TELEFONICA S A
Form 424B3
April 25, 2005
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Filed Pursuant to Rule 424(b)(3)
Registration No. 333-123162

MERGER BY ABSORPTION PROPOSED   YOUR VOTE IS VERY IMPORTANT

At meetings held on February 23, 2005, the Boards of Directors of Telefónica, S.A. and Terra Networks, S.A. approved a merger plan which provides for the merger of the two companies and prepared their respective balance sheets as of December 31, 2004, which we will refer to as the   merger balance sheets   and which will be submitted to their respective annual general shareholders   meetings for their approval.

In the merger, Terra Networks will be merged into Telefónica with Telefónica being the surviving entity. If the merger is consummated the ordinary shares and ADSs of Terra Networks will cease to be traded on any exchange or quotation system, including the Spanish stock exchanges in the case of Terra Networks ordinary shares and the Nasdaq National Market in the case of Terra Networks ADSs.

If the merger is completed, holders of Terra Networks ordinary shares will receive 2 Telefónica ordinary shares for every 9 ordinary shares of Terra Networks they hold and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs they hold. Each Terra Networks ADS represents one Terra Networks ordinary share, and each Telefónica ADS represents three Telefónica ordinary shares.

Telefónica will deliver approximately 29,274,686 ordinary shares of Telefónica (including ordinary shares in the form of ADSs) to Terra Networks shareholders in the merger. The ordinary shares of Telefónica to be delivered to Terra Networks shareholders in the merger will represent approximately 0.6% of the outstanding ordinary shares of Telefónica after the merger.

Telefónica will not deliver fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any fractional ordinary shares or ADSs. Telefónica shareholders and ADS holders will continue to own their existing ordinary shares and ADSs after the merger.

We are asking shareholders and ADS holders of Telefónica to approve Telefónica   s merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters.

We are asking shareholders and ADS holders of Terra Networks to approve Terra Networks   merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters.

An English-language translation of the merger plan, deposited with the Madrid Commercial Registry, is attached as Annex A-1 to this joint information statement/prospectus.

We cannot complete the merger unless shareholders of both companies approve it.

This joint information statement/prospectus has been prepared for shareholders of Telefónica and Terra Networks residing in the United States and for holders of Telefónica and Terra Networks ADSs to provide information about the merger described herein which is to be voted on at the annual general shareholders meetings of Telefónica s and Terra Networks shareholders.

Under Spanish law, if a quorum is not obtained on the first date for which the meeting is called, the meeting is adjourned until the date and time specified in the meeting notice for the second call, if any. On the second call of a meeting, the quorum requirements are lower than those for the first call.

The dates, times and places of the annual general shareholders meeting on the first call or on the second call, if required, are:

For Telefónica shareholders:

First Call: May 30, 2005

Second Call: May 31, 2005

12:00 Noon, Local Time

Madrid, at IFEMA (Feria de Madrid), Campo de las Naciones, Parque Ferial Juan Carlos I, Pabellón 3

For Terra Networks shareholders:

First Call: June 2, 2005

12:00 Noon, Local Time

Barcelona, at Palau Sant Jordi, Barcelona 92 Room, Passeig Olímpic 5-7 de Barcelona

For Telefónica and Terra Networks shareholders, approval of the merger on the terms and conditions set forth in the merger plan, the merger balance sheets and related matters described herein requires a majority of the votes present or represented by proxy at the annual general shareholders meeting of Telefónica or Terra Networks, as the case may be, if a quorum of at least 50% is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% of the subscribed capital of Telefónica or Terra Networks, as the case may be, entitled to vote but at least 25% of the subscribed share capital entitled to vote. At February 23, 2005, Telefónica owned 75.87% of the outstanding Terra Networks ordinary shares and, accordingly, there will be only one call for the Terra Networks annual general shareholders meeting. Telefónica intends to vote its Terra Networks ordinary shares in favor of the merger.

The holders of at least 300 ordinary shares of Telefónica and at least 25 ordinary shares of Terra Networks, or holders who join a group of shareholders who hold in the aggregate at least the required number of ordinary shares, will be allowed to attend and vote at the annual general shareholders meeting if those holders are recorded on the applicable book-entry registry of shareholders on May 25, 2005, and May 28, 2005, five days prior to the date of Telefónica and Terra Networks annual general shareholders meetings, respectively. Shareholders holding fewer ordinary shares may vote by proxy. The holders of ADSs representing ordinary shares of Telefónica and Terra Networks will be allowed to vote by proxy in accordance with the procedures set forth in their respective ADS deposit agreements, which are described below, if those holders are recorded on the ADS depositaries registries on April 22, 2005.

The principal market on which Telefónica ordinary shares trade is the Spanish stock exchanges, where they trade under the symbol TEF . Telefónica ADSs, each representing three ordinary shares, are listed on the New York Stock Exchange under the symbol TEF . The principal market on which Terra Networks ordinary shares trade is the Spanish stock exchanges, where they trade under the symbol TRR . Terra Networks ADSs, each representing one ordinary share, are traded on the Nasdaq National Market under the symbol TRRA .

This joint information statement/prospectus provides detailed information about the proposed merger and important information about the Telefónica ordinary shares and ADSs to be offered to Terra Networks shareholders and ADS holders pursuant to the merger. You are encouraged to read everything in this document, including the list of risk factors relating to the merger that begins on page II-1.

César Alierta Izuel	Joaquín Faura Batlle
Executive Chairman	*Executive Chairman*
Telefónica, S.A.	*Terra Networks, S.A.*

Joint information statement/prospectus dated April 25, 2005, and first mailed to shareholders on April 25, 2005.

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Information Incorporated by Reference

This joint information statement/prospectus incorporates by reference business and financial information about Telefónica and Terra Networks that is not included in or delivered in this joint information statement/prospectus. We may also incorporate by reference some of the reports on Form 6-K that we or Terra Networks furnishes to the SEC between the date of this joint information statement/prospectus and the date of the annual general shareholders meetings. You may obtain documents incorporated by reference in this joint information statement/prospectus without charge by requesting them in writing or by telephone from the appropriate party at the following address:

Georgeson Shareholder

17 State Street, 10th Floor

New York, NY 10004

Toll Free: (877) 278-4794

Banks & Brokers: (212) 440-9800

To obtain timely delivery of these documents, you must request them no later than May 24, 2005. For a list of those documents that are incorporated by reference into this joint information statement/prospectus, see Part Eight Additional Information for Shareholders Where You Can Find More Information.

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TELEFÓNICA, S.A.

Annual General Shareholders Meeting

The Board of Directors of Telefónica, S.A. has resolved to call the annual general shareholders meeting of the company, to be held in Madrid, at IFEMA (Feria de Madrid), Campo de las Naciones, Parque Ferial Juan Carlos I, Pabellón 3 on May 30, 2005 at 12:00 Noon on first call and on May 31, 2005 at 12:00 Noon on second call in the same place, if the necessary legal quorum is not reached on the first call.

The purpose of this call is to submit to the consideration and approval of the annual general shareholders meeting the items stated in the Agenda below.

AGENDA

I. Examination and approval, if applicable, of the Annual Accounts and Management Report of Telefónica, S.A. and its consolidated group of companies, as well as the proposal for the application of the results of Telefónica, S.A., and that of the management of the company s Board of Directors, all for the 2004 financial year.

II. Shareholder remuneration: A) distribution of dividends with a charge to the additional paid-in capital reserve and B) extraordinary non-cash distribution of additional paid-in capital.

III. Examination and approval, as the case may be, of the merger plan between Telefónica, S.A. and Terra Networks, S.A. and approval, as the Merger Balance Sheet, of Telefónica, S.A. s Balance Sheet closed as of December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by absorption (*absorción*) of Terra Networks, S.A. by Telefónica, S.A. with the dissolution without liquidation of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares as a result of the merger. Delegation of powers.

IV. Appointment of Directors.

V. Designation of the Accounts Auditor for Telefónica, S.A. and its consolidated group of companies, under the provisions of article 42 of the Spanish Commerce Code (Código de Comercio) and article 204 of the Spanish Corporations Act (Ley de Sociedades Anónimas).

VI. Authorization for the acquisition of treasury stock, directly or through group companies.

VII. Reduction of share capital through the amortization of treasury stock, with the exclusion of the right to opposition by creditors, through the redrafting of the article in the bylaws that refers to the share capital.

VIII. Delegation of powers to formalize, construe, correct and execute the resolutions adopted by the annual general shareholders meeting.

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TERRA NETWORKS, S.A.

Annual General Shareholders Meeting

The Board of Directors of Terra Networks, S.A. has resolved to call the annual general shareholders meeting of the company, to be held in Barcelona, at Palau Sant Jordi, Barcelona 92 Room, Passeig Olímpic 5-7 de Barcelona on June 2, 2005 at 12:00 Noon on the first, and only, call.

The purpose of this call is to submit to the consideration and approval of the annual general shareholders meeting the items stated in the Agenda below.

AGENDA

I. Examination and, if appropriate, approval of the financial statements and management report, both of Terra Networks, S.A. (parent company) and of its consolidated group, as well as the proposed distribution of income and the conduct of business by its Board of Directors, all in relation to 2004.

II. Reappointment, ratification and, if appropriate, appointment of Directors.

III. Shareholders remuneration: distribution of dividends with a charge to the additional paid-in capital reserve.

IV. Designation of auditor for Terra Networks, S.A. and its consolidated group of companies.

V. Examination and approval, if applicable, of the merger plan of Telefónica, S.A. and Terra Networks, S.A. and approval, as the merger balance sheet, of Terra Networks, S.A. s balance sheet closed on December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by means of the absorption (*absorción*) of the latter by the former with the extinction of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares. Delegation of powers.

VI. To consent to and approve, as far as necessary, the resolutions to be adopted by the annual shareholders meeting of Telefónica, S.A. under items IV and VII of the Agenda for the Meeting relating to: (i) appointment of Directors and (ii) capital reduction by means of the retirement of treasury stock, with the exclusion of the right of creditors to object, rewording the Article in the corporate bylaws relating to capital stock.

VII. Delegation of powers to formalize, interpret, rectify and implement the resolutions adopted by the shareholders meeting.

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Annexes

The contents of Telefónica s and Terra Networks World Wide Web sites are not part of this joint information statement/prospectus.

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Glossary

The terms below are used as follows throughout this joint information statement/prospectus:

Telefónica means Telefónica, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires. In addition, references to we , us and our are to Telefónica, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires.

Terra Networks means Terra Networks, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires.

Telefónica s Consolidated Financial Statements means Telefónica s audited consolidated financial statements at December 31, 2004 and 2003 and for the three years ended December 31, 2004, as included in Telefónica s 2004 Form 20-F.

Terra Networks Consolidated Financial Statements means Terra Networks audited consolidated financial statements at December 31, 2004 and 2003 and for the three years ended December 31, 2004, as included in Terra Networks 2004 Form 20-F.

Telefónica Merger Balance Sheets means the Spanish statutory audited balance sheets of Telefónica, S.A. at December 31, 2004, included in Annex A-2.

Terra Networks Merger Balance Sheets means the Spanish statutory audited balance sheets of Terra Networks, S.A. at December 31, 2004, included in Annex A-3.

Telefónica s 2004 Form 20-F means Telefónica s annual report on Form 20-F for the year ended December 31, 2004, as filed with the Securities and Exchange Commission on April 18, 2005, as amended on April 22, 2005, and incorporated by reference into this joint information statement/prospectus.

Terra Networks 2004 Form 20-F means Terra Networks annual report on Form 20-F for the year ended December 31, 2004 as filed with the Securities and Exchange Commission and incorporated by reference into this joint information statement/prospectus.

Cautionary Statement Regarding

Forward-Looking Statements

This document contains statements that constitute forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, Section 21E of the U.S. Securities Exchange Act of 1934, as amended, and the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this document can be identified in some instances, by the use of words such as expects , aims , hopes , anticipates , intends , believes and similar language or the negative thereof or by the forward-looking r of discussions of strategy, plans or intentions. These statements appear in a number of places in this document including, without limitation, certain statements made in Questions and Answers About the Merger, Summary, The Merger Background of the Merger, The Merger Our Reasons for the Merger, The Merger Other Expenses, Opinion of Morgan Stanley & Co. Limited, Opinion of Lehman Brothers Europe Limited, Opinion of Citigroup Global Markets Limited, Opinion of the Spanish Independent Expert, Information about Telefónica and Information about

Terra Networks. The sections of documents incorporated by reference which contain forward-looking statements include Operating and Financial Review and Prospects and Quantitative and Qualitative Disclosures About Market Risk in Telefónica s 2004 Form 20-F and Terra Networks 2004 Form 20-F. Other forward-looking statements contained herein or therein include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of increased competition in the Spanish telecommunications market and our other principal markets;

- trends affecting our financial condition or results of operations;

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- acquisitions or investments which we may make in the future;
- our capital expenditures plan;
- supervision and regulation of the Spanish telecommunications sector and in other countries where we have significant operations;
- our strategic partnerships;
- the potential for growth and competition in current and anticipated areas of our business; and
- the adoption of International Financial Reporting Standards in preparing Telefónica, S.A. s consolidated financial statements beginning January 1, 2005.

Such forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties, and actual results may differ materially from those anticipated in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our businesses that could affect the matters referred to in such forward-looking statements include but are not limited to:

- changes in general economic, business, or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services;
- changes in currency exchange rates and interest rates;
- the impact of current, pending or future legislation and regulation in Spain, other countries where we operate and the European Union;
- the impact of new pronouncements from the International Accounting Standards Board regarding International Financial Reporting Standards on Telefónica, S.A. s consolidated financial statements beginning January 1, 2005;
- the actions of existing and potential competitors in each of our markets; and
- the potential effects of technological changes.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this document. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date of this document, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

You should understand that the following important factors, in addition to those discussed above and elsewhere in this document and in the documents which are incorporated by reference, could affect the future results of Telefónica and Terra Networks, and of Telefónica after the closing of the merger, and could cause those results or other outcomes to differ materially from those expressed in our forward-looking statements:

our ability to integrate the businesses of Telefónica and Terra Networks successfully after the merger;

the challenges inherent in diverting management s focus and resources from other strategic opportunities and from operational matters during the integration process;

the process of, or conditions imposed in connection with, obtaining regulatory approvals for the merger;

the outcome of negotiations with partners and governments;

the growth of free internet access in many core markets that may increase competition;

the need to establish and maintain strategic relationships with content providers, e-commerce merchants and technology providers;

declining prices for our services; and

reliance on third-party content providers.

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Questions and Answers about the Merger

Q: When and where are the shareholders meetings?

A: Telefónica s annual general shareholders meeting will take place on May 30, 2005 or May 31, 2005, if a quorum is not obtained at the first call, in Madrid, Spain. Terra Networks annual general shareholders meeting will take place on June 2, 2005 in Barcelona, Spain. For the address of each meeting, see Part Four Information about the Meetings and Voting Matters Relating to the Meetings.

Q: What do I need to do now if I hold Telefónica or Terra Networks ordinary shares?

A: All holders of at least 300 Telefónica ordinary shares will be allowed to attend the Telefónica meeting and vote. All holders of at least 25 Terra Networks ordinary shares will be allowed to attend the Terra Networks meeting and vote.

Holders of fewer than 300 Telefónica ordinary shares or fewer than 25 Terra Networks ordinary shares may join other shareholders to form a group owning at least the minimum required ordinary shares and appoint a shareholder representative to vote their ordinary shares. In addition, holders of fewer than 300 Telefónica ordinary shares may also grant a proxy to a holder who already has sufficient ordinary shares to attend the meeting.

In order to attend the meetings, shareholders must request an admission ticket from the Spanish depositary for their ordinary shares.

Q: What do I need to do now if I hold Telefónica or Terra Networks ADSs?

A: If you hold Telefónica or Terra Networks ADSs representing Telefónica or Terra Networks ordinary shares and wish to vote, you must complete the voting instruction card provided by the relevant depositary. Please contact the relevant depositary for more information about these procedures.

Q: How many votes will I get for each ordinary share of Telefónica or Terra Networks?

A: Holders of Telefónica ordinary shares will be entitled to one vote for every ordinary share they own and that is represented at Telefónica s annual general shareholders meeting. Holders of Terra Networks ordinary shares will be entitled to one vote for every ordinary share they own and that is represented at Terra Networks annual general shareholders meeting.

However, each shareholder of Telefónica, including any affiliates of that shareholder, is limited to a maximum number of votes representing 10% of the paid-in capital of Telefónica entitled to vote.

Q: How many votes will I get for each Telefónica or Terra Networks ADS?

A: If you hold Telefónica or Terra Networks ADSs representing Telefónica or Terra Networks ordinary shares and you complete the voting instruction card and return it, in the case of the Telefónica ADSs, to the Telefónica depositary by May 27, 2005, and in the case of the Terra Networks ADSs, to the Terra Networks depositary by May 31, 2005, you will be entitled to three votes for each Telefónica ADS held and one vote for each Terra Networks ADS held.

Q: Can I vote by proxy?

A: Telefónica shareholders may vote by proxy by executing a written instrument in favor of another person, including a director of Telefónica. Terra Networks shareholders may vote by proxy by executing a written instrument in favor of another person, including a director of Terra Networks. A proxy may be appointed for only one single meeting, including the first and second calls relating to such meeting.

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Q: Will my depositary vote the ordinary shares represented by my ADSs for me?

A: If you own Terra Networks ADSs, the Terra Networks depositary will, subject to certain conditions, vote the ordinary shares represented by your ADSs in accordance with the Board of Directors recommendation unless you provide the Terra Networks depositary with instructions to the contrary.

If you own Telefónica ADSs, the Telefónica depositary will, subject to certain conditions, vote the ordinary shares represented by your ADSs in accordance with the Board of Directors recommendation unless you provide the Telefónica depositary with instructions to the contrary.

Q: What will I receive in the merger for my Terra Networks ordinary shares and ADSs?

A: Terra Networks shareholders will receive 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks, and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs.

Telefónica will not deliver any fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any ordinary shares or ADSs Terra Networks that do not entitle them to receive one ordinary share or ADS of Telefónica.

Q: What happens to my future dividends?

A: The merger plan describes that the holders of ordinary shares of Telefónica and Terra Networks will receive separate dividends prior to the merger as follows: (1) holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share as interim dividends with respect to the fiscal year ended December 31, 2004; (2) holders of Terra Networks ordinary shares and ADSs will receive 0.60 per Terra Networks ordinary share; and (3) holders of Telefónica ordinary shares and ADSs will receive a dividend of one Telefónica ordinary share for every 25 Telefónica ordinary shares already held. The dividends described under (2) and (3) above are subject to the final approval of the annual general shareholders meetings of the relevant company. The determination of the exchange ratio took into consideration the dividends that both companies are expected to distribute. Other than the dividends described in (1), (2) and (3) above, which will be paid prior to the merger, the holders of Telefónica ordinary shares and ADSs received in connection with the merger will be entitled to receive dividends on an equal basis with current holders of Telefónica ordinary shares and ADSs with respect to the year beginning January 1, 2005, including a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share payable on November 11, 2005, subject to final approval by the annual general shareholders meeting of Telefónica. To compare dividends paid by each of Telefónica and Terra Networks, see Part One Summary Summary Comparative per Ordinary Share Data.

Q: When do you expect the merger to be completed?

A: We are working towards completing the merger as quickly as possible. We hope to complete the merger within two months of the date of the annual general shareholders meetings.

Q: What do I have to do in order to exchange my ordinary shares of Terra Networks for ordinary shares in Telefónica?

A: Nothing. If the merger is approved, your Terra Networks ordinary shares will be automatically exchanged for ordinary shares of Telefónica.

Q: What do I have to do in order to exchange my Terra Networks ADSs for ADSs of Telefónica?

A: Nothing. If the merger is approved, the Terra Networks ordinary shares represented by your ADSs will be automatically exchanged for ordinary shares of Telefónica and ADSs representing Telefónica ordinary shares will be delivered to you.

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If you hold your Terra Networks ADSs in the form of ADR certificate(s), you must surrender your ADR certificate(s) for cancellation and obtain a new ADR certificate representing the Telefónica ADSs you are entitled to received in the merger.

Q: *Who do I call if I have questions about the meetings or the merger?*

A: Telefónica shareholders and ADS holders may call Telefónica s Shareholder Assistant Service, at 011-34-900-11-1004.

Terra Networks shareholders and ADS holders may call 011-34-900-50-0525.

Q: *If I own ADSs, how do I contact the depositary?*

A: If you own Telefónica ADSs, you should contact Citibank, N.A. at the address and number provided in the instructions to your voting card.

If you own Terra Networks ADSs, you should contact Citibank, N.A. at the address and number provided in the instructions to your voting card.

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Part One Summary

This summary highlights selected information from this joint information statement/prospectus and may not contain all of the information that is important to you. To understand the merger fully and for a more complete description of the legal terms of the merger, you should read this document and the documents we have referred you to carefully. See Part Eight Additional Information for Shareholders Where You Can Find More Information.

The Companies

Telefónica, S.A.

The registered offices of Telefónica are at Gran Vía, 28, 28013 Madrid, Spain; the telephone number of Telefónica s registered offices is 011-34-900-11-1004.

We are a diversified telecommunications group which provides a comprehensive range of services in Spain and Latin America through one of the world s largest and most modern telecommunications networks. We are also the leading provider of fixed line public voice telephone services, wireless communications services, Internet access services and data transmission services in Spain and one of the largest telecommunications operators in Latin America, with operations principally in Brazil, Argentina, Chile, Peru, Mexico, Colombia, Ecuador, Nicaragua, Panama, Uruguay, Venezuela, El Salvador and Guatemala.

Our group is organized according to seven principal lines of business: Spanish fixed line business, Latin American fixed line business, mobile business, directories business, Internet portal business, call centers and content and media business.

At December 31, 2004, we had approximately 43.2 million access lines in service and 74.4 million wireless subscribers. In addition, we have 0.4 million pay television subscribers. We had a total of approximately 118.1 million clients at December 31, 2004, more than half of which were in Latin America.

Terra Networks, S.A.

The registered offices of Terra Networks are at Calle Nicaragua, 54, 08029, Barcelona, Spain; the telephone number of Terra Networks registered offices is 011-34-93-493-2300. The main offices of Terra Networks are at Via de las Dos Castillas, 33, 28224, Pozuelo de Alarcón, Madrid, Spain; the telephone number of Terra Networks main offices is 011-34-91-452-3000.

Terra Networks is a leading portal to Spanish- and Portuguese-speaking markets. Terra Networks offers a suite of Internet services in a variety of languages that provides users throughout our markets in Europe, Latin America and North America with:

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

Through Terra Networks portals and network of websites and joint venture partnerships, it has one of the largest global footprints of any Internet portal or network, with portals in 27 countries. Terra Networks holds a leading position in the following markets: Spain, Latin America and the U.S. Hispanic market. Terra Networks is also a leading interactive services provider in Spain and Latin America, offering Internet access and local-language interactive content and services to more than 6 million pay customers in Spain, the United States, Brazil, Mexico, Peru, Chile and Central America.

Telefónica and Terra Networks   Reasons for the Merger

Telefónica and Terra Networks believe that by combining Terra Networks   Internet access and portal services with Telefónica s fixed-line telephony network and broadband services, the two companies can create more shareholder value than could be achieved by the companies on their own. This is the fundamental reason for the merger.

Telefónica and Terra Networks believe that the strategy of independently developing telecommunications and Internet businesses is no longer attractive, particularly in light of the recent growth in penetration of broadband technology in many of the markets in which the two companies operate. As a result of the success of broadband technology, a new market dynamic has developed in which Internet access and connection and telephony services offered in one integrated package is the business model that best serves customers   increasing desire to obtain these services from one telecommunications provider.

For Telefónica and Terra Networks, the integration of Telefónica s telecommunications business, and in particular its fixed-line telephony network infrastructure, with the requisite technical and human capital to operate such network, and broadband capability, with Terra Networks Internet access and portal services, provides greater growth opportunities for the companies as an integrated unit than as independent operators. As an integrated telephony and Internet services provider, Telefónica will be able to provide a complete package of services in order to compete successfully with other integrated operators, such as cable companies.

In addition, after the merger, Telefónica and Terra Networks believe that:

- The two companies   competitive position will be stronger as a result of an increased capability to compete with the integrated telephony, internet service and content packages offered by competitors;
- The two companies will be better positioned to develop new services that optimize the use of Terra Networks   network or that require significant resources;
- The two companies will improve their ability to leverage each company s client relationships by creating global strategies based on client segment, rather than product line, reducing customer churn through the sale of packaged services and increasing cross-selling; and
- The two companies   costs and expenses will decrease as a result of, among other measures, integrating their networks and platforms, eliminating duplicative marketing and advertising and reducing corporate overhead.

Telefónica and Terra Networks believe the combined company can be run more efficiently and can compete more effectively and use its capital more profitably than either company on its own. Of course, these benefits and the other benefits described above depend on our ability to obtain the necessary approvals for the merger, to integrate the businesses of Telefónica and Terra Networks successfully after the merger and on other uncertainties.

Merger Recommendations to Shareholders

To Telefónica Shareholders:

The Board of Directors of Telefónica has approved the merger plan, an English-language translation of which is attached as Annex A-1, and the holders of Telefónica ordinary shares and Telefónica ADSs are being invited to approve the merger on the terms and conditions set forth in the merger plan at the Telefónica annual general shareholders meeting. In accordance with Spanish law, Telefónica s Board of Directors has prepared a report to shareholders which explains certain legal and financial aspects of the merger. See Part Three The Merger Report of the Board of Directors of Telefónica for a description of such report. An English-language translation of the report is attached as Annex C-2 to this joint information statement/prospectus.

To Terra Networks Shareholders:

The Board of Directors of Terra Networks has approved the merger plan, an English-language translation of which is attached as Annex A-1, and the holders of Terra Networks ordinary shares and Terra Networks ADSs are being invited to approve the merger plan at the Terra Networks annual general shareholders meeting. In accordance with Spanish law, Terra Networks Board of Directors has prepared a report to shareholders which explains certain legal and financial aspects of the merger. See Part Three The Merger Report of the Board of Directors of Terra Networks for a description of such report. An English-language translation of the report is attached as Annex C-3 to this joint information statement/prospectus.

The Merger

In the merger, Terra Networks will be merged into Telefónica with Telefónica being the surviving entity. If the merger is consummated the ordinary shares and ADSs of Terra Networks will cease to be traded on any exchange or quotation system, including the Spanish stock exchanges in the case of the Terra Networks ordinary shares and the Nasdaq National Market in the case of the Terra Networks ADSs.

The English-language translation of the merger plan is attached as Annex A-1 to this joint information statement/prospectus. We encourage you to read the merger plan because it is the document that governs the merger.

What Holders of Terra Networks Ordinary Shares and ADSs Will Receive

As a result of the merger, Terra Networks shareholders will receive 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks, and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs.

Telefónica will not deliver any fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any ordinary shares or ADSs of Terra Networks that do not entitle them to receive one ordinary share or ADS of Telefónica.

Comparative Per Ordinary Share and ADS Market Price Information

Telefónica and Terra Networks ordinary shares are both listed on the Automated Quotation System of the Spanish stock exchanges. On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, Telefónica ordinary shares closed at 14.46 and Terra Networks ordinary shares closed at 3.19. On April 21, 2005 Telefónica ordinary shares closed at 13.12 and Terra Networks ordinary shares closed at 3.32.

Telefónica ADSs are listed on the New York Stock Exchange. Terra Networks ADSs are traded on the Nasdaq National Market. On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, Telefónica ADSs closed at U.S.$55.91 and Terra Networks ADSs closed at U.S.$4.07. On April 21, 2005, Telefónica ADSs closed at U.S.$51.98 and Terra Networks ADSs closed at U.S.$4.29.

Listing of New Telefónica ADSs

The new Telefónica ADSs will be listed on the New York Stock Exchange under the ticker symbol TEF, subject to approval by the NYSE of Telefónica s application to list such ADSs.

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Part One Summary

Ownership of Telefónica After the Merger

Telefónica will deliver approximately 29,274,686 ordinary shares of Telefónica (including ordinary shares in the form of ADSs) to Terra Networks shareholders in the merger. The ordinary shares of Telefónica to be delivered to Terra Networks shareholders in the merger will represent approximately 0.6% of the outstanding ordinary shares of Telefónica after the merger.

Shareholder Vote Required to Approve the Merger Proposals

For Telefónica shareholders: Approval of the merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of the annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Telefónica entitled to vote is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%.

For Terra Networks shareholders: Approval of the merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of the annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Terra Networks entitled to vote is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%.

At February 23, 2005, Telefónica owned 75.87% of the outstanding Terra Network ordinary shares. Telefónica intends to vote its Terra Networks ordinary shares in favor of the merger.

Appraisal Rights

The holders of Telefónica and Terra Networks ordinary shares and ADSs do not have any right to an appraisal of the value of their ordinary shares in connection with the merger. However, an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the share exchange ratio is justified. See Part Three The Merger Report of the Spanish Independent Expert for a description of such report. An English-language translation of this report is attached as Annex C-1 to this joint information statement/prospectus.

Board of Directors of Telefónica After the Merger

Following the merger, the Board of Directors of Telefónica will remain unchanged with 19 members.

Accounting Treatment

The merger by absorption of Terra Networks with and into Telefónica will be accounted for as a transaction of entities under common control in the consolidated financial statements of Telefónica under both Spanish and U.S. GAAP except for the acquisition of the noncontrolling equity interests in Terra Networks, which will be accounted for under the pooling of interests method under Spanish GAAP and under the purchase method under U.S. GAAP (purchase of the noncontrolling equity interests).

Material Spanish and U.S. Federal Income Tax Consequences of the Merger

Holders of Terra Networks ordinary shares or ADSs (except those who reside in certain tax haven jurisdictions, as defined by Spanish tax regulations) generally will not recognize any gain or loss for Spanish tax purposes on the exchange of their Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs in the merger, except for any gain or loss recognized in connection with the receipt of cash in lieu of fractional ordinary shares. In addition, the companies will not recognize gain or loss as a result of the merger.

Based on certain factual representations made by Telefónica and assuming that (a) there will not be any changes in facts or in law between the date of this joint information statement/prospectus and the date on which the merger is completed and (b) the merger is completed in accordance with the current terms of the merger plan and any other related agreements, although there is no authority that directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and therefore it is not certain, for U.S. federal income tax purposes, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger should qualify as a reorganization under Section 368(a) of the U.S. Internal Revenue Code of 1986, as amended (the Code). However, even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992, if Terra Networks was a passive foreign investment company (PFIC) for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. Furthermore, the U.S. Internal Revenue Service (the IRS) or the courts may disagree with the conclusion that the merger should qualify as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be treated as a taxable exchange for U.S. federal income tax purposes. See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

Your tax consequences will depend upon your personal situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you.

Conditions to the Completion of the Merger

The completion of the merger depends upon meeting a number of conditions, including the conditions described below. For a more detailed discussion of conditions to the merger, see Part Three The Merger Conditions to the Completion of the Merger :

- approval of the merger on the terms and conditions set forth in the merger plan by the shareholders of Telefónica and Terra Networks at their respective annual general shareholders meetings;
- approval by the shareholders of Telefónica of its merger balance sheets and approval by the shareholders of Terra Networks of its merger balance sheets at their respective annual general shareholders meetings;
- approval by the shareholders of Telefónica and Terra Networks of any other applicable resolutions related to the merger at their respective annual shareholders meetings;
- compliance with all corporate requirements under Spanish law, including registration of the merger deed with the Madrid Commercial Registry;

Telefónica s registration statement on Form F-4, which includes this joint information statement/prospectus, being effective and not subject to any stop order by the SEC; and

approval for the listing on the NYSE of the Telefónica ADSs to be issued in the merger.

We can give no assurance as to when or whether any of these approvals and consents will be obtained, the terms and conditions that may be imposed in connection with any such approvals and consents, or the consequences of failing to obtain and approvals and consents.

Opinions of Financial Advisors

In deciding to approve the merger plan, each Board of Directors considered the opinion of one or more financial advisors. The Board of Directors of Terra Networks received opinions from (i) Lehman Brothers Europe Limited, that based upon and subject to the matters stated therein, as of February 23, 2005, from a financial point of view, the exchange ratio to be offered in the proposed merger was fair to the shareholders of Terra Networks (other than Telefónica) and (ii) Citigroup Global Markets Limited, that, based upon and subject to the assumptions and qualifications set forth therein, as of February 23, 2005, the exchange ratio was fair, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates). In connection with rendering their opinions, each of Lehman Brothers Europe Limited and Citigroup Global Markets Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Networks shareholders prior to the merger. The Board of Directors of Telefónica received an opinion from Morgan Stanley & Co. Limited as to the fairness from a financial point of view to Telefónica of the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan as of February 23, 2005, based upon and subject to the matters stated in its opinion. These opinions are attached as Annex B-2, Annex B-3 and Annex B-1, respectively. We encourage you to read these opinions in their entirety.

Directors Reports on the Merger plan

In accordance with the Spanish Corporations Law, the Boards of Directors of each of Telefónica and Terra Networks have prepared Directors reports on the merger plan. These reports describe certain of the merger plan s legal and economic aspects, including the exchange ratio and the procedure for the valuation of the companies. See Part Three The Merger Report of the Board of Directors of Telefónica and Part Three The Merger Report of the Board of Directors of Terra Networks for a description of these reports. English-language translations of the Directors reports are attached as Annexes C-2 and C-3, respectively, to this joint information statement/prospectus.

Summary Selected Historical Financial Data

We are providing the following information to aid you in your analysis of the financial aspects of the merger. We derived this information from the audited financial statements of Telefónica and Terra Networks at and for the years ended December 31, 2000 through 2004. The information is only a summary and you should read it together with the annual reports and other information that we have filed with the SEC and incorporated by reference and information that we incorporate by reference in the future. See Part Eight Additional Information for Shareholders Where You Can Find More Information.

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Part One Summary

Summary Selected Historical Consolidated Financial Data of Telefónica

For important information concerning the preparation and presentation of the financial statements from which these data have been selected, see Part Eight Additional Information for Shareholders Presentation of Financial Information.

	At and for the year ended December 31,				
	2000	**2001**	**2002**	**2003**	**2004**
	(in millions of euro, except per ordinary share and per ADS data)				
INCOME STATEMENT DATA					
Amounts in accordance with Spanish GAAP:					
Revenues from operations	28,485.5	31,052.6	28,411.3	28,399.8	30,321.9
Other operating revenues(1)	266.7	254.7	297.6	288.9	381.7
Internal expenditures capitalized	899.1	730.4	496.7	530.3	474.3
Increase (decrease) in inventories (net)	112.3	(103.9)	(18.1)	(135.5)	32.9
Total Revenues	**29,763.6**	**31,933.8**	**29,187.5**	**29,083.5**	**31,210.8**
Goods purchased	(6,045.2)	(7,111.9)	(6,953.6)	(6,276.6)	(7,558.69)
External services and local taxes	(5,786.1)	(5,534.3)	(4,976.7)	(5,082.7)	(5,601.63)
Personnel expenses	(5,111.7)	(5,390.3)	(4,793.8)	(4,641.3)	(4,411.81)
Provision for depreciation and amortization	(6,960.8)	(7,374.0)	(6,692.4)	(6,274.2)	(5,980.15)
Trade provisions	(761.1)	(1,023.8)	(645.6)	(420.6)	(336.16)
Other operating expenses	(140.7)	(69.3)	(93.7)	(60.3)	(87.20)
Total operating costs before financial expenses and goodwill amortization	**(24,805.6)**	**(26,503.6)**	**(24,155.7)**	**(22,755.7)**	**(23,975.6)**
Operating profit	4,958.0	5,430.2	5,031.8	6,327.9	7,235.3
Amortization of goodwill and reversal of negative goodwill	(500.6)	(841.6)	(665.4)	(442.5)	(432.6)
Financial income (expense)	(1,611.8)	(1,608.4)	(1,589.3)	(1,555.9)	(1,240.21)
Exchange gains (losses), net	(248.5)	(782.7)	(632.3)	495.8	56.41
Income (losses) from associated companies	(161.4)	(376.5)	(527.9)	(212.6)	(56.11)
Profit from ordinary activities	**2,435.7**	**1,821.1**	**1,616.8**	**4,612.2**	**5,562.8**
Extraordinary revenues	4,302.3	1,167.1	474.6	1,167.2	409.0
Losses on fixed assets	(239.9)	(233.0)	(9,614.6)	(55.3)	(49.71)
Extraordinary expenses	(3,630.5)	(721.3)	(7,078.0)	(2,361.6)	(1,525.1)
Income (loss) before tax and minority interest	**2,867.6**	**2,033.9**	**(14,601.1)**	**3,362.5**	**4,397.0**
Corporate income tax	(242.2)	(198.1)	3,228.7	(913.4)	(1,138.7)
Minority interest	(120.6)	271.0	5,795.6	(245.5)	(381.0)
Net income (loss)	**2,504.8**	**2,106.8**	**(5,576.8)**	**2,203.6**	**2,877.3**
Net income (loss) per ordinary share(2)	0.59	0.43	(1.13)	0.45	0.60
Weighted average number of ordinary shares (thousands)	4,269,839	4,916,564	4,948,037	4,960,125	4,795,892
Net income (loss) per ADS(2)(3)	1.76	1.28	(3.38)	1.35	1.80
Weighted average number of ADSs (thousands)	1,423,280	1,638,855	1,649,346	1,653,375	1,598,631

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Part One Summary

	At and for the year ended December 31,				
	2000	2001	2002	2003	2004
	(in millions of euro, except per ordinary share and per ADS data)				
Amounts in accordance with U.S. GAAP:					
Total revenues	27,326.1	31,577.2	28,912.6	27,708.4	29,854.9
Income (loss) before tax	1,549.7	(6,713.6)	(8,593.5)	3,804.9	3,979.2
Corporate income tax	295	(477.8)	3,387.5	(1,114.6)	(1,401.2)
Net income	1,844.6	(7,191.3)	(5,206.1)	2,690.3	2,578.0
Net income per ordinary share(2)(5)	0.43	(1.46)	(1.05)	0.54	0.55
Net income per ADS(2)(3)(5)	1.30	(4.39)	(3.16)	1.63	1.64
BALANCE SHEET DATA					
Amounts in accordance with Spanish GAAP:					
Cash	765.6	621.9	543.9	336.4	855.0
Property plant and equipment	38,721.9	36,606.1	27,099.7	24,315.8	23,348.1
Total assets	92,377.3	86,422.6	68,041.3	62,075.2	63,466.3
Total long term debt	24,692.9	27,692.4	21,726.1	18,495.4	16,003.7
Total shareholders equity	25,930.5	25,861.6	16,996.0	16,756.6	16,225.1
Amounts in accordance with U.S. GAAP (4):					
Cash	678.7	619.6	517.5	336.4	827.5
Property, plant and equipment	38,277.9	35,563.2	25,282.7	27,718.4	21,823.2
Total assets	107,884.6	90,930.9	67,211.0	61,600.4	62,519.3
Total long term debt	20,618.5	27,771.2	21,778.0	18,310.0	14,881.9
Total shareholders equity	44,225.3	31,659.6	16,973.7	17,224.0	16,314.6
CASH FLOW DATA					
Amounts in accordance with Spanish GAAP:					
Net cash provided by operating activities	8,996.9	8,828.8	8,814.6	9,191.1	10,186.8
Net cash used in (provided by) investing activities	(17,719.5)	(9,895.4)	(5,780.2)	(5,171.7)	(8,978.7)
Net cash used in (received from) financing activities(6)	14,320.9	(1,321.1)	(2,101.1)	(4,178.9)	(1,961.2)
Amounts in accordance with U.S. GAAP:					
Net cash provided by operating activities	16,370.1	8,995.8	9,019.5	9,558.7	10,042.7
Net cash used in (provided by) investing activities	(25,572.6)	(9,528.5)	(5,585.4)	(5,462.8)	(8,543.1)
Net cash used in (received from) financing activities(6)	14,689.4	(1,347.0)	(2,082.0)	(4,220.0)	(2,264.6)

(1) Includes internal capitalized expenditures on fixed assets and increase in inventories (net).
(2) The per ordinary share and per ADS computations for all periods presented have been adjusted to reflect the stock split and stock dividends which occurred during the periods presented.
(3) Each ADS represents the right to receive three Telefónica ordinary shares. Figures do not include any charges of the depositary.
(4) U.S. GAAP data for the years ended December 31, 2000, 2001, 2002, and 2003 have been restated retroactively to record our investment in Portugal Telecom, SGPS under the equity method. See Note 25.7 to our Consolidated Financial Statements incorporated by reference herein. The effect of the change on net income in 2003, 2002, 2001 and 2000 was an increase or (decrease) of 4.2 million, 8.4 million, (9.0) million and (11.4) million, respectively. The effect of the change on Shareholders equity in 2003, 2002, 2001 and 2000 was a decrease of 67.3 million, 15.6 million, 110.2 million and 132.5 million, respectively.
(5) U.S. GAAP earnings per ordinary share and per ADS have been computed using the weighted average number of ordinary shares outstanding for each period.
(6) Includes net cash outflow for capital expenditures and for investments in affiliates.

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Part One Summary

Summary Selected Historical Consolidated Financial Data of Terra Networks

For important information concerning the preparation and presentation of the financial statements from which these data have been selected, see Part Eight Additional Information for Shareholders Presentation of Information.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands of euro, except per ordinary share data)				
Consolidated Statement of Operations Data:					
Amounts in accordance with Spanish GAAP:					
Revenues:					
Access	117,666	200,451	220,416	216,492	236,501
Advertising and E-commerce	145,328	389,142	281,362	143,021	119,661
Communication and Portal Services	2,017	33,936	66,638	119,023	122,304
Corporate Services	29,306	46,130	43,657	58,581	59,633
Other	13,212	23,853	9,718	9,510	2,379
Total revenues	307,529	693,512	621,791	546,627	540,478
Operating expenses					
Goods purchased	(193,626)	(352,039)	(293,619)	(265,836)	(256,307)
Personnel expenses	(116,868)	(204,969)	(165,433)	(119,653)	(95,785)
Depreciation and amortization	(83,513)	(157,426)	(142,718)	(78,742)	(79,513)
Other	(356,281)	(396,522)	(304,433)	(200,622)	(167,520)
Total operating expenses before financial expenses	(750,288)	(1,110,956)	(906,203)	(664,853)	(599,125)
Operating loss	(442,759)	(417,444)	(284,412)	(118,226)	(58,627)
Financial income (expense), net	35,487	126,262	63,544	57,743	18,277
Amortization of goodwill[(1)]	(253,484)	(386,332)	(254,157)	(83,269)	(65,577)
Reversal of negative goodwill in Consolidation		2,825	1,602	972	729
Equity share of affiliate losses, net	(54,721)	(181,732)	(148,902)	(34,734)	(14,559)
Loss from ordinary activities	(715,477)	(856,421)	(622,325)	(177,514)	(119,777)
Extraordinary income (expense)[(2)]	(89,710)	(74,847)	(1,046,332)	4,534	(25,773)
Corporate income tax	248,142	363,350	(342,625)	(266)	306,456
Minority interest	691	1,620	2,412	536	3,066
Net income (loss)	(556,354)	(566,298)	(2,008,870)	(172,710)	163,972
Basic and diluted net income (loss) per ordinary share	(1.61)	(1.02)	(3.59)	(0.31)	0.292
Weighted average ordinary shares outstanding	344,819,216	557,603,245	559,298,611	560,532,170	562,157,469
Dividends per ordinary share					2.00
Amounts in accordance with U.S. GAAP					
Net income (loss)	(1,236,441)	(11,411,749)	(1,597,689)	(219,033)	(977,799)
Basic and diluted net income (loss) per ordinary share	(3.59)	(20.47)	(2.86)	(0.39)	(1.74)

(1) Under U.S. GAAP, goodwill amortization is included in operating expenses. Under U.S. GAAP, goodwill is not amortized after 2001.
(2) Extraordinary income (expense) items under Spanish GAAP would not qualify as extraordinary items under U.S. GAAP.

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	Year ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands of euro, except ordinary share data)				
Selected Consolidated Balance Sheet Data:					
Amounts in accordance with Spanish GAAP:					
Cash and cash equivalents	2,673,384	2,190,124	1,761,088	1,599,521	854,182
Working capital[(1)]	2,467,155	1,980,947	1,675,746	1,563,973	837,784
Total assets	6,738,237	6,107,331	3,497,508	2,987,218	1,852,210
Total long-term obligations	159,888	97,877	36,235	52,802	67,817
Shareholders equity	6,126,833	5,556,792	3,190,887	2,720,541	1,634,736
Capital stock (excluding long-term debt and redeemable preferred stock)	1,242,532	1,242,532	1,216,321	1,202,936	1,149,883
Amounts in accordance with U.S. GAAP					
Total assets	16,958,819	4,743,246	2,691,526	2,518,171	1,507,867
Shareholders equity	16,409,923	4,220,453	2,346,243	2,207,834	1,249,295

(1) Working capital is defined as total current assets minus total current liabilities.

Summary Comparative Per Ordinary Share Data

Set forth below are net income, cash dividends and book value per ordinary share data for Telefónica and Terra Networks on a historic basis and on a per Terra Networks equivalent ordinary share basis. The exchange ratio for the merger is 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks. The Terra Networks per Telefónica equivalent ordinary share data shows the effect of the merger from the perspective of an owner of Terra Networks ordinary shares and was calculated by multiplying Telefónica s net income, cash dividends and book value by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares.

You should read the information below together with our historical financial statements and related notes contained in the annual reports and other information that we have filed with the SEC and incorporated by reference. See Part Eight Additional Information for Shareholders Where You Can Find More Information .

	Year ended December 31, 2004
	(in euro)
Spanish GAAP	
Telefónica Historic per Ordinary Share Data:	
Net income	0.60
Cash dividends	0.40
Book value	3.38
U.S. GAAP	
Telefónica Historic per Ordinary Share Data:	
Net income	0.54
Cash dividends	0.40

Book value	3.40
Spanish GAAP	
Terra Networks Historic per Ordinary Share Data:	
Net income	0.29
Cash dividends	2.00
Book value	2.91
U.S. GAAP	
Terra Networks Historic per Ordinary Share Data:	
Net income (loss)	(1.74)

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	Year ended December 31, 2004
	(in euro)
Cash dividends	2.00
Book value	2.22
Spanish GAAP	
Terra Networks per Telefónica Equivalent Ordinary Share Data:	
Net income	0.13
Cash dividends	0.09
Book value	0.75
U.S. GAAP	
Terra Networks per Telefónica Equivalent Ordinary Share Data:	
Net income	0.12
Cash dividends	0.09
Book value	0.76

Comparative Market Price Data

The following table presents the per ordinary share closing prices for Telefónica ordinary shares and Terra Networks ordinary shares as quoted on the Automated Quotation System of the Spanish stock exchanges. These prices are presented on the following dates:

February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger; and April 21, 2005, the latest practicable date before the date of this joint information statement/prospectus.

The table also presents implied equivalent per ordinary share values for Terra Networks ordinary shares by multiplying the price per Telefónica ordinary share, converted into U.S. dollars, on each of the two dates by the merger exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares.

	Telefónica ordinary share price (in)	Telefónica ordinary share price (in U.S. dollars)	Terra Networks ordinary share price (in)	Terra Networks ordinary share price (in U.S. dollars)	Implied value per Terra Networks ordinary share (in U.S. dollars)
February 11, 2005	14.46	18.60	3.19	4.10	4.13
April 21, 2005	13.12	17.18	3.32	4.35	3.82

You are urged to obtain current market quotations for Telefónica ordinary shares and Terra Networks ordinary shares before making a decision with respect to the merger.

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Part Two Risk Factors Relating Specifically to the Merger

Telefónica s 2003 Form 20-F and current reports on Form 6-K that are incorporated by reference into this joint information statement/prospectus describe a variety of risks relevant to Telefónica s business and financial condition, which you are urged to read. The following discussion concerns risk factors relating specifically to the merger.

The merger agreement was negotiated between Telefónica and its subsidiary, which may result in actual or perceived conflicts of interest relating to the merger.

The merger agreement was negotiated between Telefónica and its 75.87% -owned subsidiary, Terra Networks, which may result in actual or perceived conflicts of interest relating to the merger. To address conflicts of interest relating to the merger, Terra Networks Board of Directors created a Merger Committee comprised solely of independent Directors with no relationship with Telefónica to analyze and negotiate the merger. In addition, Terra Networks Board of Directors received opinions from two investment banks regarding the fairness of the consideration to be received by Terra Networks shareholders in the merger. In connection with the merger, the Boards of Directors of each of Telefónica and Terra Networks have issued Directors reports on the merger plan describing certain of the merger plan s legal and economic aspects, including the exchange ratio and the procedure used for the valuation of the companies, and an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the exchange ratio is justified.

Telefónica has the power to establish a quorum at the annual general shareholders meeting and approve the merger at such duly constituted meeting.

Approval of the merger balance sheets and the merger on the terms and conditions set forth in the merger plan requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of Terra Networks annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Terra Networks entitled to vote is present or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%. As of February 23, 2005, we owned 75.87% of the outstanding ordinary shares of Terra Networks and, as a result, have the power to establish a quorum at the annual general shareholders meeting and approve the merger at such duly constituted meeting. We intend to vote in favor of the merger.

We may fail to realize the anticipated benefits of the merger.

The success of the merger will depend, in part, on our ability to realize the anticipated growth opportunities and synergies from fully integrating the businesses of Telefónica with the businesses of Terra Networks. To realize the anticipated benefits of this combination, members of the management team of Telefónica must develop strategies and implement a business plan that will:

- effectively and efficiently integrate the policies, procedures and operations of Telefónica and Terra Networks;

- successfully retain and attract key employees of the combined company, including operating management and key technical personnel, during a period of transition and in light of the competitive employment market;

- and achieve the benefits described in Part Three The Merger Telefónica and Terra Networks Reasons for the Merger .

If members of the management team of Telefónica are not able to develop strategies and implement a business plan that achieves these objectives, among others, the anticipated benefits of the combination may not

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be realized. In particular, anticipated growth in operating profit before depreciation and amortization and cash flow may not be realized, which would have an adverse impact on Telefónica and the market price of ordinary shares and ADSs of Telefónica.

The market price of Telefónica ordinary shares and ADSs may decrease significantly between the time you vote on the merger plan and the time the merger is completed. As a result, at the time you vote on the merger plan you will not know the market value you will receive for your Terra Networks ordinary shares and ADSs.

The merger exchange ratio is fixed, and the merger plan does not contain a mechanism to adjust the merger exchange ratio in the event that the market price of the Telefónica ordinary shares or ADSs declines. As a result, if the market price of Telefónica ordinary shares or ADSs at the completion of the merger is lower than their market prices on the date of the Terra Networks annual general shareholders meeting, the market value of the Telefónica ordinary shares or ADSs that you receive in the merger will be less than the market value on the date of the Terra Networks annual general shareholders meeting and may be less than you paid for your Terra Networks ordinary shares or ADSs. We expect that the closing of the merger will occur in July, 2005, but it may occur at some other time.

The trading market for Terra Networks ordinary shares or ADSs after the merger plan has been approved by the requisite shareholders meetings may be severely impaired or disrupted. As a result, until the merger closes and you receive Telefónica ordinary shares or ADSs, the liquidity of the Terra Networks ordinary shares or ADSs may decline and their volatility may increase.

Following approval of the merger plan by the requisite shareholders meetings and prior to registration of the merger deed in the Madrid Commercial Registry, the trading volume of Terra Networks ordinary shares or ADSs and the liquidity of the ordinary shares or ADSs could decrease. This could result in substantial fluctuations in the trading price for Terra Networks ordinary shares or ADSs.

Following the registration of the merger deed in the Madrid Commercial Registry, Terra Networks will cease to exist and we intend to solicit the delisting of the Terra Networks ADSs from the Nasdaq National Market and terminate Terra Networks reporting obligations in the United States.

Investors who wished to own Terra Networks ordinary shares or ADSs but who do not wish to hold Telefónica ordinary shares or ADSs may sell the Telefónica ordinary shares or ADSs they receive or expect to receive in the merger. This may put downward pressure on the market price of the Telefónica ordinary shares or ADSs that you will receive in the merger. Arbitrageurs may also adversely influence the price of the ordinary shares or ADSs.

For a number of reasons, some shareholders of Terra Networks may wish to sell their Terra Networks ordinary shares or ADSs prior to completion of the merger, or the Telefónica ordinary shares or ADSs that they will receive in the merger. In addition, the market price of the Telefónica ordinary shares or ADSs may be adversely affected by arbitrage activities prior to the completion of the merger. These sales or the prospect of future sales, as well as arbitrage activity, could adversely affect the market price for Terra Networks ordinary shares or ADSs and Telefónica ordinary shares or ADSs.

The merger may be taxable for U.S. federal income tax purposes

While the merger should qualify as a tax free reorganization under Section 368(a) of the Code, such treatment is not certain because there is no authority which directly addressees a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization. Even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992, if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. Furthermore, the IRS or the courts could disagree with the conclusion that the merger should qualify as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be a taxable exchange for U.S. federal income tax purposes and a U.S. Holder would recognize gain or loss for U.S. federal income tax purposes equal to the difference between the fair market value of the Telefónica ordinary shares or ADSs received, plus the amount of any cash received in lieu of a fractional Telefónica ordinary share or ADS, and such U.S. Holders tax basis in the Terra Networks ordinary shares or ADSs exchanged therefor.

See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

Possible adverse tax consequences if Terra Networks is or was a PFIC

Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in one or more prior years. If Terra Networks was a PFIC for any taxable year during which a U.S. Holder held ordinary shares or ADSs, (i) under proposed Treasury regulations which are not yet in effect but which are proposed to be effective from April 11, 1992, gain realized on the U.S. Holder s exchange of such Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be taxable under the PFIC rules and (ii) the proposed 0.60 per Terra Networks ordinary share distribution would, unless the U.S. Holder acquired its Terra Networks ordinary shares or ADSs in the current taxable year, be treated as an Excess Distribution under the PFIC rules to the extent it exceeds 125 percent of the average of the annual distributions on the Terra Networks ordinary shares received by the U.S. Holder during the preceding three years or, if shorter, the U.S. Holder s holding period. Under the PFIC rules, any such gain or Excess Distribution would be allocated ratably over the U.S. Holder s holding period for the ordinary shares or ADSs. The amount allocated to the current taxable year and any year before Terra Networks became a PFIC would be taxed as ordinary income. Amounts allocated to each other taxable year would be subject to tax at the highest rate of tax in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the amount allocated to each such taxable year.

See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

The merger exchange ratio that was agreed in the merger plan by the Boards of Directors of Telefónica and Terra Networks was based on a valuation methodology routinely used in mergers in the telecommunications sector. You should not assume that the methodology employed produces values that everyone would agree are intrinsically correct or representative of fair value. You should also not assume that they are indicative of future market prices or valuations.

The merger exchange ratio that was agreed in the merger plan by the Boards of Directors of Telefónica and Terra Networks was based on a valuation methodology routinely used in mergers in the telecommunications sector. An independent expert appointed by the Madrid Commercial Registry has prepared a report on the merger plan and on the net worth contributed by Terra Networks to Telefónica. Such report address, among other matters, whether (i) the exchange ratio is justified, (ii) what methods were used to establish the exchange ratio, (iii) whether such methods were adequate and (iv) the valuations that are produced by such methodologies, including whether any issues relating to the valuation arose. Notwithstanding the methodologies discussed in the independent expert s report, you should be aware that other valuation methodologies may have produced

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different results, particularly if the assumptions underlying the valuation methodologies are modified. You should make your own assessment concerning the Telefónica ordinary shares and the merger exchange ratio, calling on your advisors as you deem appropriate. You should not assume that everyone would agree that relative valuations applied are intrinsically correct or representative of fair value. You should also not assume that they are indicative of future market prices or valuations. See Part Three The Merger Report of the Spanish Independent Expert for a description of the Spanish Independent Expert s report. An English-language translation of the report is attached as Annex C-1 to this joint information statement/prospectus.

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Part Three The Merger

General

The Board of Directors of each of Telefónica and Terra Networks is using this joint information statement/prospectus to solicit proxies from the holders of Telefónica and Terra Networks ordinary shares and Telefónica and Terra Networks ADSs for use at their respective annual general shareholders meetings.

Telefónica Proposals

At the Telefónica annual general shareholders meeting, holders of Telefónica ordinary shares and Telefónica ADSs will be asked to vote upon:

I. Examination and approval, if applicable, of the Annual Accounts and Management Report of Telefónica, S.A. and its consolidated group of companies, as well as the proposal for the application of the results of Telefónica, S.A., and that of the management of the company s Board of Directors, all for the 2004 financial year.

II. Shareholder remuneration: A) distribution of dividends with a charge to the additional paid-in capital reserve and B) extraordinary non-cash distribution of additional paid-in capital.

III. Examination and approval, as the case may be, of the merger plan between Telefónica, S.A. and Terra Networks, S.A. and approval, as the Merger Balance Sheet, of Telefónica, S.A. s Balance Sheet closed as of December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by absorption (*absorción*) of Terra Networks, S.A. by Telefónica, S.A. with the dissolution without liquidation of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares as a result of the merger. Delegation of powers.

IV. Appointment of Directors.

V. Designation of the Accounts Auditor for Telefónica, S.A. and its consolidated group of companies, under the provisions of article 42 of the Spanish Commerce Code (Código de Comercio) and article 204 of the Spanish Corporations Act (Ley de Sociedades Anónimas).

VI. Authorization for the acquisition of treasury stock, directly or through group companies.

VII.

Reduction of share capital through the amortization of treasury stock, with the exclusion of the right to opposition by creditors, through the redrafting of the article in the bylaws that refers to the share capital.

VIII. Delegation of powers to formalize, construe, correct and execute the resolutions adopted by the annual general shareholders meeting.

The merger will not be completed unless proposal III is approved by Telefónica s shareholders at the annual general shareholders meeting.

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Part Three The Merger

Terra Networks Proposals

At the Terra Networks annual general shareholders meeting, holders of Terra Networks ordinary shares and Terra Networks ADSs will be asked to vote upon:

I. Examination and, if appropriate, approval of the financial statements and management report, both of Terra Networks, S.A. (parent company) and of its consolidated group, as well as the proposed distribution of income and the conduct of business by its Board of Directors, all in relation to 2004.

II. Reappointment, ratification and, if appropriate, appointment of Directors.

III. Shareholders remuneration: distribution of dividends with a charge to the additional paid-in capital reserve.

IV. Designation of auditor for Terra Networks, S.A. and its consolidated group of companies.

V. Examination and approval, if applicable, of the merger plan of Telefónica, S.A. and Terra Networks, S.A. and approval, as the merger balance sheet, of Terra Networks, S.A. s balance sheet closed on December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by means of the absorption (*absorción*) of the latter by the former with the extinction of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares. Delegation of powers.

VI. To consent to and approve, as far as necessary, the resolutions to be adopted by the annual shareholders meeting of Telefónica, S.A. s under items IV and VII of the Agenda for the Meeting relating to: (i) appointment of Directors and (ii) capital reduction by means of the retirement of treasury stock, with the exclusion of the right of creditors to object, rewording the Article in the corporate bylaws relating to capital stock.

VII. Delegation of powers to formalize, interpret, rectify and implement the resolutions adopted by the shareholders meeting.

The merger will not be completed unless proposal V is approved by Terra Networks shareholders at the annual general shareholders meeting.

Background of the Merger

General Background

Terra Networks was created as a subsidiary of Telefónica in December 1998 to operate the Spanish residential and small office/home office Internet access business carried out by the Telefónica Group since 1995. In November 1999, Terra Networks issued approximately 66 million Terra Networks ordinary shares, or approximately 24% of Terra Networks capital stock, in an initial public offering. Following the initial public offering, Terra Networks ordinary shares have traded on the Spanish stock exchanges and been quoted on the Nasdaq National Market. In May 2000, Terra Networks entered into a strategic alliance agreement with Bertelsmann, one of the largest media companies in the world, as well as Telefónica and Lycos, Inc., then one of the leading Internet multi-brand networks, pursuant to which Bertelsmann agreed to purchase content and services from Terra Networks beginning in November 2000 and Telefónica agreed to subscribe to a rights offering by Terra Networks. In September 2000, pursuant to such agreement, Terra Networks completed a 2.2 billion rights offering, substantially all of which was subscribed by Telefónica. In October 2000, Terra Networks acquired 100% of the outstanding shares of Lycos, Inc. in a stock-for-stock exchange. On February 12, 2003 Telefónica and Terra Networks entered into a strategic alliance framework agreement to replace the Bertelsmann strategic alliance agreement.

On May 28, 2003, Telefónica launched a tender offer for 100% of the outstanding ordinary shares of Terra Networks that it did not own and on June 19, 2003, the CNMV approved the prospectus for the tender offer. The offer price was 5.25 per ordinary share, payable in cash. The offer was subject to Telefónica owning at least 75% of the total share capital of Terra Networks on the closing date of the offer. Terra Networks shareholders owning 33.6% of the outstanding ordinary shares of Terra Networks accepted the offer, which, following Telefónica s waiver of the 75% minimum ownership condition, resulted in Telefónica holding 71.97% of Terra Networks capital stock. During 2004, Terra Networks distributed a 2.00 per ordinary share cash dividend and Telefónica purchased in the open market an additional 3,753,140 ordinary shares of Terra Networks and sold in the open market 432,092 ordinary shares. As of February 23, 2005, Telefónica held 75.87% of Terra Networks share capital.

Background of the Merger

The management of each of Telefónica and Terra Networks continually review their companies respective positions in light of the changing competitive environment of the telecommunications and Internet industries in Spain, Europe and Latin America, with the objective of determining what alternatives are available to further enhance shareholder value. Terra Networks began operations with a business model based on the separation of traditional telecommunications and Internet service providers. However, in the past several years a new business model has emerged based on combining traditional telecommunications, internet and broadband services. The emergence of this new model has significantly changed the competitive environment for Internet service providers. In this context, both Telefónica and Terra Networks have considered a range of options to improve their competitive positions, including acquisitions or dispositions of assets, possible partnerships, alliances or other significant transactions.

On February 9, 2005, the Executive Committee of Telefónica met and, following an analysis of the opportunity to merge Telefónica and Terra Networks, resolved to initiate all necessary actions to execute the transaction. As the first step, on that date, Mr. César Alierta, Executive Chairman of Telefónica, sent a letter to Mr. Kim Faura, Executive Chairman of Terra Networks, inviting the latter to jointly explore the possibility of merging both companies in order to successfully face the challenges of technological changes, evolving clients needs and the telecommunication industry s evolution. The letter enclosed a form of the merger plan with proposed terms and conditions, which included an exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares. The Telefónica Executive Committee decision took into account, among other matters, the advice of Morgan Stanley & Co. Limited, as financial advisor, and, regarding matters of Spanish telecommunications and antitrust law, the advice of Uría & Menéndez, as external Spanish legal counsel, to Telefónica.

On February 10, 2005, at a special meeting of the Terra Networks Board of Directors, it was agreed that the three Directors appointed by Telefónica and one independent Director were subject to a conflict of interest and, accordingly, would abstain from participating in any meetings or discussions regarding, and from voting on, the merger plan. It was further agreed that the remaining five members of the Terra Networks Board of Directors not subject to a conflict of interest would create a Merger Committee comprised solely of independent Directors, with no relationship with Telefónica, namely, Mr. Moreno de Alborán y de Vierna and Mr. Badía Almirall, charged with the responsibility of negotiating the merger and determining the full Board of Directors position regarding the merger. The remaining three Directors, Mr. Faura, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez agreed unconditionally to vote on all matters relating to the merger plan according to the Merger Committee s recommendation. The Board of Directors of Terra Networks agreed that the Merger Committee should initiate a phase of analysis and negotiation of the transaction.

On February 10 and February 16, 2005, the Terra Networks Merger Committee of the Board of Directors resolved and ratified the appointment of Lehman Brothers Europe Limited and Citigroup Global Markets Limited as financial advisors to the Board of Directors. Mr. Faura Battle, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez voted unanimously in accordance with the recommendation of the Merger Committee.

On February 11, 2005, Mr. Faura addressed a letter to Mr. Alierta acknowledging the receipt of Mr. Alierta s letter, and informing Mr. Alierta of the willingness of the Board of Directors of Terra Networks to study and evaluate the proposed transaction.

On February 14, 2005, Telefónica issued a press release stating that its Executive Committee, in its meeting held February 9, 2005, agreed to propose to Terra Networks the initiation of negotiations leading to a potential merger of the two companies. On the same date, Terra Networks issued a press release stating that it had received Telefónica s proposal, and that its Board of Directors was studying the proposed transaction.

On February 23, 2005, the two companies agreed that prior to the merger Terra Networks would issue to holders of Terra Networks ordinary shares and ADSs a dividend of 0.60 per Terra Networks ordinary share.

On February 23, 2005, the Board of Directors of Terra Networks met to consider the proposed transaction. At this meeting (i) Lehman Brothers Europe Limited rendered its oral opinion, subsequently confirmed in writing, that based upon and subject to the matters set forth therein, as of February 23, 2005, from a financial point of view, the exchange ratio to be offered in the proposed merger was fair to the shareholders of Terra Networks (other than Telefónica) and (ii) Citigroup Global Markets Limited delivered its oral opinion, subsequently confirmed in writing, to the effect that, based upon and subject to the qualifications and assumptions set forth therein, as of February 23, 2005, the exchange ratio was fair, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates). In connection with rendering their opinions, each of Lehman Brothers Europe Limited and Citigroup Global Markets Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Networks shareholders prior to the merger. The Merger Committee of the Terra Networks Board of Directors approved the merger plan, subject to shareholder approval at the annual general shareholders meeting, and the three Terra Networks Directors not subject to a conflict of interest, Mr. Faura, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez, voted in accordance with the Merger Committee s recommendation.

On February 23, 2005, the Board of Directors of Telefónica met to consider the proposed transaction. At this meeting, the Board of Directors was presented with the written fairness opinion rendered by Morgan Stanley & Co. Limited to the effect that, as of February 23, 2005 and based upon and subject to the matters stated in its opinion, the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan was fair, from a financial point of view, to Telefónica. After considering the opinion of Morgan Stanley & Co. Limited, among other matters, the Telefónica Board of Directors approved the merger plan, subject to shareholder approval at the annual general shareholders meeting.

After finalizing the merger plan on February 23, 2005, representatives of Telefónica and Terra Networks executed the merger plan and each company issued a press release announcing the proposed merger of Telefónica and Terra Networks.

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Part Three The Merger

Telefónica and Terra Networks Reasons for the Merger

Telefónica and Terra Networks believe that by combining Terra Networks Internet access and portal services with Telefónica s fixed-line telephony network and broadband services, the two companies can create more shareholder value than could be achieved by the companies on their own. This is the fundamental reason for the merger.

Telefónica and Terra Networks believe that the strategy of independently developing telecommunications and Internet businesses is no longer attractive, particularly in light of the recent growth in penetration of broadband technology in many of the markets in which the two companies operate. As a result of the success of broadband technology, a new market dynamic has developed in which Internet access and connection and telephony services offered in one integrated package is the business model that best serves customers increasing desire to obtain these services from one telecommunications provider.

For Telefónica and Terra Networks, the integration of Telefónica s telecommunications business, and in particular its fixed-line telephony network infrastructure, with the requisite technical and human capital to operate such network, and broadband capability, with Terra Networks Internet access and portal services, provides greater growth opportunities for the companies as an integrated unit than as independent operators. As an integrated telephony and Internet services provider, Telefónica will be able to provide a complete package of services in order to compete successfully with other integrated operators, such as cable companies.

In addition, after the merger, Telefónica and Terra Networks believe that:

- The two companies competitive position will be stronger as a result of an increased capability to compete with the integrated telephony, internet service and content packages offered by competitors;
- The two companies will be better positioned to develop new services that optimize the use of Terra Networks network or that require significant resources;
- The two companies will improve their ability to leverage each company s client relationships by creating global strategies based on client segment, rather than product line, reducing customer churn through the sale of packaged services and increasing cross-selling; and
- The two companies costs and expenses will decrease as a result of, among other measures, integrating their networks and platforms, eliminating duplicative marketing and advertising and reducing corporate overhead.

Telefónica and Terra Networks believe the combined company can be run more efficiently and can compete more effectively and use its capital more profitably than either company on its own. Of course, these benefits and the other benefits described above depend on our ability to obtain the necessary approvals for the merger, to integrate the businesses of Telefónica and Terra Networks successfully after the merger and on other uncertainties.

For additional information regarding the reasons the Boards of Directors of Telefónica and Terra Networks approved the merger plan, see section 1.1 of the English-language translation of the merger plan attached hereto as Annex A-1.

Accounting Treatment

The merger by absorption of Terra Networks with and into Telefónica will be accounted for as a transaction of entities under common control in the consolidated financial statements of Telefónica under both Spanish and U.S. GAAP except for the acquisition of the noncontrolling equity interests in Terra, which will be accounted for under the pooling of interests method under Spanish GAAP and under the purchase method under U.S. GAAP (purchase of the noncontrolling equity interests).

Material Spanish and U.S. Federal Income Tax Consequences

In the opinion of Uría & Menendez, Spanish counsel to Telefónica, with respect to taxes imposed by the Kingdom of Spain, and Davis Polk & Wardwell, U.S. counsel to Telefónica (U.S. counsel), with respect to U.S. federal income taxes, the following are the material Spanish tax consequences and the material U.S. federal income tax consequences of the merger and of the ownership and disposition of the Telefónica ordinary shares or ADSs to U.S. Holders (as defined below). However, the following is not a complete discussion of all potential tax consequences that might be relevant to the merger or the ownership of Telefónica ordinary shares or ADSs and it does not address all of the tax consequences that may be relevant to investors subject to special rules, including U.S. expatriates, insurance companies, tax-exempt organizations, certain financial institutions, partnerships, persons subject to the alternative minimum tax, dealers or traders in securities or currencies, persons who acquired their ordinary shares or ADSs pursuant to the exercise of employee stock options or otherwise as compensation, persons whose functional currency is not the U.S. dollar, persons who own Telefónica or Terra Networks ordinary shares or ADSs as part of an integrated investment (including a straddle) comprised of such ordinary shares or ADSs and one or more other positions for tax purposes, or persons who will own 5 percent or more of the stock of Telefónica immediately following the merger. Such holders may be subject to U.S. federal income tax consequences different from those set forth below. This tax section also does not address the Spanish tax consequences applicable to look-through (*entidades en régimen de atribución de rentas*) entities that may be subject to the tax regime applicable to such entities under the Spanish Non-Resident Income Tax Law.

As used herein, the term U.S. Holder means a beneficial owner of one or more Telefónica or Terra Networks ordinary shares or ADSs:

(a) who is, for U.S. federal income tax purposes, one of the following:

i. a citizen or resident of the United States,

ii. a corporation (or other entity taxable as a corporation) created or organized in or under the laws of the United States or any political subdivision thereof, or

iii. an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source;

(b) who is entitled to the benefits of the Treaty (defined below) under the Limitation on Benefits provisions contained in the Treaty;

(c) who holds the ordinary shares or ADSs as capital assets for U.S. federal income tax purposes;

(d) who owns, directly, indirectly or by attribution, less than 5 percent of the share capital or voting stock of Telefónica or Terra Networks; and

(e) whose holding is not effectively connected with a permanent establishment in Spain.

If a partnership holds ordinary shares or ADSs, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner in a partnership that holds ordinary shares or ADSs is urged to consult its own tax advisor regarding the specific tax consequences of the merger and of acquiring, owning and disposing of Telefónica ordinary shares or ADSs.

This summary is based upon Spanish tax laws, U.S. tax laws, including the U.S. Internal Revenue Code of 1986, as amended (the Code), final, temporary and proposed Treasury regulations, rulings, judicial decisions, administrative pronouncements, and the Convention Between the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, signed February 22, 1990, together with related protocol (the Treaty), all as currently in effect and all of which are subject to change or changes in interpretation, possibly with retroactive effect. In addition, the summary is based in part on representations of the depositary and assumes that each obligation provided for in, or otherwise contemplated by, the deposit agreement or any other related document will be performed in accordance with its terms.

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Part Three The Merger

The U.S. Treasury has expressed concerns that parties to whom ADSs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. Holders of ADSs. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate U.S. Holders. Accordingly, the availability of foreign tax credits to U.S. Holders of ADSs and the reduced tax rate for dividends received by certain non-corporate U.S. Holders, both as described below, could be affected by future actions that may be taken by parties to whom ADSs are pre-released.

For purposes of the Treaty and for U.S. federal income tax purposes, U.S. Holders of American Depositary Receipts will generally be treated as owners of the ADSs evidenced thereby and the ordinary shares represented by such ADSs.

This discussion assumes that Telefónica is not, and will not become, a passive foreign investment company (PFIC), as discussed below under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks -U.S. Federal Income Tax Considerations- Telefónica-Passive Foreign Investment Company Considerations.

U.S. Holders of ordinary shares or ADSs should consult their own tax advisors concerning the specific Spanish and U.S. federal, state and local tax consequences of the merger and of the ownership and disposition of Telefónica ordinary shares or ADSs in light of their particular situations, as well as any consequences arising under the laws of any other taxing jurisdiction. In particular, U.S. Holders are urged to consult their own tax advisors concerning whether they are eligible for benefits under the Treaty.

Income Tax Consequences of the Merger

Spanish Taxation

Under Spanish general merger regulations, shareholders of Terra Networks would be taxed on the capital gain realized upon the exchange of their ordinary shares, which is equal to the difference between the fair market value of the ordinary shares of Telefónica received in exchange for the ordinary shares of Terra Networks and the shareholder s basis in such Terra Networks ordinary shares as determined under Spanish tax law.

However, the merger plan provides that Telefónica and Terra Networks will opt for the special tax regime applicable to mergers provided in Chapter VIII, Title VII of Spanish Corporate Income Tax Law (approved by Royal Decree Legislative 4/2004 of March 5, 2004).

According to this law, income derived from the receipt of ordinary shares of Telefónica in exchange for ordinary shares of Terra Networks will not be taxable in Spain for shareholders since the ordinary shares received pertain to a participation in the capital of an entity resident in Spain for tax purposes.

However, this special tax regime will not apply to Terra Networks investors who reside in tax haven territories (the United States is not a tax haven territory for this purpose), as defined by Spanish Royal Decree 1080/1991. Such residents will be taxed in Spain at a rate of 35 percent on any capital gain realized from the merger. The special tax regime described above shall apply at the option of Telefónica and Terra Networks and must be communicated to the Ministry of Finance within the three-month period following the registration of the merger in the Madrid Commercial Registry. The special tax regime will not apply if the merger is not effected for valid economic reasons. Telefónica and Terra Networks have described the economic reasons for the merger above under Telefónica and Terra Networks Reasons For the Merger.

Based on the above, to the extent Telefónica duly communicates its election to consider the merger as falling under the special tax regime:

The holders of Terra Networks ordinary shares or Terra Networks ADSs not residing in a tax-haven jurisdiction, as defined under Spanish tax law, will not incur any tax obligation in Spain upon the exchange of their Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs. For Spanish tax purposes, these shareholders tax basis and the acquisition date of the Telefónica ordinary shares or ADSs received will be the same as those of the Terra Networks ordinary shares or ADSs exchanged.

The holders of Terra Networks ordinary shares or ADSs residing in a tax haven jurisdiction will be taxed at a rate of 35 percent in Spain on the capital gain realized upon the exchange of their ordinary shares or ADSs.

The special tax regime does not apply to the sale of fractional ordinary shares or ADSs. Consequently, capital gains realized upon the sale of ordinary shares or ADSs of Terra Networks that do not entitle the holder to one ordinary share or ADS of Telefónica will be taxed as explained below under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-Spanish Tax Considerations-Taxation of Capital Gains.

United States Taxation

U.S. counsel is unable to opine that U.S. Holders will not be subject to U.S. federal income tax on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger because (a) there is no authority which directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and, therefore, while the merger should qualify as a reorganization under Section 368(a) of the Code, due to the lack of authority qualification is not certain, and (b) even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992 (the Proposed Regulations), if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. See Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-U.S. Federal Income Tax Considerations-Terra Networks-Passive Foreign Investment Company Considerations below.

Under the Proposed Regulations, if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs, any gain realized by a U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be taxable under the PFIC rules unless Telefónica were a PFIC for the 2005 taxable year, which is not expected to be the case. If the exchange of shares were to be taxable under this PFIC rule, any gain realized by a U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger (generally, the excess, if any, of the value of Telefónica ordinary shares or ADSs and cash in lieu of fractional ordinary shares or ADSs received over the U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs surrendered) would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year. In addition, the U.S. Holder s holding period for its Telefónica ordinary shares or ADSs received in the exchange would begin the day after they were received, and such Telefónica ordinary shares or ADSs would have a tax basis equal to their fair market value on the date the exchange of shares occurred. U.S. Holders are urged to consult their own tax advisors regarding any PFIC considerations with respect to the exchange of Terra Networks ordinary shares or ADSs pursuant to the merger that may be relevant to their particular circumstances.

If the exchange of ordinary shares or ADSs qualifies as a reorganization under Section 368(a) of the Code and Terra Networks was not a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs, for U.S. federal income tax purposes:

A U.S. Holder of Terra Networks ordinary shares or ADSs would not recognize any gain or loss upon its exchange pursuant to the merger of such ordinary shares or ADSs for Telefónica ordinary shares or ADSs.

If a U.S. Holder of Terra Networks ordinary shares or ADSs receives cash in respect of a fractional ordinary share or ADS, the U.S. Holder would recognize gain or loss, measured by the difference between the amount of cash received in respect of that fractional ordinary share or ADS and the portion of the U.S. Holder s tax basis allocable to that fractional ordinary share or ADS. This gain or loss would be capital gain or loss, and would be long-term capital gain or loss if the U.S. Holder had held the Terra Networks ordinary shares or ADSs exchanged for more than one year at the time the share exchange occurs.

A U.S. Holder of Terra Networks ordinary shares or ADSs would have a tax basis in the Telefónica ordinary shares or ADSs received in the exchange of Terra Networks ordinary shares or ADSs pursuant to the merger equal to (1) the U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs exchanged by that U.S. Holder pursuant to the merger, reduced by (2) the tax basis that is allocable to any fractional ordinary share or ADS for which cash is received.

The holding period for the Telefónica ordinary shares or ADSs received in exchange for Terra Networks ordinary shares or ADSs would include the holding period for such Terra Networks ordinary shares or ADSs so exchanged.

In general, any cash received by a U.S. Holder in respect of a fractional ordinary share or ADS may be subject to backup withholding under circumstances comparable to those described under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-U.S. Federal Income Tax Considerations-Telefónica-Information Reporting and Backup Withholding below. Furthermore, if a U.S. Holder realizes gain or loss on a sale or other disposition of euro it receives with respect to a fractional ordinary share or ADS, it will be U.S. source ordinary income or loss.

The foregoing discussion is based on U.S. counsel s opinion that, although there is no authority that directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and therefore the conclusion is not certain, the exchange of Terra Networks ordinary shares and ADSs for Telefónica ordinary shares and ADSs pursuant to the merger should qualify as a reorganization under Section 368(a) of the Code. This opinion is based on certain factual representations made by Telefónica and assumes that (a) there will not be any changes in facts or in law between the date of this joint information statement/prospectus and the date on which the merger is completed and (b) the merger will be completed in accordance with the current terms of the merger plan and any other related agreements. If any of the representations or assumptions described above are inaccurate, the U.S. federal income tax consequences may differ from those described herein.

An opinion of counsel is not binding upon the IRS or the courts, either or both of which could reach a contrary conclusion with respect to the qualification of the merger as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary

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shares or ADSs pursuant to the merger would be treated as taxable for U.S. federal income tax purposes and a U.S. Holder would recognize gain or loss equal to the difference between the fair market value of the Telefónica ordinary shares or ADSs received, plus the amount of any cash received in lieu of a fractional ordinary share or ADS, and such U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs exchanged therefor. Such gain or loss would be capital gain or loss and would be long-term if the U.S. Holder has held such Terra Networks ordinary shares or ADSs for more than one year at the time the share exchange occurs, unless Terra Networks was treated as a PFIC for any taxable year during which the U.S. Holder held such Terra Networks ordinary shares or ADS. If Terra Networks was treated as a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADS, gain recognized by such U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year. In addition, the U.S. Holder s holding period for its Telefónica ordinary shares or ADSs received in the exchange would begin the day after they were received, and such Telefónica ordinary shares or ADSs would have a tax basis equal to their fair market value on the date the exchange of shares occurred.

Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks

Spanish Tax Considerations

Taxation of Dividends

Under Spanish law, dividends paid by a Spanish resident company to a U.S. Holder of ordinary shares or ADSs are subject to Spanish Non-Resident Income Tax, approved by Royal Decree Legislative 5/2004 of March 5, 2004 (NRIT), withheld at source on the gross amount of dividends, currently at a tax rate of 15 percent.

Taxation of Extraordinary Distributions

The merger plan describes that the holders of ordinary shares and ADSs of Telefónica and Terra Networks will receive separate dividends as follows: (1) prior to the merger holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share in connection with the fiscal year ended December 31, 2004; (2) prior to the merger holders of Terra Networks ordinary shares and ADSs will receive (subject to the approval of the shareholders at the annual general shareholders meeting of Terra Networks) 0.60 per Terra Networks ordinary share, which will be treated as a distribution of paid-in surplus (*reserva de prima de emisión*); and (3) prior to the merger holders of Telefónica ordinary shares or ADSs will receive (subject to the approval of the shareholders at the annual general shareholders meeting of Telefónica) a dividend of one Telefónica ordinary share for every 25 Telefónica ordinary shares already held, which will be treated as a distribution of paid-in surplus (*reserva de prima de emisión*). This share dividend will not be paid in respect of Telefónica ordinary shares to be received in connection with the merger.

In addition, subject to the approval of the shareholders at the annual general shareholders meeting of Telefónica, holders of Telefónica ordinary shares and ADSs received in connection with the merger will be entitled to receive (along with all other shareholders of Telefónica) a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share consisting of a distribution of paid-in surplus (*reserva de prima de emisión*) and payable on November 11, 2005.

Under Spanish law, these distributions of paid-in surplus (*reserva de prima de emisión*) are subject to special tax treatment. In general, the amount of these distributions received in cash or in shares is not taxable

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under Spanish income tax law but instead reduces the tax acquisition cost of the ordinary shares or ADSs on which it was distributed for Spanish tax purposes (i.e., in the event of a subsequent sale or disposition of such ordinary shares or ADSs, the amount of gain realized will be greater). In the case of the distribution of Telefónica ordinary shares, the amount by which a U.S. Holder must reduce the tax acquisition cost of its Telefónica ordinary shares or ADSs will be the market value of the ordinary shares or ADSs received. However, if the amount of the distributions received in cash or in shares is greater than the U.S. Holder s adjusted tax acquisition cost for the Telefónica shares or ADSs, then the amount by which the distributions exceed the U.S. Holder s adjusted tax acquisition cost generally will be subject to tax in Spain at a 15 percent tax rate and such U.S. Holder will be required to file a Spanish Form 210 within one month of the distribution. No amount will be withheld by Telefónica in respect of Spanish taxes on those distributions of paid-in surplus.

Taxation of Capital Gains

Under Spanish law, any capital gains derived from securities issued by persons residing in Spain for Spanish tax purposes are considered to be Spanish source income and, therefore, are taxable in Spain. Spanish income tax is generally levied at a 35 percent tax rate on capital gains of non-residents of Spain who are not entitled to the benefit of any applicable treaty for the avoidance of double taxation and who do not operate through a fixed base or a permanent establishment in Spain.

Under the Treaty, capital gains realized by U.S. Holders arising from the disposition of Telefónica ordinary shares or ADSs will not be taxed in Spain provided that the seller has not maintained a direct or indirect holding of 25 percent of the company s capital during the twelve months preceding the disposition of the stock. U.S. Holders will be required to establish that they are entitled to the exemption from tax under the Treaty by providing to the relevant Spanish tax authorities Spanish Form 210 and a certificate of residence on IRS Form 6166 from the IRS stating that to the best knowledge of the IRS such U.S. Holder is a U.S. resident within the meaning of the Treaty. Spanish law requires that both of these forms be filed within one month from the date on which the capital gain is realized. U.S. Holders must request the IRS Form 6166 certificate of residence by filing IRS Form 8802 with the IRS. The U.S. Holder must attach to IRS Form 8802 a statement declaring that it was or will be a resident of the United States for the period for which the Treaty benefit is claimed.

Spanish Wealth Tax

Individual U.S. Holders who hold ordinary shares or ADSs located in Spain or rights attached to such ordinary shares or ADSs exercisable in Spain are subject to the Spanish Wealth Tax (*Impuesto sobre el Patrimonio*) (Spanish Law 19/1991), which imposes tax on property and rights located in Spain, or that can be exercised within the Spanish territory, on the last day of any year. Therefore, U.S. Holders who held Telefónica ordinary shares or ADSs on the last day of any year are subject to the Spanish Wealth Tax for such year at marginal rates varying between 0.2 percent and 2.5 percent of the average market value of such ordinary shares or ADSs during the last quarter of such year, as published by the Spanish Ministry of Economic Affairs. U.S. Holders should consult their tax advisors with respect to the Spanish Wealth Tax.

Spanish Inheritance and Gift Taxes

Transfers of ordinary shares or ADSs upon death and by gift to individuals not resident in Spain for tax purposes are subject to Spanish inheritance and gift taxes (*Impuesto sobre Sucesiones y Donaciones*) (Spanish Law 29/1987), respectively, if the ordinary shares or ADSs are located in Spain or the rights attached to such ordinary shares or ADSs are exercisable in Spain at the time of death or gift, regardless of the residence of the heir or the beneficiary. The applicable tax rate, after applying all relevant factors, ranges from between 7.65 percent and 81.6 percent for individuals. Gifts of ordinary shares granted to U.S. Holders that are not individuals will be subject to the NRIT at a 35 percent tax rate on the fair market value of the ordinary shares as a capital gain. However, if the donee is a U.S. Holder entitled to the benefits of the Treaty, the exclusions available under the Treaty described under -Taxation of Capital Gains above will be applicable.

Expenses of Transfer

Transfers of ordinary shares or ADSs will be exempt from Transfer Tax (*Impuesto sobre Transmisiones Patrimoniales*) and Value Added Tax. Additionally, no Stamp Duty will be levied on such transfers.

U.S. Federal Income Tax Considerations

Terra Networks

Passive Foreign Investment Company Considerations

A foreign company is considered a PFIC for any taxable year if either: (i) 75 percent or more of its gross income consists of passive income (such as dividends, interest, rents and royalties) or (ii) 50 percent or more of the average quarterly value of its assets consists of assets that produce, or are held for the production of, passive income. For these purposes, the foreign company is treated as owning its proportionate share of the assets and receiving its proportionate share of the income of each company in which it owns directly or indirectly at least 25 percent by value of the stock (25 percent owned companies).

Accordingly, Terra Networks PFIC status is dependent upon the composition of its and its 25 percent owned companies income and assets and the value of its and its 25 percent owned companies assets from time to time. Because there are uncertainties in the application of the PFIC rules to companies such as Terra Networks and its 25 percent owned companies and the law regarding the classification of certain assets as active or passive is unclear, and the value of assets is uncertain, Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years.

Taxation of Extraordinary Distributions

Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in one or more prior years. If Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs then, unless the U.S. Holder acquired its Terra Networks ordinary shares or ADSs in the current taxable year, the proposed 0.60 per Terra Networks ordinary share distribution will be treated as an Excess Distribution to the extent it exceeds 125 percent of the average of the annual distributions on the Terra Networks ordinary shares or ADSs received by the U.S. Holder during the preceding three years or, if shorter, the U.S. Holder s holding period. The Excess Distribution would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year.

Subject to the PFIC discussion above, distributions, including the proposed 0.60 per Terra Networks ordinary share distribution, received by a U.S. Holder on Terra Networks ordinary shares or ADSs, including the amount of any Spanish taxes withheld, will constitute foreign source dividend income to the extent paid out of Terra Networks current or accumulated earnings and profits (as determined for U.S. federal income tax purposes). 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 the U.S. Holder s basis in the Terra Networks ordinary shares or ADSs and then as capital gain. Terra Networks has not calculated, and does not intend to calculate, its earnings and profits for U.S. federal income tax purposes.

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The amount of a dividend a U.S. Holder is required to include in income will equal the U.S. dollar value of the euro, calculated by reference to the exchange rate in effect on the date the payment is received by the depositary (in the case of ADSs) or by the U.S. Holder (in the case of ordinary shares) regardless of whether the payment is converted into U.S. dollars on the date of receipt. If a U.S. Holder realizes gain or loss on a sale or other disposition of euro, it will be U.S. source ordinary income or loss. Corporate U.S. Holders will not be entitled to claim the dividends-received deduction with respect to dividends paid by Terra Networks. Subject to applicable limitations, dividends received by certain non-corporate U.S. Holders in taxable years beginning before January 1, 2009 will be taxable at a maximum rate of 15 percent, provided Terra Networks is not a PFIC for the taxable year in which the dividend is paid or the prior taxable year. Non-corporate U.S. Holders should consult their own tax advisors to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Spanish taxes withheld from the proposed 0.60 per Terra Networks ordinary share distribution will be creditable against a U.S. Holder s U.S. federal income tax liability, subject to applicable restrictions and limitations that may vary depending upon the U.S. Holder s circumstances. Instead of claiming a credit, a U.S. Holder may elect to deduct such Spanish taxes in computing its taxable income, subject to generally applicable limitations. The limitation of foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex. Therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

Telefónica

Taxation of Dividends

Distributions received by a U.S. Holder on Telefónica ordinary shares or ADSs, including the amount of any Spanish taxes withheld, other than certain pro rata distributions of Telefónica ordinary shares to all shareholders (including ADS holders), will constitute foreign source dividend income to the extent paid out of Telefónica s current or accumulated earnings and profits (as determined for U.S. federal income tax purposes). The amount of the dividend a U.S. Holder will be required to include in income will equal the U.S. dollar value of the euro, calculated by reference to the exchange rate in effect on the date the payment is received by the depositary (in the case of ADSs) or by the U.S. Holder (in the case of ordinary shares) regardless of whether the payment is converted into U.S. dollars on the date of receipt. If a U.S. Holder realizes gain or loss on a sale or other disposition of euro, it will be U.S. source ordinary income or loss. Corporate U.S. Holders will not be entitled to claim the dividends-received deduction with respect to dividends paid by Telefónica. Subject to applicable limitations, dividends received by certain non-corporate U.S. Holders in taxable years beginning before January 1, 2009 will be taxable at a maximum rate of 15 percent. Non-corporate U.S. Holders should consult their own tax advisors to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Spanish taxes withheld from dividends on Telefónica ordinary shares or ADSs at a rate not exceeding the rate provided in the Treaty will be creditable against a U.S. Holder s U.S. federal income tax liability, subject to applicable restrictions and limitations that may vary depending upon the U.S. Holder s circumstances. Instead of claiming a credit, a U.S. Holder may elect to deduct such Spanish taxes in computing its taxable income, subject to generally applicable limitations. The limitation of foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex. Therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

Pro rata distributions of ordinary shares to all shareholders (including ADS holders) are not generally subject to U.S. federal income tax provided that no shareholder may elect to receive cash or other property in lieu of receiving ordinary shares.

Taxation Upon Sale or Other Disposition of Telefónica Ordinary Shares or ADSs

A U.S. Holder will generally recognize capital gain or loss on the sale or other disposition of Telefónica ordinary shares or ADSs, which will be long-term capital gain or loss if the U.S. Holder has held such ordinary shares or ADSs for more than one year. The amount of the U.S. Holder s gain or loss will be equal to the difference between such U.S. Holder s tax basis in the ordinary shares or ADSs sold or otherwise disposed of and the amount realized on the sale or other disposition. Any gain or loss will generally be U.S. source gain or loss for foreign tax credit purposes.

As discussed under Spanish Tax Considerations-Taxation of Capital Gains above, gain realized by a U.S. Holder on the sale or other disposition of Telefónica ordinary shares or ADSs may be subject to Spanish tax unless the U.S. Holder provides the relevant Spanish tax authorities with both a certificate of U.S. tax residence on IRS Form 6166 and Spanish Form 210. Spanish law requires that both of these forms be filed within one month from the date on which the capital gain is realized. Applicants are advised to submit IRS Form 8802 and the accompanying declaration to the IRS well in advance of the date on which the IRS Form 6166 that will be issued by the IRS may be required by the Spanish tax authorities, as there may be delays in obtaining the necessary forms. U.S. Holders should consult their own tax advisors regarding the potential Spanish tax consequences of a sale or other disposition of Telefónica ordinary shares or ADSs and the procedures available for an exemption from such tax.

Passive Foreign Investment Company Considerations

Telefónica believes that it was not a PFIC for its most recent taxable year and does not expect to become a PFIC in the foreseeable future. However, since PFIC status depends upon the composition of a company s income and assets and the market value of its assets from time to time, there can be no assurance that it will not be considered a PFIC for any taxable year. If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADSs, certain adverse tax consequences could apply to the U.S. Holder.

If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADSs, gains recognized by such U.S. Holder on a sale or other disposition of Telefónica ordinary shares or ADSs would be allocated ratably over the U.S. Holder s holding period for such ordinary shares or ADSs. The amount allocated to the taxable year of the sale or other disposition and to any year before Telefónica became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the amount allocated to each such taxable year. Further, any distribution in respect of Telefónica ordinary shares or ADSs in excess of 125 percent of the average of the annual distributions on such ordinary shares or ADSs received by a U.S. Holder during the preceding three years or the U.S. Holder s holding period, whichever is shorter (an Excess Distribution), would be subject to taxation as described above.

If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADS and the ordinary shares or ADSs are regularly traded on a qualified exchange, such U.S. Holder may make a mark-to-market election, which may mitigate some of the adverse tax consequences resulting from Telefónica s PFIC status. The ordinary shares and ADSs will be treated as regularly traded in any calendar year in which more than a de minimis quantity of ordinary shares or ADSs are traded on a qualified exchange on at least 15 days during each calendar quarter of such calendar year. A qualified exchange includes certain exchanges in the United States, including the New York Stock Exchange where Telefónica ADSs are traded, and foreign exchanges that are regulated by a governmental authority in which the exchange is located and with respect to which certain other requirements are met. The IRS has not yet identified specific foreign exchanges that are qualified for this purpose.

If a U.S. Holder makes the mark-to-market election, for each year in which Telefónica is a PFIC, the U.S. Holder generally will include as ordinary income the excess, if any, of the fair market value of the Telefónica ordinary shares or 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 Telefónica ordinary shares or 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 a U.S. Holder makes the election, such U.S. Holder s basis in the Telefónica ordinary shares or ADSs will be adjusted to reflect any such income or loss amounts. Any gain recognized on the sale or other disposition of Telefónica ordinary shares or ADSs will be treated as ordinary income.

Regardless of whether a mark-to-market election is made, dividends paid by a PFIC will not be eligible for the preferential rates applicable to dividends received by certain non-corporate U.S. Holders, as discussed above.

U.S. Holders should consult their own tax advisors regarding the potential application of the PFIC rules to their ownership of Telefónica ordinary shares or ADSs.

Information Reporting and Backup Withholding

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and to backup withholding unless the U.S. Holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. Holder provides a correct taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder s U.S. federal income tax liability and may entitle such U.S. Holder to a refund, provided that the required information is furnished to the IRS.

Appraisal Rights

The holders of Telefónica and Terra Networks ordinary shares and ADSs do not have any right to an appraisal of the value of their ordinary shares in connection with the merger. However, an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the share exchange ratio is justified. See Report of the Spanish Independent Expert and Annex C-1 for an English-language translation of the report.

U.S. Federal Securities Laws Consequences

This joint information statement/prospectus does not cover any resales of the ordinary shares of Telefónica or Telefónica ADSs to be received by the shareholders of Terra Networks upon completion of the merger, and no person is authorized to make any use of this joint information statement/prospectus in connection with any such resale.

Relationship between Telefónica and Terra Networks

Telefónica Board of Directors Representation

As of February 23, 2005, Telefónica beneficially owned 436,205,419 Terra Networks ordinary shares, which represented 75.87% of the voting power of Terra Networks voting securities. As a result of our ownership of 75.87% of Terra Networks ordinary shares, we have the power to appoint at least 7 out of 9 members of Terra Networks Board of Directors. In addition, Mr. Isidro Fainé Casas, a member of Telefónica s Board of Directors, beneficially owned 3,546 ordinary shares of Terra Networks as of April 22, 2005.

Terra Networks is part of Telefónica s consolidated group for accounting purposes and, since 2004, has been included in Telefónica s consolidated tax group.

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Part Three The Merger

Strategic Alliance with Terra Networks

On February 12, 2003 Telefónica and Terra Networks entered into a Strategic Alliance Framework Agreement to replace a strategic alliance agreement dated May 16, 2000 to which Bertelsmann AG was also a party.

The Strategic Alliance Framework Agreement s term is for a period of six years ending on December 31, 2008 and will be renewed automatically on an annual basis thereafter, unless expressly terminated by the parties.

The following are the main characteristics of the Strategic Alliance Framework Agreement:

Terra Networks is to be the:

- Exclusive provider of essential portal elements within the Telefónica Group: the use of the brand, the aggregator of broad and narrowband Internet content and services aimed at household, SoHo and, when agreed, SME market segments in connection with Internet access and connectivity services offered by Telefónica Group companies.

- Preferred supplier of audit, consultancy, management and maintenance services for the Telefónica Group s country portals.

- Exclusive provider of online training services for the Telefónica Group s employees.

- Preferred supplier of comprehensive online marketing services for the companies of the Telefónica Group.

- Telefónica Group s exclusive provider of advanced network services and platforms necessary for developing services offered to household, SoHo and, when agreed, SME clients in both broad and narrowband, under most favored customer treatment, as allowed by regulations.

Pursuant to the Strategic Alliance Framework Agreement, Telefónica Group companies are required to acquire a minimum amount of online advertising space from Terra Networks Group companies and Terra Networks Group companies are required to purchase wholesale Internet access and connectivity services exclusively from Telefónica Group companies, provided, however, that such purchases are undertaken under the most favored customer treatment allowed by regulations. In addition, pursuant to the Strategic Alliance Framework Agreement, Terra Networks Group companies are to provide to Telefónica Group companies management of all or part of the service and/or operation of the network access elements for providing Internet access to the Telefónica Group companies household, SoHo and, when agreed, SME clients, under most favored customer treatment, as allowed by regulations.

Throughout its term, the Strategic Alliance Framework Agreement guarantees the Terra Networks Group at least 78.5 million per year in value, which represents the difference between the revenues arising from the services provided under the Strategic Alliance Framework Agreement and the costs and capital expenditures directly associated with those revenues. In compliance with the terms of the Strategic Alliance Framework Agreement, the annual minimum value was generated for the Terra Networks Group in 2003 and 2004.

Comparative per Ordinary Share and per ADS Market Price Information

The ordinary shares of Telefónica are listed on the Spanish stock exchanges in Madrid, Bilbao, Barcelona and Valencia and are traded on the Automated Quotation System of the Spanish stock exchanges. The ordinary shares of Terra Networks are listed on the Spanish stock exchanges in Madrid, Bilbao, Barcelona and Valencia and are traded on the Automated Quotation System of the Spanish stock exchanges.

ADSs representing ordinary shares of Telefónica are listed on the New York Stock Exchange. Each Telefónica ADS represents 3 ordinary shares of Telefónica. ADSs representing ordinary shares of Terra

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Networks are traded on Nasdaq National Market. Each Terra Networks ADS represents 1 ordinary share of Terra Networks. Citibank, N.A. is Telefónica s depositary issuing ADRs evidencing the Telefónica ADSs. Citibank, N.A. is Terra Networks depositary issuing ADRs evidencing the Terra Networks ADSs. Telefónica s ticker symbol on the NYSE is TEF and Terra Networks ticker symbol on the Nasdaq National Market is TRRA .

The following table shows, for the periods indicated, the high and low of the last reported closing prices per Telefónica and Terra Networks ordinary share and ADS, as reported on the Automated Quotation System, the NYSE and the Nasdaq National Market (as reported on the consolidated tape), respectively. All ordinary share and ADS prices are adjusted to reflect stock splits.

	Telefónica Ordinary Shares		**Telefónica ADSs**		**Terra Networks Ordinary shares**		**Terra Networks ADSs**	
	High	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**
	(euro)		**(U.S. dollars)**		**(euro)**		**(U.S. dollars)**	
2002								
First Quarter	15.75	12.35	39.43	30.83	10.07	7.95	9.0	6.85
Second Quarter	13.20	8.15	33.63	23.10	8.85	4.17	7.85	4.07
Third Quarter	10.04	7.54	28.75	21.47	7.22	3.95	7.24	3.76
Fourth Quarter	10.31	7.45	29.52	21.97	5.50	3.71	5.32	3.60
2003								
First Quarter	10.18	7.82	31.39	26.08	5.03	3.96	5.66	4.3
Second Quarter	10.40	8.70	36.61	28.54	5.50	4.38	6.95	4.67
Third Quarter	11.11	9.83	37.26	33.32	5.31	4.60	6.20	5.22
Fourth Quarter	11.78	10.23	44.38	35.84	5.09	4.60	6.0	5.35
2004								
First Quarter	13.44	11.98	51.67	43.70	5.34	4.80	6.63	5.85
Second Quarter	13.06	11.33	46.95	40.59	5.21	4.82	6.25	5.70
Third Quarter	12.37	11.11	45.50	40.75	4.96	2.75	6.06	3.25
Fourth Quarter	14.08	12.11	56.94	46.12	3.05	2.77	3.98	3.34
2005								
First Quarter	14.61	13.32	56.89	51.86	3.67	2.85	4.75	3.71
Second Quarter (through April 21)	13.49	13.04	52.32	50.61	3.43	3.32	4.49	4.24

On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, the last reported closing price, as reported on the Automated Quotation System was 14.46 for Telefónica ordinary shares and 3.19 for Terra Networks ordinary shares (or 3.21 per Telefónica-equivalent ordinary share, calculated by multiplying the Telefónica ordinary share price by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares). The last reported closing price on such day on the NYSE (as reported on the consolidated tape) was U.S.$55.91 for Telefónica ADSs and on the Nasdaq National Market was U.S.$4.07 for Terra Networks ADSs (or U.S.$4.14 per Telefónica-equivalent ADS, calculated by multiplying the Telefónica ADS price by the exchange ratio of 2 Telefónica ADSs for every 27 Terra Networks ADSs).

On April 21, 2005, the most recent practicable date prior to the date of this joint information statement/prospectus, the last reported closing price, as reported on the Automated Quotation System was 13.12 for Telefónica ordinary shares and 3.32 for Terra Networks ordinary shares (or 2.92 per Telefónica-equivalent ordinary share, calculated by multiplying the Telefónica ordinary share price by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares). The last closing price on such day on the

NYSE (as reported on the consolidated tape) was U.S.$51.98 for Telefónica ADSs and on the Nasdaq National Market was U.S.$4.29 for Terra Networks ADSs (or U.S.$3.85 per Telefónica-equivalent ADS, calculated by multiplying the Telefónica ADS price by the exchange ratio of 2 Telefónica ADSs for every 27 Terra Networks ADSs). **We urge you to obtain current market quotations prior to making any decision with respect to the merger.**

The Telefónica ADSs to be issued in the merger, like the currently issued Telefónica ADSs, will be listed on the NYSE, subject to approval by the NYSE of Telefónica s application to list such ADSs.

The merger plan describes that the holders of ordinary shares of Telefónica and Terra Networks will receive separate dividends prior to the merger as follows: (1) holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share as interim dividends with respect to the fiscal year ended December 31, 2004; (2) holders of Terra Networks ordinary shares and ADSs will receive 0.60 per Terra Networks ordinary share; and (3) holders of Telefónica ordinary shares and ADSs will receive a dividend of 1 Telefónica ordinary share for every 25 Telefónica ordinary shares already held. The determination of the exchange ratio took into consideration the dividends that both companies are expected to distribute. The dividends described under (2) and (3) above are subject to the final approval of the annual general shareholders meetings of each company.

Telefónica expects to continue to pay dividends on the ordinary shares of Telefónica and the Telefónica ADSs after completion of the merger. The payment of dividends by Telefónica in the future, however, will depend on business conditions, Telefónica s financial condition and earnings and other factors. Other than the dividends described in (1), (2) and (3) above, which will be paid prior to the merger, the holders of Telefónica ordinary shares and ADSs delivered in connection with the merger will be entitled to receive dividends on an equal basis with current holders of Telefónica ordinary shares and ADSs with respect to the year beginning January 1, 2005, including a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share payable on November 11, 2005, subject to final approval by the annual general shareholders meeting of Telefónica.

Report of the Spanish Independent Expert Appointed Pursuant to Spanish Law

On March 3, 2005, pursuant to Section 236 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), an independent expert was appointed by the Madrid Commercial Registry to prepare a report (the Spanish Independent Expert s Report) on the merger plan and on the net worth contributed by Terra Networks.

A free English-language translation of the full text of the Spanish Independent Expert s Report to the Boards of Directors of Telefónica and Terra Networks, which sets forth the procedures followed, assumptions made, matters considered and limitations on the review undertaken, is attached to this joint information statement/prospectus as Annex C-1. We encourage you to read this report carefully in its entirety. The Spanish Independent Expert s Report was provided to the Boards of Directors of Telefónica and Terra Networks in connection with its evaluation of the exchange ratio and relates only to the adequacy of the valuation methodologies used to determine the exchange ratio of the ordinary shares and the assessment of the net equity transferred by the company being dissolved. The Spanish Independent Expert s Report does not address any other aspect of the transaction, does not express an opinion regarding the fairness of the transaction or the value of the securities and does not constitute a recommendation to any holder of Telefónica s or Terra Networks ordinary shares as to how such shareholder should vote at its annual general shareholders meeting. The summary of the independent expert s report in this document is qualified in its entirety by reference to the full text of the report. The independent expert has consented to the inclusion of its report in this joint information statement/prospectus. By giving such consent, the independent expert has not admitted it is an expert with respect to any part of this joint information statement/prospectus within the meaning of the term expert as used in, or that the independent expert comes within the category of persons whose consent is required under, the Securities Act or the rules and regulations of the Securities and Exchange Commission promulgated thereunder. The independent expert has assumed responsibility for its work as an independent expert and prepared its report in accordance with the applicable provisions of Spanish law.

Subject to the assumptions made and limitations on the review undertaken in the Spanish Independent Expert s Report, and taking into account the matters described in section 4 of the report, the Spanish Independent Expert s Report considered that:

- the valuation methodologies used by the Board of Directors to determine the actual value of Telefónica and Terra Networks are appropriate in the context and the circumstances of the proposed transaction, and justify the share exchange ratio proposed in the merger plan and

- the net equity transferred by Terra Networks is at least equal to the maximum increase in capital of Telefónica as foreseen in the merger plan.

Report of the Board of Directors of Telefónica

Pursuant to Section 237 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), the Board of Directors of Telefónica has prepared and approved a report regarding the merger plan (the Telefónica Report) which, in accordance with the provisions of Section 237, provides a detailed explanation of the legal and financial aspects of the merger.

An English-language translation of the Telefónica Report is attached to this joint information statement/prospectus as Annex C-2. We encourage you to read this report carefully in its entirety. The Telefónica Report is divided into three parts. The first part contains the strategic rationale for the merger, which includes a discussion of recent changes in the telephony and Internet businesses and the Telefónica Board of Directors reasons for, and objectives of, the merger. The second part of the Telefónica Report contains a review of the legal aspects of the merger, including the legal structure of the merger, an analysis of legal aspects of the merger plan, the procedure for the exchange of shares, implementation of the legal process of a merger by absorption and a description of the information that will be made available to Telefónica shareholders prior to the annual general shareholders meeting. The third part of the Telefónica Report contains a discussion of the financial aspects of the merger, including the determination of the exchange ratio and the actual values of Telefónica and Terra Networks and valuation methodologies and procedures (which includes a discussion of the procedures employed by Morgan Stanley & Co. Limited in rendering its fairness opinion to the Board of Directors of Telefónica).

For the reasons stated therein, the Telefónica Report states that the Directors of Telefónica conclude that:

- the merger plan which is the subject of this Report is highly appropriate for both entities and the shareholders thereof, given that the merger will allow for the integration of the telephony and Internet businesses and thereby ensure success in facing the challenges raised by the development of the industry, technological change and new customer needs and the exchange ratio proposed in the merger plan is justified, and is fair for the shareholders of both entities, as confirmed by the reports of the financial advisors and the independent expert appointed by the Commercial Registry.

Report of the Board of Directors of Terra Networks

Also pursuant to Section 237 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), the Board of Directors of Terra Networks has prepared and approved a report regarding the merger plan (the Terra Networks Report) which, in accordance with the provisions of Section 237, provides a detailed explanation of the legal and financial aspects of the merger.

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An English-language translation of the Terra Networks Report is attached to this joint information statement/prospectus as Annex C-3. We encourage you to read this report carefully in its entirety. The Terra Networks Report is divided into two parts. The first part discusses the legal aspects of the merger, including the legal procedures for effecting the merger, the information that will be made available to Terra Networks shareholders prior to the annual general shareholders meeting, the procedure for the exchange of shares, treatment of the Terra Networks stock option plans and the tax treatment applicable to the merger. The second part of the Terra Networks Report contains a discussion of the financial aspects of the merger, including the strategic rationale for the merger and the Terra Networks Board of Director s reasons for, and objectives of, the merger, the determination of the exchange ratio and the actual values of Telefónica and Terra Networks and valuation methodologies and procedures (which includes a discussion of the procedures employed by Lehman Brothers Europe Limited and Citigroup Global Markets Limited in rendering their fairness opinions to the Board of Directors of Terra Networks).

For the reasons stated therein, the Terra Networks Report states that the Directors of Terra Networks conclude:

- that the merger examined in this Report is highly advisable for both merging companies and their shareholders, since the merger will permit the integration of the telephone and Internet businesses and thus enable the two companies to deal successfully with the challenges posed by the development of the industry, technological change and customers new needs and

- that the exchange ratio was calculated on the basis of the actual values of the two merging Companies, and that the exchange ratio is deemed fair for the shareholders of Terra other than its majority shareholder, Telefónica, as confirmed by the financial advisors.

Management Share Ownership and Stock Option Plans

In the merger, each stock option to buy Terra Networks ordinary shares granted under Terra Networks stock option plans, including stock option plans assumed by Terra Networks from Lycos Inc., that is outstanding and not yet exercised immediately before completing the merger will be transferred to Telefónica and Telefónica will issue as of the completion of the merger, in exchange therefor, an option to purchase Telefónica ordinary shares or ADSs, as applicable. The number of Telefónica ordinary shares and ADSs subject to each new option, as well as the exercise price of such option, will be adjusted to reflect the exchange ratio.

As of April 22, 2005, Terra Networks officers and directors and their affiliates beneficially owned (as defined in the rules promulgated under the Securities Exchange Act of 1934) an aggregate of 400 ordinary shares of Terra Networks, or less than 0.0001% of the issued and outstanding ordinary shares of Terra Networks. All of these ordinary shares will be treated in the merger in the same manner as ordinary shares of Terra Networks held by other shareholders of Terra Networks. As of December 31, 2004, options to purchase a total of 650,000 ordinary shares of Terra Networks, at exercise prices ranging from 4.48 to 17.78, were held by officers of Terra Networks under Terra Networks stock option plan. As of the same date, options to purchase 12,512,009 ordinary shares of Terra Networks, at exercise prices ranging from 0.00 to 24.00, were held by other beneficiaries of Terra Networks stock option plans.

Stock Option Plan Purchase

In December 2003 the Board of Directors of Terra Networks approved the acquisition of 4.41% of its capital stock owned by Citibank, N.A. as the agent bank for the stock option plans assumed by Terra Networks as part of the integration of Lycos Inc. The Terra Networks ordinary shares acquired from Citibank, N.A. were amortized following a resolution of the Terra Networks annual general shareholders meeting held on June 22, 2004 approving such action. Following the foregoing acquisition and amortization, the Terra Networks ordinary shares issuable under Terra Networks stock option plans were covered by 6.9 million ordinary shares held by La Caixa and 7.0 million ordinary shares held by Barclays Bank (formerly Banco Zaragozano).

On July 15, 2004, Terra Networks acquired the 7.0 million ordinary shares held by Barclays Bank. These ordinary shares are being held in treasury pending approval of a resolution at the annual general shareholders meeting to decrease Terra Networks share capital and amortize the 7.0 million ordinary shares.

Following the payment by Terra Networks of a dividend of 2.00 (U.S.$2.399) per ordinary share, on July 22, 2004, the Board of Directors of Terra Networks approved a resolution decreasing the strike price of Terra Networks stock options by 2.00 per ordinary share.

As of December 31, 2004, stock options to purchase 12,512,009 Terra Networks shares had been granted, the majority of which were out of the money, and were covered by 6.8 million Terra Networks ordinary shares held by La Caixa.

Summary of Opinion of Morgan Stanley & Co. Limited

Telefónica retained Morgan Stanley & Co. Limited to provide it with financial advisory services and a financial opinion in connection with its merger with Terra Networks. Telefónica selected Morgan Stanley & Co. Limited to act as its financial advisor based on Morgan Stanley & Co. Limited s qualifications, expertise and reputation. On February 23, 2005, Morgan Stanley & Co. Limited rendered its written opinion, that, as of that date, based upon and subject to the various considerations set forth in the opinion, the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan was fair from a financial point of view to Telefónica.

The full text of the written opinion of Morgan Stanley & Co. Limited, dated as of February 23, 2005, is attached to this joint information statement/prospectus statement as Annex B-1. The opinion sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Morgan Stanley & Co. Limited in rendering its opinion. We encourage you to read the entire opinion carefully. Morgan Stanley & Co. Limited s opinion is directed to Telefónica s Board of Directors and addresses only the fairness from a financial point of view of the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan to Telefónica as of the date of the opinion. It does not address any other aspects of the merger and does not constitute a recommendation to any holder of Telefónica or Terra Networks ordinary shares as to how to vote at their annual general shareholders meetings. The summary of the opinion of Morgan Stanley & Co. Limited set forth in this joint information statement/prospectus is qualified in its entirety by reference to the full text of the opinion. Morgan Stanley has consented to the inclusion of its opinion and the summary of its opinion in this joint information statement/prospectus statement. By giving such consent Morgan Stanley has not admitted that it is an expert with respect to any part of this joint information statement/prospectus statement within the meaning of the term expert as used in, or that Morgan Stanley comes within the category of persons whose consent is required under, the Securities Act or the rules and regulations of the Securities and Exchange Commission promulgated thereunder.

In connection with rendering its opinion, Morgan Stanley & Co. Limited, among other things:

a) reviewed certain publicly available financial statements and other business and financial information relating to Telefónica and Terra Networks respectively;

b) reviewed the reported prices and trading activity for the ordinary shares of Telefónica and Terra Networks respectively;

c) compared the financial performance of Terra Networks and Telefónica and the prices and trading activity of the ordinary shares of each of Telefónica and Terra Networks with that of certain other comparable publicly-traded companies comparable with Telefónica and Terra Networks, respectively and their securities;

d) reviewed the financial terms, to the extent publicly available, of certain comparable merger transactions;

e) reviewed certain equity research reports prepared by a number of investment banks relating to Telefónica and Terra Networks respectively;

f) reviewed certain equity research reports prepared by a number of investment banks relating to certain publicly-traded companies comparable with Telefónica and Terra Networks respectively;

g) reviewed certain internal financial statements and other financial and operating information concerning Telefónica and Terra Networks respectively;

h) reviewed Terra Networks management business plan dated February 14, 2005;

i) discussed the past, current and future operations of Terra Networks with the management of Telefónica;

j) reviewed the pro-forma impact of the merger on Telefónica s earnings per share;

k) reviewed the merger plan and certain related documents; and

l) considered such other factors, reviewed such other information and performed such other analyses as Morgan Stanley & Co. Limited deemed appropriate.

In arriving at its opinion, Morgan Stanley & Co. Limited assumed and relied upon, without independent verification, the accuracy and completeness of the information reviewed by it for the purposes of its opinion. With respect to internal financial statements, the financial projections and other financial data, Morgan Stanley & Co. Limited assumed that they had been reasonably prepared on bases reflecting the best currently available estimates and judgments of the future financial performance of Terra Networks and Telefónica. Morgan Stanley & Co. Limited discussed with the management of Telefónica the strategic rationale for the merger and the perceived strategic, financial and operating benefits of the merger for Telefónica if the merger is consummated. Morgan Stanley & Co. Limited did not make any independent valuation or appraisal of the assets or liabilities of Telefónica or Terra Networks, nor was it furnished with any such appraisals. Further, in accordance with

Telefónica s instructions, Morgan Stanley & Co. Limited only conducted a limited due diligence review for the purposes of its opinion and, in particular, Morgan Stanley & Co. Limited was not provided with, or had, access to the management of Terra Networks. With respect to legal, tax and accounting matters relating to the merger, Morgan Stanley & Co. Limited relied upon the information provided by and the judgments made by Telefónica and its legal, tax and accounting advisors. In arriving at its opinion, Morgan Stanley & Co. Limited was not authorized to solicit, and did not solicit, interest from any party with respect to the merger. Morgan Stanley & Co. Limited s opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to it as of the date of its opinion. Events occurring after the date of its opinion may affect Morgan Stanley & Co. Limited s opinion and the assumptions used in preparing it, and Morgan Stanley & Co. Limited did not assume any obligation to update, revise or reaffirm its opinion. In addition, Morgan Stanley & Co. Limited assumed that the merger will be consummated in accordance with the terms set forth in the merger plan without any waiver, amendment or delay of any terms or conditions.

The following is a brief summary of the material analyses performed by Morgan Stanley & Co. Limited in connection with the preparation of its written opinion letter dated February 23, 2005. Some of these summaries of financial analyses include information presented in tabular format. In order to fully understand the financial analyses used by Morgan Stanley & Co. Limited, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses.

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The various analyses summarized below were based on closing prices for the ordinary shares of Telefónica and Terra Networks as of February 21, 2005, adjusted to reflect the announced dividend distributions by each of the two companies:

i) Telefónica s share price: adjusted for a total of 0.80 per share in dividends declared by Telefónica (and which will not be payable to Terra Networks current shareholders with respect to the Telefónica shares they will receive following the merger, pursuant to the merger plan) as follows: (a) 0.23 per share cash dividend payable to Telefónica s current shareholders on May 13, 2005; and, (b) one Telefónica share for each 25 Telefónica shares to be distributed to current Telefónica s shareholders following the 2005 annual general shareholders meeting to be held on May 30, 2005 (estimated at 0.57 per share at Telefónica s closing share price as of February 21, 2005);

ii) Terra Networks share price: adjusted for the 0.60 per share cash dividend announced by Terra Networks Board of Directors on February 23, 2005, which will be distributed to Terra Networks current shareholders prior to the merger.

Trading Range Analysis

Morgan Stanley & Co. Limited reviewed the range of closing prices of Telefónica and Terra Networks ordinary shares for various periods ending on February 21, 2005. Morgan Stanley & Co. Limited observed the following:

Period Ending February 21, 2005	Telefónica	Terra Networks
Last Three Months	12.18 - 13.76	2.20 - 2.70
Last Six Months	10.66 - 13.76	2.17 - 2.70
Last Twelve Months	10.40 - 13.76	2.17 - 2.70

Morgan Stanley & Co. Limited calculated that the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares pursuant to the merger plan represented a 15% price premium to the unaffected share price of Terra Networks ordinary shares as of February 11, 2005, and a 14% price premium to the 30 trading days average of Terra Networks ordinary shares prior to February 21, 2005.

Comparable Companies Analysis

Morgan Stanley & Co. Limited compared certain financial information of Telefónica and Terra Networks with publicly available consensus financial estimates for other companies that shared similar business characteristics to Telefónica and Terra Networks, respectively. The companies used in this comparison included the following companies:

i) With respect to Telefónica: Belgacom, British Telecom, Deutsche Telekom, France Telecom, KPN, Hellenic Telecommunications (OTE), Portugal Telecom, Swisscom, Tele Danmark (TDC), Telecom Italia, TeliaSonera, Telekom Austria and Telenor; and

ii) With respect to Terra Networks: using as reference the unaffected closing share price of T-Online as of October 8, 2004 (prior to Deutsche Telekom s announcement of a minority buy out tender offer followed by a statutory merger with T-Online).

For the purposes of this analysis, Morgan Stanley & Co. Limited analyzed the ratio of aggregate value (defined as market capitalization plus total debt less cash and cash equivalents, plus other adjustments) to estimated calendar year 2005 earnings before interest, taxes, depreciation and amortization for Telefónica and to estimated calendar year 2006 earnings before interest, taxes, depreciation and amortization for Terra Networks. Morgan Stanley & Co. Limited applied this multiple to Telefónica s 2005 and Terra Networks 2006 earnings before interest, taxes, depreciation and amortization, utilizing as information sources for Telefónica, publicly available consensus financial forecasts, and for Terra Networks, financial forecasts prepared by the management of Terra Networks.

Based on Telefónica s and Terra Networks current outstanding ordinary shares and options, Morgan Stanley & Co. Limited estimated the implied value per Telefónica and Terra Networks ordinary share, respectively, as of February 21, 2005, as follows:

Calendar Year Financial	Financial Statistic	Comparable Companies Multiple Statistic	Implied Value Per Share
Telefónica Aggregate Value to Estimated 2005 Earnings Before Interest, Taxes, Depreciation and Amortization	14,301 MM	5.6x - 6.6x	10.89 - 13.77
Terra Networks Aggregate Value to Estimated 2006 Earnings Before Interest, Taxes, Depreciation and Amortization	60 MM	12.6	2.67

No company utilized in the comparable companies analysis is identical to Telefónica or Terra Networks. In evaluating comparable companies, Morgan Stanley & Co. Limited made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of Telefónica or Terra Networks, such as the impact of competition on the businesses of Telefónica or Terra Networks and the industry generally, industry growth and the absence of any adverse material change in the financial condition and prospects of Telefónica or Terra Networks or the industry or in the financial markets in general. Mathematical analysis (such as determining the average or median) is not in itself a meaningful method of using comparable company data.

Discounted Cash Flow Analysis

Morgan Stanley & Co. Limited calculated the range of equity values per ordinary share for each of Telefónica and Terra Networks based on a discounted cash flow analysis. With respect to Telefónica, Morgan Stanley & Co. Limited relied on publicly available consensus financial forecasts for calendar years 2005 through 2010 and extrapolations from such projections for calendar years 2011 through 2014. In arriving at a range of equity values per share of Telefónica ordinary shares, Morgan Stanley & Co. Limited calculated the terminal value by applying a range of perpetual growth rates ranging from 1.0% to 1.5% . The unlevered free cash flows from calendar year 2005 through 2014 and the terminal value were then discounted to present values using a range of discount rates of 8.0% to 9.0% . With respect to Terra Networks, Morgan Stanley relied on Terra Networks financial projections provided by the management of Telefónica (as received by them from Terra Networks) for calendar years 2005 through 2008 and extrapolations from such projections for calendar years 2009 through 2014. With respect to those financial projections and other information and data relating to Terra Networks, including information as to Terra Networks material tax attributes, Morgan Stanley & Co. Limited was advised by the Telefónica management that such forecasts and other information and data were reasonably prepared on bases reflecting the best current estimates and judgments of the management of Telefónica as to the future financial performance of Terra Networks and the expected realization by Terra Networks of its material tax attributes. In arriving at a range of equity values per share of Terra Networks ordinary shares, Morgan Stanley & Co. Limited calculated the terminal value by applying a range of perpetual growth rates from 3.0% to 4.0% . The unlevered free cash flows from calendar year 2005 through 2014 and the terminal value were then discounted to present values using a range of discount rates of 11.5% to 12.5% . The unlevered free cash flows included the benefits to Telefónica resulting from future tax or business or other savings as well as payments to be received by Terra Networks under its strategic agreement with Telefónica.

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The following table summarizes the results of Morgan Stanley & Co. Limited s analysis:

Key Assumptions	Implied Equity Value (MM)	Implied Equity Value Per Share
Telefónica: 1.0% - 1.5% perpetual growth rate, 8.0% - 9.0% discount rate	69,928 - 88,215	14.11 - 17.80
Terra Networks: 3.0% - 4.0% perpetual growth rate, 11.5% - 12.5% discount rate	1,448 - 1,522	2.55 - 2.68

Equity Research Analysts Price Targets

Morgan Stanley & Co. Limited reviewed and analyzed future public market trading price targets for Telefónica and Terra Networks ordinary shares prepared and published by equity research analysts. These targets reflect each analyst s estimate of the future public market trading price of Telefónica and Terra Networks ordinary shares. The range of equity analyst price targets reviewed for Telefónica and Terra Networks were 13.70 - 15.70 and 2.30 - 2.65, respectively.

The public market trading price targets published by equity research analysts do not necessarily reflect current market trading prices for Telefónica or Terra Networks ordinary shares and these estimates are subject to uncertainties, including the future financial performance of Telefónica and Terra Networks and future financial market conditions.

Analysis of Precedent Transactions

Morgan Stanley & Co. Limited reviewed Deutsche Telekom s minority buy out tender offer for the 26% free float of T-Online it did not own and the follow-on statutory merger between Deutsche Telekom and T-Online announced on October 9, 2004.

For the purposes of this analysis, Morgan Stanley & Co. Limited analyzed the ratio of aggregate value, defined as market capitalization plus total debt less cash and cash equivalents plus other adjustments, to estimated calendar year 2005 earnings before interest, taxes, depreciation and amortization and applied this multiple to Terra Networks 2005 earnings before interest, taxes, depreciation and amortization, included in the financial forecasts prepared by the management of Terra Networks. Based on Terra Networks current outstanding ordinary shares and options, Morgan Stanley & Co. Limited estimated the implied value per Terra Networks ordinary share as of February 21, 2005 as follows:

Valuation Statistic and Calendar Year	Financial Statistic	Comparable Company Multiple Statistic	Implied Value Per Share Range for Terra Networks
	52 MM	17.7x	2.96

Aggregate Value to Estimated 2005 Earnings Before Interest, Taxes, Depreciation and Amortization

No company or transaction utilized in the precedent transaction analyses was identical to Terra Networks or the merger. In evaluating the precedent transactions, Morgan Stanley & Co. Limited made judgments and assumptions with regards to general business, market and financial conditions and other matters, which are beyond the control of Terra Networks, such as the impact of competition on the business of Terra Networks or the industry generally, industry growth and the absence of any adverse material change in the financial condition of Terra Networks or the industry or in the financial markets in general, which could affect the public trading value of the companies and the aggregate value of the transactions to which they are being compared.

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Part Three The Merger

Exchange Ratio Analysis

Morgan Stanley & Co. Limited reviewed the ratios of the closing prices of Terra Networks ordinary stock divided by the corresponding closing prices of Telefónica ordinary stock over various periods ending February 21, 2005. Morgan Stanley & Co. Limited examined the premiums represented by the merger exchange ratio of 0.2222, as set forth in the merger plan, over the benchmarks mentioned below and found them to be as follows:

	Telefónica (/share)	Terra Networks (/share)	Implied Exchange Ratio	Implied Premium[1]
Last Twelve Months Avge.	10.40 - 13.76	2.17 - 2.70	0.196 - 0.209	6% - 13%
Last Six Months Avge.	10.66 - 13.76	2.17 - 2.70	0.196 - 0.204	9% - 13%
Last 90 Days Avge.	12.18 - 13.76	2.20 - 2.70	0.181 - 0.196	23% - 13%

1 Implied premium defined as announced exchange ratio of 0.2222 divided by implied exchange ratio for each trading average.

In connection with the review of the merger by Telefónica s Board of Directors, Morgan Stanley & Co. Limited performed a variety of financial and comparative analyses for purposes of rendering its opinion. The preparation of a financial opinion is a complex process and is not necessarily susceptible to a partial analysis or summary description. In arriving at its opinion, Morgan Stanley & Co. Limited considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor it considered. Morgan Stanley & Co. Limited believes that selecting any portion of its analyses, without considering all analyses as a whole, would create an incomplete view of the process underlying its analyses and opinion. In addition, Morgan Stanley & Co. Limited may have given various analyses and factors more or less weight than other analyses and factors, and may have deemed various assumptions more or less probable than other assumptions. As a result, the ranges of valuations resulting from any particular analysis described above should not be taken to be Morgan Stanley & Co. Limited s view of the actual value of Telefónica or Terra Networks. In performing its analyses, Morgan Stanley & Co. Limited made numerous assumptions with respect to industry performance, general business and economic conditions and other matters. Many of these assumptions are beyond the control of Telefónica. Any estimates contained in Morgan Stanley & Co. Limited s analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by such estimates.

Morgan Stanley & Co. Limited conducted the analyses described above solely as part of its analysis of the fairness of the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan from a financial point of view to Telefónica and in connection with the delivery of its opinion to Telefónica s Board of Directors. These analyses do not purport to be appraisals or to reflect the prices at which shares of ordinary shares of Telefónica or Terra Networks might actually trade.

The merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, was determined through arm s-length negotiations between Telefónica and Terra Networks and was approved by Telefónica s Board of Directors. Morgan Stanley & Co. Limited provided advice to Telefónica during these negotiations. Morgan Stanley & Co. Limited did not, however, recommend any specific merger consideration to Telefónica or that any specific merger consideration constituted the only appropriate merger consideration for the merger.

Morgan Stanley & Co. Limited s opinion and its presentation to Telefónica s Board of Directors was one of many factors taken into consideration by Telefónica s Board of Directors in deciding to approve, adopt and authorize the merger. Consequently, the analyses as described above should not be viewed as determinative of the opinion of Telefónica s board of directors with respect to the merger consideration or of whether Telefónica s Board of Directors would have been willing to agree to a different merger consideration.

Telefónica s Board of Directors retained Morgan Stanley & Co. Limited based upon Morgan Stanley & Co. Limited s qualifications, experience and expertise. Morgan Stanley & Co. Limited is an internationally recognized investment banking and advisory firm. Morgan Stanley & Co. Limited, as part of its investment banking and financial advisory business, is continuously engaged in the valuation of businesses and securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate, estate and other purposes. In the ordinary course of its trading, brokerage, investment management and financing activities, Morgan Stanley & Co. Limited or its affiliates may actively trade the equity securities of Telefónica and its listed subsidiaries, including Terra Networks, for its own accounts or for the accounts of its customers and, accordingly, may at any time hold long or short positions in such securities.

Under the terms of its engagement letter, Morgan Stanley & Co. Limited provided Telefónica with financial advisory services and a financial opinion in connection with the merger, and Telefónica agreed to pay Morgan Stanley & Co. Limited a fee of 1 million, which is contingent upon completion of the merger. Telefónica has also agreed to reimburse Morgan Stanley & Co. Limited for its expenses incurred in performing its services. In addition, Telefónica has agreed to indemnify Morgan Stanley & Co. Limited and its affiliates, their respective directors, officers, agents and employees and each person, if any, controlling Morgan Stanley & Co. Limited or any of its affiliates against certain liabilities and expenses, including certain liabilities under the federal securities laws, related to or arising out of Morgan Stanley & Co. Limited s engagement. In the past, Morgan Stanley & Co. Limited and its affiliates have provided financial advisory and financing services for Telefónica and have received fees in connection with such services.

Summary of Opinion of Lehman Brothers Europe Limited

The Board of Directors of Terra Networks engaged Lehman Brothers Europe Limited to act as its financial advisor in connection with a possible business combination transaction with Telefónica. As part of its engagement, Lehman Brothers Europe Limited was asked to render an opinion to Terra Networks Board of Directors with respect to the fairness, from a financial point of view, to the shareholders of Terra Networks (other than Telefónica) of the exchange ratio to be offered in the merger. On February 23, 2005, Lehman Brothers Europe Limited rendered its oral opinion, subsequently confirmed in writing, to the Board of Directors of Terra Networks that based upon and subject to matters stated therein, as of the date of its opinion, from a financial point of view, the exchange ratio of two Telefónica ordinary shares per each nine Terra Networks ordinary shares to be offered in the proposed merger was fair to the shareholders of Terra Networks (other than Telefónica). In connection with rendering its opinion, Lehman Brothers Europe Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Network shareholders prior to the merger.

The full text of Lehman Brothers Europe Limited s written opinion, dated February 23, 2005, is attached as Annex B-2 to this joint information statement/prospectus. The description of the opinion set forth below is qualified in its entirety by reference to the opinion. You should read the opinion in its entirety for a discussion of the assumptions made, procedures followed, factors considered and limitations upon the review undertaken by Lehman Brothers Europe Limited in rendering its opinion. The following is a summary of Lehman Brother s opinion and the methodology that Lehman Brothers Europe Limited used to render its fairness opinion. Lehman Brothers Europe Limited has consented to the inclusion of its opinion in this joint information statement/prospectus. By giving such consent Lehman Brothers Europe Limited has not thereby admitted that they are experts with respect to any part of the joint information statement/prospectus within the meaning of the term expert as used in, or that they come within the category of persons whose consent is required under, the Securities Act of 1933, as amended, or the rules and regulations of the Securities and Exchange Commission promulgated thereunder.

Lehman Brothers Europe Limited s opinion was provided for the information and assistance of the Board of Directors of Terra Networks in connection with its consideration of the proposed merger. Lehman Brothers Europe Limited s opinion is not intended to be and does not constitute a recommendation to any shareholder of Terra Networks as to how such shareholder should vote with respect to the proposed merger, whether such shareholder should hold or sell any of such shareholder s Terra Networks ordinary shares prior to the completion of the merger or whether such shareholder should hold or sell any Telefónica ordinary shares received in the merger. Lehman Brothers Europe Limited was not requested to opine as to, and Lehman Brothers Europe Limited s opinion does not in any manner address, Terra Networks underlying business decision to proceed with or effect the proposed merger.

In arriving at its opinion and in relation to Terra Networks, Lehman Brothers Europe Limited reviewed and analyzed:

(1) a draft of the merger plan and the specific terms of the proposed merger;

(2) publicly available information concerning Terra Networks that Lehman Brothers Europe Limited believed to be relevant to its analysis;

(3) financial and operating information with respect to the business, operations and prospects of Terra Networks furnished to Lehman Brothers Europe Limited by Terra Networks;

(4) a trading history of Terra Networks ordinary shares since its initial public offering to the date of its opinion and a comparison of that trading history with those of other companies that Lehman Brothers Europe Limited deemed relevant; and

(5) a comparison of the financial terms of the proposed merger with the financial terms of certain other recent transactions that Lehman Brothers Europe Limited deemed relevant.

In addition, Lehman Brothers Europe Limited had discussions with the management of Terra Networks concerning Terra Networks business, operations, assets, financial condition and prospects and undertook such other studies, analyses and investigations as Lehman Brothers Europe Limited deemed appropriate.

In arriving at its opinion and in relation to Telefónica, Lehman Brothers Europe Limited reviewed and analyzed such publicly available information as Lehman Brothers Europe Limited deemed relevant and, in particular the consensus price targets for Telefónica ordinary shares published by research analysts and an analysis of the recent trading performance of Telefónica ordinary shares. Lehman Brothers Europe Limited did not have access to non-public information relating to Telefónica nor did Lehman Brothers Europe Limited meet with Telefónica s management team to assess its future prospects.

In arriving at its opinion, Lehman Brothers Europe Limited assumed and relied upon the accuracy and completeness of the financial and other information provided to Lehman Brothers Europe Limited without assuming any responsibility for independent verification of such information and further relied upon the assurances of management of Terra Networks that they were not aware of any facts or circumstances that would make such information inaccurate or misleading. At the request of Terra Networks Board of Directors, Lehman Brothers Europe Limited also retained independent counsel to advise it on certain matters relating to the material tax attributes of Terra Networks and the effect of the proposed merger on those attributes, and Lehman Brothers Europe Limited relied on that advice. With respect to the financial projections of Terra Networks, including information as to Terra Networks material tax attributes, upon advice of Terra Networks, Lehman Brothers Europe Limited assumed that such projections and information were reasonably prepared on a basis reflecting the best currently available estimates and judgments of, and information available to, the management of Terra Networks as to the future financial performance and tax attributes of Terra Networks. However, for purposes of its analysis, Lehman Brothers Europe Limited also utilised its own sector wide and company specific assumptions and estimates which resulted in certain adjustments to the projections of Terra Networks. Lehman Brothers Europe Limited discussed these adjusted projections with the management of Terra Networks and management agreed with the logic of the use of such adjusted projections in arriving at Lehman Brothers Europe Limited s opinion.

In arriving at its opinion, Lehman Brothers Europe Limited (i) took into account, among other factors, the proposed dividend of 0.23 to be paid by Telefónica to its shareholders in respect of 2004 and the proposed distribution by Telefónica of one Telefónica share for each 25 Telefónica shares, in which Terra Networks shareholders will not participate, and (ii) did not conduct a physical inspection of the properties and facilities of Terra Networks and did not make or obtain any evaluations or appraisals of the assets or liabilities of Terra Networks. In addition, Lehman Brothers Europe Limited was not asked or authorized to solicit, and Lehman Brothers Europe Limited did not solicit, any indications of interest from any third party with respect to the purchase of all or a part of Terra Networks business. Lehman Brothers Europe Limited s opinion necessarily was based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of its opinion.

In connection with rendering its opinion, Lehman Brothers Europe Limited performed certain financial, comparative and other analyses as described below. The preparation of a fairness opinion involves determinations as to the most appropriate and relevant methods of financial and comparative analysis and the application of those methods to the particular circumstances, and therefore, such an opinion is not readily susceptible to summary description. Accordingly, Lehman Brothers Europe Limited believes that its analyses must be considered as a whole and that considering any portion of such analyses and factors, without considering all analyses and factors as a whole, could create a misleading or incomplete view of the process underlying its opinion. In its analyses, Lehman Brothers Europe Limited made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of Terra Networks and Telefónica. None of Terra Networks, Telefónica, Lehman Brothers Europe Limited or any other person assumes responsibility if future results are materially different from those discussed or assumed. Any estimates contained in these analyses were not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than as set forth therein. In addition, analyses relating to the value of businesses do not purport to be appraisals or to reflect the prices at which businesses may actually be sold.

The following is a summary of the material financial analyses used by Lehman Brothers Europe Limited in connection with providing its opinion to Terra Networks Board of Directors. Certain of the summaries of financial analyses include information presented in tabular format. In order to fully understand the financial analyses performed by Lehman Brothers Europe Limited, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Accordingly, the analyses listed in the tables and described below must be considered as a whole. Considering any portion of such analyses and of the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying Lehman Brothers Europe Limited s opinion.

Terra Networks Valuation

Sum-of-the-Parts Analysis

Lehman Brothers Europe Limited reviewed the stand-alone valuation of Terra Networks on the basis of a sum-of-the-parts approach, utilizing different valuation methodologies depending on the type of asset. For Terra Networks cash position, Lehman Brothers Europe Limited used book value as of December 31, 2004. For financial investments and interest in other companies, Lehman Brothers Europe Limited used market value, option value or net present value of future proceeds from the sale of interests subject to an offer or a commitment

to buy from a third party. For the strategic alliance contract between Terra Networks and Telefónica and Terra Networks joint venture interests, operating assets and tax credits, Lehman Brothers Europe Limited used discounted cash flow valuation, pursuant to which forecasted free cash flows attributable to such assets were discounted to net present value by weighted cost of capital rates.

In addition to being valued on a discounted cash flow basis, as a supplemental comparison, Terra Networks Spanish operating assets were also valued by using a comparable companies approach, pursuant to which multiples derived from implied values from transactions involving companies in comparable businesses and from EBITDA and revenue of comparable companies were applied to Terra Networks Spanish access business and its other Spanish business. Multiples derived from subscriber acquisition costs and gross margins of companies in comparable businesses were also applied to Terra Networks Spanish access business.

The result of Lehman Brother s sum-of-the-parts analysis was an implied value per Terra Networks ordinary share of 3.18.

Other Value Effects

Lehman Brothers Europe Limited then observed that potential synergies, loss of historical tax credits and the potential ability to realize value from a tax credit relating to Terra Networks sale of Lycos Inc. were other potential sources of value or loss of value not included in the sum-of-the parts analysis of Terra Networks. Accordingly, Lehman Brothers Europe Limited calculated an adjustment to its sum-of-the-parts implied value per Terra Networks ordinary share described above to take into account an estimate of the aggregate impact of these other potential effects on value to arrive at an adjusted merger value per Terra Networks ordinary share of 3.57.

Comparable Companies Analysis

Lehman Brothers Europe Limited compared Terra Networks as a whole against the following eight other companies:

- easynet
- freenet.de
- Iliad
- TI Media
- T-Online

Tiscali

United Internet

Web.de

Lehman Brothers Europe Limited applied the average multiple of the listed companies enterprise values to forecasted EBITDA for each of 2005 and 2006 to Terra Networks forecasted EBITDA for such years to calculate implied firm values for Terra Networks, and then made adjustments to such firm values for other assets and liabilities. The results of this analysis were implied equity values of 3.05 and 3.18 per Terra Networks ordinary share based on Terra Networks forecasted EBITDA for 2005 and 2006, respectively.

Lehman Brothers Europe Limited noted that, while the review of comparable companies served as comparative information, due to the different profitability and risk profile of Terra Networks, the comparable companies analysis should not be deemed a meaningful valuation methodology.

Broker Views

Lehman Brothers Europe Limited also reviewed brokers target prices for Terra Networks ordinary shares in reports published between April 2004 and February 8, 2005. Lehman Brothers Europe Limited adjusted two of the target prices published in April 2004 for the 2.00 dividend on Terra Networks ordinary shares paid in July 2004. The average of these target prices was 3.00 and the median was 3.00.

Telefónica Valuation

As noted above, Lehman Brothers Europe Limited was not provided with any non-publicly available business or financial information, including financial forecasts, for Telefónica. Therefore, Lehman Brothers Europe Limited analyzed Telefónica s valuation using a market-based approach.

Broker Views

Lehman Brothers Europe Limited reviewed brokers target prices for Telefónica ordinary shares in reports published between November 11, 2004 and February 21, 2005. The average of these target prices was 14.92 and the median was 14.55.

Historical Share Price Performance

Lehman Brothers Europe Limited reviewed the historical share price performance and trading volumes of Telefónica ordinary shares from May 25, 2003, the launch date of Telefónica s 2003 tender offer for Terra Networks shares, through to February 14, 2005, the date that Telefónica announced its intention to make an offer for a business combination transaction with Terra Networks. Lehman Brothers Europe Limited also calculated the average market price of Telefónica ordinary shares for the one-month, six-month and one-year periods prior to February 14, 2005 and for the period from May 25, 2003 to February 14, 2005. The following table sets forth the results of this analysis:

Period	Average Share Price ( )
1 month	14.02
6 months	13.05
1 year	12.67
Since Launch of Tender Offer on May 28, 2003	11.52

Relative Valuation

Lehman Brothers Europe Limited performed a relative analysis of the historical share price performance for both Terra Networks and Telefónica by comparing market prices of Terra Networks ordinary shares (as adjusted for a dividend payment of 2.00 per share on July 29, 2004) to market prices of Telefónica ordinary shares during the period from May 28, 2003 to February 1, 2005. Lehman Brothers Europe Limited also calculated the average ratio of the market price of a Telefónica ordinary share to the adjusted price of a Terra Networks ordinary share for the month of January 2005, the six-month period of August 2004 through January 2005, the one-year period of February 2004 through January 2005 and for the period from May 25, 2003 to January 4, 2005. The following table sets forth the results of this analysis:

Period	**Average Ratio**
1 month	4.49:1
6 months	4.45:1
1 year	4.30:1
Since Launch of Tender Offer on May 28, 2003	4.02:1

Lehman Brothers Europe Limited noted that the ratios set forth in the table above were not adjusted to include the effect of the anticipated cash dividend of 0.60 to be paid to Terra Networks shareholders, including Telefónica, prior to consummation of the merger.

Public Market Valuation of Consideration

Lehman Brothers Europe Limited then analyzed the implied offer price for the proposed merger based on the exchange ratio of 4.5:1 for the proposed merger, the high and low market prices for Telefónica ordinary shares during the one month period prior to February 22, 2005 and the market price on such date, and adding the effect of the 0.60 anticipated dividend on Terra Network ordinary shares. The results of this analysis are set forth in the table below:

	Low	High	As of February 22, 2005
Implied Terra Networks Share Price in Offer ( )	3.59	3.84	3.69

Lehman Brothers Europe Limited observed that the range of the implied offer price set forth in the table above is greater than the adjusted merger value of 3.57 per Terra Networks ordinary share discussed above under the heading Terra Networks Valuation Other Value Effects .

Miscellaneous

Lehman Brothers Europe Limited is an internationally recognized investment banking firm and, as part of its investment banking activities, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive bids, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes. Terra Networks Board of Directors selected Lehman Brothers Europe Limited because of its expertise, reputation and familiarity with Terra Networks and its industry generally and because its investment banking professionals have substantial experience in transactions comparable to the merger.

As compensation for its services in connection with the merger, Lehman Brothers Europe Limited received a fee of 1 million upon delivery of its opinion. In addition, Terra Networks has agreed to reimburse Lehman Brothers Europe Limited for reasonable out-of-pocket expenses incurred in connection with the merger and to indemnify Lehman Brothers Europe Limited and its related parties for certain liabilities that may arise out of its engagement by Terra Networks and the rendering of Lehman Brothers Europe Limited s opinion.

Lehman Brothers Europe Limited and its affiliates in the past have provided, and currently provide, services to Terra Networks and Telefónica, including in connection with mergers and acquisitions other than the proposed merger. An affiliate of Lehman Brothers Europe Limited has provided a two-year 100 million revolving credit facility to Telefónica which remains undrawn as of the date of Lehman Brothers Europe Limited s opinion. In the ordinary course of its business, Lehman Brothers Europe Limited and its affiliates may actively trade in the debt or equity securities of Terra Networks and Telefónica or their affiliates for their own accounts or for the account of their customers and, accordingly, may at any time hold a long or short position in such securities.

Summary of Opinion of Citigroup Global Markets Limited

Terra Networks retained Citigroup Global Markets Limited to act as its joint financial advisor in connection with a possible business combination transaction with Telefónica. In connection with its engagement, Terra Networks instructed Citigroup Global Markets Limited to evaluate the fairness, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates) of the exchange ratio. At the February 23, 2005 meeting of the Board of Directors of Terra Networks, Citigroup Global Markets Limited delivered its oral opinion to the Board of Directors of Terra Networks, subsequently confirmed in writing, to the effect that, based upon and subject to the qualifications and assumptions set forth therein, as of the date thereof, the exchange ratio of 2/9ths of an ordinary share of Telefónica for each ordinary share of Terra Networks was fair, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates). In connection with rendering its opinion, Citigroup Global Markets Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Network shareholders prior to the merger.

The full text of Citigroup Global Markets Limited s opinion dated February 23, 2005 is attached as Annex B-3 to this prospectus. We urge you to read this opinion in its entirety for assumptions made, procedures followed, matters considered and limits of the review by Citigroup Global Markets Limited in arriving at its opinion. The following summary of the opinion of Citigroup Global Markets Limited is qualified in its entirety by reference to the full text of Citigroup Global Markets Limited s opinion. Citigroup Global Markets Limited has consented to the inclusion of its opinion in this joint information statement/prospectus. By giving such consent Citigroup Global Markets Limited has not thereby admitted that they are experts with respect to any part of the joint information statement/prospectus within the meaning of the term expert as used in, or that they come within the category of persons whose consent is required under, the Securities Act of 1933, as amended, or the rules and regulations of the Securities and Exchange Commission promulgated thereunder.

Citigroup Global Markets Limited s opinion is directed only to the fairness, from a financial point of view, of the exchange ratio to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates) and is not intended and does not constitute a recommendation to any Terra Networks shareholder as to how such shareholder should vote at the annual general shareholders meeting of Terra Networks or whether such shareholder should hold or sell any of such shareholder s Terra Networks ordinary shares prior to the completion of the merger. Except as described below, no limitations were imposed by Terra Networks or Telefónica upon Citigroup Global Markets Limited with respect to the investigations made or procedures followed by it in rendering its opinion. Although Citigroup Global Markets Limited evaluated the financial terms of the merger and participated in discussions concerning the determination of the exchange ratio, Citigroup Global Markets Limited was not asked to and did not recommend this exchange ratio, which was the result of negotiations between Terra Networks and Telefónica.

In connection with rendering its opinion, Citigroup Global Markets Limited, among other things:

- reviewed a draft dated February 23, 2005, of the merger plan;
- held discussions with certain senior officers, directors and other representatives and advisors of Terra Networks concerning the businesses, operations and prospects of Terra Networks;
- examined certain publicly available business and financial information relating to Terra Networks and Telefónica as well as certain financial forecasts and other information and data relating to Terra Networks, including information as to Terra Networks material tax attributes, which were provided to or discussed with Citigroup Global Markets Limited by the management of Terra Networks;
- reviewed the financial terms of the merger in relation to, among other things:
    - current and historical market prices of Terra Networks ordinary shares and Telefónica ordinary shares,

the historical and projected earnings and other operating data of Terra Networks and Telefónica (Citigroup Global Markets Limited, however, was not provided with any non-publicly available business or financial information, including financial forecasts, for Telefónica); and

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the capitalization and financial condition of Terra Networks and Telefónica;

considered, to the extent publicly available, the financial terms of certain other transactions which Citigroup Global Markets Limited considered relevant in evaluating the merger;

analyzed certain financial, stock market and other publicly available information relating to the businesses of other companies whose operations Citigroup Global Markets Limited considered relevant in evaluating those of Terra Networks and Telefónica;

took into account, among other factors, the proposed dividend of 0.23 per Telefónica ordinary share in respect of 2004 and the proposed distribution by Telefónica of one Telefónica ordinary share for each 25 Telefónica ordinary shares, in which the holders of Terra Networks ordinary shares will not participate, and the proposed dividend of 0.60 per Terra Networks ordinary share to be paid by Terra Networks to all holders of Terra Networks ordinary shares; and

conducted such other analyses and examinations and considered such other information and financial, economic and market criteria as Citigroup Global Markets Limited deemed appropriate.

In rendering its opinion, Citigroup Global Markets Limited assumed and relied, without assuming any responsibility for independent verification, upon the accuracy and completeness of all financial and other information and data publicly available or provided to or otherwise reviewed by or discussed with Citigroup Global Markets Limited and upon the assurances of the management of Terra Networks that it was not aware of any relevant information that had been omitted or that remained undisclosed to Citigroup Global Markets Limited. With respect to financial forecasts and other information and data relating to Terra Networks, including information as to Terra Networks material tax attributes, provided to or otherwise reviewed by or discussed with Citigroup Global Markets Limited, Citigroup Global Markets Limited was advised by the management of Terra Networks that such forecasts and other information and data were reasonably prepared on bases reflecting the best currently available estimates and judgments of the management of Terra Networks as to the future financial performance of Terra Networks and the expected realization by Terra Networks of its material tax attributes. At the request of Terra Networks Board of Directors, Citigroup Global Markets Limited also retained independent counsel of international standing to advise Citigroup Global Markets Limited on certain matters relating to the material tax attributes of Terra Networks and the effect of the merger on those attributes, and Citigroup Global Markets Limited relied on that advice.

Citigroup Global Markets Limited s opinion relates to the relative values of Terra Networks and Telefónica. Citigroup Global Markets Limited s opinion and analyses are not intended to be and do not constitute a recommendation as to whether any Terra Networks shareholder should hold or sell any Telefónica ordinary shares received in the merger. Citigroup Global Markets Limited did not express any opinion as to what the value of the Telefónica ordinary shares actually will be when issued pursuant to the merger or the price at which the Telefónica ordinary shares will trade at any time. Citigroup Global Markets Limited did not make nor was it provided with an independent evaluation or appraisal of the assets or liabilities (contingent or otherwise) of Terra Networks or Telefónica (other than material tax attributes of Terra Networks, referred to above), nor did Citigroup Global Markets Limited make any physical inspection of the properties or assets of Terra or Telefónica. Citigroup Global Markets Limited was not requested to, and did not, solicit third party indications of interest in the possible acquisition of all or a part of Terra Networks. Citigroup Global Markets Limited expressed no view as to, and its opinion does not address, the relative merits of the merger as compared to any alternative business strategies that might exist for Terra Networks or the effect of any other transaction in which Terra Networks might engage. In particular, Citigroup Global Markets Limited took into account the fact that Telefónica currently controls Terra Networks. Citigroup Global Markets Limited s opinion was necessarily based upon information available to Citigroup Global Markets Limited, and financial, stock market and other conditions and circumstances existing, as of the date of its opinion.

Citigroup Global Markets Limited s opinion and financial analyses were only one of many factors considered by Terra Networks Board of Directors in its evaluation of the merger and should not be viewed as determinative of the views of Terra Networks Board of Directors with respect to the merger or the exchange ratio provided for in the transaction.

In preparing its opinion, Citigroup Global Markets Limited performed a variety of financial and comparative analyses. The preparation of a financial opinion is a complex analytical process, involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances and, therefore, a financial opinion is not readily susceptible to summary description. Accordingly, Citigroup Global Markets Limited believes that its analyses must be considered as a whole and that selecting portions of its analyses and factors or focusing on information presented in tabular format, without considering all analyses and factors, could create a misleading or incomplete view of the processes underlying its analyses and opinion.

The following is a summary of the material financial analyses performed by Citigroup Global Markets Limited in connection with the preparation of its opinion and presented to the Board of Directors of Terra Networks at its meeting on February 23, 2005.

Historical Share Price Performance

Citigroup Global Markets Limited reviewed the relationship between movements in prices of Terra Networks ordinary shares and Telefónica ordinary shares and the implied offer price for the merger for the period from July 25, 2003, the date on which Telefónica officially announced to the CNMV the number of Terra Networks ordinary shares it acquired in the tender offer, through February 11, 2005, the last trading day before Telefónica publicly announced its intention to make an offer for a business combination transaction with Terra Networks. The implied offer price for the merger was calculated by multiplying the adjusted Telefónica share price by the exchange ratio of 2/9 and then adding 0.60 for the effect of the anticipated dividend on Terra Network ordinary shares to be paid before consummation of the merger. The adjusted Telefónica share price was arrived at by subtracting the anticipated cash dividend of 0.23 from the Telefónica unadjusted share price and then adjusting the result for the anticipated stock dividend on Telefónica ordinary shares of one share for every 25 outstanding shares, in which cash and stock dividends Terra Networks shareholders will not participate. Citigroup Global Markets Limited also adjusted the Terra Networks share pri