Terra Networks and Lycos in October 2000, Mr. Martínez was responsible for Operations Handling Management at Terra Networks, which handles the corporate functions of Technology, Customer Relationship Management (CRM) and Wireless. Before joining Terra Networks, Mr. Martínez was partner of finances and telecommunications and responsible for the e-business practice at a European strategic consulting firm for several years. Prior to then, Mr. Martínez led an international program for industrial technological development in Germany as an international program team leader. Mr. Martínez holds a degree in civil engineering and has carried out continuous training throughout his professional career, including program management (University of Munich), business management (Behoust, Paris) and e-strategy (IESE Barcelona).

Antonio de Esteban Quintana serves as our Executive Vice President–Audit and is also responsible for the Corporate Initiative Group. Prior to the combination of Terra Networks and Lycos in October 2000, he served as Chief Financial Officer of Terra Networks. From 1998 until 1999, Mr. de Esteban served as director of sales for Spain and Portugal for Barclays Capital. From 1993 until 1998, he served as director of sales for derivatives products at Bankers Trust International PLC, where he was named managing director in 1997.

Antonio Botas Bañuelos serves as our Executive Vice President for Vertical and Transactional Joint Ventures. From 1997 until September of 1999, Mr. Botas served as director and general manager of DoubleClick Iberoamérica. From 1995 until 1997, Mr. Botas served in a number of executive positions at Telefónica Publicidad e Información, S.A., including director of marketing. From 1991 to 1994, Mr. Botas served as marketing manager of the Royal Life Insurance Company.

John McMahon serves as Executive Vice President–Human Resources. Prior to the combination of Terra Networks and Lycos in October 2000, Mr. McMahon served as chief human resource officer at Lycos. Prior to joining Lycos, Mr. McMahon served as vice president of human resources at Wang Global. Before joining Wang Global, Mr. McMahon served as senior vice president of human resources at Stream International and vice president of human resources a Stride Rite and held several human resource management positions at ITT.

B. COMPENSATION

For the year ended December 31, 2001, the aggregate compensation of all of our current directors paid or accrued by us was approximately €2.2 million. During the same period, the aggregate compensation of the members of our current executive committee and senior management (who are not current directors) paid or accrued was approximately €2.4 million.

C. BOARD PRACTICES

Committees of the Board

The Board of Directors has established a delegate committee, an audit committee and a nominating and compensation committee in accordance with the recommendations set forth in the Code of Good Corporate Governance. Each of the audit committee and the nominating and compensation committee is required by board regulations to have a minimum of three and a maximum of five external directors. The following is a brief description of the committees of our Board of Directors.

Delegate Committee

The delegate committee has all of the powers of the Board of Directors other than those non-delegable powers pursuant to Spanish corporate law.

Audit Committee

The audit committee is responsible for supervising corporate accounting and auditing, nominating our independent auditor and verifying our compliance with the Internal Regulations of Conduct in the Securities Markets. The following directors serve on our audit committee: Antonio Viana-Baptista (on behalf of Telefónica DataCorp, S.A.), Francisco Moreno de Alborán y de Vierna, Enrique Used Aznar and Luis Ramón Arrieta Durana. In particular, the audit committee:

- proposes the appointment of the auditor, the terms and conditions of its recruitment, the scope of its work and the renewal or termination of its mandate;
- reviews the accounts of the company, monitors the fulfillment of all the legal requirements and the correct application of the generally accepted accounting principles and criteria suggested by the management of the company;
- serves as the communication channel between the Board of Directors and the auditor, assesses the results of each audit carried out and mediates and arbitrates should differences arise between the Board of Directors and the auditor in connection with the principles and criteria applicable to the preparation of the financial statements;
- reviews the adequacy and integrity of the internal control procedures followed in the preparation of the consolidated and individual accounts;
- supervises the fulfilment of the audit contract and ensures that the opinion on the annual accounts and the main contents of the auditors' report is drafted in a clear and accurate way;
- reviews the prospectuses, annual reports and interim financial information which the company must provide to the markets and its supervisory bodies; and
- monitors the fulfilment of the Internal Conduct Code in the securities markets, of the Senior Executives Conduct Code and of the Internal Regulation of the Board of Directors.

Nominating and Compensation Committee

The nominating and compensation committee is responsible for nominating directors and periodically revising the board's compensation and approving any transaction with a significant shareholder. The following directors serve on our nominating and compensation committee: Enrique Used Aznar, Luis Ramón Arrieta Durana and Francisco Moreno de Alborán. In particular, the nominating and compensation committee:

- issues reports on the proposals for the appointment of board members and senior executives of the company and of its subsidiaries;
- approves the remuneration of senior executives;
- determines the remuneration system for the Board of Directors; and
- issues reports on the incentive schemes.

D. EMPLOYEES

At December 31, 2001, we had 2,920 employees. The following table breaks down each category of employee by principal countries or markets in which we operate.

Country/Market	Total
Argentina	64
Brazil	588
Caribbean	5
Central America	63
Colombia	40
Chile	101
Spain	517
Mexico	424
Peru	45
U.S. Hispanic	91
U.S.	774
Uruguay	5
Venezuela	35
Headquarters (Spain)	168
Total	2,920

In 2001, we reduced our workforce by approximately 15%.

From time to time, we employ independent contractors to support our research and development, marketing, sales and editorial departments. The average number of independent contractors we used during 2001 was 211. None of our personnel are represented under collective bargaining agreements. We consider our relations with our employees to be good.

E. SHARE OWNERSHIP

At May 20, 2002, the following directors beneficially owned our ordinary shares:

Name	No. of shares beneficially owned
Joaquim Agut Bonsfills	10
Angel Vilá Boix	10
Luis Ramón Arrieta Durana	100
Enrique Used Aznar	5
Robert J. Davis	799
Edward M. Philip	9,494
Jesús María Zabalza Lotina	5

None of our directors and executive officers beneficially owned shares representing one percent or more of our share capital at that date.

At December 31, 2001, the following directors and executive officers held options to acquire our ordinary shares:

Name	No. of shares subject to options	Exercise price	Number of options exercisable per year	Expiration date
Joaquim Agut Bonsfills	450,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
Antonio de Esteban Quintana	65,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005

Name	No. of shares subject to options	Exercise price	Number of options exercisable per year	Expiration date
	70,908	€11.81	One-third per year beginning two years from date of grant	March 2004
Antonio Botas Bañuelos	45,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
	70,908	€11.81	One-third per year beginning two years from date of grant	March 2004
Juan Antonio García-Urgelés Capdevilla	65,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
	15,000	€11.81	One-third per year beginning two years from date of grant	March 2004
Elías Rodríguez-Viña Cancio	50,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
Javier Martínez Díaz	50,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
José F. Mateu Isturiz	50,000	€19.78	One-fourth per year beginning one year from date of grant	December 2005
Robert J. Davis	2,150,000(1)	U.S.$30.41	n/a	February 9, 2009
	1,343,750(1)	U.S.$15.32	n/a	August 4, 2009
	1,290,000(1)	U.S.$19.19	n/a	April 27, 2010
Edward M. Philip	580,776(1)	U.S.$6.28	n/a	August 3, 2008
	2,150,000(1)	U.S.$30.41	n/a	February 9, 2009
	752,500(1)	U.S.$15.32	n/a	August 4, 2009
John McMahon	82,000(1)	U.S.$15.32	n/a	August 4, 2009
	430,000(1)	U.S.$28.66	One-fourth one year from date of grant and $^{1}/_{48}$th per month thereafter	May 15, 2010
	200,000	€25.70	One-fourth per year beginning one year from date of grant	October 27, 2010
Stephen J. Killeen	250,000(1)	€12.43	One-fourth per year beginning one year from date of grant	March 1, 2006
Juan Rovira de Osso	50,000	€9.51	One-fourth per year beginning one year from date of grant	June 2006

(1) Represent options to acquire ADSs.

(2) Features one-year acceleration as a result of combination of Terra Networks, S.A. and Lycos, Inc.

Employee Stock Options

Terra Networks Stock Option Plan

In October 1999 we established an employee stock option plan in order to help us attract, retain and motivate talented employees. We allocated 14 million ordinary shares for distribution under this plan and transferred these shares to two Spanish banks at book value. The banks have granted options to us to purchase these plan shares at book value. We will exercise those options to meet our obligations to our employees under the plan.

At December 31, 2001, options to purchase an aggregate of 9,600,246 ordinary shares were outstanding under this plan, representing 1.55% of our capital stock on a fully-diluted basis at that date. These options have an average exercise price of €11.45

Of the options to purchase an aggregate of 9,600,246 ordinary shares outstanding at December 31, 2001, options to purchase an aggregate of 2,311,863 ordinary shares were granted in October 1999 and June 2000 and have the following terms:

Exercise price	€11.81
Vesting	One-third of the employee's options can be exercised each year beginning in the second year after the date the options are granted
Transferability	None
Continuing employment requirement	Employee must maintain employment continuously from date the option is granted until option is exercised
Exercise/our settlement options	Upon exercise of an option, we can elect to deliver to the employee either: • one ordinary share; or • a cash amount equal to the then-current market price of the share less the exercise price, less applicable taxes
Expiration date	March 1, 2004

At our general shareholders' meeting on June 8, 2000, our shareholders authorized, among other things, our Board of Directors to determine the exercise price for new options (with an exercise price equal to the market price of our ordinary shares on the respective date of grant) and to extend the expiration of the exercise period for such options. In accordance with this authorization, as of December 31, 2001, our Board of Directors has granted options to purchase ordinary shares (of which options to purchase an aggregate of 7,288,383 ordinary shares were outstanding at December 31, 2001) with exercise prices ranging from €4.92 to €28.81. Under the terms of these options, one-fourth of the employee's options can be exercised each year beginning in the first year after the respective date the options are granted.

On June 7, 2001, our shareholders voted to modify in part the resolution adopted by the general shareholders' meeting in June 2000, by allowing our Board of Directors to extend the exercise period for new options to ten years from the respective date on which the options are granted. The resolution would also permit grantees of such options to exercise a portion of their options each year during the ten-year period. As of the date of this annual report, our Board of Directors has not granted any options featuring this extended exercise period.

Terra Networks Options Relating to Former Lycos Options

Prior to the combination of Terra Networks and Lycos in October 2000, Lycos had several stock option plans pursuant to which Lycos employees, directors and officers were granted options to acquire Lycos common stock. On October 27, 2000, in connection with the combination of Terra Networks and Lycos, in exchange for each outstanding option to purchase a share of Lycos, Terra Networks issued an option to purchase the number of Terra Networks ADSs equal to the number of shares of Lycos common stock subject to the original option multiplied by the exchange ratio of 2.15, at an exercise price per Terra Networks ADS equal to the exercise price per share of the Lycos common stock under the original option divided by the exchange ratio of 2.15. Consequently, Terra Networks issued options to purchase 62,540,249 ordinary shares in the form of ADSs.

The terms of such Terra Networks options are substantially identical to the terms of the Lycos options for which they were exchanged, except that in accordance with the terms of the merger agreement, each vesting date after the completion of the combination with respect to such options (other than options held by certain officers, directors and employees of Lycos) will be deemed to occur on the date that is one year prior to the original vesting date. At December 31, 2001, options to purchase 35,324,581 ordinary shares (representing 5.69% of our capital stock on a fully-diluted basis) resulting from the exchange of Lycos options were outstanding, at exercise prices ranging from U.S.$0.14 to U.S.$39.71. At that date, 24,927,556 of such options were vested and 10,397,025 were unvested.

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

At April 30, 2002, according to the information available in the public registers of the Spanish National Securities Market Commission, beneficial owners of 5% or more of our voting stock were as follows:

Title of Class	Identity of Person or Group	Number of Shares	Percent of Class
Ordinary	Telefónica, S.A.	230,074,863	37.83(1)

(1) Parent company-only.

The Telefónica group had a 91.15% interest in us immediately prior to our initial public offering in November 1999. Following our initial public offering and our delivery of our ordinary shares to certain third parties in connection with acquisitions we made during 1999, the Telefónica group's interest in us was 70.47%. The Telefónica group's interest in us was later increased to 70.72% in September 2000 as a result of a rights offering by us pursuant to which Telefónica acquired its pro rata portion as well as all shares not subscribed for by other shareholders in accordance with the terms of a rights offering agreement entered into by us, Telefónica and Lycos in connection with our agreement to acquire Lycos. The Telefónica group's interest was reduced to 36.33% in October 2000 as a result of our combination with Lycos.

Our major shareholders have the same voting rights as all of our other holders of ordinary shares.

At April 30, 2002, approximately 44,000 non-objecting shareholders with registered addresses in the United States owned an aggregate of 73,352,335 of our ordinary shares in the form of ADSs. At that date, members of Telefónica's board of directors did not own any of our ordinary shares.

B. RELATED PARTY TRANSACTIONS

Ongoing Relationships with Members of the Telefónica Group

We have entered into or expect to enter into a number of agreements and relationships with other members of the Telefónica group relating to services that these companies will provide to us and that we will provide to them. It is our policy to ensure that the terms of these arrangements are at least as favorable to us as we could obtain in an arm's-length transaction between non-affiliated parties, and, whenever possible in light of legal or regulatory constraints, that we obtain services on a preferential or most-favored-customer basis.

Framework Agreement

On September 3, 2001, Terra Networks España, S.A., Telefónica de España, S.A. and Telefónica Data España, S.A. entered into an agreement that establishes how the companies will conduct and develop their commercial relations. Under the agreement, Telefónica de España, S.A. provides certain network-related services to Terra Networks España, S.A. and Telefónica Data España, S.A., including:

- use and operation of the IP network resources of Telefónica de España, S.A. to provide Internet access services; and

- broadband access services and IP backbone services through ADSL.

Further, Telefónica de España, S.A. may offer Terra Networks España additional services, including:

- access node connection to Telefónica de España, S.A.'s IP network closest to Terra Networks España, S.A.'s center of operations for purposes of its portal and Internet access services; and

- network management services.

The agreement has a term of three years and is renewable for successive one-year periods unless prior notice of termination is given by a party. In addition, the parties have agreed to enter into a definitive agreement relating to, among other things, the quality and levels of service to be provided.

Traffic-Inducement Fees

We entered into an agreement with Telefónica Data España, S.A. in October 1999 under which Telefónica Data España, S.A. agreed to pay us traffic-inducement fees for usage of Telefónica Data España, S.A.'s network generated by customers of our Spanish ISP. The contract had an initial term of one year and was renewed in November 2000 on the same terms. Total fees earned by us were calculated according to a graduated fee schedule (based on the total number of monthly minutes consumed by our free Internet access customers), which provided for minimum fees of Ptas 0.38 (approximately €0.002283) per minute and a maximum fee of Ptas 1.04 (approximately €0.00625) per minute for traffic above 1.25 billion minutes per month.

This fee schedule was modified in January 2001, as a result of which traffic-inducement fees are currently paid to us at a rate equal to the total number of minutes of traffic consumed by our Spanish ISP customers multiplied by a factor of approximately €0.002283 per minute. In September 2001, we entered into a new agreement with Telefónica de España which replaced our then existing agreement with Telefónica Data España.

Traffic-inducement fees paid by members of the Telefónica group, including Telefónica de España and Telefónica Data España, to ISPs such as Terra Networks are determined pursuant to negotiated agreements between Telefónica de España or Telefónica Data España and the individual ISP.

Other Relationships

- Telefónica Data España, S.A. — we contract IP connectivity from Telefónica Data Espanã, S.A.

- Telefónica Móviles, S.A. — we will be considered by Telefónica Móviles, S.A., to the extent permitted by Spanish law, and subject to market conditions, as a preferred provider of content for its Internet-related services. In addition, we and Telefónica Móviles established in June 2000 Terra Mobile, S.A., a joint venture that operates wireless internet portals accessible from wireless devices. In December 2001, Terra Mobile converted loans made by Telefónica Móviles and us into capital of €132 million. Subsequent to such capital increase, we sold a portion of our holdings in Terra Mobile for its net book value to Telefónica Móviles. At December 31, 2001, we owned 20% and Telefónica Móviles owned 80% of Terra Mobile. We have entered into a put/call arrangement with Telefónica Móviles, S.A. in connection with our investment in Terra Mobile. See “Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Contractual Obligations and Commercial Committments”.

- Telefónica Publicidad e Información, S.A. (TPI) — TPI publishes yellow pages directories. We will jointly pursue the development of Internet-related businesses in Spain.

- Telefónica y Finanzas, S.A. — we obtain cash management services from this company.

- Telefónica de España, S.A. — we distribute our Internet access product through Telefónica de España’s network of stores throughout Spain. We have also created a mirror co-branded site with our content for Telefónica Net’s site, and we support the e-mail and personal page services for Telefónica’s users on our servers. In addition, as described above, we have an agreement with Telefónica de España pursuant to which Telefónica de España pays us fees based on the total of traffic over Telefónica de España’s consumed by our Spanish ISP customers who pay metered rates to connect to our ISP service. In addition, pursuant to this agreement, Telefónica de España pays us, on a monthly basis, €2.10 for each flat rate user who subscribes to a flat rate plan sold directly by us. This agreement is valid for a term of one year and may be renewed for successive one-year periods by mutual agreement of the parties. See “Item 5—Operating and Financial Review and Prospects—Revenues—Access Revenues–Spain”.

- Telefónica del Perú, S.A. — we have entered into a non-compete agreement with Telefónica del Perú pursuant to which it has agreed not to provide Internet access services to residential users in Peru for a period of 10 years, expiring in 2009.

- Atento, S.A. — we obtain help-desk services from this company.

- Atento Holding Telecomunicaciones — we outsource some of our call center functions to this company.

- T-Gestiona — This company provides management, administrative and other related services such as legal, accounting and human resources in several countries to us.

Uno-e Bank, S.A.

Pursuant to certain agreements entered into in February 2000 between Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), we acquired a 49% interest in Uno-e Bank, S.A. for approximately €160 million in August 2001. At December 31, 2001, BBVA had a 1.35% interest in us. At June 5, 2002, based on publicly available information, BBVA had an approximately 5.52% interest in Telefónica, S.A.

Certain Transactions

We also utilize services provided by Telefónica, S.A. and its subsidiaries, such as the leasing of circuits, cash-management services, the obtaining of reference information and other services. Costs related to services provided by related parties for the years ended December 31, 1999, 2000 and 2001 were approximately €23.0 million, approximately €88.1 million and approximately €191.5 million, respectively. For those contracts currently in place, we believe that the terms of these arrangements are at least as favorable as could be obtained in arm’s-length transaction between non-affiliated parties.

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

Item 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

Please see Item 19(a) for a list of financial statements filed under Item 18.

Legal Proceedings

There are no material legal proceedings pending or to our knowledge threatened against or affecting us except as noted below.

Terra Networks, S.A. and certain of our directors and officers who worked for us in 1999 at the time our initial public offering in the United States have been named as defendants in five lawsuits filed in the United States. These lawsuits were consolidated into one amended complaint which is related to numerous purported class actions filed in the Southern District of New York against certain issuers of securities in initial public offerings, certain individual directors and officers of those issuers, and the underwriters of those initial public offerings, purportedly on behalf of purchasers of stock in the initial public offerings or the aftermarket. The complaints allege principally that the financial institutions underwriting the initial public offering assigned shares to certain customers in exchange for those customers agreeing (i) to purchase shares in the aftermarket at a fixed price to maintain an artificially high market value for the shares and (ii) to pay the financial institutions inflated fees or other remuneration in violation of applicable Securities and Exchange Commission and National Association of Securities Dealers rules and regulations. Because these allegations have been made principally against the underwriters, we, and other companies whose initial public offerings have been the subject of similar allegations, are negotiating the stay of all proceedings brought against the issuers and directors and officers of the issuers until the issue between the plaintiffs and the underwriters are addressed by the court. Additionally, plaintiff's counsel, issuers and the issuer's insurance companies have initiated a mediation. However, as of May 2002 no agreement has been reached. Our outside U.S. counsel has advised us that there are significant legal defects and weaknesses in the claims presently alleged, and it anticipates that, if the litigation against us is not stayed, we will file a motion to dismiss substantially all of the allegations in the complaints as a matter of law. We believe that even if the outcome is unfavorable to us it will not have a material adverse effect on our business, financial condition or results of operations.

On January 31, 2001, IDT Corporation filed a lawsuit in the United States District Court for the District of New Jersey against Terra Networks, S.A., Telefónica, S.A., Terra Networks USA, Inc. and Lycos, Inc. The complaint alleges principally (i) that Terra Networks breached its obligations to deliver a specified number of Terra Networks ordinary shares pursuant to the agreement dated April 2000 (the "Termination Agreement"), which terminated Terra Networks' joint venture with IDT Corporation, (ii) that Terra Networks failed to disclose its negotiations relating to the acquisition Lycos, Inc. to IDT Corporation during the negotiation of the Termination Agreement and (iii) that Terra Networks breached its obligations pursuant to its joint venture agreement with IDT Corporation. The complaint, as amended in March 2001, seeks an unspecified award of damages. We made a motion to dismiss substantially all of the complaints as a matter of law, and such motion is still pending. At this stage of the lawsuit, our outside counsel feels strongly about our defense and believes that our motion to dismiss has reasonable probability of being granted, as least with respect to certain of IDT Corporation's claims, but we cannot predict how the court will ultimately rule as to the final outcome of the case. We believe that even if the outcome is unfavorable to us, it will not have a material adverse effect on our business, financial condition or results of operations.

In the first quarter of 2001, CIERV NUEVA, S.L. and its shareholders presented a demand for arbitration to the court for civil and commercial arbitration (*Corte Civil y Mercantíl de Arbitraje*, or "CIMA"). Pursuant to their demand for arbitration, they sought to require us to purchase 2,157 shares of Corporación Real Time Team, S.L., of which they hold the majority of the outstanding shares. In December 2001, the CIMA issued an arbitration award whereby we are obligated to acquire such shares for approximately €21 million, which is more than 50% less than the amount they requested. We prepared a general appeal to be heard by the provincial appellate court (*Corte Provincial de Apelaciones*) of Madrid, in which we asked the court to set aside the arbitration award. On June 6, 2002, the provincial appellate court dismissed our general appeal. We have recorded a provision for the full amount of this potential liability.

In February 1999, Lycos announced its intention to enter into a transaction with USA Networks, Inc. and certain affiliated companies pursuant to which, among other things, Lycos would have been merged into a subsidiary of USA Networks. In May 1999, the parties to the proposed transaction terminated the merger by mutual agreement. Prior to the termination of the proposed merger, a series of purported securities class action lawsuits were filed in the United States District Court for the District of Massachusetts. The suits, which have since been consolidated, allege, among other claims, violations of United States Federal securities law through alleged misrepresentations and omissions relating to the announced transaction with USA Networks. The consolidated complaint seeks an unspecified award of damages. We believe that the allegations in the consolidated complaint are without merit and intend to contest them vigorously. A motion to dismiss the consolidated complaint was denied by the court in April 2002.

Dividend Policy

We have never declared or paid any cash dividends. We currently intend to retain future earnings, if any, to finance our business. As a result, we do not anticipate paying any cash dividends in the foreseeable future.

Item 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

Our ordinary shares, nominal value two euro each, trade on the New Market segment of the Spanish stock exchanges and on the Automated Quotation System of the Spanish stock exchanges. Our ADSs, each ADS representing one ordinary share, are quoted on the Nasdaq National Market under the symbol “TRLY.” The following table summarizes the high and low trading price for our ordinary shares in Spain and ADSs on Nasdaq from November 17, 1999 (the date of our initial public offering) through June 17, 2002.

SPANISH STOCK EXCHANGES

Period	High	Low
	(euro)	
Year Ended December 31, 1999 (from November 17, 1999)	54.50	28.00
Quarter Ended March 31, 2000	136.35	52.00
Quarter Ended June 30, 2000	85.40	39.81
Quarter Ended September 30, 2000	59.70	35.60
Quarter Ended December 31, 2000	48.94	10.53
Quarter Ended March 31, 2001	18.45	10.22
Quarter Ended June 30, 2001	10.87	7.85
Quarter Ended September 30, 2001	9.62	5.09
Quarter Ended December 31, 2001	10.69	5.55
Quarter Ended March 31, 2002	9.83	8.09
Month Ended January 31, 2002	9.83	8.86
Month Ended February 28, 2002	9.29	8.09
Month Ended March 31, 2002	9.17	8.63
Month Ended April 30, 2002	8.50	7.25
Month Ended May 31, 2000	6.95	5.94
Month Ended June 30, 2002 (through June 17)	6.15	5.26

NASDAQ NATIONAL MARKET

Period	High	Low
	(U.S. dollars)	
Year Ended December 31, 1999 (from November 17, 1999)	54.80	30.81
Quarter Ended March 31, 2000	135.50	52.37
Quarter Ended June 30, 2000	76.50	36.46
Quarter Ended September 30, 2000	45.43	31.06
Quarter Ended December 31, 2000	43.00	15.46
Quarter Ended March 31, 2001	9.50	9.06
Quarter Ended June 30, 2001	9.56	6.66
Quarter Ended September 30, 2001	8.22	4.50
Quarter Ended December 31, 2001	9.27	5.00
Quarter Ended March 31, 2002	8.85	6.90
Month Ended January 31, 2002	8.85	7.75
Month Ended February 28, 2002	7.91	6.90
Month Ended March 31, 2002	8.09	7.52
Month Ended April 30, 2002	7.80	6.48
Month Ended May 31, 2002	6.53	5.45
Month Ended June 30, 2002 (through June 17)	5.62	4.88

B. PLAN OF DISTRIBUTION

Not applicable.

C. MARKETS

Trading on the Nasdaq National Market

ADSs representing our ordinary shares have been quoted on the Nasdaq National Market since November 1999 and trade under the symbol “TRLY”.

Trading on the Spanish Stock Exchanges

Our ordinary shares are listed on the New Market segment of the Spanish stock exchanges and are quoted through the Automated Quotation System of the Spanish stock exchanges. Our shares have been listed on the Spanish stock exchanges since November 1999 and trade under the symbol “TRR”.

D. SELLING SHAREHOLDERS

Not applicable.

E. DILUTION

Not applicable.

F. EXPENSES OF THE ISSUE

Not applicable.

Item 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Terra Networks is a company organized under the laws of the Kingdom of Spain and is governed by the Spanish Corporation Law of 1989 (*Texto Refundido de la Ley de Sociedades Anonimas*). In addition, the rights of Terra Networks shareholders are governed by the Terra Networks by-laws (*estatutos*). The following discussion is qualified in its entirety by reference to the Spanish Corporation Law of 1989 and the full text of the Terra Networks by-laws. The Terra Network by-laws are filed as an exhibit to this annual report.

Registry and Company's Purposes

Terra Networks is registered with the Commercial Registry in Barcelona on Page B-217,925, Volume 32,874. Terra Networks' purpose is to set up activities and provide services in the telecommunications, information and communication fields. Terra Networks may set up Internet and other network-related activities, including those related to access, production, distribution and exhibition of its own or third-party content, portals, e-commerce and any other activities that may exist in these fields in the future, all geared towards meeting market demand. Terra Networks may devote itself, without reservation or limitation of any kind, to any type of lawful business that directly or indirectly contributes to performing the activities included in Terra Networks' purpose described above. The Company's purpose is set forth in Article 2 of its by-laws.

Directors

A Director need not be a shareholder to be elected to the Board of Directors, unless he or she is provisionally appointed by the Board of Directors itself through co-option, in accordance with the provisions of Article 138 of the Spanish Corporation Law of 1989.

Description of Terra Networks Ordinary Shares

Dividend Rights

The shareholders shall vote on how fiscal year profits are to be distributed pursuant to the approved balance sheet. Dividends may be paid out from fiscal year profits or from freely available reserves only if Terra Networks' net worth is no less than the value of the corporate stock, and will not become so as a result of the distribution. All dividends paid out to Terra Networks shareholders shall be in proportion to the capital that they paid in.

Attendance and Voting at Shareholders' Meetings

Each ordinary share entitles the shareholder to one vote. Any share may be voted by written proxy, and proxies may be given to any individual. Proxies are valid only for a single meeting.

Pursuant to the by-laws of Terra Networks and to the Spanish Corporation Law, general meetings of shareholders may be either ordinary or extraordinary. Ordinary general meetings must be convened within the first six months of each fiscal year on a date fixed by the Board of Directors. As a general rule, extraordinary general meetings may be called from time to time by Terra Networks' Board of Directors at its discretion or at the request of shareholders representing at least 5% of Terra Networks' share capital. Notices of all shareholders' meetings must be published in the Commercial Registry Official Gazette (*Boletín Official del Registro Mercantil*) and in a local newspaper within the province of Barcelona at least 15 days prior to the date fixed for the meeting.

At ordinary general meetings, shareholders are asked to approve Terra Networks' management, the financial statements for its previous fiscal year and the application of our net income or loss. All other matters may be addressed at extraordinary general meetings called for such purpose. Shareholders can vote on these matters at an ordinary general meeting if such items are included on the meeting's agenda.

Only holders of more than 25 ordinary shares duly registered in the book-entry record maintained by the Servicio de Compensación y Liquidación de Valores, S.A. (SCLV) at least five days prior to the day on which a meeting is scheduled to be held are entitled to attend shareholders' meetings.

Terra Networks' by-laws provide that, on the first call of a general shareholders' meeting, a duly constituted general meeting of shareholders requires a quorum of at least one-quarter of our issued share capital. On the second call, there is no quorum requirement. Consideration of extraordinary matters such as modification of our by-laws, changes in our share capital structure, change in the corporate form, mergers, spin-offs, issues of bonds, dissolution and liquidation require on first call a quorum of at least one-half of our issued share capital, and on second call the presence of shareholders representing at least one-quarter of our issued share capital. If, after the second call, the shareholders present or represented constitute less than one-half of our issued share capital, resolutions relating to extraordinary matters may be adopted only with the approval of two-thirds of the share capital present or represented at such meeting. A shareholders' meeting at which 100% of the capital stock is present or represented is validly constituted even if no notice of such meeting was given, and, upon unanimous agreement, shareholders may consider any matter at such meeting.

A resolution passed in a general meeting of shareholders is binding on all shareholders, subject to Spanish law. In certain circumstances, such as change of corporate purpose or corporate form, Spanish law allows dissenting or absent shareholders to contest resolutions. In the case of resolutions contrary to law, the right to contest is extended to all shareholders.

Under the Spanish Corporation Law, shareholders who voluntarily aggregate their shares so that they are equal to or greater than the result of dividing the total capital stock by the number of directors have the right to appoint a corresponding proportion of the members of the Board of Directors. Shareholders who exercise this right may not vote on the appointment of other directors.

Preemptive Rights

Pursuant to the Spanish Corporation Law, shareholders and holders of convertible bonds have preemptive rights to subscribe for any new shares issued by Terra Networks, including ordinary shares, and for bonds issued which are convertible into ordinary shares. These preemptive rights may be abolished in certain circumstances if shareholders of Terra Networks pass a resolution at a shareholders' meeting in accordance with Article 159 of the Spanish Corporation Law.

Form and Transfer

The ordinary shares are in book-entry form and are indivisible. Joint holders must nominate one person to exercise the shareholders' rights, though joint holders are jointly and severally liable for all obligations arising from their status as shareholders. The Servicio de Compensación y Liquidación de Valores, S.A. (SCLV), which manages the clearance and settlement system of the Spanish stock exchanges, maintains the central registry of shares reflecting the number of shares held by each of its member entities (*entidades adheridas*) as well as the amount of such shares held by beneficial owners. Each member entity in turn maintains a register of the owners of such shares.

Transfers of ordinary shares quoted on a Spanish stock exchange must be made through or with the participation of a member of a Spanish stock exchange that is an authorized broker or dealer by book-entry registry or delivery of evidence of title to the buyer. The transfer of shares may be subject to certain fees and expenses.

Reporting Requirements

Because Terra Networks ordinary shares are listed on a Spanish stock exchange, agreements with respect to the acquisition or disposition of our ordinary shares must be reported within seven business days of the acquisition or disposal to us, the CNMV, the relevant Spanish Stock Exchanges and, where the person or group effecting the transaction is a non-Spanish resident, the Spanish Registry of Foreign Investment, where:

- in the case of an acquisition, the acquisition results in that person or group holding 5% (or successive multiples thereof) of our share capital; or
- in the case of a disposal, the disposal takes any existing holding of that person or group below a threshold of 5% (or successive multiples thereof) of our share capital.

Any member of the Board of Directors must report to Terra Networks, to the CNMV and to the relevant Spanish stock exchanges, any percentage or number of shares and stock options held at the time of becoming a member of the Board of Directors.

Furthermore, any member of the Board of Directors of Terra Networks must similarly report any acquisition or disposal, regardless of size, of our ordinary shares or stock options. Additional disclosure obligations apply to purchasers in jurisdictions designated as tax havens or lacking adequate supervision and also to voting agreements.

C. MATERIAL CONTRACTS

Material Contracts

Lycos

On May 16, 2000 our Board of Directors approved several agreements with Lycos pursuant to which we acquired 100% of the shares of Lycos through a share capital increase with a share exchange that we consummated on October 27, 2000.

In addition, pursuant to a rights offering agreement entered into by us, Telefónica and Lycos, we agreed to make a rights offering whereby we would issue to our shareholders rights to purchase our ordinary shares for an aggregate of €2.2 billion at a price per share of €62.00, which was the closing price of our ordinary shares on May 16, 2000. We completed this rights offering in September 2000. In accordance with the rights offering agreement, Telefónica subscribed for all shares not subscribed for by other shareholders in the rights offering.

Employment contracts were executed with the Lycos management team and became effective at the moment the merger became effective. The following persons signed such contracts: Robert J. Davis, Edward M. Philip, Jeffrey S. Bennett, Tom Guilfoile, David G. Peterson, Ronald Sege and John McMahon. Messrs. Peterson, Davis, Guilfoile and Sege are no longer employed by us. At April 30, 2002, Messrs. Bennett and McMahon held options to acquire Terra Networks shares received pursuant to their respective employment contracts.

Agreements with Bertelsmann AG

On May 16, 2000, the following agreements and letters of intent were signed:

- Strategic alliance among Lycos, Inc., Terra Networks, S.A. and Bertelsmann AG for the first and second years from the date the merger between Lycos, Inc. and Terra Networks is effective. During such years, Bertelsmann is obliged to pay $325 million for services to be performed during such period.
- Strategic alliance among Lycos, Inc., Terra Networks, S.A., Telefónica, S.A. and Bertelsmann AG for the third, fourth and fifth years after the date the merger between Lycos, Inc. and Terra Networks

is effective. During such three-year period, Bertelsmann will purchase up to $675 million of services. Telefónica has agreed to purchase, if necessary, any portion of those services that Bertelsmann does not buy, up to $675 million.

- Non-binding letter of intent regarding the possible acquisition by Terra Networks of Bertelsmann AG's approximately 20% stake in Lycos Europe, N.V. after May 2003.

- Letter of intent regarding the potential formation of one or more joint venture companies in which Bertelsmann AG would hold a 75% or more stake and Terra Networks up to a 25% stake. Such joint venture companies would be formed for the sale and purchase of books and products over websites in Spain, Portugal and countries in Latin America under the trademark BOL. Such letter of intent was terminated by mutual agreement by means of a letter signed on July 31, 2001.

Other Important Agreements

In January 2002, we entered into a five-year agreement with DoubleClick to use its ad serving tools, which enable us to serve advertising on our network. This agreement supersedes prior agreements entered with DoubleClick and has a term of five years.

D. EXCHANGE CONTROLS

Foreign Investment and Exchange Control Regulations

In 1991, Spain adopted the European Union standards for free movement of capital and services. As a result, exchange controls and restrictions on foreign investments have generally been abolished.

Pursuant to Spanish Law 18/1992 on Foreign Investments (*Ley 18/1992, de 1 de julio*) and Royal Decree 664/1999 (*Real Decreto 664/1999, de 23 de abril*), foreign investors may freely invest in shares of Spanish companies, except in the case of certain strategic industries.

Shares in Spanish companies held by foreign investors must be reported to the Spanish Registry of Foreign Investments by the depositary bank or relevant member of the clearance and settlement system of the Spanish stock exchanges, the Servicio de Compensación y Liquidación de Valores, S.A. (SCLV). When a foreign investor acquires shares that are subject to the reporting requirements of the CNMV, notice must be given by the foreign investor directly to the Registry of Foreign Investment in addition to the notices of majority interests that must be sent to the company, the CNMV and the applicable stock exchanges. This notice must be given through a bank or other financial institution duly registered with the Bank of Spain and the CNMV or through bank accounts opened with any branch of such registered entities.

Investment by foreigners domiciled in tax haven jurisdictions (countries identified in Royal Decree 1080/1997 (*Real Decreto 1980/1997, de 5 de julio*) is subject to special reporting requirements.

Preemptive Rights

Pursuant to the Spanish Corporation Law, shareholders and holders of convertible bonds have preemptive rights to subscribe for any new shares issued by us, including our ordinary shares and for bonds issued which are convertible into ordinary shares. These preemptive rights may be abolished in certain circumstances if our shareholders pass a resolution at a shareholders' meeting in accordance with Article 159 of the Spanish Corporation Law.

Shares issuable upon exercise of rights must be registered under the Securities Act of 1933, as amended, in order to be offered to holders of ADRs. If Terra Networks decided not to register the shares, the rights would not be distributed to holders of ADRs. Pursuant to the deposit agreement, however, the depositary will use its best efforts to sell the ordinary shares that it receives and will distribute the proceeds of the sale to holders of ADRs.

Purchase of Shares

Subject to certain exceptions, Terra Networks may purchase its own shares if:

- the purchase has been authorized by the general shareholders' meeting by means of a resolution establishing the terms of the purchase, including the maximum number of shares to be purchased, the minimum and maximum purchase price and the duration of the authorization, which authorization shall not exceed 18 months;
- the aggregate nominal value of the shares purchased, together with that of those shares already held by the company and its affiliates, does not exceed five percent of the share capital of the company;
- the company is able to meet the special reserve required by the provisions of Article 79.3 of the Spanish Corporation Law of 1989, without decreasing its share capital and reserves; and
- the shares to be purchased are fully paid.

Generally, shares that are not purchased in accordance with the above must be disposed of within one year from the date of the first purchase, cancelled and/or declared void.

Our shareholders' meeting of June 7, 2001 authorized the acquisition by us or our affiliates of up to five percent of our share capital, including acquisitions of shares in connection with our employee stock option plans. See "Item 10.E—Employee Stock Option Plan". This authorization is valid for a period of 18 months from the date of authorization and supersedes previous authorizations.

E. TAXATION

General

The following is a discussion of the material Spanish and U.S. federal income tax consequences to you of the acquisition, ownership and disposition of the ADSs or shares.

This discussion only applies to you if you are a beneficial owner of shares or ADSs and are:

- a citizen or resident of the United States for United States federal income tax purposes;
- a corporation, or other entity taxable as a corporation for U.S. federal income tax purposes, created or organized under the laws of the United States or any state of the United States; or
- an estate or trust the income of which is subject to United States federal income tax without regard to its source.

The discussion of Spanish tax consequences below applies to you only if you are a non-resident of Spain and your ownership of ADSs or shares is not effectively connected with a permanent establishment or fiscal base in Spain and only if you are a U.S. resident entitled to the benefits of the Spanish-U.S. income tax treaty.

You should consult your own tax advisor as to the particular tax consequences to you of owning the shares or ADSs including your eligibility for the benefits of any treaty between Spain and the country of your residence for the avoidance of double taxation, the applicability or effect of any special rules to which you may be subject, and the applicability and effect of state, local, foreign and other tax laws and possible changes in tax law.

For purposes of the Spanish-U.S. income tax treaty and the U.S. Internal Revenue Code of 1986, as amended, United States holders of ADRs will generally be treated as the owners of the ADSs evidenced by the ADRs and of the shares represented by such ADSs.

Spanish tax considerations

The following is a summary of material Spanish tax matters and is not exhaustive of all the possible tax consequences to you of the acquisition, ownership and disposition of ADSs or shares. This discussion is based upon the tax laws of Spain and regulations thereunder, which are subject to change, possibly with retroactive effect.

Taxation of dividends

Under Spanish law, if you do not reside in Spain for tax purposes, dividends paid by a Spanish resident company to you are subject to Spanish Non-Resident Income Tax at an 18% rate.

We will levy an initial withholding tax on the gross amount of dividends at an 18% tax rate, following the procedures set forth by Law 41/1998, dated December 9, 1998 and the Order of April 13, 2000. However, under the Spanish-U.S. income tax treaty, you may be entitled to the reduced rate of 15%.

To benefit from the reduced rate of 15%, you must provide:

- a certificate from the United States Internal Revenue Service (the "IRS") that to the best knowledge of the IRS you are a resident of the United States within the meaning of the Spanish-U.S. income tax treaty; and

- a certificate from the depositary (if you hold ADSs) or your broker (if you hold shares) representing that, at the dividend payment date, you are or were the beneficial owner of the ADSs or shares.

According to the Order of April 13, 2000, to get a direct application of the Spanish-U.S. income tax treaty-reduced rate of 15%, the certificates referred to above must be provided to us before the tenth day following the end of the month in which the dividends became payable. Otherwise, you may afterwards obtain a refund of the 3% withheld in excess of the 15% rate provided for in the Spanish-U.S. income tax treaty from the Spanish tax authorities.

Spanish refund procedure

According to Spanish Regulations on Non-Resident Income Tax, approved by Law 41/1998, dated December 9, 1998 and Royal Decree 326/1999, dated February 26, 1999, as amended, a refund of the amount withheld in excess of the rate provided by the Spanish-U.S. income tax treaty can be obtained from the relevant Spanish tax authorities. To pursue the refund claim, if you are a U.S. resident entitled to the benefits of the Spanish-U.S. income tax treaty, you are required to file all of the following:

- a Spanish 210 Form;

- the IRS certificate referred to in the preceding section; and

- evidence that Spanish non-resident income tax was withheld with respect to you.

The refund claim must be filed within two years of the date on which the withheld tax was collected by the Spanish tax authorities, although this period could be extended to four years under certain provisions.

You are urged to consult your own tax advisor regarding refund procedures and any U.S. tax implications of refund procedures.

Taxation of capital gains

Under the Spanish law, any capital gains derived from securities issued by persons residing in Spain for tax purposes are considered to be Spanish source income and, therefore, are taxable in Spain. For Spanish tax purposes, income obtained by you if you are a U.S. resident from the sale of ADSs or shares will be treated as capital gains. Spanish non-resident income tax is currently levied at an 18% tax rate on capital gains obtained by persons not residing in Spain for tax purposes who are not entitled to the benefit of any applicable treaty for the avoidance of double taxation (Art. 24 Law 41/1998).

Notwithstanding the above, capital gains derived from the transfer of shares in an official Spanish secondary stock market by any holder who is resident in a country that has entered into a treaty for the avoidance of double taxation with Spain containing an "exchange of information" clause will be exempt from taxation in Spain upon submitting appropriate information to the relevant Spanish tax authority. Under the Spanish-U.S. income tax treaty, capital gains realized by you upon the disposition of ADSs or shares will not be taxed in Spain provided (i) you have not held, directly or indirectly, 25% of our capital during the twelve months preceding the disposition of the stock and (ii) you submit appropriate information to the relevant Spanish authority. You may be required to establish that you are entitled to this exemption by providing to the relevant Spanish tax authorities an IRS certificate of residence in the United States, together with the appropriate Spanish tax form.

Spanish wealth tax

Individuals not residing in Spain who hold shares or ADSs located in Spain are subject to the Spanish wealth tax (Spanish Law 19/1991), which imposes a tax on property located in Spain on the last day of any year. The Spanish tax authorities may take the view that all shares of Spanish corporations and all ADSs representing such shares are located in Spain for Spanish tax purposes. If such a view were to prevail, non-residents of Spain who held shares or ADSs on the last day of any year would be subject to the Spanish wealth tax for such year at marginal rates varying between 0.2% and 2.5% of the average market value of such shares or ADSs during the last quarter of such year.

Spanish inheritance and gift taxes

Transfers of shares or ADSs on death or by gift are subject to Spanish inheritance and gift taxes (Spanish Law 29/1987) if the transferee is a resident in Spain for tax purposes, or if the shares or ADSs are located in Spain at the time of gift or death, regardless of the residence of the beneficiary. In this regard, the Spanish tax authorities may determine that all shares of Spanish corporations and all ADSs representing such shares are located in Spain for Spanish tax purposes. The applicable tax rate, after applying all relevant factors, ranges between 2.65% and 34% for individuals.

U.S. corporations may be subject to Non-Resident Income Tax on transfers at a rate of 18% on the fair market value of the shares (Art. 24 Law 41/1998).

Expenses of transfer

Transfers of ADSs or shares will be exempt from any transfer tax or value-added tax. Additionally, no stamp tax will be levied on such transfers.

United States tax considerations

The following discussion describes the material U.S. federal income tax consequences of acquiring, owning and disposing of ADSs or shares. The discussion is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended (the "Code"), existing and proposed regulations, published rulings and court decisions, as well as on the Spanish-U.S. income tax treaty, all as currently in effect or proposed and all subject to change at any time, perhaps with retroactive effect.

This discussion deals only with ADSs or shares held by you as capital assets as defined in Section 1221 of the Code and does not address the tax treatment of persons that are subject to special treatment under the U.S. income tax laws. Persons subject to special treatment include, but are not limited to:

- banks, financial institutions, securities dealers or traders and insurance companies;
- tax-exempt entities;
- investors liable for the alternative minimum tax;
- investors who will hold the ADSs or shares as part of straddles, hedging transactions or conversion transactions;
- holders that have a principal place of business or "tax home" outside the United States, or investors whose functional currency is not the U.S. dollar;
- U.S. persons who own ADSs or shares indirectly through foreign partnerships or other pass-through entities;
- persons who acquired ADSs or shares pursuant to the exercise of an employee stock option or otherwise as compensation; and
- persons owning directly, indirectly or by attribution 10% or more of the ADSs or shares.

Moreover, the effect of any applicable U.S. state or local tax laws is not discussed herein.

This discussion also assumes that each obligation of the deposit agreement dated as of November 15, 1999, between us, Citibank, N.A. as depositary, and all holders of our ADRs and any related agreement will be performed in accordance with its terms and that the representations made by Citibank, N.A. as depositary regarding the pre-release of our ADRs are true. The U.S. Treasury has expressed concerns that parties to whom ADRs are released may be taking actions that are inconsistent with the claiming of foreign tax credits. Accordingly, the analysis of the creditability of Spanish taxes described below could be affected by actions that may be taken by the U.S. Treasury.

Passive Foreign Investment Company rules

We cannot provide you any assurance that we were not considered a passive foreign investment company (a "PFIC") for United States federal income tax purposes for the 2001 taxable year. PFIC status is determined based on the composition of a company's income and assets and the market value of its assets (including, among others goodwill and equity investments in less than 25 percent owned entities) from time to time. During the 2001 taxable year, we held substantial investments in cash and cash equivalents, including short-term financial investments, all of which are considered passive assets, and our market capitalization did not increase since the end of the 2000 taxable year.

If we are treated as a PFIC for any year during your holding period and you have not made the mark-to-market election, as described below, you will be subject to special rules that could result in adverse tax consequences. Upon a disposition of shares or ADSs, including a disposition pursuant to an otherwise tax-free reorganization, or on receipt of an "excess distribution" from us (generally, a distribution in excess of 125% of the average annual distributions paid by us in the three preceding taxable years), you generally would be subject to tax as if the gain or excess distribution had been (i) realized ratably over your holding period for the shares or ADSs and (ii) taxable at the highest rates in effect over that period, and would be subject to an interest charge on the deferred tax.

If the shares or ADSs are "regularly traded" on a "qualified exchange," you may make a mark-to-market election, which may mitigate the adverse tax consequences resulting from the company's PFIC status. Under Treasury regulations, the ADRs representing ADSs currently are "regularly traded" on a "qualified exchange." If you make the election, you generally will include each year as ordinary income the excess, if any, of the fair market value of the ADSs at the end of the taxable year over their adjusted basis, and will be permitted an ordinary loss in respect of the excess, if any, of the adjusted basis of the ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). If you make the election, your basis in the ADSs will be adjusted to reflect any such income or loss amounts. Any gain recognized on the sale or other disposition of ADSs will be treated as ordinary income.

Special rules apply to determine the foreign tax credit with respect to withholding taxes imposed on distributions on shares in a PFIC. If you own shares or ADSs during any year in which we are a PFIC, you must file Internal Revenue Service Form 8621.

We urge you to consult your tax advisers concerning our status as a PFIC and the tax considerations relevant to an investment in a PFIC, including the availability and consequences of making the mark-to-market election discussed above.

The discussion below is applicable if we are not a PFIC during any year in which you hold shares or ADSs.

Taxation of dividends

Distributions paid on ADSs or shares out of current or accumulated earnings and profits, as determined under United States federal income tax principles (including amounts withheld by us in respect of Spanish taxes) will be treated as foreign source dividend income to you and will not be eligible for the dividends received deduction allowed to corporations under the Code. Distributions in excess of current or accumulated earnings and profits will be treated first as a tax free return of capital to the extent of your basis in the shares and then as capital gain.

You will be required to include dividends paid in euro as income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date the dividends are actually or constructively received. If you hold shares, dividends are received on the date you receive your distribution, regardless of whether the euro are converted into U.S. dollars. If you hold ADRs, that date would be the date Citibank, N.A. receives the dividend. If items received in euro are not converted into U.S. dollars on the day they are received, you may be required to recognize foreign currency gain or loss, which will be U.S. source ordinary income or loss, as the case may be, upon a subsequent sale or other disposition of the euro.

Effect of Spanish withholding taxes.

Payments of dividends on the ADSs or shares to foreign investors are subject to Spanish withholding taxes. For U.S. federal income tax purposes, you will be treated as having received the gross amount of any dividend paid, including Spanish taxes withheld by us, and then as having paid over the withheld taxes to Spanish taxing authorities. As a result of this rule, the amount of dividend income included in gross income for U.S. federal income tax purposes by you in connection with a payment of dividends will be greater than the amount of cash actually received or receivable by you from us.

Subject to generally applicable limitations and restrictions, you will be entitled to a credit against your United States federal income tax liability, or a deduction in computing your U.S. federal taxable income, for Spanish income taxes withheld by us. However, taxes withheld in excess of the rate provided in the Spanish-U.S. income tax treaty will not be eligible for this foreign tax credit or deduction unless you exhaust all remedies to recover such excess withholding, including the seeking of competent authority assistance from the IRS, without obtaining a refund. A description of how you can secure the rate provided in the Spanish-U.S. income tax treaty for withholding on dividends paid by us is contained in the discussion of Spanish tax consequences above. You may be required to recognize ordinary income or loss attributable to currency fluctuations upon any receipt of a refund in respect of Spanish withholding tax to the extent that the U.S. dollar value of the refund differs from the U.S. dollar equivalent of the refund amount on the date the underlying dividend was received.

You must satisfy minimum holding period requirements to be eligible to claim a foreign tax credit for foreign taxes withheld on dividends. A foreign tax credit will be denied for foreign taxes withheld on dividends in circumstances where you are under an obligation to make related payments in connection with positions in "substantially similar or related property." The limitation on foreign taxes eligible for credit is calculated separately for specific classes of income. For this purpose, depending on your particular circumstances, dividends paid by us on our shares will generally constitute "passive income" or "financial services income." We urge you to consult your tax advisor to determine whether and to what extent a foreign tax credit would be available to you.

Sale or other disposition

Upon a sale or other disposition of ADSs or shares, you generally will recognize a capital gain or loss for United States federal income tax purposes equal to the difference, if any, between the amount realized on the sale or other disposition and your adjusted tax basis in the ADSs or shares. This gain or loss will be long-term capital gain or loss if your holding period in the ADSs or shares exceeds one year. Any gain or loss will generally be U.S. source gain or loss.

Backup withholding and other reporting requirements

Payments of dividends and other proceeds in connection with ADSs or shares by a U.S. paying agent or other U.S. intermediary may be reported to the IRS and to you. Backup withholding at the rates specified in the Code may apply to these payments if you fail to provide an accurate taxpayer identification number or fail to report all interest and dividends required to be shown on your federal income tax returns. Some persons, such as corporations, are not subject to backup withholding. Depending on the type of person you are, you may qualify for exemption from backup withholding provided you comply with the procedure for obtaining exemption. Any amounts withheld under the backup withholding rules may be refunded (or credited against the beneficial owner's U.S. federal income tax liability, if any), provided that the required information is furnished to the IRS.

F. DIVIDENDS AND PAYING AGENTS

Not applicable.

G. STATEMENTS BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

This report and other information filed or to be filed by Terra Networks can be inspected and copied at the public reference facilities maintained by the SEC at:

- Judiciary Plaza
450 Fifth Street, N.W.
Room 1024
Washington, D.C. 20529

Copies of these materials can also be obtained from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, DC 20549, at prescribed rates.

The SEC maintains a website at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. As a foreign private issuer, we are not required to use the EDGAR system, but may do so in order to make our reports available over the Internet.

Additionally, documents referred to in this Form 20-F may be inspected at the corporate offices of Terra Networks which are located at Vía de Las Dos Castillas, 33, Complejo Atica, Edificio 1, Pozuelo de Alarcón, 28223 Madrid, Spain.

English translations of the material contracts and agreements discussed in this annual report have been filed as an exhibit hereto. Where a complete agreement has not been provided, a summary of the contract in English has been included.

I. SUBSIDIARY INFORMATION

Not applicable.

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our principal market risks relate to changes in foreign currency exchange rates and changes in equity prices.

We are exposed to market risk from changes in foreign currency exchange rates due to our operations and investments in countries outside the euro zone, principally the United States and countries in Latin America such as Brazil and Mexico. The currency of many Latin American countries, including Brazil and Mexico, and recently, Argentina, have experienced substantial depreciation and volatility in the past and our revenues may decline in value if the local currencies depreciate relative to the euro.

We are also exposed to market risk from changes in the market values of equity securities we hold for investment. We record such investments on our consolidated balance sheet at the lower of cost or market value. For listed securities, market value is based on the lower of the average market price during the last quarter of the year and the market price at year end. For unlisted securities, market value is based on cost, net, if appropriate, of the required allowance for diminution in value. Substantially all of the equity securities held for investment by us at December 31, 2001 were included in Lycos's portfolio of equity investments when we acquired Lycos. The table below shows information regarding our equity securities held for investment at December 31, 2000 and December 30, 2001.

	At December 31, 2000		
Investment	**Number of shares held**	**Market price per share**	**Total market value**
		(in dollars)	**(in millions of dollars)**
Fast Search & Transfer	14,127,855	2.34	33.1
Easylink Services Corp.	2,000,000	0.72	1.4
Amazon.com Inc.	64,422	15.56	1.0
Fairmarket	724,823	1.50	1.1
Autoweb	3,035,025	0.25	0.8
WIT Capital	175,000	3.59	0.6

Investment	At December 31, 2001 Number of shares held	Market price per share	Total market value
		(in dollars)	(in millions of dollars)
Fast Search & Transfer	14,127,855	1.29	18.2
Easylink Services Corp.	2,000,000	0.49	1.0
Amazon.com Inc.	62,262	10.82	0.7
Global Sports	7,927	19.95	0.2
Cross Media	13,073	9.00	0.1
Fairmarket	724,823	1.12	0.8
Autobytel	1,078,344	1.73	1.9
WIT Capital	175,000	2.33	0.4

We do not use derivative instruments, such as forward contracts, option contracts, interest rate swaps and forward rate agreements, to manage these market risks, nor do we hold or issue derivative or other financial instruments for trading purposes.

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

Item 15. RESERVED

Not applicable.

Item 16. RESERVED

Not applicable.

PART III

Item 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of responding to this Item.

Item 18. FINANCIAL STATEMENTS

See Item 19(a) for a list of financial statements filed under Item 18.

Item 19. FINANCIAL STATEMENTS AND EXHIBITS

(a) List of Financial Statements

(b) List of Exhibits

1.1	Revised Bylaws
1.2	Revised Bylaws (English translation)
4.1	Amended and Restated Agreement and Plan of Reorganization dated as of September 20, 2000, among Terra Networks, S.A., Lycos, Inc. and Lycos Virginia, Inc.**
4.2	Amended and Restated Rights Offering Agreement dated as of May 16, 2000, by and among Telefónica, S.A., Terra Networks, S.A. and Lycos, Inc.**
4.3	Strategic Alliance Memorandum of Understanding, dated as of May 16, 2000, by and among Bertelsmann AG, Telefónica, S.A., Terra Networks, S.A. and Lycos, Inc.*
4.4	Strategic Alliance Memorandum of Understanding, dated as of May 16, 2000, by and among Bertelsmann AG, Terra Networks, S.A. and Lycos, Inc.*
4.5	Letter of Understanding, dated as of May 16, 2000, between Terra Networks, S.A. and Bertelsmann AG.*
4.6	Letter of Intent, dated as of May 16, 2000, between Terra Networks, S.A. and Bertelsmann AG.*
4.7	Statement of Intent, dated as of January 4, 2000, between Argentaria, Caja Postal y Banco Hipotecario, S.A. and Terra Networks, S.A.*
4.8	Statement of Intent, dated as of January 4, 2000, between Argentaria, Caja Postal y Banco Hipotecario, S.A. and Terra Networks, S.A. (English translation)*
4.9	Letter of Intent, dated as of March 2000, by and among Wit Capital Group, Inc., Banco Bilbao Vizcaya Argentaria, S.A., Terra Networks, S.A., ENBA PLC and the shareholders and optionholders listed therein.*
4.10	Series B Convertible Preferred Stock Purchase Agreement, dated as of February 3, 2000, by and among Aremate.com, Inc. and Terra Networks USA, Inc.*
4.11	Agreement for the Supply of Journalistic Content, dated as of April 20, 2000, between Terra Networks Brasil S.A., Agência Estado LTDA., S.A. "O Estado de S. Paulo", Rádio Eldorado LTDA. and Terra Networks S.A.*
4.12	Agreement for the Supply of Journalistic Content, dated as of April 20, 2000, between Terra Networks Brasil S.A., Agência Estado LTDA., S.A. "O Estado de S. Paulo", Rádio Eldorado LTDA. and Terra Networks S.A. (English translation)*
8.1	List of Subsidiaries.

* Incorporated by reference to Terra Networks' annual report on Form 20-F for the fiscal year ended December 31, 1999 filed with the Commission on June 30, 2000.

** Incorporated by reference to Terra Networks' registration statement on Form F-4, registration number 333-12208.

INDEX TO TERRA NETWORKS CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of TERRA NETWORKS, S.A. and SUBSIDIARIES, as of December 31, 2001 and 2000, and the related consolidated statements of operations, for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Group's directors. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Terra Networks España, S.A. (formerly Telefónica Servicios y Contenidos por la Red (TSCR), S.A., through December 5, 2000), for the years ended December 31, 2001 and December 31, 1999, and those of Lycos Europe NV for the year ended December 31, 2001, which statements reflect total assets, net income and revenues representing 9.26%, 32.84% and 18.32% in 2001 and 18.46%, 24.00% and 22.29% in 1999, respectively, of the related consolidated totals. These statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for this entity, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements present fairly, in all material respects, the financial position of Terra Networks, S.A. and Subsidiaries as of December 31, 2001 and 2000, and the results of their operations for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in Spain.

Accounting principles generally accepted in Spain vary in certain significant respects from accounting principles generally accepted in the United States of America. The application of the latter would have affected the determination of consolidated net loss for each of the three years in the period ended December 31, 2001 and the determination of shareholders' equity as of December 31, 2001 and 2000, to the extent summarized in Note 21.

Arthur Andersen y Cía., S.Com.

(A member firm of Andersen Worldwide until April 1, 2002.
Arthur Andersen y Cia, S.Com. has entered into an agreement to associate with Deloitte Touche Tohmatsu, which will become final upon receipt of antitrust clearance.)

Madrid, Spain

February 26, 2002 (except with respect to the notes 19 and 21, as to which the date is June 10, 2002)

BDO

BDO Audiberia
Auditores y Consultores

Juan Bravo, 3-B, 6ª • 28006 Madrid - España
Teléfono: 00 34-914 364 190
Fax: 00 34-914 364 191/192
Email bdo@bdo.es

AUDITORS' REPORT ON THE ANNUAL FINANCIAL STATEMENTS

To the sole shareholder of TERRA NETWORKS ESPAÑA, S.A. (Sociedad Unipersonal), (Company with a sole shareholder)

1. We have audited the annual financial statements of TERRA NETWORKS ESPAÑA, S.A. (Sociedad Unipersonal), which comprise the balance sheet at December 31, 2001, the profit and loss account and the notes to the financial statements for the year then ended, the preparation of which is the responsability of the company's Administradors. Our responsibility is to express an opinion on the financial statements taken as a whole, based on our work carried out in accordance with generally accepted auditing standards, which require the examination, on a test basis, of the evidence supporting the financial statements and the evaluation of their presentation, of the accounting principles applied and of the estimates carried out.

2. In accordance with commercial law, the Administrators present, for comparative purposes, in addition to the figures for 2001, comparative figures for the previous year, for each of the items in the balance sheet, in the profit and loss account, and in the statement of source and application of funds. Our opinion refers exclusively to the annual financial statements for 2001. On February 12, 2001 we issued our audit report on the 2000 annual financial statements, in which we expressed an unqualified audit opinion.

3. As explained in detail in note 1 of the attached notes to the financial statements, the company's main activity is centred on internet access and portal. The progress of the company and of its dependant companies (note 8 to the financial statements) is at present in the development and consolidation stage within the frame of a business plan. The financial statements at December 31, 2001 showed significant accumulative losses as well as negative working capital at that date.

   Notwithstanding the above, the company is expected to generate a profit before the end of the period on the assumption that the business estimates are met and the expected results achieved. To obtain this, the company and its dependants can count on the financial support of the sole shareholder. Additionally, and based on the estimates and projections of future results, in agreement with the above named business plan, the company has capitalised the tax credits and anticipated taxes generated by the tax losses during 1999 and 2000.

4. As indicated in notes 11 and 12 of the attached notes to the financial statements, the company maintains balances and carries out significant transactions with companies of the Telefónica Group.

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5. In our opinion, the annual 2001 financial statements present, in all material respects, a true and fair view of the net equity and of the financial situation of TERRA NETWORKS ESPAÑA, S.A. (Sociedad Unipersonal), (Company with a sole shareholder) at December 31, 2001 and of the results of its operations and of the sources and applications of funds during the year then ended, and contain the necessary and sufficient information for their adequate interpretation and understanding, in accordance with generally accepted accounting principles in Spain applied on a consistent basis with that of the preceding year.

6. The attached 2001 Directors' Report contains such explanations as the Administrators consider relevant to the situation of the company, the development of its business and other matters, and does not form an integral part of the annual financial statements. We have verified that the accounting information included therein is consistent with that disclosed in the 2001 annual financial statements. Our work as auditors is limited to the verification of the Directors' Report within the scope described in this paragraph, and does not include a review of information other than that obtained from the accounting records of the company.

BDO Auditoria

Alfonso Osorio Iturmendi
Partner Registered Auditor

Madrid, February 8, 2002

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BDO Audiberia
Auditores y Consultores

AUDITORS' REPORT ON THE ANNUAL FINANCIAL STATEMENTS

To the sole shareholder of **TELEFÓNICA SERVICIOS Y CONTENIDOS POR LA RED, S.A.**, (Company with a sole shareholder)

1. We have audited the annual financial statements of **TELEFÓNICA SERVICIOS Y CONTENIDOS POR LA RED, S.A.**, (Company with a sole shareholder), which comprise the balance sheet as of December 31, 1999, the profit and loss account and the notes to the financial statements for the year then ended, the preparation of which is the responsibility of the Sole Administrator. Our responsibility is to express an opinion on the financial statements taken as a whole, based on our audit. We conducted our audit in accordance with generally accepted auditing standards in the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

2. As required by Spanish corporate law for comparison purposes, the Sole Administrator presents, in addition to the figures for 1999, comparative figures for the previous year, for each of the items in the balance sheet, in the profit and loss account and in the statement of source and application of funds. Our opinion refers exclusively to the annual financial statements for 1999. Our auditor's report dated February 19, 1999 on the 1998 annual financial statements, contained an unqualified opinion.

3. During 1999 the share capital was converted into Euros and a reduction and increase operation was carried out, compensating accumulated losses at December 31, 1998 and subsequently increasing the share capital. At the date of issue of this report, these operations were pending of inscription into the Mercantile Register.

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4. The company maintained balances and carried out transactions with companies of the Telefónica Group during 1999.

5. In our opinion, the annual 1999 financial statements present, in all material respects, a true and fair view of the net equity and of the financial situation of **TELEFÓNICA SERVICIOS Y CONTENIDOS POR LA RED, S.A.**, (Company with a sole shareholder) at December 31, 1999 and of the results of its operations and of the sources and applications of funds during the year then ended, and contain the necessary and sufficient information for their adequate interpretation and understanding, in accordance with generally accepted accounting principles in Spain applied on a consistent basis with that of the preceding year.

BDO Audiberia

/s/Alfonso Osorio Iturmendi
Alfonso Osorio Iturmendi
Partner Registered Auditor

Madrid, Spain, February 17, 2000

KPMG

Appendix 2

Audit opinion

To Lycos Europe N.V., Haarlem:

We have audited the accompanying consolidated balance sheets of Lycos Europe N.V. and subsidiaries as of December 31, 2001, and June 30, 2001, and the related consolidated statements of operations and statements of changes in shareholders' equity and cash flows for the six month and twelve month periods then ended. We have not audited the consolidated statements of operations, statement of changes in shareholders' equity and cash flows for the six month period ended December 31, 2000 which are included as comparative information in the accompanying consolidated financial statements. The preparation and the content of these consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with International Standards on Auditing (ISA). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lycos Europe N.V. as of December 31, 2001, and June 30, 2001, and the results of its operations and its cash flows for the six month and twelve month periods then ended in accordance with generally accepted accounting principles in the United States (US GAAP).

Düsseldorf, February 12, 2002

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Stefan Haas
Independent Auditor

Britta Siebelink
Independent Auditor

1308/Fe In case of publication or dissemination of the consolidated financial statements in a version different to the version confirmed by us (including translations into other languages), in so far as our audit opinion is quoted or our review referred to, a new statement is to be obtained from us.

TERRA NETWORKS, S.A. AND DEPENDENT COMPANIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2001 AND 2000

ASSETS	Thousands of Euros 12/31/01	Thousands of Euros 12/31/00
DUE FROM STOCKHOLDERS FOR UNCALLED CAPITAL (Note 4-a)	**367,013**	**501,887**
FIXED AND OTHER NONCURRENT ASSETS		
Start-up expenses (Note 7)	**85,838**	**116,151**
Intangible assets (Note 8)-	**158,097**	**181,226**
Research and development expenses	155	55,215
Intellectual property	26,209	18,433
Computer software	85,006	59,945
Intangible assets in progress	2,979	6,677
Other intangible assets	203,674	115,314
Provisions	(22)	(337)
Accumulated amortization	(159,904)	(74,021)
Property and equipment (Note 9)-	**128,218**	**120,840**
Land and structures	18,888	3,528
Technical installations and machinery	9,919	7,314
Computer hardware	154,325	119,902
Furniture	15,640	13,150
Advances and construction in progress	3,232	2,308
Other tangible fixed assets	7,377	12,183
Accumulated depreciation	(81,163)	(37,545)
Long-term financial investments-	**1,125,515**	**641,862**
Holdings in companies carried by the equity method (Note 6)	274,995	209,892
Other holdings (Note 10)	50,193	110,652
Receivable from Telefónica Group companies (Note 13)	1,496	1,496
Loans to associated companies (Note 14)	21,109	3,197
Other loans	390	132
Long-term deposits and guarantees	2,065	1,197
Tax receivables (Note 15)	683,260	325,093
Other long-term financial investments (Note 4-a)	138,942	22,935
Allowance for holdings in companies carried by the equity method (Note 6)	(5,644)	(5,322)
Portfolio provisions (Note 10)	(39,795)	(27,410)
Other financial provisions	(1,496)	0
Long-term treasury stock (Note 11)	**2,187**	**2,078**
Total fixed and other noncurrent assets	**1,499,855**	**1,062,157**
GOODWILL IN CONSOLIDATION (Notes 4-a and 5)	**1,819,185**	**2,266,089**
DEFERRED CHARGES	**8,824**	**7,686**
CURRENT ASSETS		
Inventories	**2,334**	**2,111**
Accounts receivable-	**179,977**	**170,591**
Customer receivables for sales and services	62,025	87,039
Receivable from Telefónica Group companies (Note 13)	44,407	18,703
Receivable from associated companies (Note 14)	2,667	3,774
Tax receivables (Note 15)	68,881	50,108
Other accounts receivable	1,997	10,967
Short-term financial investments-	**2,189,388**	**2,586,461**
Current account with Telefónica Group companies (Note 13)	1,591,598	1,804,455
Current account with associated companies (Note 14)	6,202	46,512
Other short-term financial investments (Note 4-h)	591,588	735,494
Cash	**736**	**86,923**
Accrual accounts	**40,019**	**54,332**
Total current assets	**2,412,454**	**2,900,418**
TOTAL ASSETS	**6,107,331**	**6,738,237**

STOCKHOLDERS' EQUITY AND LIABILITIES	Thousands of Euros 12/31/01	Thousands of Euros 12/31/00
STOCKHOLDERS' EQUITY (Note 11)		
Capital stock	1,242,532	1,242,532
Additional paid-in capital	5,635,694	5,635,694
Reserves of the Controlling Company:		
Unrestricted reserves	6	6
Reserves for treasury stock	2,187	2,078
Prior years' earnings	15,691	9,081
Reserves at companies consolidated by the global integration method	(609,783)	(87,877)
Reserves at companies carried by the equity method	(41,227)	(60)
Translation differences in consolidation	(122,010)	(118,267)
Loss for the year attributable to the Controlling Company	(566,298)	(556,354)
Total stockholders' equity	**5,556,792**	**6,126,833**
MINORITY INTERESTS (Note 12)	**3,528**	**310**
NEGATIVE GOODWILL IN CONSOLIDATION (Note 4-a)	**12,903**	**15,392**
DEFERRED REVENUES	**4,724**	**2,551**
PROVISIONS FOR CONTINGENCIES AND EXPENSES (Note 4-h)	**30,581**	**27,869**
LONG-TERM DEBT	**16,088**	**13,971**
LONG-TERM DEFERRED TAX LIABILITY (Note 15)	**51,208**	**118,048**
CURRENT LIABILITIES		
Payable to credit entities	0	1,178
Payable to Telefónica Group companies (Note 13)	138,559	49,337
Payable to associated companies (Note 14)	3,077	1,502
Trade accounts payable	172,345	241,219
Other nontrade payables:		
Accrued taxes payable (Note 15)	6,627	10,707
Other nontrade payables	53,411	64,707
Accrual accounts	57,488	64,613
Total current liabilities	**431,507**	**433,263**
TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES	**6,107,331**	**6,738,237**

The accompanying Notes 1 to 21 are an integral part of these consolidated balance sheets.

TERRA NETWORKS, S.A. AND DEPENDENT COMPANIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2001, 2000 AND 1999

	Thousands of Euros				Thousands of Euros		
DEBIT	**2001**	**2000**	**1999**	**CREDIT**	**2001**	**2000**	**1999**
EXPENSES:				**REVENUES:**			
Decrease in inventories	2,441	745	1,354	Net sales:			
Purchases:				Net sales to Telefónica Group companies (Note 16)	28,030	26,282	3,727
Purchases from Telefónica Group companies (Note 16)	99,749	27,202	-	Net sales and services to associated companies	1,445	409	-
Purchases from associated companies	-	6	-	Net sales and services (Note 16)	660,480	277,301	42,816
Other purchases	55,288	49,205	4,385	Capitalized expenses of Group work on fixed assets	2,488	968	-
Work performed by Telefónica Group companies (Note 16)	66,704	49,535	16,639	Other operating revenues from Telefónica Group companies (Note 16)	494	1,052	-
Work performed by other companies	127,857	66,933	8,666	Other operating revenues	575	1,517	3,688
Personnel expenses (Note 16)	204,969	116,868	19,942		**693,512**	**307,529**	**50,231**
Period depreciation and amortization	157,426	83,513	6,272				
Variation in operating provisions	22,887	13,727	1,320				
Other operating expenses:							
Outside services provided by Telefónica Group companies (Note 16)	25,023	11,347	6,331				
Outside services provided by associated companies (Note 16)	58	18	-				
Outside services and other operating expenses (Note 16)	348,554	331,189	76,253				
	1,110,956	**750,288**	**141,162**				
Operating income	**-**	**-**	**-**	**Operating loss**	**417,444**	**442,759**	**90,931**
				Revenues from loans to Telefónica Group companies (Note 16)	70,366	37,173	2,861
Financial expenses on debts with Telefónica Group companies	-	-	1,977	Revenues from shareholdings in and loans to associated companies	8,576	228	-
Financial expenses on debts	10,480	6,581	5,405	Financial revenues from shareholdings and loans	57,384	14,346	2,536
Exchange losses	13,152	44,331	739	Exchange gains	14,009	30,970	3,544
Other financial and similar expenses	7,257	494	2,692	Other financial and similar revenues	6,816	4,176	3,711
Financial income	**126,262**	**35,487**	**1,839**	**Financial loss**	**-**	**-**	**-**
Share in losses of companies carried by the equity method (Note 6)	181,732	54,721	60				
Amortization of goodwill in consolidation (Note 5)	386,332	253,484	28,654	Reversal of negative goodwill in consolidation	2,825	-	-
Income from ordinary activities	**-**	**-**	**-**	**Loss on ordinary activities**	**856,421**	**715,477**	**117,806**
Extraordinary expenses and losses (Note 16)	77,696	93,544	2,467	Other extraordinary revenues	2,849	3,834	1,042
Extraordinary income	**-**	**-**	**-**	**Extraordinary loss**	**74,847**	**89,710**	**1,425**
Income before taxes and minority interests	**-**	**-**	**-**	**Loss before taxes and minority interests**	**931,268**	**805,187**	**119,231**
				Corporate income tax (Note 15)	363,350	248,142	35,899
				Loss attributed to minority interests (Note 12)	1,620	691	1,928
Net income for the year	**-**	**-**	**-**	**Loss for the year**	**566,298**	**556,354**	**81,404**

The accompanying Notes 1 to 21 are an integral part of these consolidated statements of operations.

TERRA NETWORKS, S.A.

AND DEPENDENT COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2001 and 2000 and for the Years Ended December 31, 2001, 2000 and 1999

(1) DESCRIPTION OF THE TERRA NETWORKS GROUP

Terra Networks, S.A. ("the Controlling 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 Controlling Company changed its corporate name to Telefónica Interactiva, S.A. on February 17, 1999, and to Terra Networks, S.A. on September 7, 1999.

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

Its corporate purpose is the provision and operation of Spanish and international telecommunications services, the provision of related content production services for on-line access, interactive services, and the provision and operation of current and future information and communications services and technologies, subject in all cases to the applicable legislation and to the prior obtainment, where necessary, of such administrative authorizations or licenses as might be required. The Controlling 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 Controlling Company may perform them directly or through interests in the business activities of other companies with a similar corporate purpose, either by promoting the foundation or formation of such companies or by acquiring holdings in their capital.

In order to carry on its business activities, Terra Networks, S.A. has incorporated subsidiaries in most of the countries in which it provides its services. Specifically, as of December 31, 2001, the Group was providing services through direct or indirect holdings in Spain, France, Italy, Germany, the U.K., the Netherlands, Austria, Switzerland, Denmark, Norway, Sweden, Finland, Mexico, Brazil, the U.S., Guatemala, Argentina, Peru, Chile, Colombia, Venezuela, El Salvador, Uruguay, Costa Rica, Honduras, Nicaragua, Panama, Japan, Korea, China, Singapore, Taiwan, the Philippines, Malaysia, India and Canada (see Note 2-d). The holdings in France, Italy, Germany, the U.K., the Netherlands, Austria, Switzerland, Denmark, Norway, Sweden, Finland, Japan, Korea, China, Singapore, Taiwan, the Philippines, Malaysia, India and Canada arose as a result of the merger with Lycos, Inc. (formerly Lycos Virginia, Inc.), which was approved by the Board of Directors of Terra Networks, S.A. on May 16, 2000, and is described below.

On May 16, 2000, Lycos, Inc., Terra Networks, S.A., Telefónica, S.A. and the German company Bertelsmann, AG entered into an agreement in relation to a strategic alliance at world level for the joint performance of the e-commerce business which established, between these four companies, the cooperation and management criteria relating to content and joint marketing campaigns (see Note 4-a).

Terra Networks, S.A. is listed on the Spanish (New Market) and the Nasdaq National Market. As of December 31, 2001 and 2000, its stockholders were as follows:

	Percentage of Ownership	
Stockholder	12/31/01	12/31/00
Telefónica, S.A.	37.03	36.27
Citibank, NA	7.80	8.40
Other stockholders	55.17	55.33
Total	**100.00**	**100.00**

The purpose of the holdings of Citibank, NA and of the minority holdings of Banco Zaragozano and Caja de Ahorros y Pensiones de Barcelona (Caixa) is to enable the finance entities acting as agents in the Stock Option Plan for Terra Networks, S.A.'s employees (see Notes 11, 18-a and 18-b) to have ownership interests in the capital stock of Terra Networks, S.A.

(2) BASIS OF PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

a) *True and fair view-*

The accompanying consolidated financial statements of the Group were prepared from the individual accounts of Terra Networks, S.A. and of those companies that comprise the access (ISP) and portal activities controlled by Terra Networks, S.A. or its parent company, Telefónica, S.A., during the period beginning January 1, 1999 and ending December 31, 2001.

The accompanying consolidated financial statements, which were prepared by the Controlling Company's directors from the accounting records of Terra Networks, S.A. and its dependent companies, are presented in accordance with the Spanish National Chart of Accounts and Royal Decree 1815/1991 and, accordingly, give a true and fair view of the net worth, financial position and results of operations of the Controlling Company and its dependent companies. The financial statements of the dependent companies 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 consolidated financial statements of Terra Networks, S.A. were prepared in accordance with generally accepted accounting principles in Spain ("Spanish GAAP"), which differ in some respects from generally accepted accounting principles in the United States ("U.S. GAAP"). A reconciliation of the consolidated net loss and shareholders' equity from Spanish GAAP to US GAAP is provided in Note 21.

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 consolidated by the global integration method; those in which there is significant influence but not ownership of a majority of the voting rights or joint management with third parties are carried by the equity method.

As of December 31, 2001, all the dependent companies (see Note 2-d) were consolidated by the global integration method. Red Universal de Marketing y Bookings Online, S.A., A tu hora, S.A., Corporación Real Time Team, S.L., Uno-e Bank, S.A., Azeler Automoción, S.A., OneTravel.com, Inc., Terra Mobile, S.A., Emplaza, S.A. and the associated companies of Lycos, Inc. (Lycos Japan K.K., Lycos Asia Limited, Lycos Korea, Inc., Lycos Europe N.V., Simpatico Lycos, Inc., Lycos Ventures LP, Fast Search & Transfer ASA and Autobytel, Inc.) are carried by the equity method.

As of December 31, 2000, all the dependent companies were consolidated by the global integration method. Red Universal de Marketing y Bookings Online, S.A. and A tu hora, S.A. were consolidated by the proportional integration method. Corporación Real Time Team, S.L., OneTravel.com, Inc., Aremate.com, Inc., Terra Mobile, S.A. and the associated companies of Lycos, Inc. (Lycos Japan K.K., Lycos Asia Limited, Lycos Korea, Inc., Lycos Europe N.V., Simpatico Lycos, Inc. and Lycos Ventures LP) were carried by the equity method.

The effect of the change in the method used to consolidate Red Universal de Marketing y Bookings Online, S.A. and A tu hora, S.A. in 2001 from that applied in 2000 is not material.

Also, the Terra Group has holdings of 50% or less in other companies that were not consolidated, the effect of which on the consolidated financial statements was not material. These holdings are recorded under the "Other Holdings" caption in the consolidated balance sheet (see Note 10).

All material accounts and transactions between the consolidated companies were eliminated in consolidation.

The equity of the minority stockholders in the net worth and results of the dependent companies consolidated by the global integration method 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.

The result of carrying the holdings in associated companies in the consolidated balance sheet by the equity method is reflected under the "Holdings in Companies Carried by the Equity Method" caption on the asset side of the consolidated balance sheet and the "Share in Losses of Companies Carried by the Equity Method" 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 companies to the Controlling Company's accounts, since it is considered that these reserves will be used as self-financing resources by the respective consolidated companies.

c) Comparative information-

The 2000 consolidated financial statements were prepared in Spanish pesetas. However, in order to facilitate their comparison with the 2001 consolidated financial statements, the figures in the consolidated balance sheet as of December 31, 2000, and in the consolidated statement of operations for the years ended December 31, 2000 and 1999 were translated to euros, applying for this purpose the exchange rate established by Article 2 of Law 46/1998 on the introduction of the euro, and taking into account the related rounding off.

As a general rule, and pursuant to current accounting legislation, the Controlling Company amortizes goodwill systematically over the period in which it will contribute to the obtainment of revenues.

In 2000 goodwill was amortized on a straight-line basis over five years. In order to adapt the amortization period to the revenue generation estimates made on the basis of the new economic situation and the rate of maturation of the industry, and to thus achieve a better matching of expenses and revenues, from July 1, 2001 onwards, goodwill not assigned to specific assets started to be amortized over ten years, and the remaining useful lives of such assets as of June 30, 2001, were extended by five years.

d) Scope of consolidation-

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

The main changes in the consolidated Group in 2001 and 2000 were as follows (in chronological order):

Dependent companies

Terra Networks USA, Llc. (formerly Terra Networks USA, Inc.)-

On May 27, 1999, Terra Networks, S.A. incorporated the portfolio company Terra Networks USA, Llc. (formerly Terra Networks USA, Inc.). On October 5, 1999, the latter and International Discount Telecommunications Corporation (IDT) entered into a joint venture contract to provide Internet access and portal services for the Spanish-speaking market in the U.S.

Under this joint venture contract, on October 5, 1999, Terra Networks USA, Llc. and IDT formed the Internet service provider Terra Networks Access Services USA Llc. (owned 51% and 49%, respectively). On that same date, Terra Networks USA, Llc. and IDT formed Terra Networks Interactive Services USA, Llc. (owned 90% and 10%, respectively) to engage in portal business activities.

On May 1, 2000, Terra Networks, S.A. and IDT entered into an agreement allowing IDT to exchange early its holdings in the above-mentioned companies for shares of Terra Networks, S.A. This share exchange transaction was performed in July 2000 through the delivery of shares of Terra Networks, S.A. (see Note 11).

In February 2000 Terra Networks USA, Llc. acquired for US$ 45 million a minority interest in Aremate.com, Inc.

In December 2001, the holding in Terra Networks USA, Llc. was contributed by Terra Networks, S.A. to Lycos, Inc. for its net book value.

Terra Networks Brasil, S.A.-

Telefónica Interactiva Brasil, Ltda ("TIB"), in which Terra Networks, S.A. has a 99.99% holding, owns all the shares of Terra Networks Brasil, S.A. ("T.N. Brasil").

Control over T.N. Brasil was obtained in various stages in 1999. Subsequently, on January 6, 2000, January 31, 2000, and February 11, 2000, three capital increases were carried out at T.N. Brasil, all of which were subscribed and paid in full by TIB, thereby increasing the latter's ownership interest in T.N. Brasil to 99.55%.

On September 28, 2000, the remaining 0.45% holding was acquired in compliance with a previous purchase commitment whereby Terra Networks, S.A. acquired from Taetel, S.L. all the shares of Segovia Participações Ltda ("Segovia", a wholly-owned investee of Taetel, S.L.) for €77.8 million. Accordingly, Terra Networks, S.A. owns all the shares of T.N. Brasil. As a result of the corporate restructuring carried out in December 2000, TIB absorbed Segovia.

In 2001 capital was increased by a total amount of US$ 128 million at T.N. Brasil through the conversion of accounts payable to Terra Networks, S.A. into equity. Also, in 2001, TIB's capital was increased by a total of US$ 38 million through the conversion of accounts payable to Terra Networks, S.A. into equity.

T.N. Brasil has majority holdings in various Internet companies (see Exhibit I). It engages mainly in the provision of Internet access, the marketing of software developed by third parties, the provision of services related to access networks and the performance of business activities as an Internet portal.

Terra Networks Colombia Holding, S.A.-

This company was incorporated on March 30, 2000. Terra Networks, S.A. has a direct holding of 83.34% and a 16.66% indirect holding through Terra Networks España, S.A., Terra Lycos Intangibles, S.A., Terra Networks Perú, S.A. and Terra Networks Venezuela, S.A. Consequently, Terra Networks, S.A. owns, directly or indirectly, all the shares of this company.

In July 2000 Terra Networks Colombia Holding, S.A. acquired a 65% holding in LaCiudad.com, S.A. for US$ 20 million. The other stockholders of this company are Comercializadora Semana, S.A. (10.83%), Casa Editorial El Tiempo, S.A. (9.3%), Tempora, S.A. (8.2%), El Colombiano Ltda. y Cía, S.C.A. (4.9%), El País, S.A. (1.05%) and Inversiones PTT Ltda. (0.72%). In 2001 LaCiudad.com, S.A. changed its name to Terra Networks Colombia, S.A.

In 2001 Terra Networks Colombia Holding, S.A. carried out capital increases totaling US$ 3.3 million, which were subscribed in full by Terra Networks, S.A.

Ifigenia Plus, S.L.-

In June 2000 Terra Networks, S.A. entered into an agreement with the stockholders of Ifigenia Plus, S.L. whereby Terra Networks España, S.A. acquired all the shares of Ifigenia Plus, S.L. On June 16, 2000, Terra Networks España, S.A. acquired for €11,948,000 the shares (90% of the capital stock) not owned by it through that date from the previous stockholders. Ifigenia Plus, S.L. engages mainly in the development and distribution of cultural and educational content and applications.

Ifigenia Plus, S.L. owns all the shares of Educaterra, S.L., whose corporate purpose is to operate a portal targeted at the on-line education and training market.

Lycos, Inc. (formerly Lycos Virginia, Inc.)-

Lycos, Inc. is a Delaware, U.S. company that was incorporated in June 1995. On October 27, 2000, the stockholders of Lycos, Inc. approved the merger of Lycos, Inc. with its subsidiary Lycos Virginia, Inc., which succeeded Lycos, Inc. as the post-merger company.

On June 8, 2000, the Stockholders' Meeting of Terra Networks, S.A. resolved to increase its capital in order to acquire all of the shares of Lycos, Inc. (formerly Lycos Virginia, Inc.) through a share exchange transaction whereby Terra Networks, S.A. acquired all the shares of Lycos, Inc. Accordingly, on October 27, 2000, Terra Networks, S.A. issued 302,031,974 shares of €2 par value each with additional paid-in capital of €9. The total amount of the capital increase was €3,322,351,000 (see Note 11). The method used to record the difference arising in first-time consolidation is described in Note 4-a.

In 2001 Lycos Virginia, Inc. changed its name to Lycos, Inc. Lycos, Inc. owns majority holdings in several Internet companies (see Exhibit I). It engages mainly in the provision of Internet portal services worldwide.

Associated companies

Red Universal de Marketing y Bookings Online, S.A.-

In July 1999 Terra Networks, S.A. entered into an agreement with Amadeus Global Travel Distribution, S.A. (an Iberia, Lufthansa and Air France investee engaged in the airline ticket booking business) to create a joint-venture company engaging in the electronic distribution over the Internet of booking services in the tourism and travel area.

In March 2000 Red Universal de Marketing y Bookings Online, S.A. (Rumbo) was incorporated with an initial capital stock of €1 million. Terra Networks, S.A. has a 50% holding in this company, whose business activity focuses on Spanish- and Portuguese-speaking countries. Terra Networks, S.A. and Amadeus Global Travel Distribution, S.A. have undertaken not to invest in businesses similar to that of the aforementioned joint-venture company in the areas in which it will provide its services (Spain, Portugal and Latin America).

In July 2000 Rumbo increased its capital by €7.5 million, with additional paid-in capital of €1.5 million, through a monetary contribution by its two stockholders.

In March 2001 Rumbo increased its capital by €500,000, with additional paid-in capital of €4.5 million, through a monetary contribution by its two stockholders.

A Tu Hora, S.A.-

In April 2000 Terra Networks, S.A. entered into an agreement with TelePizza, S.A. to set up a joint venture to engage in the marketing, through communication networks such as the Internet or wireless telephony, of products such as books, videos, CDs, prepaid phonecards, entertainment products, etc., with distribution and delivery times ranging from 1 to 24 hours. In July 2000 Terra Networks, S.A. and Lubasto Holding, B.V., a wholly-owned subsidiary of TelePizza, S.A., incorporated A Tu Hora, S.A., in which they each have a 50% holding, with a capital stock of €2.6 million and initial stockholders' equity of €5.6 million.

In September 2001 A Tu Hora, S.A. increased its capital by €4.6 million through a monetary contribution by its two stockholders.

Terra Mobile, S.A.-

On June 21, 2000, Terra Networks, S.A. and Telefónica Móviles, S.A. entered into a stockholders' agreement and incorporated Terra Mobile, S.A. with an initial capital stock of €601,120. This company's corporate purpose is the operation of content and services such as paging, scheduling, e-commerce and games through wireless access using WAP technology and any other technology that might be developed in the future.

In July 2000 Terra Mobile, S.A. announced the acquisition of the Finnish company Iobox Oy, owner of the Iobox portal, which engages in the provision of Internet services and applications for wireless telephones.

In December 2001 Terra Mobile, S.A. increased its capital by €132 million through the conversion of loans from its two stockholders into capital. Subsequently, Terra Networks, S.A. sold to Telefónica Móviles, S.A. a portion of the holding in this company for its net book value, thereby reducing Terra Networks, S.A.'s ownership interest in Terra Mobile, S.A. from 49% to 20%.

OneTravel.com, Inc.-

In November 2000 Terra Networks, S.A. and Amadeus Global Travel Distribution, S.A. announced the acquisition of a majority holding in One Travel.com, Inc., a U.S. website specializing in travel. In December 2000, subsequent to approval by the Stockholders' Meeting of One Travel.com, Inc., Terra Networks, S.A. acquired a 27.73% holding for €15,957,000.

Uno-e Bank, S.A.-

Pursuant to the agreements entered into in February 2000 by Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), in August 2001 Terra Networks, S.A. acquired a 49% holding in Uno-e Bank, S.A. for €160,434,000.

The detail of the capital increases at foreign dependent Group companies in 2001 is as follows (amounts in thousands of U.S. dollars):

Company	Capital Increase through Conversion of Payables to Terra Networks, S.A. into Capital	Capital Increase through Monetary Contribution Subscribed in Full by Terra Networks, S.A.
T.N Guatemala, S.A.	6,772	2,000
T.N. Perú, S.A.	13,732	-
T.N. Argentina, S.A.	5,500	-
T.N. México Holding, S.A. de C.V.	140,760	75,000
Telefónica Interactiva Brasil, S.A.	38,007	-
Terra Networks Brasil, S.A.	127,979	-
T.N. Chile Holding Ltda.	-	8,500
T.N. Venezuela, S.A.	4,700	5,450
T.N. Colombia Holding S.A.	-	3,250
T.N. Uruguay, S.A.	2,072	-

The detail of the capital increases at foreign dependent Group companies in 2000 is as follows (amounts in thousands of U.S. dollars):

Company	Capital Increase through Conversion of Payables to Terra Networks, S.A. into Capital	Capital Increase through Monetary Contribution Subscribed in Full by Terra Networks, S.A.
T.N. Perú, S.A.	30,496	-
T.N. Argentina, S.A.	12,396	9,300
T.N. México Holding, S.A. de C.V.	32,641	-
T.N. Venezuela, S.A.	5,094	-
T.N. Colombia Holding S.A.	-	30,125
T.N. Uruguay, S.A.	2,573	-

(3) ALLOCATION OF LOSS

The Controlling Company's directors propose to allocate the Controlling Company's loss for 2001 in full to "Prior Years' Losses".

(4) ACCOUNTING PRINCIPLES

The main valuation standards applied by the Controlling Company in preparing the accompanying consolidated financial statements were as follows:

a) *Goodwill in consolidation-*

Goodwill in consolidation relates to the positive difference between the amounts paid to acquire the dependent companies and the value of the proportional part of their equity at the acquisition date, net of value adjustments and provisions recorded before the date of first-time consolidation and prior to uniformity adjustments.

Pursuant to Royal Decree 1815/1991 enacting 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 "Goodwill in Consolidation" 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.

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

In 2001 the Controlling Company has carried out a study of the evolution of the acquired companies' business plans in order to ascertain whether or not it was necessary to write down the goodwill arising from the acquisitions of companies in prior years. As a result of the study, the balance of the "Goodwill in Consolidation" caption was written down by €35,083,000.

After the study had been carried out and the write-down made, the Controlling Company adapted the goodwill amortization period to the new revenue estimates in order to better match future revenues and expenses in accordance with the actual rate of maturation of the Group and of the industry in which it operates. The business model of the acquired companies was based on free Internet access and advertising revenues and it has evolved towards a new model based on pay per access, pay per content and customized advertising.

As a general rule, the goodwill amortization period has been extended to ten years, except for the portion of goodwill, amounting to €400,000,000, which was allocated to the agreement entered into on May 16, 2000, between Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A., to be recovered in proportion to the revenues generated by the agreement over its five-year term.

€145,458,000 of goodwill arose in 2001, and €386,332,000 of amortization of goodwill in consolidation were charged to the 2001 consolidated statement of operations (see Note 5). Had the goodwill in consolidation been amortized on a straight-line basis over five years throughout 2001, the charge in this connection to the 2001 consolidated statement of operations would have increased by €163,408,000.

The goodwill arising from the acquisitions made in 2000 amounted to €1,124,422,000. Also, the goodwill recorded by the dependent company Lycos, Inc., which arose on the acquisitions made by that company prior to its consolidation, amounts to €881,991,000.

€253,484,000 of amortization of goodwill in consolidation were charged to the 2000 consolidated statement of operations (see Note 5).

The main goodwill arising in 2000 related to the acquisition of all the shares of Lycos, Inc.

The agreements entered into on May 16, 2000, by Terra Networks, S.A., Telefónica, S.A., Lycos, Inc. and Bertelsmann AG in connection with the acquisition of Lycos, Inc. included an agreement for cooperation relating to access to the new content of the Group and joint marketing campaigns. The agreement stipulated that Bertelsmann AG would make payments of US$ 325 million for the products and services purchased from the Group in the first two years following the merger of Terra Networks, S.A. and Lycos, Inc. The agreement also stated that Bertelsmann AG would make certain payments up to a total amount of US$ 675 million for the products and services purchased from the Group in the first three years following the second anniversary of the merger of Terra Networks, S.A. and Lycos, Inc., and Telefónica, S.A. undertook to purchase goods and services from the Group during that period for the amount of the purchases not made by Bertelsmann AG, up to a total amount of US$ 675 million.

For the purposes 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. (capital increase of 302,031,974 shares issued at a value of €11 each plus the expenses relating to the transaction) was broken down in two different tranches:

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

These shares were issued by Terra Networks, S.A. in exchange for 111,391,500 shares of Lycos, Inc. at an exchange ratio of 2.15.

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 a value of €11 each). These shares are deposited at Citibank, under a share deposit agreement (see Note 11). These shares were issued by Terra Networks, S.A. in exchange for 29,088,488 Lycos, Inc. shares at an exchange ratio of 2.15.

For accounting purposes, a distinction was drawn between:

2A.- Shares that cover options of employees of Lycos, Inc. with an exercise price equal to or greater than €11 (44,664,894 shares)

2B.- Shares that cover options of employees of Lycos, Inc. with an exercise price less than €11 (17,875,355 shares)

The different accounting treatment of the differences between the acquisition price recorded in the 2A and 2B tranches and the acquired company's equity is detailed below:

2A.- Shares that cover options of employees of Lycos, Inc. with an exercise price equal to or greater than €11 (44,664,894 shares).

This asset, valued at €11 per share and recorded under the "Long-Term Financial Investments" caption in the individual financial statements of Terra Networks, S.A., was reclassified for the purposes of the consolidated financial statements to the "Due from Stockholders for Uncalled Capital" caption on the asset side of the consolidated balance sheet for an initial amount of €491,314,000. As the employees exercise their options covered by these shares, the positive difference between the exercise price paid by the employee and the €11 is recorded in the accompanying consolidated financial statements under the "Negative Goodwill in Consolidation" caption on the liability side of the consolidated balance sheet. This difference will be allocated to income over the remaining period over which the goodwill which initially arose in the transaction is being amortized, up to a maximum of ten years from the acquisition date (October 27, 2000).

In 2001 the employees of Lycos, Inc. exercised 45,036 options on Terra Networks, S.A. shares of this nature, giving rise to a reduction of €495,000 in the balance of the "Due from Stockholders for Uncalled Capital" caption and to "Negative Goodwill in Consolidation" amounting to €240,000.

In the period from October 27 to December 31, 2000, the employees of Lycos Virginia, Inc. exercised 2,162,205 options on Terra Networks, S.A. shares of this nature, giving rise to a reduction of €23,775,000 in the balance of the "Due from Stockholders for Uncalled Capital" caption and to "Negative Goodwill in Consolidation" amounting to €15,392,000.

As of December 31, 2001, there was an accumulated total of 11,798,319 shares amounting to €129,781,000 covering the options of employees of Lycos, Inc. with an exercise price of at least €11 which will not be exercised and which currently form part of capital stock and additional paid-in capital. A balancing entry of the same amount is recorded under the "Other Long-Term Financial Investments" caption on the asset side of the consolidated balance sheet.

As of December 31, 2000, there were 1,578,662 shares amounting to €17,358,000 covering the options of employees of Lycos Virginia, Inc. with an exercise price of at least €11 which will not be exercised and which currently form part of capital stock and additional paid-in capital. A balancing entry of the same amount is recorded under the "Other Long-Term Financial Investments" caption on the asset side of the consolidated balance sheet.

2B.- Shares that cover options of employees of Lycos, Inc. with an exercise price of less than €11 17,875,355 shares).

This asset, recorded under the "Long-Term Financial Investments" caption in the individual financial statements of Terra Networks, S.A., was initially reclassified for the purposes of the consolidated financial statements to the "Due from Stockholders for Uncalled Capital" caption on the asset side of the consolidated balance sheet for the effective exercise price of the options (€83,474,000), and the difference of €113,153,000 between this price and the €11 per share was recorded as additional goodwill. This goodwill will be allocated to income on a straight-line basis over a maximum period of ten years.

In 2001 the employees of Lycos, Inc. exercised 3,708,532 options on Terra Networks, S.A. shares of this nature, giving rise to a reduction of €18,377,000 in the balance of the "Due from Stockholders for Uncalled Capital" caption.

In the period from October 27 to December 31, 2000, the employees of Lycos, Inc. exercised 8,194,309 options on Terra Networks, S.A. shares of this nature, giving rise to a reduction of €26,186,000 in the balance of the "Due from Stockholders for Uncalled Capital" caption.

As of December 31, 2001, there were 1,307,267 shares amounting to €14,379,000 covering the options of employees of Lycos, Inc. which will not be exercised and which currently form part of capital stock and additional paid-in capital. Balancing entries are recorded under the "Other Long-Term Financial Investments" (€9,161,000) and "Goodwill in Consolidation" (€5,218,000) captions on the asset side of the consolidated balance sheet.

As of December 31, 2000, there were 507,300 shares amounting to €5,577,000 covering the options of employees of Lycos, Inc. which will not be exercised and which currently form part of capital stock and additional paid-in capital. A balancing entry of the same amount is recorded under the "Other Long-Term Financial Investments" caption on the asset side of the consolidated balance sheet.

Also, on October 27, 2000, Terra Networks, S.A. and Citibank NA (the custodian of the options - see Note 11) entered into a contract to regulate all matters relating to the new stock option plan on Terra Networks, S.A. shares. Under this contract, the Agent Bank granted Terra Networks, S.A. an option to take possession of the shares of Terra Networks, S.A. held by the Agent Bank for their subsequent delivery to the beneficiaries of the new plan once the latter exercise their options. If after the option exercise period has expired certain options have not been exercised, Terra Networks, S.A. will have to acquire the excess shares and retire them. Accordingly, the shares issued by Terra Networks, S.A. on which the related purchase options are not exercised will be retired with the concomitant effect on the financial statements due to the reduction of its capital stock and additional paid-in capital.

b) Transactions between consolidated companies-

All receivables and payables between the consolidated Group companies, as well as the transactions giving rise to 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 variations, such methods were made uniform in consolidation by adapting them to the methods applied by the Controlling Company.

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

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

1. Capital stock and reserves, which were translated at historical exchange rates.
2. Goodwill arising at the Controlling Company on the acquisition of a foreign holding, either directly or through a portfolio company in the country concerned, which, together with the related amortization, was translated at the historical exchange rates.
3. Income statement items, which were translated at the average exchange rates for the year. The amortization of goodwill was translated at historical exchange rates, as described above.

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

e) *Start-up expenses-*

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

They relate mainly to expenses associated with the public offerings of shares, such as lawyers' fees, public deed and registration expenses, security underwriting and placement fees, etc., and advertising expenses incurred in launching the Terra brand name and publicizing the aforementioned public offerings of shares.

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

€30,627,000 and €19,633,000 of amortization of start-up expenses were charged to the consolidated statement of operations in 2001 and 2000, respectively (see Note 7).

f) Intangible assets-

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

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 to five years, as well as rights acquired under long-term service and content contracts, which are amortized on a straight-line basis over the contract term.

€85,386,000 and €46,651,000 of amortization of intangible assets were charged to the consolidated statement of operations in 2001 and 2000, respectively (see Note 8).

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.

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
Technical installations	5-10
Furniture	6-11
Computer hardware	2-5
Other tangible fixed assets	4-6
Other installations	10

€41,413,000 and €17,229,000 of depreciation were charged to the 2001 and 2000 consolidated statements of operations, respectively (see Note 9).

h) Long- and short-term financial investments-

Nonconsolidated shareholdings 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 average market price in the last quarter or market price at year-end.

2. Unlisted securities:

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

Unrealized losses (cost higher than market value or underlying book value at year-end) are recorded under the "Long-Term Financial Investments - Provisions" caption up to the limit of cost. Should unrealized losses exceed cost, reducing the value to zero, the overprovision is reclassified for the purposes of the consolidated balance to the liability "Provisions for Contingencies and Expenses" caption.

The "Current account with Group Companies" caption includes mainly short-term investments of cash surpluses in Telefónica y Finanzas, S.A. by Terra Networks, S.A. and various Group companies, earning interest at market rates (see Note 13) which as of December 31, 2001 and 2000, amounted to €1,591,598,000 and €1,804,455,000, respectively.

Also, the short-term financial investments include deposits at various finance entities, which earn interest at market rates, amounting to €591,588,000 and €735,494,000 as of December 31, 2001 and 2000, respectively.

i) 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 and those maturing at or over 12 months from year-end are classified as long term.

j) Inventories-

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

k) Treasury stock-

Treasury stock is valued at the lower of cost, comprising the total amount paid for its acquisition, or market value. Market value is taken to be the lower of 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 11).

l) Corporate income tax-

This caption relates to both Spanish corporate income tax and the similar taxes to which the foreign 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 Controlling Company recorded the tax asset arising from the tax losses incurred in the year, since it considered that, on the basis of the Group's business plan, its recoverability was assured within ten years, which, under current accounting legislation, is the maximum period for recognizing tax assets for tax loss carryforwards (see Note 15).

m) Foreign currency transactions-

Fixed-income securities and receivables and payables denominated in foreign currencies are translated into euros at the exchange rates prevailing 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 are incurred.

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.

n) 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.

(5) GOODWILL IN CONSOLIDATION

The variations in 2001 and 2000 in this caption in the accompanying consolidated balance sheets were as follows:

	Thousands of Euros					
	Balance at 01/01/01	Additions	Retirements/ Transfers	Amortiza-tion	Translation Differences	Balance at 12/31/01
Ordenamiento de Links Especializados, S.L.	7,960	-	-	(1,659)	-	6,301
Terra Networks Brasil, S.A.	153,693	-	-	(30,177)	-	123,516
Dependent companies of Terra Networks Brasil, S.A.	14,485	-	(4,484)	(3,011)	2,272	9,262
Terra Networks Guatemala, S.A.	2,844	-	-	(535)	-	2,309
Terra Networks Argentina, S.A.	9,134	-	-	(6,473)	-	2,661
Terra Networks México Holding, S.A. de C.V.	206,048	-	-	(57,810)	-	148,238
Terra Networks México, S.A. de C.V.	1,118	-	-	(276)	-	842
Dependent companies of Terra Networks México, S.A. de C.V.	547	-	463	(246)	-	764
Terra Networks Chile, S.A.	33,942	-	-	(6,196)	-	27,746
Lycos, Inc.	1,772,522	11,054	(150,159)	(254,032)	(54,122)	1,325,263
Terra Networks USA, Inc. and subsidiaries	8,829	-	-	(8,829)	-	-
Terra Networks Venezuela, S.A.	3,889	-	-	(643)	-	3,246
Terra Networks Colombia Holding, S.A.	19,737	-	-	(3,125)	-	16,612
Ifigenia Plus, S.L.	10,055	-	-	(1,617)	-	8,438
A tu hora, S.A.	1,395	-	(1,395)	-	-	-
Bumeran Participaciones, S.L.	5,782	2,350	-	(3,636)	-	4,496
Goodwill arising at companies consolidated by the global or proportional integration method	2,251,980	13,404	(155,575)	(378,265)	(51,850)	1,679,694
Goodwill arising at companies carried by the equity method	14,109	-	133,449	(8,067)	-	139,491
Total	**2,266,089**	**13,404**	**(22,126)**	**(386,332)**	**(51,850)**	**1,819,185**

	Thousands of Euros						
	Balance at 01/01/00	Inclusion of Companies	Additions	Other adjustment	Retirements	Amorti-zation	Balance at 12/31/00
Ordenamiento de Links Especializados, S.L. (OLE)	10,406	-	-	-	-	(2,446)	7,960
Terra Networks Brasil, S.A.	163,706	-	37,569	-	-	(47,582)	153,693
Dependent companies of Terra Networks Brasil, S.A.	10,272	-	7,699	-	-	(3,486)	14,485
Terra Networks Guatemala, S.A.	3,030	-	559	-	-	(745)	2,844
Terra Networks Argentina, S.A.	11,544	-	-	-	-	(2,410)	9,134
T. N. México Holding, S.A.de C.V.	-	-	685	-	-	(138)	547
T. N. México, S.A. de C.V.	258,919	-	-	-	-	(52,871)	206,048
Dependent companies of T. N. México, S.A. de C.V.	1,394	-	-	-	-	(276)	1,118
Terra Networks Chile, S.A.	38,345	-	-	4,838	(383)	(8,858)	33,942
Lycos, Inc.	-	881,991	964,005	-	-	(73,474)	1,772,522
T. N. USA, Inc. and subsidiaries	-	-	9,634	-	-	(805)	8,829
Terra Networks Venezuela, S.A.	-	-	4,490	-	-	(601)	3,889
T. N. Colombia Holding, S.A.	-	-	21,534	-	-	(1,797)	19,737
Ifigenia Plus, S.L.	-	-	11,173	-	-	(1,118)	10,055
A tu hora, S.A.	-	-	1,497	-	-	(102)	1,395
Bumeran Participaciones, S.L.	-	-	5,782	-	-	-	5,782
OLE Contenidos Interactivos, S.A.	-	-	6,010	-	-	(6,010)	-
Goodwill arising at companies consolidated by the global or proportional integration method	497,616	881,991	1,070,637	4,838	(383)	(202,719)	2,251,980
Goodwill arising at companies carried by the equity method	11,089	-	53,785	-	-	(50,765)	14,109
Total	**508,705**	**881,991**	**1,124,422**	**4,838**	**(383)**	**(253,484)**	**2,266,089**

	Thousands of Euros				
	Balance at 01/01/99	Additions	Retirements	Amorti-zation	Balance at 12/31/99
Ordenamiento de Links Especializados, S.L. (OLE)	-	12,242	-	(1,836)	10,406
Terra Networks Brasil, S.A.	-	181,897	-	(18,191)	163,706
Dependent companies of Terra Networks Brasil, S.A.	-	10,392	-	(120)	10,272
Terra Networks Guatemala, S.A.	-	3,305	-	(275)	3,030
Terra Networks Argentina, S.A.	-	12,074	-	(530)	11,544
Double Click, S.L.	-	139	(139)	-	-
Terra Networks México, S.A. de C.V.	-	264,392	-	(5,473)	258,919
Dependent companies of Terra Networks México, S.A. de C.V.	-	1,394	-	-	1,394
Terra Networks Chile, S.A.	2,288	37,379	-	(1,322)	38,345
Goodwill arising at companies consolidated by the global or proportional integration method	2,288	523,214	(139)	(27,747)	497,616
Goodwill arising at companies carried by the equity method	-	11,996	-	(907)	11,089
Total	**2,288**	**535,210**	**(139)**	**(28,654)**	**508,705**

The additions to goodwill arose in 2001, 2000 and 1999 on the acquisitions of holdings in the various companies composing the Terra Networks Group (see Note 2-d). The amortization relates to the period from the date of acquisition of the holdings through December 31, 2001 and 2000, respectively.

The main variation in 2001, amounting to €130,251,000, relates to the goodwill that arose on the acquisition of shares of Uno-e Bank, S.A.

The main addition in 2000 related to the goodwill that arose from the merger with Lycos, Inc. (see Note 4-a). Another significant addition of €881,991,000 arose from the goodwill contributed by Lycos, Inc. as a result of the acquisitions made by this company before it was consolidated.

The "Retirements/Transfers" column relating to Lycos, Inc., amounting to €150,159,000, relates mainly to the reclassification from the "Goodwill in Consolidation" caption to the "Holdings in Companies Carried by the Equity Method" caption (€70,525,000), which affects several dependent companies of Lycos, Inc. (see Note 6).

Also, as a result of the acquisition of Spray Network by Lycos Europe, N.V. (a Lycos, Inc. investee) which took place at the end of the year 2000, the Controlling Company has adjusted the goodwill that arose in 2000 from the merger with Lycos, Inc. This transaction was recorded by Terra Networks, S.A. in 2001, upon completion of its analysis. The net effect was a reduction of the goodwill amounting to €79,633,000.

(6) HOLDINGS IN COMPANIES CARRIED BY THE EQUITY METHOD

The variations in 2001 and 2000 in this caption in the consolidated balance sheets and in the related provisions for diminution in value were as follows:

	Thousands of Euros							
	Balance at 01/01/01	Additions	Retirements	Share in Losses	Transfers	Other Variations	Translation Differences	Balance at 12/31/01
CIERV, S.L.	853	-	-	(3,804)	2,951	-	-	-
Aremate.com, Inc.	5,319	-	-	-	-	-	325	5,644
OneTravel.com, Inc.	1,833	-	-	(2,380)	547	-	-	-
Terra Mobile, S.A.	-	64,680	(28)	(43,111)	(21,541)	-	-	-
Uno-e Bank, S.A.	-	160,434	-	(7,711)	(130,251)	-	-	22,472
Azeler Automoción, S.A.	-	4,219	-	(1,448)	-	-	-	2,771
Emplaza, S.A.	-	-	-	(2,524)	3,215	-	-	691
Rumbo, S.A.	-	2,494	-	(3,456)	3,029	-	-	2,067
A Tu Hora, S.A.	-	2,290	-	(1,208)	2,163	-	-	3,245
Lycos Japan K.K.	6,137	-	-	(7,711)	-	3,130	338	1,894
Lycos Asia Limited	15,500	7,560	(20,099)	(5,205)	-	1,412	832	-
Lycos Korea, Inc.	12,657	-	-	-	-	(13,343)	686	-
Lycos Europe N.V.	152,417	-	-	(73,588)	-	102,243	8,262	189,334
Simpatico Lycos, Inc.	8,216	-	-	-	-	(8,654)	438	-
Lycos Ventures LP	6,960	628	-	(3,065)	-	(421)	388	4,490
Autobytel, Inc.	-	-	-	(4,538)	21,170	-	1,208	17,840
Fast Search & Transfer ASA	-	-	-	(21,983)	44,072	-	2,458	24,547
Holdings in companies carried by the equity method	**209,892**	**242,305**	**(20,127)**	**(181,732)**	**(74,645)**	**84,367**	**14,935**	**274,995**
Provisions	**(5,322)**	**-**	**-**	**-**	**-**	**-**	**(322)**	**(5,644)**

	Thousands of Euros							
	Balance at 01/01/00	Additions or Provisions	Inclusion of Companies	Retire-ments	Share in Losses	Transfers	Translation Differences	Balance at 12/31/00
CIERV, S.L.	2,013	2,644	-	-	(3,804)	-	-	853
Aremate.com, Inc.	-	12,928	-	-	(8,036)	-	427	5,319
OneTravel.com, Inc.	-	1,833	-	-	-	-	-	1,833
Terra Mobile, S.A.	-	294	-	-	(27,310)	27,016	-	-
Lycos Japan K.K.	-	-	12,453	(4,417)	(757)	-	(1,142)	6,137
Lycos Asia Limited	-	-	18,655	-	(973)	-	(2,182)	15,500
Lycos Korea, Inc.	-	-	14,394	-	-	-	(1,737)	12,657
Lycos Europe N.V.	-	-	185,364	-	(11,401)	-	(21,546)	152,417
Simpatico Lycos, Inc.	-	-	9,340	-	-	-	(1,124)	8,216
Lycos Ventures LP	-	-	10,494	-	(2,440)	-	(1,094)	6,960
Holdings in companies carried by the equity method	**2,013**	**17,699**	**250,700**	**(4,417)**	**(54,721)**	**27,016**	**(28,398)**	**209,892**
Provisions	**-**	**(5,445)**	**-**	**-**	**-**	**-**	**123**	**(5,322)**

The "Inclusion of Companies" column relates to the balances of the dependent companies as of the dates on which they were included in the scope of consolidation.

The "Transfers" column relates mainly to the reclassification of the accounts payable by the companies carried by the equity method to the "Provisions for Contingencies and Expenses" caption on the liability side of the consolidated balance sheet (see Note 4-h), and to the reclassifications to the "Goodwill in Consolidation" caption arising in the consolidation of consolidated companies by the global integration method. As indicated in Note 5, the "Other Variations" column relating to several subsidiaries of Lycos, Inc. (basically Lycos Japan K.K., Lycos Asia Limited, Lycos Korea, Inc. and Lycos Europe N.V.) includes the reclassification from the "Goodwill in Consolidation" caption.

(7) START-UP EXPENSES

The variations in this caption in 2001, 2000 and 1999 were as follows:

	Thousands of Euros
Balance at January 1, 1999	**22**
Additions	52,028
Amortization	(920)
Balance at December 31, 1999	**51,130**
Inclusion of companies	5,551
Additions	79,742
Translation differences	(639)
Accumulated amortization	(19,633)
Balance at December 31, 2000	**116,151**
Inclusion of companies	95
Translation differences	1,239
Other variations	(1,020)
Accumulated amortization	(30,627)
Balance at December 31, 2001	**85,838**

The "Inclusion of Companies" caption includes the balances of the dependent companies as of the date on which they were included in consolidation.

The additions for 1999 relate mainly to expenses associated with the public offering of Terra Networks, S.A. common shares and with the advertising for the launch of the Terra brand name. The additions in 2000 relate mainly to expenses incurred in capital increases carried out during the year.

The "Translation Differences" caption 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 the respective countries.

(8) INTANGIBLE ASSETS

The detail of the balances of this caption and of the variations therein in 2001, 2000 and 1999 is as follows:

	Thousands of Euros			
	Cost	Amortization	Provisions	Total, Net
Balance at 01/01/99	1,429	(902)	-	527
Additions	94,847	(3,136)	-	91,711
Retirements	(510)	474	-	(36)
Inclusion of companies	605	-	-	605
Balance at 31/12/99	**96,371**	**(3,564)**	**-**	**92,807**
Inclusion of companies	85,680	(27,731)	-	57,949
Additions or provisions	116,158	(46,651)	(12,723)	56,784
Transfers	1,226	48	-	1,274
Translation differences	(8,356)	(1,352)	-	(9,708)
Retirements	(35,495)	5,229	12,386	(17,880)
Balance at 12/31/00	**255,584**	**(74,021)**	**(337)**	**181,226**
Inclusion of companies	1,508	(859)	-	649
Additions or provisions	56,795	(85,386)	-	(28,591)
Transfers	4,334	1,489	-	5,823
Translation differences	9,923	(2,841)	-	7,082
Other variations	(712)	60	-	(652)
Retirements	(9,409)	1,654	315	(7,440)
Balance at 12/31/01	**318,023**	**(159,904)**	**(22)**	**158,097**

The "Inclusion of Companies" caption includes the balances of the dependent companies as of the date on which they were included in consolidation.

The "Translation Differences" caption 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 the respective countries.

In 2001 and 2000 the main additions to intangible assets related to acquisitions made by the Group's subsidiaries in Mexico (long-term content supply contracts), Brazil and the U.S.

(9) PROPERTY AND EQUIPMENT

The detail of the balances of the "Property and Equipment" caption and of the variations therein in 2001, 2000 and 1999 is as follows:

	Thousands of Euros							
	Balance at 01/01/01	Inclusion of Companies	Additions or Provisions	Transfers	Retire-ments	Other Variations	Translation Differences	Balance at 12/31/01
Land and structures	3,528	-	1,184	14,220	(591)	(22)	569	18,888
Technical installations and machinery	7,314	251	2,643	730	(189)	(27)	(803)	9,919
Computer hardware	119,902	1,116	30,358	1,610	(2,861)	(508)	4,708	154,325
Furniture	13,150	160	4,044	(1,434)	(988)	(61)	769	15,640
Construction in progress	2,308	-	9,550	(7,721)	(1,192)	-	287	3,232
Other tangible fixed assets	12,183	-	2,717	(8,125)	(109)	-	711	7,377
Accumulated depreciation	(37,545)	(787)	(41,413)	1,223	1,099	50	(3,790)	(81,163)
Total, net	**120,840**	**740**	**9,083**	**503**	**(4,831)**	**(568)**	**2,451**	**128,218**

	Thousands of Euros						
	Balance at 01/01/00	Inclusion of Companies	Additions or Provisions	Transfers	Retire-ments	Translation Differences	Balance at 12/31/00
Land and structures	216	3,492	433	(198)	-	(415)	3,528
Technical installations and machinery	1,546	132	6,214	(481)	-	(97)	7,314
Computer hardware	28,740	15,127	75,367	9,328	(5,012)	(3,648)	119,902
Furniture	4,683	2,548	8,330	(1,707)	(325)	(379)	13,150
Construction in progress	11,092	-	445	(9,328)	(685)	784	2,308
Other tangible fixed assets	1,537	12	11,317	1,160	(1,574)	(269)	12,183
Accumulated depreciation	(10,558)	(13,120)	(17,229)	(48)	1,863	1,547	(37,545)
Total, net	**37,256**	**8,191**	**84,877**	**(1,274)**	**(5,733)**	**(2,477)**	**120,840**

	Thousands of Euros				
	Balance at 01/01/99	Inclusion of Companies	Additions or Provisions	Retire-ments	Balance at 12/31/99
Land and structures	-	66	150	-	216
Technical installations and machinery	164	198	1,184	-	1,546
Computer hardware	3,411	21,446	4,658	(775)	28,740
Furniture	84	1,179	3,420	-	4,683
Construction in progress	133	723	10,524	(288)	11,092
Other tangible fixed assets	18	1,020	511	(12)	1,537
Accumulated depreciation	(332)	(8,244)	(2,216)	234	(10,558)
Total, net	**3,478**	**16,388**	**18,231**	**(841)**	**37,256**

In 2001 and 2000 the most significant investments in property and equipment related to those made by the Group's subsidiaries in Spain, Mexico, Brazil, and the U.S., mainly in computer hardware.

The "Inclusion of Companies" column includes the balances of the dependent companies as of the date on which they were included in consolidation.

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 the respective countries.

(10) OTHER HOLDINGS

The detail of the balances as of December 31, 2001 and 2000, of the “Long-Term Financial Investments – Other Holdings” caption, of the related provisions for diminution in value and of the variations therein in 2001 and 2000 is as follows:

Thousands of Euros	Other Holdings	Provisions
Balance at January 1, 2000	**6**	**-**
Inclusion of companies	121,591	(25,193)
Additions or provisions	3,684	(5,643)
Translation differences	(14,629)	3,426
Balance at December 31, 2000	**110,652**	**(27,410)**
Additions or provisions	5,072	(12,163)
Retirements	(3,194)	2,069
Transfers	(64,617)	(898)
Translation differences	2,280	(1,393)
Balance at December 31, 2001	**50,193**	**(39,795)**

The “Inclusion of Companies” caption includes the balances of the dependent companies as of the date on which they were included in consolidation.

In 2000, this caption relates to several holdings contributed by Lycos, Inc., which were acquired by the latter before its inclusion in consolidation.

The “Additions” in 2001 and 2000 relate mainly to investments in Inversis Networks, S.A.

(11) STOCKHOLDERS’ EQUITY

The variations in equity accounts in 2001 and 2000 were as follows:

	Thousands of Euros							
	Capital Stock	Additional Paid-in Capital	Reserves for Treasury Stock	Prior Years' Losses	Reserves at Consolidated Companies & Investments Carried by the Equity Method	Translation Differences	Loss for the Year	Total
Balance at January 1, 2000	560,000	754,625	6	931	-	(631)	(81,404)	1,233,527
Capital increases	682,532	4,881,069	-	-	-	-	-	5,563,601
Allocation of loss	-	-	-	5,968	(87,937)	565	81,404	-
Transfers	-	-	2,078	(2,078)	-	-	-	-
Other adjustments	-	-	-	4,260	-	-	-	4,260
Loss for the year	-	-	-	-	-	-	(556,354)	(556,354)
Consolidation of foreign subsidiaries	-	-	-	-	-	(118,201)	-	(118,201)
Balance at December 31, 2000	**1,242,532**	**5,635,694**	**2,084**	**9,081**	**(87,937)**	**(118,267)**	**(556,354)**	**6,126,833**
Allocation of loss	-	-	-	22,881	(579,235)	-	556,354	-
Transfers	-	-	109	(109)	-	-	-	-
Partial disposal of holding in Terra Mobile	-	-	-	(16,162)	16,162	-	-	-
Loss for the year	-	-	-	-	-	-	(566,298)	(566,298)
Consolidation of foreign subsidiaries	-	-	-	-	-	(3,743)	-	(3,743)
Balance at December 31, 2001	**1,242,532**	**5,635,694**	**2,193**	**15,691**	**(651,010)**	**(122,010)**	**(566,298)**	**5,556,792**

a) Capital stock-

2001

The Controlling Company's capital stock as of December 31, 2001, consisted of 621,265,845 fully subscribed and paid shares of €2 par value each.

No transactions with an effect on the capital stock figure were carried out in 2001.

2000

As of December 31, 2000, the Controlling Company's capital stock consisted of 621,265,845 fully subscribed and paid shares of €2 par value each.

The following capital increases were carried out in 2000:

1. On June 8, 2000, the Stockholders' Meeting of Terra Networks, S.A. approved a capital increase in order to acquire the U.S. company Lycos, Inc. (formerly Lycos Virginia, Inc.) through a share exchange by virtue of which Terra Networks, S.A. acquired all the shares of Lycos Virginia, Inc. (successor to Lycos, Inc.), and the stockholders of Lycos Virginia, Inc. received shares of Terra Networks, S.A. in a ratio of 2.15 Terra Networks, S.A. shares for each share of Lycos, Inc. Terra Networks, S.A.'s capital was increased by €604,064,000 through the issuance of 302,031,974 shares of €2 par value each with additional paid-in capital of €9 per share. The total effective amount of the capital increase (par value plus additional paid-in capital) was €3,322,351,000.

The capital increase was subscribed and paid by Citibank NA, which, acting as the custodian, received the shares of Lycos, Inc. from its stockholders for the account of Terra Networks, S.A. Citibank acted as the share exchange agent as follows: (i) it received the shares of Lycos, Inc. (formerly Lycos Virginia, Inc.) from its stockholders, (ii) it contributed the shares of Lycos, Inc. to Terra Networks, S.A., (iii) it subscribed to the new shares of Terra Networks, S.A., and (iv) it issued the ADS's representing the new shares of Terra Networks, S.A. to the stockholders of Lycos, Inc.

Of the 302,031,974 shares issued, 62,540,249 correspond to Citibank, NA, which subscribed for them as the Agent Bank in the Stock Option Plan for Lycos, Inc. employees.

2. On July 28, 2000, the Controlling Company increased capital by €7,500,000 through the issuance of 3,750,000 shares of €2 par value each. All these shares were subscribed and paid for by International Discount Telecommunications Corporation ("IDT"). The shares were issued with additional paid-in capital of €9 per share, giving total additional paid-in capital of €33,750,000. The consideration for the capital increase consisted of the nonmonetary contribution of the following securities:

    a) shares of the U.S. company Terra Networks Access Services USA Llc. representing 49% of its capital which were owned by IDT.

    b) shares of the U.S. company Terra Networks Interactive Services USA Llc. representing 10% of its capital stock which were owned by IDT.

3. In connection with the agreements entered into by Terra Networks, S.A., Telefónica, S.A., Lycos, Inc. and the German company Bertelsmann, AG, on September 25, 2000, capital was increased by €70,968,000 through a monetary contribution. This capital increase was carried out through the issuance of 35,483,871 new common shares of €2 par value each, with additional paid-in capital of €60, giving a total value of €62. The capital increase was subscribed in full as follows:

    - Telefónica, S.A. subscribed to a total of 35,380,101 shares as a result of the exercise of the preemptive share subscription rights on the shares of Terra Networks, S.A. owned by it and as a result of its commitment to subscribe for any shares not subscribed for by other shareholders.

    - Other investors subscribed to a total of 103,770 shares.

The aforementioned capital increases in 2000 can be summarized as follows:

Transaction	Shares: Issued	Shares: Cumulative Total	Issue Price (Euros/Share)	Thousands of Euros: Capital Stock	Thousands of Euros: Additional Paid-in Capital
Situation at December 31, 1999		**280,000,000**		**560,000**	**754,625**
Capital increase for the exchange of Lycos, Inc. shares	302,031,974	582,031,974	11.00	604,064	2,718,287
IDT capital increase	3,750,000	585,781,974	11.00	7,500	33,750
Capital increase	35,483,871	621,265,845	62.00	70,968	2,129,032
Situation at December 31, 2000		**621,265,845**		**1,242,532**	**5,635,694**

As of December 31, 2001, 13,105,586 shares of Terra Networks, S.A. deposited at Citibank, NA covered options, which have been cancelled, that were granted under the stock option plan for Lycos, Inc. employees. These options on Terra Networks, S.A. shares were recorded under the "Other Long-Term Financial Investments" caption (see Note 4-a). Pursuant to the resolutions adopted by the Stockholders' Meeting on June 7, 2001, these shares will be presented, after they have been acquired, by the Board of Directors to the Stockholders' Meeting so that the latter can approve their retirement. The effect of this capital retirement on the Controlling Company's financial statements as of December 31, 2001, would be to reduce the "Capital Stock", "Additional Paid-in Capital", "Long-Term Financial Investments" and "Goodwill in Consolidation" captions by €26,211, €117,950, €138,942 and €5,219 thousands of euros, respectively.

b) Legal reserve-

Under the revised Corporations Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of capital stock.

The legal reserve can be used to increase capital provided that the remaining reserve balance does not fall below 10% of the increased capital stock amount.

Except as mentioned above, until the legal reserve exceeds 20% of capital stock, it can only be used to offset losses, provided that sufficient other reserves are not available for this purpose. Since the Controlling Company incurred losses in 2001, no appropriation was made to the legal reserve as of December 31, 2001.

c) Reserves for treasury stock-

In accordance with Article 79.3 of the revised Spanish Corporations Law, the Controlling Company has recorded a restricted reserve of €2,187,000 for a total of 2,420,468 shares of treasury stock, representing 0.39% of capital stock as of December 31, 2001, with an average acquisition cost of US$ 0.81 per share.

d) Reserves at consolidated companies-

In December 2001 a portion of the holding in Terra Mobile, S.A. was sold, thereby reducing Terra Networks, S.A.'s ownership interest in Terra Mobile, S.A. from 49% to

20% (see Note 1). This transaction reduced the reserves at consolidated companies by €16,162,000, and this amount was allocated to reserves of the Controlling Company.

e) Translation differences-

The translation differences relate to the effect of exchange rate fluctuations on the net assets of the companies located outside Spain and the effect of the adjustment for inflation on the assets contributed by the companies at which this accounting practice is applied. These effects gave rise to accumulated decreases in equity of €122,010,000 as of December 31, 2001, and of €118,267,000 as of December 31, 2000, as a result of the consolidation of the various subsidiaries composing the Group.

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

f) Contribution of the Group companies to the consolidated loss-

The detail of the contribution of the Group companies to consolidated reserves and to the consolidated loss as of December 31, 2001 and 2000, is as follows:

	Thousands of Euros					
	(Loss) Income			(Negative) Positive Reserves		
	12/31/01	12/31/00	12/31/99	12/31/01	12/31/00	12/31/99
Terra Networks, S.A. (Controlling Company)	101,040	22,881	5,968	5,531,568	5,528,592	754,931
Companies consolidated by the global or proportional integration method:						
T.N. España, S.A.	(98,983)	(32,431)	(19,861)	(52,292)	(19,861)	-
OLE	643	1,118	(3,312)	(2,194)	(3,312)	-
Terra Networks Intangibles, S.A. (formerly TIC)	(120)	(709)	(4,153)	(4,862)	(4,153)	-
Lycos, Inc. and subsidiaries	(47,695)	(41,217)	-	(41,217)	-	-
T.N Guatemala, S.A.	(3,662)	(4,051)	(126)	(4,177)	(126)	-
T.N. Perú, S.A.	(10,485)	(11,906)	(2,500)	(14,406)	(2,500)	-
T.N. USA, Inc. and subsidiaries	(41,834)	(142,981)	(337)	(143,318)	(337)	-
T.N. Argentina, S.A.	(20,904)	(15,771)	(1,406)	(17,177)	(1,406)	-
T.N. México Holding, S.A. de C.V. and subsidiaries	(110,933)	(82,399)	(9,592)	(91,991)	(9,592)	-
Telefónica Interactiva Brasil, S.A. and subsidiaries	(107,435)	(160,500)	(37,064)	(198,328)	(37,828)	-
T.N. Chile Holding Ltda. and subsidiary	(17,258)	(20,999)	(8,961)	(29,761)	(8,762)	-
T.N. Venezuela, S.A.	(6,107)	(3,744)	-	(3,744)	-	-
T.N. Colombia Holding S.A. and subsidiary	(10,137)	(3,696)	-	(3,696)	-	-
T.N. Uruguay, S.A.	(1,602)	(2,614)	-	(2,614)	-	-
Ifigenia Plus, S.L.	(601)	(12)	-	(12)	-	-
T.N. Global Management, Inc.	6	6	-	6	-	-
Rumbo	-	(1,971)	-	-	-	-
A Tu Hora, S.A.	-	(637)	-	-	-	-
T.N. Caribe, S.A.	(836)	-	-	-	-	-
Maptel Networks, S.A.	156	-	-	-	-	-
Bumeran Participaciones, S.L. and subsidiaries	(7,819)	-	-	-	-	-
Companies carried by the equity method:						
OneTravel.com, Inc.	(2,380)	-	-	-	-	-
Uno-e Bank, S.A.	(7,711)	-	-	-	-	-
Azeler Automoción, S.A.	(1,448)	-	-	-	-	-
Emplaza, S.A.	(2,524)	-	-	-	-	-
A Tu Hora, S.A.	(1,208)	-	-	(1,971)	-	-
Rumbo	(3,456)	-	-	(637)	-	-
CIERV, S.L.	(3,804)	(3,804)	(60)	(3,864)	(60)	-
Aremate.com, Inc.	-	(8,036)	-	(8,036)	-	-
Terra Mobile, S.A.	(43,111)	(27,310)	-	(11,148)	-	-
Lycos Japan K.K.	(7,711)	(757)	-	(757)	-	-
Lycos Asia Limited	(5,205)	(973)	-	(973)	-	-
Lycos Europe N.V.	(73,588)	(11,401)	-	(11,401)	-	-
Lycos Ventures LP	(3,065)	(2,440)	-	(2,440)	-	-
Autobytel, Inc.	(4,538)	-	-	-	-	-
Fast Search & Transfer ASA	(21,983)	-	-	-	-	-
TOTAL	**(566,298)**	**(556,354)**	**(81,404)**	**4,880,558**	**5,440,655**	**754,931**

(12) MINORITY INTERESTS

These relate to the equity of minority interests in the net worth and results for the year of the Group companies consolidated by the global integration method. The variations in 2001 and 2000 in this caption in the accompanying consolidated balance sheet were as follows:

	Thousands of Euros				
Company	Balance at 01/01/01	Loss for the Year	Capital Increases	Translation Differences	Balance at 12/31/01
T.N. Colombia, S.A.	310	(1,617)	1,998	102	793
Bumeran Participaciones, S.L.	-	(3)	2,738	-	2,735
Total	**310**	**(1,620)**	**4,736**	**102**	**3,528**

	Thousands of Euros						
Company	Balance at 01/01/00	Inclusion of Companies	Income (Loss) for the Year	Variation in Percentage of Ownership	Translation Differences	Other Variations	Balance at 12/31/00
T.N. Brasil, S.A. and subsidiaries	436	-	(565)	-	129	-	-
T.N. Guatemala, S.A.	24	-	-	(24)	-	-	-
T.N. Chile, S.A.	433	-	-	(433)	-	-	-
T.N. Access Services USA, Llc.	481	-	-	(481)	-	-	-
T.N. Interactive Services USA, Llc.	(73)	-	-	73	-	-	-
T.N. Colombia, S.A.	-	932	(547)	-	(75)	-	310
Subsidiaries of Lycos, Inc.	-	-	421	-	-	(421)	-
Total	**1,301**	**932**	**(691)**	**(865)**	**54**	**(421)**	**310**

(13) TELEFÓNICA GROUP COMPANIES

The detail as of December 31, 2001 and 2000, of the balances arising from transactions with Telefónica Group companies is as follows:

December 31, 2001	Thousands of Euros			
	Long-Term Receivables	Short-Term Financial Investments	Short-Term Receivables	Short-Term Payables
Telefonía y Finanzas, S.A.	-	1,591,598	-	-
Telefónica, S.A.	1,496	-	3,889	703
Telefónica Data España S.A.	-	-	16,197	78,198
Telefónica de España, S.A.	-	-	9,899	39,961
Telefónica Móviles, S.A.	-	-	1,106	1,905
Atento España, S.A.	-	-	908	2,055
CTC Chile	-	-	2,416	2,206
CTC Mundo	-	-	204	908
Telesp, S.A.	-	-	1,208	980
Telefónica del Perú, S.A.A.	-	-	1,142	631
Baja Celular Mexicana	-	-	2,921	-
Other Telefónica Group companies	-	-	4,517	11,012
Total	**1,496**	**1,591,598**	**44,407**	**138,559**

December 31, 2000	Thousands of Euros			
	Long-Term Receivables	Short-Term Financial Investments	Short-Term Receivables	Short-Term Payables
Telefonía y Finanzas, S.A.	-	1,804,455	-	-
Telefónica, S.A.	1,496	-	3,780	2,819
Telefónica Data España S.A.	-	-	7,487	28,332
Telefónica de España, S.A.	-	-	198	1,250
Teleinformática y Comunicaciones, S.A.	-	-	631	337
Telefónica Publicidad e Información, S.A.	-	-	601	361
Telefónica Servicios Móviles, S.A.	-	-	553	2,013
Telefónica Investigación y Desarrollo, S.A.	-	-	-	920
Atento Telecomunicaciones España, S.A.	-	-	-	5,481
CTC Chile	-	-	2,200	307
CTC Mundo	-	-	313	1,977
Telefónica Empresas Chile, S.A.	-	-	691	745
Telesp, S.A.	-	-	-	1,304
Telefónica del Perú, S.A.A.	-	-	-	535
Other Telefónica Group companies	-	-	2,249	2,956
Total	**1,496**	**1,804,455**	**18,703**	**49,337**

The balances with Telefonía y Finanzas, S.A. (Telfisa) relate to the current accounts held by Terra Networks S.A., Ordenamiento de Links Especializados S.L., Terra Networks España, S.A., Terra Lycos Intangibles, S.A. (formerly Terra Interactiva de Contenidos, S.A.) and Maptel Networks, S.A. at that entity. The current account balances earn interest at market rates (the average interest rate for 2001 was 4,42%).

(14) ASSOCIATED COMPANIES

The detail of the accounts receivable from and payable to associated companies as of December 31, 2001 and 2000, is as follows:

December 31, 2001	Thousands of Euros Long-Term Loans	Short-Term Financial Investments	Short-Term Receivables	Short-Term Payables
OneTravel.com, Inc.	7,729	-	-	-
Terra Mobile, S.A.	-	6,202	1,359	-
Rumbo, S.A.	403	-	270	72
A Tu Hora, S.A.	-	-	-	2,909
Lycos Asia	2,807	-	-	-
Lycos Korea	3,462	-	-	-
Lycos Japan	6,708	-	793	-
Lycos Europe	-	-	138	-
Other	-	-	107	96
Total	**21,109**	**6,202**	**2,667**	**3,077**

December 31, 2000	Thousands of Euros Long-Term Loans	Short-Term Financial Investments	Short-Term Receivables	Short-Term Payables
OneTravel.com, Inc.	3,197	-	-	-
Terra Mobile, S.A.	-	46,212	583	-
Rumbo, S.A.	-	300	403	-
A Tu Hora, S.A.	-	-	-	1,502
Aremate.com, Inc.	-	-	387	-
Asociadas Lycos, Inc.	-	-	2,401	-
Total	**3,197**	**46,512**	**3,774**	**1,502**

The loans granted to associated companies earn interest at market rates.

(15) TAX MATTERS

a) Tax receivables and accrued taxes payable-

The detail of the "Tax Receivables" and "Accrued Taxes Payable" captions in the accompanying consolidated balance sheets as of December 31, 2001 and 2000, is as follows:

December 31, 2001	Thousands of Euros	
	Long Term	Short Term
Tax receivables		
Tax asset for tax loss carryforwards	625,964	-
Prepaid income taxes	56,617	51
VAT refundable by the Spanish Treasury	-	45,964
Tax withholdings	-	229
Local taxes	-	188
Foreign taxes	679	22,449
Total	**683,260**	**68,881**
Accrued taxes payable		
Long-term deferred taxes	45,382	-
Personal income tax withholdings	-	1,124
Accrued social security taxes	-	752
Local taxes	-	37
Foreign taxes	5,826	4,714
Total	**51,208**	**6,627**

December 31, 2000	Thousands of Euros	
	Long Term	Short Term
Tax receivables		
Tax asset for tax loss carryforwards	276,768	-
Prepaid income taxes	48,325	-
VAT refundable by the Spanish Treasury	-	22,622
Withholdings from income from movable capital	-	30
Local taxes	-	140
Foreign taxes	-	27,316
Total	**325,093**	**50,108**
Accrued taxes payable		
Long-term deferred taxes	45,244	-
Personal income tax withholdings	-	1,261
VAT payable to the Spanish Treasury	-	168
Accrued social security taxes	-	637
Local taxes	-	2,745
Foreign taxes	72,804	5,896
Total	**118,048**	**10,707**

The long-term accrued foreign taxes payable as of December 31, 2000, relate mainly to a long-term deferred tax liability which arose as a result of the difference in the tax base relating to the assets acquired and the tax effect on the income obtained from the admission to listing of the Lycos, Inc. subsidiary Lycos Europe N.V.

The years open for review by the tax inspection authorities for the main applicable taxes vary from one consolidated company to another, although they are generally the years from 1996 to 2001. The Company's directors do not expect any additional material liabilities to arise for the Company in the event of a tax audit of the open years.

b) Corporate income tax-

The corporate income tax of each of the 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 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 for offset of the main tax losses incurred by the Group companies 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 following 15 years following the first year in which income is obtained.
2. In Mexico, tax losses may be carried forward for offset in a period of ten years from the year in which they were incurred.
3. In Brazil and Chile there is no deadline for the offset of tax losses, although in Brazil the amount of the losses offset may not exceed 30% of the total taxable income.
4. In Peru and Argentina, tax losses may be carried forward for offset in a period of four and five years, respectively, from the year in which they were incurred.

The Group recorded under the "Tax Asset for Tax Loss Carryforwards" caption the tax assets recorded as of December 31, 2001 and 2000, in the individual financial statements of the following subsidiaries:

	Thousands of Euros			
December 31, 2001	Tax Losses Incurred in the Year	Tax Losses Incurred in Prior Years	Translation Differences	Total
Terra Networks, S.A.	344,676	205,371	-	550,047
Terra Networks España, S.A.	-	25,955	-	25,955
Ifigenia Plus, S.L.	-	66	-	66
Terra Networks México Holding, S.A. de C.V. and subsidiaries	-	41,698	4,730	46,428
Terra Networks Chile Holding, S.A. de C.V. and subsidiary	-	3,678	(210)	3,468
	344,676	**276,768**	**4,520**	**625,964**

December 31, 2000	Thousands of Euros Tax Losses Incurred in the Year	Tax Losses Incurred in Prior Years	Total
Terra Networks, S.A.	172,409	32,962	205,371
Terra Networks España, S.A.	14,931	11,024	25,955
Ifigenia Plus, S.L.	66	-	66
Terra Networks México Holding, S.A. de C.V. and subsidiaries	34,942	6,756	41,698
Terra Networks Chile Holding, S.A. de C.V. and subsidiary	3,678	-	3,678
	226,026	**50,742**	**276,768**

The detail of the positive net balance of the "Corporate Income Tax" caption in the accompanying consolidated statement of operations is as follows:

	Thousands of Euros 12/31/01	12/31/00
Tax assets for tax loss carryforwards of subsidiaries	344,676	226,026
Prepaid income taxes	8,192	48,271
Deferred income taxes	73,335	
Recognition of deferred tax liability in consolidation	-	(35,435)
Tax effect of consolidation adjustments	(63,484)	-
	362,719	238,862
Inclusion of companies	-	8,576
Translation differences	-	1,214
Other items (net balance)	631	(510)
	363,350	**248,142**

In 2000 the Controlling Company recognized a long-term deferred tax liability of €35,435,000 in order to eliminate from the accounts the double entry arising from the aggregation of the individual tax assets already taken into account when Terra Networks, S.A. recorded its portfolio provision.

The consolidation adjustment of €63,484,000 relates to the tax effect of various transactions carried out by Lycos Europe, N.V. (a Lycos, Inc. investee) which were effective for accounting purposes prior to the date on which Lycos, Inc. was acquired by Terra Networks, S.A.

In 2001 the Controlling Company only recognized the tax effect of the portfolio provision recorded at the Controlling Company, and the subsidiaries did not recognize any tax assets in their financial statements.

The tax assets for tax loss carryforwards will be reversed as and when the companies that generated them obtain taxable income, which per the Group's business plan will occur within ten years from the first year in which income is generated, which, under current accounting legislation, 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 España, S.A., Terra Networks México Holding, S.A. de C.V. and subsidiaries and Terra Networks Chile Holding and subsidiary obtain taxable income and, consequently, as and when Terra Networks, S.A. reverses portfolio provisions relating to these companies.

(16) REVENUES AND EXPENSES

Revenues-

The operating revenues relate mainly to the following items:

1. *Internet service provider revenues*. These relate to the revenues from subscriptions to provide Internet services mainly to the residential and SOHO markets. They also include the revenues for induced traffic/interconnection received from telecommunications operators in certain countries. These revenues represent 29% of the total operating revenues in 2001.

2. *Portal advertising revenues*. These relate to revenues received on the basis of a price based on the number of impressions in Terra's portals, pursuant to the agreements to sponsor portal areas based on a fixed amount. These revenues represent 58% of the total operating revenues in 2001.

3. *e-commerce revenues*. These relate to revenues arising from e-commerce transactions made through the Group's portals. These revenues represent 2% of the total operating revenues in 2001.

4. *Other services*. These relate mainly to corporate services, i.e. services rendered to companies such as connection services, development of applications, web developing, hosting, b2b e-commerce and financial information. These revenues represent 10% of the total operating revenues in 2001.

The detail, by geographical market (based on the country in which the Group service provider company is located), of the "Net Sales and Services" caption in the accompanying consolidated statements of operations is as follows:

Country	Thousands of Euros		
	2001	2000	1999
Spain	113,307	44,926	7,992
U.S.A.	355,621	93,968	2,224
Brazil	96,294	71,268	14,581
Mexico	60,958	50,768	11,065
Chile	21,694	10,043	5,932
Guatemala	2,644	2,530	938
Peru	3,421	1,557	42
Argentina	1,636	1,358	42
Venezuela	3,410	619	-
Colombia	1,309	174	-
Uruguay	110	90	-
Caribbean	76	-	-
	660,480	**277,301**	**42,816**

The aforementioned revenues relate to the period from the date on which the Group acquired the dependent companies to December 31, 2001, 2000 and 1999, respectively.

Transactions with Telefónica Group companies-

The Group's transactions as of December 31, 2001, 2000 and 1999, with Telefónica Group companies were as follows:

Revenues

Company	Thousands of Euros		
	2001	2000	1999
Telefónica Data España, S.A.	7,453	13,974	1,482
Telefónica de España, S.A.	8,985	168	-
Endemol Entertainment UK, Plc.	1,388	258	-
CTC Chile, S.A.	-	5,036	631
CTC Mundo, S.A.	204	198	-
Telefónica Empresas Chile, S.A.	685	2,194	-
Telefónica, S.A.	1,034	1,292	-
Telefónica Centroamérica Guatemala, S.A.	174	102	-
Teleinformática y Comunicaciones, S.A.	132	1,166	469
Telefónica Servicios Móviles, S.A.	1,923	751	-
Telefónica de Argentina, S.A.	1,515	-	-
Telesp, S.A.	914	-	228
Other Telefónica Group companies	3,623	1,143	917
Total net sales to Telefónica Group companies	**28,030**	**26,282**	**3,727**
Telefónica Investigación y Desarrollo, S.A.	-	553	-
Telefónica Data USA, S.A.	204	-	-
Other Telefónica Group companies	290	499	-
Total other operating revenues received from Telefónica Group companies	**494**	**1,052**	**-**
Telefonía y Finanzas, S.A.	70,366	37,161	2,861
Other Telefónica Group companies	-	12	-
Total financial revenues received from Telefónica Group companies	**70,366**	**37,173**	**2,861**
Total	**98,890**	**64,507**	**6,588**

Expenses

Company	Thousands of Euros		
	2001	2000	1999
Telefónica Data España, S.A.	91,168	32,160	9,568
Telefónica de España, S.A.	32,545	415	-
Atento España, S.A.	8,877	8,348	1,382
Endemol Entertainment Uk, Plc.	2,073	8,138	-
Atento Brasil, S.A.	11,353	7,603	-
Telest Celular, S.A.	-	4,970	-
CTC Mundo, S.A.	2,194	4,958	-
Telefónica Empresas Chile, S.A.	3,714	4,081	-
Telefónica Moviles, S.A.	1,418	2,464	-
Atento Perú, S.A.	391	799	-
Telefónica Centroamérica Guatemala, S.A.	1,106	763	-
Telefónica Data Perú, S.A.	817	853	-
Telefónica Investigación y Desarrollo, S.A.	-	385	60
Tempotel, S.A.	-	553	313
Other Telefónica Group companies	10,797	247	5,319
Total purchases from Telefónica Group companies	**166,453**	**76,737**	**16,639**
Telefónica Investigación y Desarrollo, S.A.	721	2,122	192
Telefónica de España, S.A.	3,798	1,641	871
Telefónica, S.A.	48	1,587	679
Telefónica Data España, S.A.	12,681	1,448	691
CTC Chile, S.A.	685	192	2,302
Atento Chile, S.A.	144	1,094	-
Telefónica Publicidad e Información, S.A.	-	865	180
Teleinformática y Comunicaciones, S.A.	-	619	294
Telefónica Moviles, S.A.	475	607	-
Telefónica de Argentina, S.A.	1,797	-	-
Telesp, S.A.	980	-	-
Other Telefónica Group companies	3,694	1,172	1,122
Total outside services received from Telefónica Group companies	**25,023**	**11,347**	**6,331**
Telefónica de España, S.A.	-	-	1,977
Total financial expenses on debts with Telefónica Group companies	**-**	**-**	**1,977**
Total	**191,476**	**88,084**	**25,831**

Personnel expenses-

The detail of the personnel expenses for the years ended December 31, 2001, 2000 and 1999, is as follows:

	Thousands of Euros		
	2001	2000	1999
Wages and salaries	160,776	94,707	17,946
Employee welfare and other expenses	41,022	21,873	1,996
Pension fund	3,171	288	-
Total	**204,969**	**116,868**	**19,942**

The contributions to the external pension fund were made on the basis of a percentage of the average salary paid to employees.

Average headcount-

The Group had an average of 3,150, 2,406 and 1,870 employees in the years ended December 31, 2001, 2000 and 1999, respectively, and the year-end headcounts in 2001 and 2000 were 2,920 and 3,335, respectively.

Outside services and other operating expenses-

The detail of this caption for the years ended December 31, 2001, 2000 and 1999, is as follows:

	Thousands of Euros		
	2001	2000	1999
Advertising, publicity, public relations and outside marketing	175,945	206,904	47,258
Independent professional services	53,934	40,220	10,266
Rent and royalties	49,287	15,813	3,784
Travel expenses	10,797	11,269	2,262
Taxes other than income tax	12,357	9,797	2,820
Other operating expenses	46,234	47,186	9,863
Total	**348,554**	**331,189**	**76,253**

Extraordinary expenses and losses-

The detail of the extraordinary expenses and losses as of December 31, 2001, 2000 and 1999 is as follows:

	Thousands of Euros		
	2001	2000	1999
Early termination of contracts	20,560	4,862	-
Variation in long-term financial investment provisions	12,164	11,095	-
Provision for contingencies	21,000	4,021	-
Indemnity payments	10,335	4,105	-
Foreign taxes	-	23,367	-
Losses on intangible assets	89	27,388	-
Losses on other fixed assets	1,867	1,262	-
Prior years' expenses and losses	2,579	5,151	-
Other extraordinary expenses	9,102	11,154	2,467
Total	**77,696**	**92,405**	**2,467**

The 2001 consolidated statement of operations includes €10,335,000 relating to indemnity payments to directors, senior executives and labor force reduction plans at subsidiaries.

(17) DIRECTORS' COMPENSATION AND OTHER BENEFITS

In the years ended December 31, 2001 and 2000, the compensation and other benefits paid to the Board members and recorded in the accompanying consolidated statements of operations amounted to €2,170,000 and €1,434,000, respectively.

Note 18 contains a description of the Terra Networks, S.A. stock options assigned to certain directors and of other commitments to the directors.

As of December 31, 2001 and 2000, there were no other commitments to the directors.

(18) COMMITMENTS

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

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

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

On October 5, 1999, Banco Zaragozano, S.A., Caja de Ahorros y Pensiones de Barcelona and Terra Networks, S.A. entered into a contract under which these entities granted to Terra Networks, S.A. an irrevocable purchase option on 14,000,000 issued shares, which may be exercised at any time prior to April 30, 2004, to cover the Stock Option Plan approved.

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

On December 1, 1999 and June 8, 2000, the Board of Directors, pursuant to the powers granted to it by the Stockholders' Meeting, implemented the First Phase of the Plan by granting options to employees of the Group. The main features of these options are 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 €11.81 per share.

2. Duration of four years and three months, 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 adopted by the Stockholders' Meeting held on June 8, 2000, and launched pursuant to a resolution adopted by the Board of Directors on December 22, 2000, 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 Group.

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

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

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

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

4. Options were granted to senior executives, one director and four general managers and persons of a 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 set 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 employees, and set the exercise price at the market price of the shares during the related quarter and with the same terms and conditions regarding 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 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.

As of December 31, 2001, options on 9,600,246 shares had been assigned to Group employees, executives and directors, of which 2,311,863 relate to the First Phase of the Plan and the remainder to the Second Phase. The average stock option exercise price is €11.45.

As of December 31, 2001, the Group's executives and directors held 1,924,215 stock options under the Stock Option Plan, the average exercise price of which is €16.50.

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

Under the agreements entered into with 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 acquire 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 for their early exercise; 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 exercise of the options on Lycos, Inc. shares by the Agent Bank, the Agent Bank received 29,088,488 shares of Lycos, Inc. which, pursuant to the resolutions adopted by the Stockholders' Meeting of Lycos Inc. on October 27, 2000, were converted into 29,088,488 shares of Lycos, Inc. and contributed in the exchange, together with the other shares of Lycos, Inc.

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. held by the Agent Bank.

On June 7, 2001, the Stockholders' Meeting of Terra Networks, S.A. resolved to partially modify the resolution relating to the Stock Option Plan which was ratified and approved by the Stockholders' Meeting on June 8, 2000, as regards the obligations arising from the assumption of the Lycos, Inc. stock options by Terra Networks, S.A.

As of December 31, 2001, the employees, executives and directors of Lycos, Inc. had exercised 14,110,082 options, and 35,324,581 options were outstanding at an average exercise price of US$ 18.50.

As of that date, the executives and directors held stock option rights, derived from the Lycos, Inc. Stock Option Plans set up prior to the acquisition of Lycos, Inc. by Terra Networks, S.A., on 10,692,652 Terra Networks, S.A. shares held by the Agent Bank, the average exercise price of which is US$ 18.62.

As of December 31, 2001, the Board members who have or have had an executive position in the Group, held 8,717,026 stock options under the Terra Networks, S.A. and Lycos, Inc. Stock Option Plans, the average exercise price of which is €21.70.

c) Other commitments-

On May 16th 2000 Terra Networks, S.A. and Lycos, Inc. entered into several agreements which later on were ratified by the Stockholders' Meeting of Terra Networks, S.A., held on June 8th 2000, and made public by means of the prospectus filed with the Comisión Nacional del Mercado de Valores (CNMV) and the Securities and Exchange Commission (SEC). Under such agreements, certain executives were entitled to receive payments to offset the taxes arising from the acceleration and vesting of their stock options. The attached consolidated balance sheet includes a provision for the estimated payment stemming from these taxes, amounting to €15,700,000.

d) Litigation in progress-

Collective lawsuits filed by stockholders of Terra Networks, S.A.

Terra Networks, S.A. has been ordered to appear as the defendant in five lawsuits 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 that the Initial Public Offering was launched in the U.S. in 1999.

The five lawsuits filed against Terra 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 awards made in the IPOs, allege, principally, that the security placement institutions assigned 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 assigning shares to these customers, the customers agreed to buy shares on the secondary market at a predetermined price in order to maintain 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 contravene in any other way the rules of the SEC and NASD.

Since these allegations are made principally against the placement institutions, the parties are currently negotiating in order to have the proceedings brought against the issuers of the securities, including Terra Networks, S.A., and against the directors and executives named therein stayed until the issues between the plaintiffs and the placement institutions have been resolved by the courts. However, no agreement has yet been reached.

The issuer companies against which the complaints were filed, including Terra Networks, S.A., have not yet had to answer the complaints. The U.S. law firm defending Terra Networks, S.A. and the directors and executives against whom the complaints were filed considers that Terra Networks, S.A. has sound grounds for applying to have the complaints dismissed.

The law firm defending Terra Networks, S.A. considers that Terra Networks, S.A. and the directors and executives against whom the complaints were filed have sound grounds against the complaints, and has been instructed to conduct a robust defense on behalf of Terra Networks, S.A. Based on the analysis of the complaints performed to date by the law firm, the firm considers that there are significant legal defects and weaknesses in the complaints that have been filed and that if the actions brought against Terra Networks, S.A. are not stayed, an application will be filed to have substantially all of them dismissed.

Terra Networks, S.A. is confident that the courts will not find against it and, if they do, it considers that the decisions should not have a material adverse effect on its financial position and results of operations.

Request for arbitration filed at the Madrid Civil and Commercial Arbitration Court

In the first quarter of 2001 Cierv Nueva, S.L. and its stockholders filed a request for arbitration against Terra Networks, S.A. at the Madrid Civil and Commercial Arbitration Court.

The objective of the claimants was for Terra Networks, S.A. to acquire from them all the shares (2,157) they owned of Corporación Real Time Team, S.L. (CRTT, S.L.), of which they were the majority stockholders.

At the end of 2001 the Madrid Civil and Commercial Arbitration Court issued an Arbitral Award whereby, in principle, Terra Networks, S.A. is obliged to acquire the aforementioned shares from the claimants, although for a price (approximately €21,000,000) significantly lower (more than 50%) than that asked for by the claimants.

The lawyers of Terra Networks, S.A. have prepared a general appeal to set aside the Arbitral Award on the ground of absence of procedural due process, which makes it possible to be reasonably optimistic that a result improving on the current situation will be achieved. This appeal will be heard by the Madrid Provincial Appellate Court.

Notwithstanding the foregoing, Terra Networks, S.A. intends to take such legal actions as it considers appropriate to defend its assets and, ultimately, the interests of its stockholders.

Complaint filed by IDT

On January 31, 2001, International Discount Telecommunications Corporation (IDT) filed a lawsuit at the New Jersey Courts in the U.S. against Terra Networks, S.A., Telefónica, S.A., Terra Networks, USA, Inc. and Lycos, Inc.

In April 2000 Terra Networks, S.A. and IDT had entered into an agreement to terminate a joint venture agreement.

In this complaint, IDT claims mainly the following in relation to Terra Networks, S.A.: (i) alleged failure to comply with the obligations assumed under the termination agreement whereby IDT acquired a given number of shares; (ii) alleged concealment from IDT of the negotiations relating to the acquisition of Lycos during the negotiation of the termination agreement; and (iii) alleged breach of the joint venture agreement.

At present, the amount of the complaint cannot be determined. The law firm defending Terra Networks, S.A. has applied to have substantially all the charges contained in the complaint dismissed, but a decision has not yet been handed down in this connection. The firm considers that Terra has a solid defense and that there is a reasonable probability that the application for dismissal will be successful, at least in respect of certain of the claims made by IDT.

Terra Networks, S.A. is confident that the courts will not find against it and, if they do, it considers that the decisions should not have a material adverse effect on its financial position and results of operations.

Complaint filed by USA Networks, Inc.

In February 1999, Lycos, Inc. announced its intention to enter into a transaction with USA Networks, Inc. and certain affiliated companies pursuant to which, among other things, Lycos, Inc. would have been merged into a subsidiary of USA Networks, Inc. In May 1999, the parties to the proposed transaction terminated the merger by mutual agreement. Prior to the termination of the proposed merger, a series of purported securities class action lawsuits were filed in the United States District Court for the District of Massachusetts. The suits, which have since been consolidated, allege, among other claims, violations of United States Federal securities law through alleged misrepresentations and omissions relating to the announced transaction with USA Networks, Inc. The consolidated complaint seeks an unspecified award of damages. Terra Networks, S.A. believes that the allegations in the consolidated complaint are without merit and intend to contest them vigorously.

(19) SUBSEQUENT EVENTS

a) Acquisition of treasury stock-

As of the date of preparation of these consolidated financial statements, pursuant to the resolutions adopted by the Stockholders' Meeting on June 7, 2001, the Controlling Company acquired 13,105,586 shares of treasury stock from Citibank, NA. The Board of Directors has proposed to the Stockholders' Meeting that these shares, which were deposited at Citibank, NA and cover purchase option rights under the Stock Option Plan for Lycos, Inc.'s employees that have been cancelled, be retired.

b) Uno-e Bank-

In February 2002, Terra Networks, S.A. subscribed for shares in connection with a capital increase for €29.4 million. In May 2002, Terra Networks, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. signed a Protocol of Intent, agreeing in principle to the merger of Uno-e Bank, S.A. and the private consumer finance activities operated by Finanzia Banco de Crédito, S.A. a wholly-owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A. Our participation in Uno-e Bank, S.A. following the merger, would be 33%. The merger, as well as our participation, will be subject to completion of the corresponding business review being carried out, the execution of the definitive agreements and the receipt of necessary authorizations. In connection with our investment in Uno-e Bank, S.A., we have the right to sell our interest in Uno-e Bank, S.A. to Banco Bilbao Vizcaya Argentaria, S.A. pursuant to a liquidity mechanism, which will be subject to adjustment upon completion of the merger.

Additionally, Banco Bilbao Vizcaya Argentaria,S.A. has the right to purchase our stake in Uno-e Bank, S.A. between May 15, 2004 and May 15, 2006 at a purchase price equal to the greater of (i) fair market value (as determined by an investment bank) and (ii) the amount paid by us for our stake in Uno-e Bank, S.A. (€189.4 million) plus accrued interest at an annual interest rate of 4.70%. If a definitive agreement relating to the merger agreed to in principle is reached by the parties, the above-referenced liquidity mechanism will be modified, as a result of which Banco Bilbao Vizcaya Argentaria, S.A. will no longer have the right to purchase our shares, and the exercise price in connection with our right to require Banco Bilbao Vizcaya Argentaria, S.A. to purchase our interest in Uno-e Bank, S.A. will be equal to fair market value (as determined by an investment bank).

(20) CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

APPLICATION OF FUNDS	Thousands of Euros 2001	2000	1999	SOURCE OF FUNDS	Thousands of Euros 2001	2000	1999
Funds applied in operations	172,286	372,020	82,317	Capital increase	-	5,563,599	1,311,969
Additions to start-up expenses	95	79,740	52,028	Stock options exercised under ESOP	19,203	-	-
Intangible asset additions	57,444	116,158	95,452	Retirements of start-up expenses	1,143	-	-
Property and equipment additions	51,236	102,104	36,835	Retirements of intangible assets	6,540	3,215	36
Acquisitions of dependent companies	210,922	3,508,679	535,270	Retirements of property and equipment	5,310	5,289	841
Additions to other long-term financial investments	22,207	5,613	5,128	Retirements of dependent companies	27,264	4,417	139
Additions to deferred charges	22,550	5,848	-	Retirements of other long-term financial investments	3,133	-	-
Conversion to capital of short-term payables	64,681	-	-	Tax receivables for tax assets (net)	2,935	3,517	-
Deferred revenues	-	20,092	-	Deferred revenues	2,368	-	-
Period provision for contingencies and expenses	175	-	-	Period provision for contingencies and expenses	-	829	-
Prepaid taxes (net)	-	-	6,726	Disposal of treasury stock	12	-	-
Variation in working capital due to translation differences	-	84,708	-	Deferred charges	15,855	-	-
Minority interests	-	1,737	-	Minority interests	4,736	-	1,216
Variations due to translation differences	-	34,228	631	Long-term debt	2,115	8,030	5,153
				Increase in working capital due to inclusion of shareholdings	-	707,920	-
				Variations due to translation differences	24,774	-	-
TOTAL FUNDS APPLIED	**601,596**	**4,330,927**	**814,387**	**TOTAL FUNDS OBTAINED**	**115,388**	**6,296,816**	**1,319,354**
FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED		**1,965,889**	**504,967**	**FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED**	**486,208**		

VARIATION IN WORKING CAPITAL	Thousands of Euros					
	2001		2000		1999	
	Increase	Decrease	Increase	Decrease	Increase	Decrease
Inventories	223			517	2,106	
Accounts receivable	15,272		123,624		39,463	
Short-term financial investments		397,073	2,016,914		566,704	
Cash		86,187	66,484		20,291	
Accrual accounts		14,313	37,193		17,139	
Current liabilities		4,130		277,809		140,736
TOTAL	**15,495**	**501,703**	**2,244,215**	**278,326**	**645,703**	**140,736**
VARIATION IN WORKING CAPITAL	**486,208**			**1,965,889**		**504,967**

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

Thousands of Euros	**2001**	**2000**	**1999**
Loss for the year	(566,298)	(555,215)	(81,404)
Add:			
Write-down of start-up expenses	30,627	19,633	920
Period amortization of intangible assets	85,386	46,651	3,136
Period depreciation of property and equipment	41,413	17,229	2,216
Period amortization of goodwill in consolidation	386,332	253,484	28,654
Share in losses of companies carried by the equity method	181,732	54,721	60
Losses on property and equipment	89	1,262	-
Losses on intangible assets	1,867	27,388	-
Variation in long-term financial investment provisions	12,164	11,095	-
Variation in other long-term financial investment provisions	1,512	-	-
Period provision for contingencies and expenses	21,000	-	-
Loss attributed to minority interests	-	691	-
Less:			
Gains on intangible assets and property and equipment	(315)	(817)	-
Reversal of negative goodwill in consolidation	(2,825)	-	-
Loss attributed to minority interests	(1,620)	-	-
Tax asset generated in the year as a result of tax loss carryforwards	(363,350)	(248,142)	(35,899)
Funds applied in operations	**(172,286)**	**(372,020)**	**(82,317)**

(21) DIFFERENCES BETWEEN SPANISH AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND OTHER REQUIRED DISCLOSURES

The consolidated financial statements of Terra Networks, S.A. were prepared in accordance with generally accepted accounting principles in Spain ("Spanish GAAP"), which differ in some respects from generally accepted accounting principles in the United States ("U.S. GAAP"). A reconciliation of net loss and shareholders' equity from Spanish GAAP to U.S. GAAP is provided in this Note. The most significant differences are as follows:

1. Research and development

In accordance with Spanish GAAP, research and development costs are capitalized and amortized over a period not exceeding five years. Under U.S. GAAP research and development costs for maintenance, services performed by others, equipment and purchased intangibles that have no alternative future use are expensed when acquired, incurred or constructed.

2. Accruals and deferrals

Different criteria are applied under Spanish and U.S. GAAP to accrue certain items and, accordingly, related adjustments have to be made in the reconciliation of net loss and shareholders' equity:

a) Capital increases expenses. In accordance with Spanish GAAP, expenses associated with equity issuance are capitalized and amortized over five years. Under U.S. GAAP capital increase expenses must be charged against the gross proceeds of the new capital.

b) Start-up expenses. In accordance with Spanish GAAP, period expenses incurred during the start-up of a business which will contribute to future revenues may be deferred and amortized over five years. Under U.S. GAAP, start-up costs must be expensed as incurred.

3. Corporate income tax

In accordance with Spanish GAAP and with Corporate Income Tax Law 43/1995, tax losses may be carried forward for ten years from the commencement of the tax period following that in which the tax losses were incurred. However, under Article 23.3 of said law, newly formed entities may calculate the period for the offset from the first tax period when their taxable base is positive. Under Spanish GAAP tax credits are only recorded when there is true and total certainty that these tax credits will be realized. Under U.S. GAAP, valuation allowances are not provided on deferred tax assets, including tax credits and carryforwards, to the extent that the assets are more likely than not to be realized.

Specifically, Spanish GAAP permit the recognition of deferred tax assets, including those arising from net operating loss carryforwards, if the deferred tax assets can be reasonably realized within a ten-year period from the date on which the assets were generated. For the 2001, 2000 and 1999 financial statements, the Group has recognized such tax assets under Spanish GAAP, since the business plan prepared by management indicates that these assets will be realized within a ten-year period.

Under U.S. GAAP, deferred tax assets should be recognized if it is "more likely than not" that these assets will be realized. In making a determination of whether it is more likely than not that a deferred tax asset is realizable, all available evidence, both positive and negative, should be considered. Companies should look to both objective evidence, such as a company's operating history, as well as subjective evidence, such as a company's budgets and business plans, to determine whether a valuation allowance is needed. The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified.

Under U.S. GAAP, reaching a conclusion that a valuation allowance is not needed is difficult when there is significant objective negative evidence, such as cumulative losses, in recent years. Each of the companies in the Group have incurred such losses in each tax-reporting period since its inception. Moreover, the Group does not have other objective, positive evidence such as existing contracts or a firm sales backlog, that will produce more than enough taxable income to realize the deferred tax asset based on existing sales prices and cost structures. Based on this evidence, a valuation allowance would be provided in full against the deferred tax assets related to the Group's net operating losses under U.S. GAAP.

4. Consolidation method

Under Spanish GAAP, companies in which Terra Networks, S.A. owns at least 20% if unlisted and 3% if listed are carried by the equity method; provided that, investments in companies in which Terra Networks, S.A. owns less than 50% of the common voting stock must be consolidated when such companies are considered under Spanish GAAP to be controlled by Terra Networks, S.A. Under U.S. GAAP, companies in which a holding of between 20% and 50% is owned or in which the investor can exert significant influence (but not control) are carried by the equity method. Where significant influence does not exist, investments of less than 20% should be accounted for as either marketable investment securities or as nonmarketable investment securities (see Note 10).

Lycos, Inc., subsidiary of Terra Networks, S.A., has certain equity investments in publicly listed companies between 3% and 20% that for purposes of Spanish GAAP have been accounted for under the equity method of accounting. Under U.S. GAAP these investments are accounted for pursuant to FASB 115. Accordingly all unrealized gains or losses are recorded as a component of accumulated other comprehensive income in the equity section of the balance sheet.

5. Goodwill from acquisitions from related parties and others.-

OLÉ

In April 1999, Terra Networks, S.A. acquired 100% of OLÉ from INFOSEARCH HOLDINGS, S.A. for €12.02 million in cash and agreed to sell INFOSEARCH HOLDINGS, S.A. 4,928,000 shares of Terra Networks, S.A. for €20.8 million. The estimated fair value of the shares to be sold was €54.0 million. For U.S. GAAP purposes, the difference between the fair value of the shares and the amount received from the sale of €33.2 million would be considered additional purchase price. This additional consideration would result in the same amount of goodwill. For Spanish GAAP purposes the shares sold would be recorded based on the amount of cash received and would not be considered to be additional purchase price. In the fourth quarter of 2001, the Controlling Company determined that the goodwill (for U.S. GAAP purposes) associated with OLÉ was impaired (see Note 21.11 below).

Terra Networks Chile

On October 4, 1999, Terra Networks, S.A.'s subsidiary, Terra Networks Chile Holding Limitada (formerly Telefónica Interactiva Chile Limitada), acquired from CTC Mundo the 95% interest it owned of Proveedora de Servicios de Conectividad, S.A. Terra Networks Chile Holding Limitada paid US$ 40 million in cash, generating goodwill of €44,623 thousand. As both CTC Mundo and Terra Networks, S.A. were under common control of Telefónica, S.A. at the time of this transaction, according to U.S. GAAP the acquisition of Proveedora de Servicios de Conectividad, S.A. would be considered a reorganization of entities under common control. Therefore, under U.S. GAAP, Proveedora de Servicios de Conectividad, S.A. would be recorded at its historical cost basis and no goodwill associated with the transaction would be recognized.

6. Capital contribution to parent company (intangible assets Terra Networks Perú)

On October 20, 1999, Terra Networks, S.A.'s subsidiary Terra Networks Peru, S.A. entered into contracts with Telefónica del Perú, S.A. and Telefónica Servicios Internet del Perú, S.A.C. that enabled it to commence operations in the residential Internet segment. According to the main terms of the agreements, Telefónica del Perú, S.A. agrees not to provide directly or through subsidiaries Internet services for residential users. The consideration paid by Terra Networks, S.A. for the foregoing covenant not to compete amounted to $25 million, and this amount was recorded as an intangible asset and is being amortized on a straight-line basis over five years. Additionally, Telefónica Servicios Internet del Peru, S.A.C. transferred to Terra Networks Peru, S.A. all of its contracts with customers and the customer database of the Internet Provider Centers and made available to the latter the assets assigned to or obtained for the provision of Internet services to residential customers. Terra Networks Peru, S.A. paid $5 million in this connection, and this amount was recorded as an intangible asset and is being amortized on a straight-line basis over five years.

As Telefónica del Peru, S.A., Telefónica Servicios Internet del Peru, S.A.C. and Terra Networks, S.A. were under common control of Telefónica, S.A. at the time of this transaction, in accordance with U.S. GAAP, the $30 million in payments would not be capitalized as intangible assets but would instead be treated similar to dividends.

7. Acquisition of Lycos Virginia, Inc.

On June 8, 2000, the Shareholders' Meeting of Terra Networks, S.A. resolved to increase its capital in order to acquire all of the shares of Lycos Virginia, Inc., a successor to Lycos, Inc., through a share exchange transaction. Accordingly, on October 27, 2000, Terra Networks, S.A. issued 302,031,974 shares of €2 par value each with additional paid-in capital of €9. The total amount of the capital increase was €3,322,351,716.

Under Spanish GAAP, the acquisition was accounted for under the purchase method of accounting. The method used to obtain the purchase price and calculate and record the goodwill generated under Spanish GAAP has been described in Note 4-a above.

Under U.S. GAAP, the acquisition price of Lycos Virgina, Inc. would be determined in a different manner than the calculation under Spanish GAAP. First, the value of the Terra Networks, S.A. shares issued to consummate the acquisition would be valued using the average market price of Terra Networks, S.A.'s common stock around the time the merger was agreed and announced. In accordance with EITF 99-12, this average market price would be the share price at the last time the average security price dropped below the floor price established by the acquisition agreement without subsequent recovery, which was $45.37 per share.

Furthermore and as noted previously, upon acquisition, Terra Networks, S.A. agreed to replace outstanding options to purchase shares of Lycos, Inc. common stock held by Lycos' employees with options to purchase Terra Networks, S.A.'s shares. The Terra Networks, S.A. options have the same terms and conditions as the Lycos, Inc. stock options, except that the number of options and their exercise price have been adjusted based on the exchange ratio used to consummate the combination, 2.15.

The value of these replacement options, to a certain extent, is also considered purchase price under U.S. GAAP. Furthermore, in regards to non-vested options granted, a portion of the fair value of these awards will instead be classified as deferred compensation and be amortized over the remaining period of time in which employees earn full rights to the options.

The following calculations have been made regarding the Terra Networks, S.A. options issued:

	Original Amount of Lycos Options /Shares	Number of Replacement Terra Networks Options / Shares Issued	Weighted-Average Exercise Price of Replacement Options
Vested (1)	15,252,174	32,792,173	€16.92
Unvested (1)	13,836,314	29,748,076	€20.34
Total	29,088,488	62,540,249	
Ordinary shares	111,391,500	239,491,725	
Total Terra Networks shares issued		**302,031,974**	

(1) As of the date of the consummation of the combination: October 27, 2000.

- The value of the fully vested options is €1,369.07 million. This value was determined using a Black-Scholes pricing model and is based on the following weighted-average assumptions:

  - risk free interest rate of 5.5%,
  - volatility of 78%,
  - expected term of 5 years and
  - expected dividend yield of 0%.

  Under U.S. GAAP, this value would be recorded in its entirety as purchase price.

- The value of the unvested options is €1,179.81 million. This value was determined using a Black-Scholes pricing model and is based on the following weighted-average assumptions:

  - risk free interest rate of 5.55%,
  - volatility of 62%,
  - expected term of 6 years and
  - expected dividend yield of 0%.

On the date that Terra Networks, S.A. granted these unvested replacement options, the intrinsic value of the unvested replacement options was €5.36 per share. This amount is calculated by subtracting the weighted-average exercise price of the replacement options of €20.34 from the assumed fair market value of Terra Networks shares on the date of grant of €25.70. Thus, the aggregate intrinsic value of all of the unvested replacement options is €159.45 million as of the date of grant.

The weighted-average remaining service period on the unvested options is 3 years. The weighted-average aggregate service period under the terms of the initial options awarded by Lycos is assumed to be 3 years. Thus, the portion of fair value of the unvested stock options to be classified as deferred compensation expense is 3/3 of the aggregate intrinsic value shown above, or €159.45 million.

Accordingly, the difference of €1,020.36 million between the fair value of the unvested stock options and the amount classified as deferred compensation would be recorded as additional purchase price under U.S. GAAP, in regards to the non-vested stock options.

The following is a summary of the calculation of the purchase price, as described above:

U.S. GAAP	(Thousands of Euros, except share amounts)
Total number of Terra Networks shares issued to consummate acquisition	239,491,725
Fair market value per share (a)	50.20
Value of Terra Networks shares issued	12,022,485
Fair value of vested stock options issued	1,369,073
Fair value of unvested stock options issued	1,020,359
Direct acquisition costs (b)	66,230
Total purchase price	14,478,147

(a) In accordance with EITF 99-12, this amount represents the share price at the last time the average security price dropped below the floor price established by the acquisition agreement without subsequent recovery. Such amount is equivalent to US$ 45.37 per share.

(b) This amount represents taxes, legal fees and other direct costs in connection with the acquisition of Lycos.

8. Stock options granted to employees of Lycos

As discussed in Note 4-a to the consolidated financial statements, Terra Networks, S.A. has accounted for stock awards granted to employees of Lycos Virginia, Inc. in the following manner under Spanish GAAP:

– For options that had an exercise price of €11 or greater, Terra Networks, S.A. recorded an asset at €11 per share in the caption "Due from Shareholders for Uncalled Capital", with an offsetting credit to shareholders' equity. As the employees exercise their options covered by these shares, the positive difference between the exercise price paid by the employee and the €11 is recorded in the accompanying consolidated financial statements under the "Negative Goodwill in Consolidation" caption on the liability side of the consolidated balance sheet. This difference will be allocated to income over the remaining period over which the goodwill that initially arose in the transaction is being amortized, up to a maximum of ten years from the acquisition date.

– For options that had an exercise price of less than €11 per share, Terra Networks, S.A. recorded an asset under the "Due from Shareholders for Uncalled Capital" caption on the asset side of the consolidated balance sheet for the exercise price of the shares. The difference between this price and the €11 was recorded as additional goodwill. This goodwill is being amortized on a straight-line basis over ten years.

The accounting under Spanish GAAP when an award has been exercised or forfeited is also described in Note 4-a.

Under US GAAP, none of these entries would have been recorded. Instead, the options issued in the acquisition of Lycos Virginia would be recorded as purchase price or deferred compensation, as described in section 7 of this Note.

9. Acquisition of minority interests in Terra Networks USA

In July 2000, Terra Networks, S.A. acquired the remaining 49% holding in Terra Networks Access Services USA Llc. and the remaining 10% holding in Terra Networks Interactive Services USA Llc. from IDT, through a share exchange whereby Terra Networks issued 3,750,000 shares with a stated value, for Spanish GAAP purposes, of €41.25 million. The estimated fair value of the shares of Terra Networks, S.A. was €228.23 million, based on the fair market value of Terra Networks, S.A.'s common stock around the time the terms of the agreements were reached and announced. For U.S. GAAP purposes, the difference of €186.98 million between the fair value of the shares and the par value at which the shares were issued would be considered additional purchase price. This additional consideration would result in the same amount of goodwill. As of December 31, 2001 the goodwill arising from these acquisitions was written down both for Spanish and U.S. GAAP purposes, since the ISP operations in the U.S.A. have been discontinued.

10. Acquisition of Uno-e Bank, S.A.

Pursuant to the agreements entered into in February 2000 by Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), in August 2001 Terra Networks, S.A. acquired a 49% holding in Uno-e Bank, S.A. for an aggregate purchase price of €160,434,000. The results of Uno-e Bank, S.A.'s operations have been included in the consolidated financial statements since the date of acquisition.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

	At July 31, 2001 (thousands of Euros)
Current assets	295,046
Property, plant and equipment	3,333
Intangible assets	4,806
Other fixed assets	5,377
Goodwill	130,251
Total assets acquired	438,813
Current liabilities	23
Long-term debt and other	278,356
Total liabilities assumed	278,379
Total net assets acquired	**160,434**

For Spanish GAAP purposes, the goodwill arising in the acquisition of Uno-e Bank, S.A. is being amortized over a period of ten years. Under U.S. GAAP, according to SFAS No. 142, the use of a non-amortization approach to account for purchased goodwill and certain intangibles is required, as Uno-e Bank, S.A. was acquired after June 30, 2001, and therefore an adjustment has been made in the reconciliation of net loss and shareholders' equity.

In connection with our investment in Uno-e Bank, S.A. we have entered into an arrangement to provide for a liquidity mechanism which is subject to adjustment upon completion of the merger agreed to in principle between Uno-e Bank, S.A. and the private consumer finance activities operated by Finanzia Banco Crédito, S.A. We have the right to sell our stake in Uno-e Bank, S.A. to Banco Bilbao Vizcaya Argentaria, S.A. between May 15, 2004 and May 16, 2006 at fair market value (as determined by an investment bank). If the merger agreed to in principle is not consummated, the purchase price paid by Banco Bilbao Vizcaya Argentaria, S.A. for our stake in Uno-e Bank, S.A. in accordance with such right shall be the greater of (i) fair market value (as determined by an investment bank) and (ii) the amount paid by us for our stake in Uno-e Bank, S.A. (€189.4 million).

Under Spanish GAAP this transaction does not require any additional accounting. Under U.S. GAAP, according to SEC views on accounting matters 2001 – Topic 5, as of December 31, 2001, this transaction does not give rise to any reconciliation item.

11. Allocation of Purchase Price and Goodwill Impairment

The Group, under Spanish GAAP, has recorded the difference between the purchase price of acquired companies such as Lycos Virginia, Inc. (subsequently renamed Lycos, Inc.), Terra Networks México, S.A. de C.V., Terra Networks Brasil, S.A. (formerly Nutec Informatica, S.A.) and Ordenamiento de Links Especializados, S.L. (OLÉ) and the fair value of the net assets acquired in these entities as goodwill. This goodwill is being amortized over a period of ten years beginning from the date of each acquisition.

The table below summarizes the allocation of the purchase price for Lycos, Inc. according to U.S. GAAP.

	Fair value (thousands of Euros)	Estimated useful life (years)
Net assets (excluding intangible assets).................	1,085,686	
Web visitors and customer base..............................	389,568	3 to 5
Developed technology...	376,302	3 to 5
Other intangible..	196,593	5
Goodwill..	12,429,998	10
Total..	**14,478,147**	

Spanish GAAP requires that amounts paid to acquire companies in excess of the fair value of the assets acquired (including identified intangible assets) at their purchase date be accounted for as goodwill and amortized over a period not exceeding 20 years. The Group amortizes its goodwill over its estimated useful life of ten years for Spanish GAAP and for U.S. GAAP purposes.

Subsequent to acquisition (for U.S. GAAP purposes), according to APB 17, the carrying value is reviewed if the facts and circumstances, such as significant declines in sales, earnings or cash flows, suggest that it may be impaired. If this review indicates that goodwill will not be recoverable, impairment is measured by comparing the carrying value of goodwill to fair value. Fair value is determined based on discounted cash flows.

In 2001 the Controlling Company has carried out a study of the evolution of the acquired companies' business plans in order to ascertain whether or not it was necessary to write down the goodwill arising from the acquisitions of companies in prior years. As a result of the study, the balance of the "Goodwill in Consolidation" caption was written down by €35,083,000 for Spanish and U.S. GAAP purposes. The primary facts and circumstances leading to the impairment are described in Note 4 a.

As described in Notes 21.5, 21.7 and 21.9 above, there are significant differences between Spanish and U.S. GAAP in the value of goodwill associated with the acquisitions of OLÉ, Lycos, Inc. and the minority interests in Terra Networks USA. Under Spanish GAAP, the value of the shares issued to consummate the acquisition of Lycos, Inc. was €11 per share, while for U.S. GAAP purposes the shares were valued at €50.20 per share, which was the average market price of the Terra Networks, S.A. common stock around the time the merger was agreed and announced, in accordance with EITF 99-12 (see Note 21.7). Due to this difference in the purchase price, there is a goodwill of €1,766 million arising from the acquisition of Lycos, Inc. for Spanish GAAP purposes and a goodwill amounting to €13,441 million arising from this transaction for U.S. GAAP purposes. In the fourth quarter of 2001, the Controlling Company determined which amount of the goodwill (for U.S. GAAP purposes) associated with Lycos, Inc., Terra Networks USA and OLÉ was impaired. The write-off of the goodwill was based on an analysis of projected discounted cash flows, which were no longer deemed adequate to support the value of goodwill associated with OLÉ, Terra Networks USA and Lycos, Inc. under U.S. GAAP.

The following is a summary of the impairment charges in the consolidated statement of operations for the year ended December 31, 2001:

	Thousands of Euros
Impairment of goodwill arising from OLÉ acquisition	17,093
Impairment of goodwill arising from acquisition of Lycos, Inc.	8,628,163
Impairment of goodwill arising from acquisition of minority interests in Terra Networks USA	144,303
Total goodwill impairment charge	**8,789,559**

12. Investments under FASB 115

Under U.S. GAAP equity investments representing an ownership interest between 20% and 50%, or for which significant influence (but not control) can be exerted, should be accounted for under the equity method of accounting. Investments in debt and marketable securities for which significant influence cannot be exerted should be accounted for pursuant to FASB 115 "Accounting for Certain Investments in Debt and Equity Securities". Lycos, Inc., subsidiary of Terra Networks, S.A., has several equity investments, and pursuant to FASB 115 it has been concluded that all of its equity investments representing ownership interests of less than 20% should be considered "available for sale" and accordingly these investments are marked to market at each balance sheet date and any unrealized gains or losses are recorded in the equity section of the balance sheet (comprehensive income) and not through the statements of operations.

Under Spanish GAAP, all unrealized losses are recorded in the statement of operations and a reserve for those investments that have declined in value is recorded. In contrast, under Spanish GAAP the historical cost basis of those investments that have increased in value is not adjusted and all unrealized gains are not recognized as income until they are realized.

13. Treasury stock

In the Spanish GAAP financial statements, treasury stock is shown separately in the assets side of the consolidated balance sheet. For U.S. GAAP reporting purposes, treasury stock is shown as a component of the shareholders' equity (deduction).

14. Tax deduction benefit of stock options

Under U.S. GAAP, the exercise of employee stock options results in a tax benefit, which can be carried forward to offset future taxable income. The benefit, when recognized, is accounted for as a credit to additional paid-in capital for U.S. GAAP purposes. Under Spanish GAAP, a reduction in income tax expense would be recorded. Under U.S. GAAP, the deferred tax asset associated with the future deduction would be fully reserved against, as its ability to be realized is not certain.

15. Translation of goodwill

Under Spanish GAAP, the translation of financial statements from the funtional currency to the reporting currency involves multiplying all assets and liabilities, except for goodwill in certain cases, by the current exchange rate on the balance sheet date. Goodwill is translated using the historical exchange rate on the date the acquisition was consummated. Under U.S. GAAP, all assets, including goodwill and other intangible assets, are translated using the current rate of exchange as of the balance sheet date. This difference in accounting principles did not yield any material differences in reported net loss and shareholders' equity for the year ended December 31, 1999.

16. Shares in Deposit at Finance Entities acting as Agents in Stock Option Plans

In the Spanish GAAP financial statements, the amount paid by the two finance entities, Banco Zaragozano and Caja de Ahorros y Pensiones de Barcelona (La Caixa), acting as agents in the Stock Option Plan for Terra Networks, S.A.'s employees is recorded as a capital increase subscribed to by the afore-mentioned companies. For U.S. GAAP reporting purposes, this amount is shown as a component of the long-term liabilities.

17. The following is a reconciliation of shareholders' equity and net loss from Spanish GAAP to U.S. GAAP.

# Ref.		Thousands of Euros 12/31/01	12/31/00	12/31/99
	Shareholders' equity per Spanish GAAP	**5,556,792**	**6,126,833**	**1,233,527**
	Adjustments for U.S. GAAP purposes:			
1	Research and development expenses	(5,079)	(8,474)	(247)
2	Start-up costs			
	Advertising	(85,163)	(49,608)	(18,102)
	Offering costs	(673)	(64,374)	(33,028)
3	Valuation allowances on deferred tax assets (a)	(637,488)	(279,350)	(42,625)
4	Investments carried by the equity method	76,996	12,531	-
5,11	Goodwill arising from OLÉ acquisition	17,093	21,594	28,236
5	Adjustment arising from Chile acquisition (net)	(27,737)	(33,933)	(38,345)
6	Adjustment resulting from Perú acquisition (net)	(19,178)	(23,974)	-
7	Goodwill arising from Lycos acquisition	8,628,163	11,220,787	-
8	Stock options granted to employees of Lycos	(493,148)	(509,534)	-
9,11	Goodwill arising from acquisition of minority interests in T.N. USA	144,303	171,409	-
10	Amortization of goodwill relating to Uno-e Bank, S.A. acquisition	4,342	-	-
11	Impairment of goodwill of previous acquisitions	(8,789,559)	-	-
12	Investments under FASB 115	(53,658)	(47,720)	-
13	Treasury stock	(2,188)	(2,078)	-
15	Translation of goodwill	(63,168)	(124,186)	-
16	Capital increase subscribed to by finance entities acting as agents in ESOP	(30,197)	-	-
	Tax effects of above adjustments (b)	-	-	-
	Other	-	-	55
	Total differences	(1,336,339)	10,283,090	(104,056)
	Shareholders' equity per U.S. GAAP	**4,220,453**	**16,409,923**	**1,129,471**

(a) At 12/31/99 includes €6,677 thousand of tax carried forward relating mainly to Terra Networks México, S.A.

(b) The adjustments above do not include the tax effect, if any, of reconciling the shareholders' equity from Spanish GAAP to U.S. GAAP, since a valuation allowance would be provided in full against the deferred tax assets related to the Group's net operating losses under U.S. GAAP.

# Ref.		Thousands of Euros, except per share data		
		12/31/01	12/31/00	12/31/99
	Net loss per Spanish GAAP	**(566,298)**	**(556,354)**	**(81,404)**
1	Reversal of amortization of research and development expenses	3,865	920	96
2	Additions to research and development expenses	-	(156)	(343)
2	Reversal of amortization of start-up costs	30,627	19,569	920
2	Additions to start-up costs (advertising)	(1,629)	(51,970)	(19,020)
3	Corporate income tax	(373,829)	(239,630)	(35,899)
4	Investments carried by the equity method	68,606	4,538	-
5	Amortization of goodwill relating to OLÉ acquisition	(4,502)	(6,641)	(4,982)
5	Adjustment relating to Chile acquisition	6,196	8,858	1,322
6	Adjustment resulting from Perú acquisition	6,743	6,395	-
7	Amortization of goodwill relating to Lycos acquisition	(1,745,568)	(384,606)	-
7	Amortization of deferred compensation expense	(53,148)	(8,859)	-
8	Stock options granted to employees of Lycos	(2,825)	-	-
9	Amortization of goodwill minority interests T.N. USA	(27,106)	(15,584)	-
10	Amortization of goodwill relating to Uno-e Bank acquisition	4,342	-	-
11	Impairment of goodwill from previous acquisitions	(8,789,559)	-	-
12	Unrealized gains/losses investments under FASB 115	(91,793)	1,112	-
14	Tax deduction on employee stock options	-	(8,576)	-
15	Translation of goodwill	124,231	(5,457)	-
	Other	(102)	-	-
	Tax effects of above adjustments (a)	-	-	-
	Net loss per U.S. GAAP	**(11,411,749)**	**(1,236,441)**	**(139,310)**
	Net loss per share U.S. GAAP	**(18.369)**	**(3.586)**	**(0.684)**
	Weighted average shares outstanding	**621,265,845**	**344,819,216**	**203,763,953**

(a) The adjustments above do not include the tax effect, if any, of reconciling the net loss from Spanish GAAP to U.S. GAAP, since a valuation allowance would be provided in full against the deferred tax assets related to the Group's net operating losses under U.S. GAAP.

Shareholders' rights and any dividend distributions are based on the financial statements as reported for local Spanish statutory purposes by Terra Networks, S.A.

	Millions of Euros	
	2001	2000
U.S. GAAP shareholders' equity at January 1	**16,409,923**	**1,129,471**
Net loss of the year	(11,411,749)	(1,236,441)
Share issuance	-	5,563,601
Translation adjustments	(922,643)	(211,200)
Other adjustments: Spanish - U.S. GAAP differences	144,922	11,164,492
Interim dividend	-	-
U.S. GAAP shareholders' equity at December 31	**4,220,453**	**16,409,923**

18. Change in accounting estimate

In 2001 the Controlling Company has carried out a study of the evolution of the acquired companies' business plans in order to ascertain whether or not it was necessary to write down the goodwill arising from the acquisitions of companies in prior years. As a result of the study, the balance of the "Goodwill in Consolidation" caption was written down by €35,083,000 for Spanish and U.S. GAAP purposes (see Note 21.11).

After the study had been carried out and the write-down made, the Controlling Company adapted the goodwill amortization period to the new revenue estimates in order to better match future revenues and expenses in accordance with the actual rate of maturation of the Group and of the industry in which it operates. The business model of the acquired companies was based on free Internet access and advertising revenues and it has evolved towards a new model based on pay per access, pay per content and customized advertising.

As a general rule, the goodwill amortization period has been extended to ten years, except for the portion of goodwill, amounting to €400,000,000, which was allocated to the agreement entered into on May 16, 2000, between Bertelsmann AG, Telefónica, S.A. and Terra Networks, S.A., to be recovered in proportion to the revenues generated by the agreement over its five-year term.

€145,458,000 of goodwill arose in 2001, and €386,332,000 of amortization of goodwill in consolidation were charged to the 2001 consolidated statement of operations under Spanish GAAP (see Note 5). Had the goodwill in consolidation been amortized on a straight-line basis over five years throughout 2001, the charge in this connection to the 2001 consolidated statement of operations would have increased by €163,408,000 for Spanish GAAP purposes.

19. Comprehensive income

Comprehensive income is defined in FASB Concepts Statements No. 6 and SFAS No. 130, "Reporting Comprehensive Income", as "the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners".

SFAS No. 130 describes the items that qualify as components of comprehensive income, such as:

a. Foreign currency translation adjustments;
b. Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing, as of the designation date;
c. Gains and losses on intercompany foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting enterprise's financial statements;
d. A change in the market value of a futures contract that qualifies as a hedge of an asset reported at fair value pursuant to FASB No. 115;
e. A net loss recognized pursuant to FASB No. 87 as an additional pension liability not yet recognized as net periodic pension cost;
f. Unrealized holding gains and losses on available-for-sale securities;
g. Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category;
h. Subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of available-for-sale securities previously written down as impaired.

For each of the three years in the period ended December 31, 2001, the only component of comprehensive income (loss) besides net loss is the Group's foreign currency translation adjustments related to its investments that have functional currencies other than the Euro. The following represents the statement of comprehensive income prepared using U.S. GAAP:

	Thousands of Euros		
	12/31/01	**12/31/00**	**12/31/99**
Net loss per U.S. GAAP	**(11,411,749)**	**(1,236,441)**	**(139,310)**
Other comprehensive income (expense)-			
Foreign currency translation	(1,134,470)		
adjustments		(118,267)	(631)
Net effect of SFAS 115	91,793	-	-
Comprehensive loss	**(12,454,426)**	**(1,354,708)**	**(139,941)**

20. Statement of cash flows

For purposes of the statement of cash flows, the Group considers all highly liquid debt instruments (or investments) purchased with an original maturity of three months or less to be cash equivalents. Certain balances in the statement of cash flows for the years ended December 31, 1999 and 2000 have been reclassified to conform with the current period presentation.

	Thousands of Euros		
	12/31/01	**12/31/00**	**12/31/99**
Net loss per Spanish GAAP	**(566,298)**	**(556,354)**	**(81,404)**
Adjustments to reconcile net loss to net cash used in operating activities-			
Depreciation and amortization	157,426	83,513	6,272
Amortization of goodwill	386,332	253,484	28,654
Reversal of negative goodwill in consolidation	(2,825)	-	-
Minority interest in loss of subsidiaries	(1,620)	691	1,928
Share in losses of companies carried by the equity method	181,732	54,721	60
Losses on fixed assets	1,956	28,650	-
Gains on fixed assets	(315)	(817)	-
Provision in long-term financial investment	13,676	11,095	-
Tax assets for tax loss carryforwards	(363,350)	(248,142)	(35,899)
Other	21,000	1,142	-
Changes in operating assets and liabilities, net of effects from purchase of new investments-			
Inventory	(223)	517	(2,106)
Accounts receivable from third parties	33,984	(77,584)	(14,743)
Accounts receivable from related companies	(24,597)	(19,104)	(2,223)
Prepayments	14,313	(37,193)	(17,139)
Prepaid taxes	(18,773)	(26,936)	(22,497)
Trade creditors	(68,874)	170,785	64,933
Non-trade creditors	(11,296)	5,481	58,329
Accounts payable to related companies	90,797	34,200	8,890
Accrued taxes payable	(4,080)	2,671	7,620
Deferred revenues	(4,757)	43,638	-
Other liabilities	(1,178)	942	964
Net cash provided by (used in) operating activities	**(166,970)**	**(274,600)**	**1,639**
Cash flow from investing activities:			
Cash paid for financial investments and other	(87,515)	(7,948)	(11,854)
Acquisitions of businesses	(183,658)	(378,527)	(535,131)
Cash acquired through acquisitions	-	777,385	-
Capital expenditures	(108,680)	(218,264)	(132,287)
Payments for start-up costs	(95)	(79,740)	(52,028)
Sale of investments and other	13,005	8,506	877
Net cash provided by (used in) investing activities	**(366,943)**	**101,412**	**(730,423)**
Cash flow from financing activities:			
Proceeds from issuance of common stock	-	2,199,997	1,314,571
Proceeds from other capital contributions	19,203	65,360	(2,602)
Increase (decrease) in other-long term liabilities	1,940	8,859	5,153
Contributions from minority interest owners	4,736	(1,737)	(712)
Net cash provided by (used in) financing activities	**25,879**	**2,272,479**	**1,316,410**
Translation differences	**24,774**	**(15,893)**	**(631)**
Net change in cash and cash equivalents	(483,260)	2,083,398	586,995
Cash and cash equivalents at beginning of year	2,673,384	589,986	2,991
Cash and cash equivalents at end of year	**2,190,124**	**2,673,384**	**589,986**

21. Advertising

The Group companies advertise their branded services and products through national and regional media in the countries in which they operate. These advertising costs are expensed as incurred, and are charged to ”operating expenses“. For the years ended December 31, 2001, 2000 and 1999, advertising expenses amounted to €186,048 thousand, €211,428 thousand and €48,147 thousand, respectively.

22. Disclosure of fair value of financial instruments.

SFAS No. 107 requires that the Group disclose the estimated fair value of its financial instruments as of December 31, 2001, 2000 and 1999. The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate such fair value:

a) Cash and cash equivalents

The fair value of these investments approximates their carrying value due to the short maturity of the instruments.

b) Short-term investments

The carrying value for short-term investments approximates fair value because of the relatively short time between the origination of the instruments and their expected realization.

c) Long-term financial investments

The fair value of long-term financial investments is estimated based on listed market prices for those or similar investments. For investments for which there are no market prices, a reasonable estimate of fair value could not be made without incurring excessive costs. In view of the limited volume of these investments considered individually, the cost of valuing them based on an estimate of future cash flows discounted at market interest rates for investments of this type would be disproportionate with respect to the additional information to be gained thereby, and the Group’s management considers that the difference between the book value and the fair value is not material.

d) Accounts receivable and accounts payable

The fair value of these accounts approximates their carrying value because of their short-term nature.

23. Stock option plan

a) Terra Networks, S.A. Stock Option Plans

As described in Note 18-a, the Company has a stock incentive plan that was adopted on October 1, 1999. On November 17, 1999, the date of the Group's initial public offering ("IPO"), Terra Networks, S.A. issued 14,000,000 ordinary shares to Banco Zaragozano and Caja de Ahorros y Pensiones de Barcelona (La Caixa), as agents under the Terra Networks, S.A. Stock Option Plan. In 1999, the Company granted 2,582,588 options to employees, and in 2000, the Company granted 795,910 options to employees. Each option entitles the holder to acquire one ordinary share of Terra Networks, S.A. The exercise price of these options was €11.81. These options have an expiration date of four years and three months from the date of grant and will vest at a rate of one-third each year from the second year from the date on which the options are granted.

The weighted average contractual life of outstanding options was 2.3 years as of December 31, 2001, and at December 31, 1999 and 2000 the fair value of options granted during 1999 and 2000 was approximately €7.96 and €7.26 per share, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for the 1999 grants: risk-free interest rate of 5.915%; expected life of 4 years; expected dividend yield of zero percent; and assumed volatility of 90% based on a study of volatility factors of public companies in the same industry as Terra Networks, S.A., such as Yahoo!, AOL, Amazon and others. The assumptions used for the 2000 grants are the following: risk-free interest rate of 5.275%; expected life of 4 years; expected dividend yield of zero percent; and assumed volatility of 78% based on a study of volatility factors of public companies in the same industry as Terra Networks, S.A., such as Yahoo!, AOL, Amazon and others.

On December 22, 2000, the Board of Directors approved the launch of a second phase of the Stock Option Plan. 5,806,632 and 3,326,169 options to acquire ordinary shares of Terra Networks, S.A. were granted to employees of the Company and Board members in 2000 and 2001, respectively, under this phase of the Stock Option Plan. Each of the stock options under the second phase of the Plan entitles the holder to acquire one share of Terra Networks, S.A. at an exercise price equivalent to the market value of Terra Networks, S.A.'s common stock on the date of grant. The options granted under this phase of the Plan are exercisable at a rate of one fifth each year from the first year from the date on which the options are granted. These options have an expiration date of five years from the date of grant.

The weighted average contractual life of outstanding options was 5 years, and at December 31, 2000 and 2001 the fair value of options granted during 2000 and 2001 pursuant to the second phase of the Stock Option Plan was approximately €13.18 and €6.54 per share, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for the 2000 grants: risk-free interest rate of 4.795%; expected life of 4.47 years as of December 31, 2001; expected dividend yield of zero percent; and assumed volatility of 78% based on a study of volatility factors of public companies in the same industry as Terra

Networks, S.A., such as Yahoo!, Amazon and others. The assumptions used for the 2001 grants are the following: risk-free interest rate of 4.29%; expected life of 5 years; expected dividend yield of zero percent; and assumed volatility of 67.69%.

Terra Networks, S.A. applies Accounting Principles Board No. 25, "Accounting for Stock Issued to Employees," in accounting for its stock option grants to employees and directors. Accordingly, no compensation cost has been recognized related to such grants in the accompanying statements of operations for the years ended December 31, 1999, 2000 and 2001, as the exercise price of the options was equivalent to the fair value Terra Networks' ordinary shares on the measurement date. Had compensation cost for these grants been determined consistent with Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation," the Group's net loss would have been increased by approximately €927 thousand, €20.77 million and €40.02 million for 1999, 2000 and 2001, respectively, and the Group's basic and diluted loss per share under US GAAP would have increased by €0.004, €0.06 and €0.07 per share for the years ended December 31, 1999, 2000 and 2001, respectively.

The following table summarizes information about stock options outstanding under the Terra Networks Stock Option Plan at December 31, 2001:

	Options outstanding at 12/31/01			**Options exercisable at 12/31/01**	
Exercise prices	**Number outstanding at 12/31/01**	**Weighted - average remaining contractual life (years)**	**Weighted - average exercise price**	**Number exercisable at 12/31/01**	**Weighted - average exercise price**
€11.81	2,311,863	2.3	€11.81	770,621	€11.81
€5.60 - €10.23	1,595,500	5.0	€8.36	-	-
€10.24 - €14.87	992,500	5.0	€12.34	-	-
€14.88 - €19.51	200,00	5.0	€16.88	-	-
€19.52 - €24.15	3,879,483	4.0	€19.80	977,898	€19.78
€24.15 - €28.81	620,900	5.0	€25.74	-	-
	9,600,246			**1,748,519**	

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

In connection with the acquisition of Lycos, Inc. Terra Networks, S.A. assumed Lycos, Inc. Stock Option Plans (see Note 18-b).

The following table summarizes information about stock options outstanding under the Lycos, Inc. Stock Option Plans at December 31, 2001:

	Options outstanding at 12/31/01			Options exercisable at 12/31/01	
Range of exercise prices	**Number outstanding at 12/31/01**	**Weighted - average remaining contractual life (years)**	**Weighted - average exercise price**	**Number exercisable at 12/31/01**	**Weighted - average exercise price**
$0.0001 - $3.9709	979,664	5.7	$2.5014	893,825	$2.4281
$3.9710 - $7.9419	3,473,783	6.1	$5.8906	2,475,118	$5.9243
$7.9420 - $11.9128	368,230	6.5	$9.2027	283,520	$9.2223
$11.9129 - $15.8837	14,735,055	7.9	$15.5672	8,361,869	$15.4018
$15.8838 - $19.8546	3,478,572	8.0	$17.8449	2,729,165	$18.0500
$19.8547 - $23.8256	3,408,592	7.0	$21.3963	2,727,671	$21.4177
$23.8257 – $27.7965	1,119,384	7.6	$24.8951	734,003	$24.8869
$27.7966 - $31.7674	7,252,350	7.0	$29.9330	6,343,704	$30.0510
$31.7675 - $35.7384	347,847	7.5	$33.7500	255,906	$33.7592
$35.7385 - $39.7093	161,104	7.5	$38.7232	122,775	$38.7389
	35,324,581			**24,927,556**	

24. Earning Per Share

The Group has no potentially dilutive shares, as defined under FAS 128 “Earning Per Share”. Therefore, there are no differences between basic and diluted loss per share for any periods presented**.**

25. Business segment data

The Group operates in some business segments, based on geographic regions in which the Group conducts operations. These segments are consistent with the way management analyses its businesses.

Accounting principles-

All transactions between segments are made at market prices or at prices which have been approved, and published, by the regulatory authority. The accounting principles used in accounting for the segments are the same as those used in the consolidated financial statements.

Distribution of sales by product for the years ended as of December 31, 2001, 2000 and 1999 was as follows:

	Thousands of Euros		
	2001	**2000**	**1999**
Advertising (*)	405,789	132,447	5,123
Access	203,780	118,694	24,817
Corporate Services	46,130	29,306	-
E-commerce	12,801	12,881	66
Other	25,012	14,201	20,225
Total revenues	**693,512**	**307,529**	**50,231**

(*) As of December 31, 2001 more than one third of the revenues relate to the advertising contract with Bertelsmann.

Geographic distribution of sales for the years ended as of December 31, 2001, 2000 and 1999 was as follows:

	Thousands of Euros		
	2001	**2000**	**1999**
Sales to external clients:			
Spain	113,307	44,926	7,992
United States	355,621	93,968	2,224
Brazil	96,294	71,268	14,581
Mexico	60,958	50,768	11,065
Chile	21,694	10,043	5,932
Guatemala	2,644	2,530	938
Peru	3,421	1,557	42
Argentina	1,636	1,358	42
Venezuela	3,410	619	-
Colombia	1,309	174	-
Uruguay	110	90	-
Caribbean	76	-	-
	660,480	277,301	42,816
Sales to related parties	29,969	27,743	3,727
Other revenues	3,063	2,485	3,688
Total revenues	**693,512**	**307,529**	**50,231**

The distribution of fixed assets and intangible assets at December 31, 2001, 2000 and 1999 was as follows:

	Thousands of Euros		
	2001	**2000**	**1999**
Property, plant and equipment (net):			
Spain	31,169	24,935	9,719
Chile	7,436	9,340	8,734
Mexico	52,889	40,997	9,221
Brazil	15,894	21,212	7,495
United States	14,968	16,306	1,504
Peru	2,308	2,772	78
Argentina	1,458	3,223	307
Guatemala	1,261	1,366	198
Venezuela	245	177	-
Colombia	389	334	-
Uruguay	104	178	-
Caribbean	97	-	-
Total	**128,218**	**120,840**	**37,256**
Intangible assets (net):			
Spain	36,637	53,766	12,310
Chile	11,078	3,935	529
Mexico	21,382	14,137	16,300
Brazil	16,524	22,276	4,256
United States	37,176	48,809	29,871
Peru	21,321	25,554	28,465
Colombia	13,224	11,693	-
Argentina	471	944	1,058
Guatemala	70	60	18
Venezuela	205	34	-
Uruguay	9	18	-
Total	**158,097**	**181,226**	**92,807**

26. Pro Forma Effect of Acquisitions

U.S. GAAP requires the disclosure of certain information about significant acquisitions that occur during the periods for which financial statements are presented.
The following unaudited information presents the results of operations of the Group under U.S. GAAP as if the material acquisitions of Lycos Virginia, Inc. (subsequently renamed Lycos, Inc.), Terra Networks Brasil (formerly Nutec Informatica, S.A.), OLÉ and Terra Networks México, S.A. de C.V. had taken place at the beginning of each period presented. Such acquisitions are the only ones that have a material effect, on a proforma basis, on the accounts reported below:

(Unaudited) In Thousands of Euros, Except per Share Data	Year Ended Dec. 31, 2000	Year Ended Dec. 31, 1999
Revenues	571,837	288,817
EBITDA (*)	(429,497)	(253,856)
Net loss before amortization of goodwill arising from acquisition of Lycos	(843,585)	(476,146)
Net loss	(3,400,564)	(3,033,125)
Net loss per share	(7.16)	(5.56)

(*) Earnings before interest, taxation, depreciation and amortization. EBITDA has been included to provide additional information relating to our ability to generate cash from operations. EBITDA is not a measure of financial performance under Spanish or U.S. GAAP and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles. EBITDA is not calculated identically by all companies, and the presentation here may not be comparable to other similarly titled measures of other companies. Management's discretionary use of funds depicted by EBITDA may be limited by working capital, debt service and capital expenditure requirements and by restrictions related to legal requirements, commitments and uncertainties.

These unaudited results of operations have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on the dates indicated, or which may result in the future.

27. Classification Differences

In the Spanish GAAP financial statements, amortization of goodwill is shown separately in the consolidated statement of operations below operating loss. The amount of goodwill amortization recorded under Spanish GAAP was €386,332 thousand, €253,484 thousand and €28,654 thousand for the years ended December 31, 2001, 2000 and 1999. For U.S. GAAP reporting purposes, amortization of goodwill is shown as a deduction before operating income.

Under Spanish GAAP, certain income and expenses, such as those arising from the disposition of fixed assets can be classified as extraordinary items. Under U.S. GAAP, these amounts would be classified as a component of operating income (loss).

28. Significant accounting policies

Under US GAAP, there are some specific literatures regarding revenue recognition (SAB 101), advertising barter transactions (EITF 99-17) and web site development costs (EITF 00-02), among others, to take into account in the internet industry. The significant accounting polices specifically related to the internet industry and a comparison between U.S. and Spanish GAAP are as follows:

Web Site Development Costs-

The Emerging Issues Task Force ("EITF") addressed the issue of accounting for the costs of developing a web site in Issue No. 00-2, "Accounting for Web Site Development Costs ", and concluded that software that is developed by the company or purchased from vendors represent internal use software covered by SOP 98-1. However, in determining the appropriate accounting for costs incurred for software to be used in the company's web site, consideration should be given to the following: (1) the guidance provided in SOP 93-7, "Reporting on Advertising Costs", if the web site is to be wholly or partially used for advertising; (2) whether the costs incurred are graphics and software costs or represent content development costs; and (3) the appropriate amortization period.

Graphic costs, the costs of graphics that are a component of software and the costs of developing initial graphics should be accounted for pursuant to SOP 98-1 for internal-use software, and pursuant to Statement 86 for software marketed externally. Modifications to graphics after a web site is launched should be evaluated to determine whether the modifications represent maintenance or enhancements of the web site.

All costs relating to software used to operate a web site should be accounted for under SOP 98-1 unless a plan exists or is being developed to market the software externally, in which case the costs relating to the software should be accounted for pursuant to Statement 86.

Content development costs related to preparing, updating and organizing the information presented in the web site shall be accounted for pursuant to APB Opinion 17, "Intangible Assets". The costs of internally developed intangible assets which are not specifically identifiable should be expensed as incurred, while amounts paid to third parties should be recognized as an asset.

The majority of the Group's software and software related expenditures relate to the development and maintenance of its portal. Under Spanish GAAP, internal and external costs incurred in the planning or conceptual development of the Group's portal are expensed as incurred. Once the planning or conceptual development of a web site enhancement project has been achieved, and the project has reached the application or development stage, the following costs are capitalized as intangible assets:

- external direct costs of materials and services used in the project,
- payroll and payroll-related costs for employees who are directly associated with and who devote time to the project (to the extent of the time spent directly on the project) and
- interest cost incurred in the development of the project, if material.

Training and routine maintenance costs are expensed as incurred. Costs incurred that result in enhancements or additional functionality to the web site are capitalized in accordance with the policy described above. Due to the above, there are no major differences between Spanish and U.S. GAAP.

During the years ended December 31, 2001, 2000 and 1999, most of our costs are charged to earnings relating to web site development. Those costs relate mainly to the purchase of content or monthly rental fees paid to our suppliers and, accordingly, these costs have been not capitalized.

Revenue Recognition-

Under U.S. GAAP, the SAB 101 and a supplemental Q&A also published by the staff of the U.S. Securities and Exchange Commission, offer guidance for a number of transactions based on four requirements, which are: (a) persuasive evidence that an arrangement exists; (b) delivery has occurred or services have been rendered; (c) the seller's price to the buyer is fixed or determinable; and (d) collectibility is reasonably assured.

Under Spanish GAAP 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.

The main differences in accounting treatment regarding revenue recognition that could arise in the Company are related to up-front connection fees, which under Spanish GAAP are, in most cases, recognized directly to earnings, while under U.S. GAAP these fees are recorded in earnings throughout the expected life of the client relationship. Up to December 31, 2001, the volume of these fees represented an insignificant amount, and therefore, no difference between Spanish GAAP and U.S. GAAP was adjusted.

Barter Transactions-

Under U.S. GAAP, Emerging Issues Task Force ("EITF") 99-17, "Accounting for Advertising Barter Transactions" provides accounting guidance for barter transactions involving a nonmonetary exchange of advertising. Generally, such barter transactions should only be recorded as revenues and cost to the extent that the fair value of the advertising surrendered in the transaction is determinable based on a company's historical practice of receiving cash for similar advertising provided to buyers unrelated to the counterparty in the transaction. In addition, if an entity engages in advertising barter transactions for which the fair value is not determinable within the limits of EITF 99-17, no revenues or costs should be recorded, but information regarding the volume and type of advertising surrendered and received (such as the number of equivalent pages, the number of minutes, or the overall percentage of advertising volume) should be disclosed for each income statement period presented.

The fair value of the Group's barter transactions, which are very limited, has not been determined in accordance with the provisions of EITF 99-17 and therefore, the Group has not recorded any revenues or costs related to these transactions. Additionally, the volume of barter transactions including advertising was not significant for the three years ended December 31, 2001, both for displaying and for surrendering advertising.

Accounting for Derivatives-

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", which was subsequently amended by SFAS No. 137 and SFAS No. 138. SFAS No. 133 must be applied to all derivative instruments and certain derivative instruments embedded in host contracts and requires that such instruments be recorded in the balance sheet either as an asset or liability measured at its fair value through earnings, with special accounting allowed for certain qualifying hedges.

If the derivative is designated as a hedge, changes in the fair value of derivatives that are considered to be effective, as defined, will either offset the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or will be recorded in other comprehensive income until the hedged item is recorded in earnings, depending on the nature of the hedge. Any portion of a change in a derivative's fair value that is considered to be ineffective will have to be immediately recorded in earnings. Any portion of a change in a derivative's fair value that the Company has elected to exclude from its measurement of effectiveness, such as the change in time value of option contracts, will be recorded in earnings. Since the Company does not have any derivative instrument hedging accounting assignation or any other embedded derivatives, it was not necessary to book an adjustment for U.S. GAAP purposes.

29. New Accounting Standards

Accounting for Business Combinations, Goodwill and Other Intangible Assets-

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets". SFAS No. 141 replaces Accounting Principles Board Opinion No. 16 (APB 16) "Business Combinations" and requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangible assets will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations in the periods in which the recorded value of goodwill and certain intangibles exceeds its fair values. The provisions of SFAS No. 141 and SFAS No. 142, which apply to goodwill and intangible assets acquired prior to June 30, 2001, will be adopted by the Company on January 1, 2002. The Company is currently assessing the potential impact of theses standards on its financial position and results of operations. In addition, goodwill relating to prior business combinations will cease to be amortized for U.S. GAAP reporting purposes.

Accounting for Asset Retirement Obligations-

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as an operating item in the statement of income. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company does not anticipate that adoption of SFAS No. 143 will have a material impact on its results of operations or its financial position.

Accounting for Impairment and Disposal of certain Assets-

In October 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets", which supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and certain provisions of Accounting Principles Board Opinion No. 30 (APB 30) "Reporting Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". SFAS No. 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of the carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The provisions of SFAS No. 144, which are effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with early adoption permitted, will be adopted by the Company on January 1, 2002. The Company does not expect the adoption of SFAS No. 144 to have a material impact on the Company's financial position or results of operations.

SFAS No. 145-

On April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". This Statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of

Debt", and an amendment of that Statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements". This Statement also rescinds SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers". This Statement amends SFAS No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this Statement related to the rescission of Statement 4 shall be applied in fiscal years beginning after May 15, 2002. The provisions in paragraphs 8 and 9(c) of this Statement related to Statement 13 shall be effective for transactions occurring after May 15, 2002, with early application encouraged. All other provisions of this Statement shall be effective for financial statements issued on or after May 15, 2002, with early application encouraged. The Company has not yet assessed what effect, if any, application of this Statement will have on the financial position or results of operations of the Company.

30. Related Party Transactions

Terra Networks, S.A. has entered or expects to enter into a number of agreements with its parent company, Telefónica S.A. and its subsidiary or affiliated companies. The most significant contract involves a fee that Telefónica Data España, S.A. will pay to Terra Networks, S.A. for the Internet traffic that Terra Networks España, S.A. captures for Telefónica Data España, S.A. This contract was signed on September 15, 1999. The Comisión del Mercado de las Telecomunicaciones (CMT), the Spanish telecommunications regulator, required Telefónica, S.A. to offer the same terms to other Internet providers.

We also have a number of agreements with Telefónica S.A. or its subsidiaries to provide web site content, Internet access to cable customers and other services for which we receive revenues. The amount of these revenues for the years ended December 31, 1999, 2000 and 2001 were €3,727 thousand, €26,282 thousand and €28,030 thousand.

We also utilize services provided by Telefónica, S.A. and its subsidiaries, such as the leasing of circuits, cash-management services, the obtaining of reference information and other services. Costs related to services provided by related parties for the years ended December 31, 1999, 2000 and 2001 were €22,970 thousand, €88,084 thousand and €191,476 thousand. For those contracts currently in place, Terra Networks, S.A. believes that the terms of these arrangements are at least as favorable as could be obtained in an arm's length transaction between non-affiliated parties.

31. Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

TERRA NETWORKS, S.A.

By: /s/ Joaquim Agut Bonsfills

Name: Joaquim Agut Bonsfills
Title: President and Executive Chairman

Date: July 1, 2002