

Annual Report 2003

IBERIA 

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IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S. A.

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IBERIA GROUP

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Dear shareholder,

This is my first opportunity to address you since I was appointed Chairman of Iberia in June 2003, and it is an honour to do so through this annual report, containing a balance sheet which, in my opinion, clearly shows that Iberia has achieved the two major objectives it set itself at the beginning of the year: profitability and quality.

For the eighth year in succession, and very few air carriers in the world are able to present a similar balance sheet, Iberia has ended the year with a profit, a total of €201.7 million before tax, €145.8 million net profit and €700.7 million EBITDAR, with a 15.2% margin on revenues. At the same time, we have increased shareholders' equity by 8.7%, giving Iberia, after deducting its debt, a cash position of €938 million.

This has been no easy task. Once again, 2003 has put our ability to meet and overcome challenges and difficulties to the test. Apart from the structural changes within the sector, with the irruption of new types of air carriers and business models and the change in customer expectations, the international situation is clearly unstable.

The optimistic expectations for 2003 were soon thwarted by the international tensions in Iraq, the SARS crisis, the hike in oil prices and the weak situation of the leading world economies, especially in the European countries traditionally considered the driving forces of development.

That instability and its repercussions on world air traffic forced us, back in the first quarter, to cut capacity and adapt to market conditions. Once again, our flexibility measures were vital, enabling us to delay the delivery of three new airplanes, reduce capacity in view of the clear recession in the first half of the year and increase it in the second half of the year, as the economy picked up. Accordingly, in the first half of the year, we cut our capacity by 2.1% year-on-year, meanwhile in the second half, following the clear upturn, we increased it by 4.7%. With this timely adaptation to market fluctuations, traffic demands grew by 4% overall during the year, with a net increase in capacity of 1.3%, thus reaching a load factor of 75%, an all-time high for the company.

The mushrooming of low-cost airlines on our markets, the excess capacity in Europe and the consequent fall in average revenues produced by both these circumstances forced us to speed up the measures contemplated in the Master Plan 2002-2005 for cost-cutting measures and productivity enhancement. These measures, together with the improved load factor, partly offset the fall in average revenues caused by the tough competition.

Some of the decisions forged during 2003 within the revision of the Master Plan have now materialized and are bearing fruit in 2004, for example the change in the form of remuneration of travel agencies in Spain, à la carte catering services on short and medium haul flights, measures to improve productivity in the different groups of employees and the change in the price structure for Spain and European destinations to be more competitive.

The new system of remuneration of Spanish travel agencies has matched the company's needs with the interests of its main distribution channel. It was essential for the company to adjust the commissions of travel agencies to the new market conditions and an agreement was reached without major disputes to gradually adjust them, up to 2005, when a fixed commission of 1% will be paid, along with variable incentives, which are maintained at current percentages. Meanwhile, travel agencies will charge their customers according to the services offered. Of the total cost savings contemplated in the Master Plan, estimated at €350-400 million by 2005, more than €100 million will be achieved through this new remuneration system.

After modifying the pricing system in Spain and on certain European routes, with a general lowering of prices and more flexible conditions, Iberia simplified its catering services on short and medium haul flights, as a provisional measure towards introducing an à la carte service, which has been in use since March 2004, giving customers a wide choice of products, paying only for what they consume.

But these are not the only significant measures adopted during 2003. I should highlight, for example, the decision adopted on the pending fleet renewal, opting for the Airbus A-340/600 to replace the Boeing B-747, pursuing Iberia's fleet modernization and homogenization programme to cut operating costs while raising fleet utilization and staff productivity. When this renewal is completed, Iberia will have a single model of airplane for long-haul flights, the Airbus A-340/300 and A-340/600, giving the company considerable flexibility to adapt supply to demand.

In 2003, the company shed some investments in non-strategic areas, disposing of a variety of activities such as catering and holiday packages. In line with this decision, we reached agreements to sell our shares in Iberswiss, Viva Tours and Tiempo Libre/Mundicolor, and adopted different formulas for other activities, including the agreement with the Canadian Company CAE for flight training of crews in Spain using simulators.

The Plan for Streamlining and Optimizing Investments and Costs (PROICO) was also concluded, outperforming the targets set by more than 20%, achieving €133 million saving in the two years of its application.

But apart from all these measures, Iberia's main priority is still to improve its service quality. During 2003 it has strived to achieve maximum punctuality, 83.8% on all its flights, the best among European network companies and three percentage points higher than the European average. It is also the highest level achieved by Iberia in the last eight years. As a result, customers have a better opinion of the company, noticing that other incidents deriving from late flights, such as missed passenger and baggage connections, have been considerably reduced.

This is not the only initiative that has been taken to improve customer satisfaction. The implementation of the CRM (Customer Relationship Management), which the company has continued working on throughout this year, and the renewal of Iberia business classes are another two good examples. Through the CRM, we obtain a better knowledge of the customer and are thus able to offer a more personalized service and the most appropriate solution in each situation. The renewal of the Business and First Classes on long-haul flights corresponds to Iberia's determination to secure a large share of the business market, on which it already has 18.5% from Europe to Latin America. This ambitious project to redesign Iberia's so-called "noble" classes, including beds on long-haul flights, although developed during 2003, will produce its first results in October 2004, when the first Airbus A-340/600 are delivered with the new specifications and improvements on the service offered to date. We will continue working in this area.

At the end of 2003, Brussels authorized the extended collaboration agreement between Iberia and British Airways, through which we aim to establish a commercial agreement for joint network planning with a gradual combination of sales activities. This will bring additional benefits to the customers of both companies, who will have access to more destinations, a wider array of frequencies and better connections.

These are some of the most significant highlights of the year. The markets have undoubtedly perceived that Iberia is taking the appropriate measures, since the value of our shares rose by 62.9% during the year, thus meeting another of our goals, to offer our shareholders increased value.

And now, putting all our energy into 2004, Iberia has set itself several goals that we are currently working on. The first of these is an Integral Quality Programme, under which eight working groups from all areas of the company are working on a set of measures to improve ground and in-flight customer service, covering not only specific services, but also the general treatment, attitude and appearance of our staff.

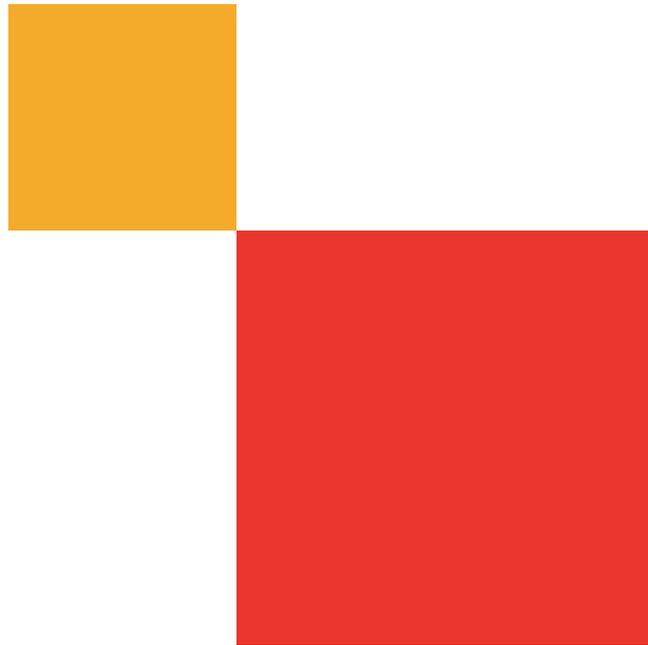
The company continues committed to its strategic markets, with new lines and frequencies in Latin America (Lima, Montevideo, Mexico and Buenos Aires, among others), within the strategic aim of consolidating our leadership between Europe and Latin America, and always with a great degree of flexibility to adapt to market conditions.

And we plan to achieve all this while improving the company's productivity and competitiveness against a scenario of growing competition, to continue to meet your expectations as shareholder.

Thank you.

A handwritten signature in black ink, appearing to read 'Fernando Conte', is written over a horizontal line. The signature is stylized and cursive.

Fernando Conte
CHAIRMAN OF IBERIA



Legal Information



Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain. In the event of a discrepancy, the Spanish-language version prevails.

AUDITORS' REPORT ON FINANCIAL STATEMENTS

To the Shareholders of
Iberia, Líneas Aéreas de España, S.A.:

We have audited the financial statements of IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A. comprising the balance sheet as of December 31, 2003, and the related statement of income and notes to financial statements for the year then ended. The preparation of these financial statements is the responsibility of the Company's directors. Our responsibility is to express an opinion on the financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made.

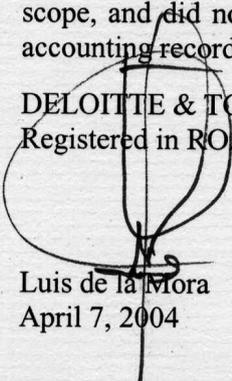
For comparison purposes the directors present, in addition to the 2003 figures for each item in the balance sheet and statements of income and of changes in financial position, the figures for 2002. Our opinion refers only to the 2003 financial statements. Our auditors' report dated April 7, 2003, on the 2002 financial statements contained an unqualified opinion.

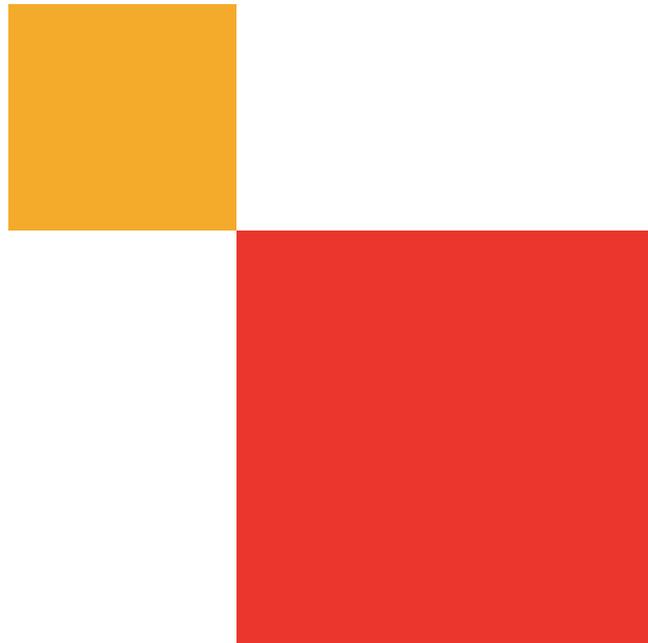
Since the Company is the head of a group and meets certain requirements, it is obliged under current corporate legislation to prepare separate consolidated financial statements, on which we issued our auditors' report on this same date containing an unqualified opinion. The effect of consolidation is indicated in Note 4-c to the financial statements referred to above.

In our opinion, the 2003 financial statements referred to above present, in all material respects, a true and fair view of the net worth and financial position of Iberia, Líneas Aéreas de España, S.A. as of December 31, 2003, and of the results of its operations and of the funds obtained and applied by it in the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with generally accepted accounting principles and standards applied on a basis consistent with that of the preceding year.

The accompanying management report for 2003 contains the explanations which the directors consider appropriate about the Company's situation, the evolution of its business and other matters, but is not an integral part of the financial statements. We have checked that the accounting information in the management report is consistent with that contained in the financial statements for 2003. Our work as auditors was confined to checking the management report with the aforementioned scope, and did not include a review of any information other than that drawn from the Company's accounting records.

DELOITTE & TOUCHE ESPAÑA, S.L.
Registered in ROAC under no. S0692


Luis de la Mora
April 7, 2004



Financial Statements



Balance Sheets as of December 31, 2003 and 2002. (Thousands of Euros).

The accompanying Notes 1 to 24 are an integral part of the balance sheet as of December 31, 2003.

| ASSETS | THOUSANDS OF EUROS | |
|--|--------------------|------------------|
| | 2003 | 2002 |
| FIXED AND OTHER NONCURRENT ASSETS: | | |
| START-UP EXPENSES | 78 | - |
| INTANGIBLE ASSETS (NOTE 5) | 423,428 | 460,478 |
| PROPERTY, PLANT AND EQUIPMENT (NOTE 6) | 965,489 | 1,225,252 |
| AIRCRAFT: | | |
| COST | 1,509,972 | 1,885,563 |
| ACCUMULATED DEPRECIATION AND ALLOWANCES | (921,375) | (1,036,834) |
| | 588,597 | 848,729 |
| OTHER TANGIBLE FIXED ASSETS: | | |
| COST | 1,021,424 | 1,007,136 |
| ACCUMULATED DEPRECIATION AND ALLOWANCES | (644,532) | (630,613) |
| | 376,892 | 376,523 |
| LONG-TERM INVESTMENTS (NOTE 7) | 645,644 | 385,830 |
| INVESTMENTS IN GROUP AND ASSOCIATED COMPANIES | 121,696 | 120,890 |
| LOANS TO GROUP AND ASSOCIATED COMPANIES | 25,623 | 25,623 |
| LONG-TERM INVESTMENT SECURITIES | 114,736 | 117,373 |
| OTHER LOANS | 168,598 | 200,862 |
| LONG-TERM DEPOSITS AND GUARANTEES GIVEN | 398,082 | 86,431 |
| ALLOWANCES | (183,091) | (165,349) |
| LONG-TERM RECEIVABLES (NOTE 18) | 303,689 | 351,567 |
| TOTAL FIXED AND OTHER NONCURRENT ASSETS | 2,338,328 | 2,423,127 |
| | | |
| DEFERRED CHARGES (NOTE 5) | 85,107 | 121,653 |
| | | |
| CURRENT ASSETS: | | |
| TREASURY STOCK (NOTE 8) | 20,066 | 31,896 |
| INVENTORIES (NOTE 9) | 75,719 | 89,014 |
| RECEIVABLE FROM GROUP COMPANIES (NOTE 17) | 26,511 | 24,185 |
| ACCOUNTS RECEIVABLE (NOTE 10) | 529,319 | 521,595 |
| SHORT-TERM INVESTMENTS (NOTE 11) | 1,347,108 | 1,198,371 |
| CASH | 14,814 | 9,623 |
| ACCRUAL ACCOUNTS | 31,034 | 36,060 |
| TOTAL CURRENT ASSETS | 2,044,571 | 1,910,744 |
| TOTAL ASSETS | 4,468,006 | 4,455,524 |

SHAREHOLDERS' EQUITY AND LIABILITIES

THOUSANDS OF EUROS

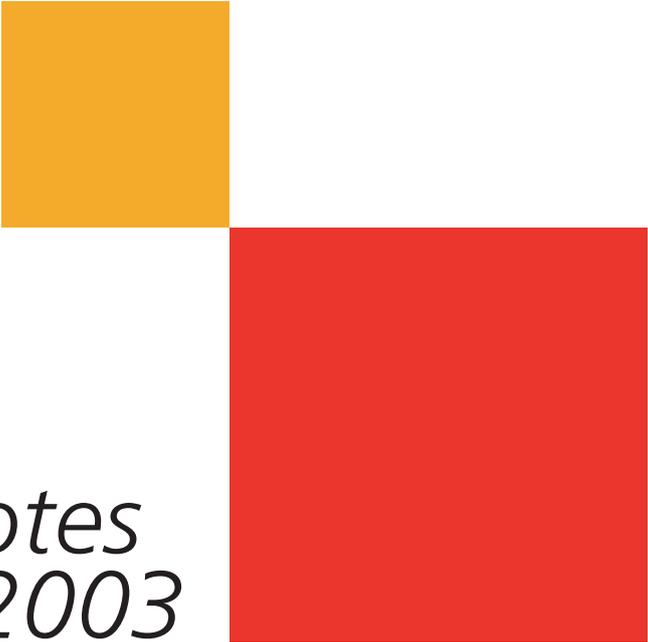
| | 2003 | 2002 |
|---|------------------|------------------|
| SHAREHOLDERS' EQUITY (NOTE 12): | | |
| CAPITAL STOCK | 716,833 | 712,110 |
| ADDITIONAL PAID-IN CAPITAL | 98,937 | 96,454 |
| REVALUATION RESERVE | 38 | 38 |
| LEGAL RESERVE | 75,671 | 61,352 |
| VOLUNTARY RESERVES | 216,418 | 111,327 |
| RESERVE FOR TREASURY STOCK | 20,066 | 31,896 |
| MERGER RESERVE | 165 | 165 |
| DIFFERENCES DUE TO THE ADJUSTMENT OF CAPITAL STOCK TO EUROS | 1,201 | 1,201 |
| INCOME FOR THE YEAR | 105,762 | 143,188 |
| TOTAL SHAREHOLDERS' EQUITY | 1,235,091 | 1,157,731 |
| DEFERRED REVENUES (NOTE 4-g) | 56,841 | 70,535 |
| PROVISIONS FOR CONTINGENCIES AND EXPENSES (NOTE 13): | | |
| PROVISIONS FOR PENSIONS | 36,395 | 41,367 |
| PROVISIONS FOR OBLIGATIONS TO PERSONNEL | 487,529 | 452,157 |
| PROVISION FOR MAJOR REPAIRS | 104,906 | 109,775 |
| PROVISION FOR THIRD-PARTY LIABILITY | 618,661 | 656,679 |
| TOTAL PROVISIONS FOR CONTINGENCIES AND EXPENSES | 1,247,491 | 1,259,978 |
| LONG-TERM DEBT: | | |
| CONVERTIBLE DEBENTURES (NOTE 15) | 27,532 | 22,573 |
| PAYABLE TO CREDIT INSTITUTIONS (NOTE 14) | 418,518 | 476,903 |
| OTHER PAYABLES | 3,236 | 10,187 |
| TOTAL LONG-TERM DEBT | 449,286 | 509,663 |
| CURRENT LIABILITIES: | | |
| CONVERTIBLE DEBENTURES (NOTE 15) | 22,573 | 7,524 |
| PAYABLE TO CREDIT INSTITUTIONS (NOTE 14) | 46,458 | 101,106 |
| PAYABLE TO GROUP AND ASSOCIATED COMPANIES (NOTE 17) | 11,643 | 14,383 |
| TRADE ACCOUNTS PAYABLE | 1,096,306 | 1,030,587 |
| CUSTOMER ADVANCES (NOTE 4-g) | 413,854 | 423,845 |
| ACCOUNTS PAYABLE FOR PURCHASES AND SERVICES | 682,452 | 606,742 |
| COMPENSATION PAYABLE | 148,102 | 161,372 |
| OTHER NONTRADE PAYABLES (NOTE 18) | 153,773 | 141,960 |
| ACCRUAL ACCOUNTS | 442 | 685 |
| TOTAL CURRENT LIABILITIES | 1,479,297 | 1,457,617 |
| TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES | 4,468,006 | 4,455,524 |

Statements of Income for 2003 and 2002. (Thousands of Euros).

The accompanying Notes 1 to 24 are an integral part of the 2003 statement of income.

| DEBIT | THOUSANDS OF EUROS | |
|---|---------------------------|----------------|
| | 2003 | 2002 |
| EXPENSES: | | |
| PROCUREMENTS (NOTE 19) | 737,012 | 742,415 |
| PERSONNEL EXPENSES (NOTE 19) | 1,355,716 | 1,310,613 |
| DEPRECIATION AND AMORTIZATION EXPENSE (NOTES 5 AND 6) | 173,382 | 164,121 |
| VARIATION IN OPERATING ALLOWANCES | 592 | 11,388 |
| OTHER OPERATING EXPENSES (NOTE 19) | 2,144,905 | 2,175,925 |
| | 4,411,607 | 4,404,462 |
| OPERATING INCOME | 139,161 | 228,655 |
| FINANCIAL AND SIMILAR EXPENSES (NOTES 13 AND 14) | 34,018 | 38,927 |
| VARIATION IN INVESTMENT VALUATION ALLOWANCES (NOTE 7) | 16,166 | - |
| EXCHANGE LOSSES | 106,691 | 119,499 |
| | 156,875 | 158,426 |
| FINANCIAL INCOME | 7,152 | - |
| INCOME FROM ORDINARY ACTIVITIES | 146,313 | 220,510 |
| VARIATION IN FIXED ASSET ALLOWANCES (NOTE 7) | 1,576 | (274) |
| LOSSES ON FIXED ASSETS (NOTE 6) | 22,653 | 10,772 |
| EXTRAORDINARY EXPENSES (NOTE 19) | 57,331 | 101,529 |
| PRIOR YEARS' EXPENSES AND LOSSES | 1,173 | 5,357 |
| | 82,733 | 117,384 |
| EXTRAORDINARY INCOME | 2,482 | - |
| INCOME BEFORE TAXES | 148,795 | 168,847 |
| CORPORATE INCOME TAX (NOTE 18) | 43,033 | 25,659 |
| INCOME FOR THE YEAR | 105,762 | 143,188 |

| | THOUSANDS OF EUROS | |
|---|--------------------|---------------|
| | 2003 | 2002 |
| CREDIT | | |
| REVENUES: | | |
| NET SALES (NOTE 19) | 4,321,560 | 4,407,797 |
| OTHER OPERATING REVENUES (NOTE 19) | 229,208 | 225,320 |
| | 4,550,768 | 4,633,117 |
| REVENUES FROM EQUITY INVESTMENTS (NOTE 7) | 11,381 | 14,769 |
| REVENUES FROM OTHER MARKETABLE SECURITIES | - | 840 |
| OTHER INTEREST AND SIMILAR REVENUES (NOTES 7 AND 11) | 52,632 | 48,539 |
| EXCHANGE GAINS | 100,014 | 86,133 |
| | 164,027 | 150,281 |
| FINANCIAL LOSS | - | 8,145 |
| GAINS ON DISPOSALS OF FIXED ASSETS AND CONTROL PORTFOLIO (NOTES 6 AND 7) | 22,124 | 42,983 |
| GAINS ON TRANSACTIONS INVOLVING TREASURY STOCK (NOTE 8) | 8,347 | 1,982 |
| EXTRAORDINARY REVENUES (NOTE 19) | 35,007 | 11,326 |
| PRIOR YEARS' REVENUES AND INCOME (NOTE 19) | 19,737 | 9,430 |
| | 85,215 | 65,721 |
| EXTRAORDINARY LOSS | - | 51,663 |



Notes to 2003 Financial Statements

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 24). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA 



1 Company description

Iberia, Líneas Aéreas de España, S.A. engages mainly in the air transport of passengers and cargo and, additionally, carries on other supplementary activities, including most notably handling, aircraft maintenance (of both proprietary aircraft and aircraft owned by other companies) and distribution through its equity interest in the Amadeus Group, which owns the Amadeus central booking system.

As a carrier of passengers and cargo, Iberia, Líneas Aéreas de España, S.A. operates through a large network serving three major markets: Spain, Europe and the Americas.

Iberia, Líneas Aéreas de España, S.A. is a fully-fledged member of the **oneworld** megacARRIER, one of the largest airline groups in the world, which facilitates the globalization of its air transport business.

Last year Group management designed the Master Plan for 2003-2005. The strategic objectives of this Master Plan, which was approved by the Company's Board of Directors on December 4, 2002, are as follows:

1. To increase the Company's routes and flights in order to maintain and strengthen its leading position at the Madrid and Barcelona hubs.
2. To endow the Company with operational and financial flexibility to enable it to adapt growth to market trends.
3. To improve competitiveness through a substantial reduction of unit costs.
4. To implement a distribution strategy capable of reducing marketing costs.
5. To implement a new in-flight service model with leading price-service ratios for each customer segment.
6. To enhance service quality and strengthen the Company's relationship with high-value customers by improving the level of punctuality.
7. To maintain a portfolio approach in the management of the businesses.
8. To reduce financing costs by controlling operational and financial risks.
9. To bolster the competitiveness of the Company's human resources.
10. To capitalize on the Company's alliances to sharpen its competitive edge.

This Master Plan was revised at the beginning of 2003 in view of the new circumstances in the airline industry. The aforementioned strategic objectives were maintained, and the measures aimed at reducing costs and expediting the implementation of the main initiatives were strengthened.

Iberia, Líneas Aéreas de España, S.A.'s registered office is in Madrid. The Company's shares have been listed on the stock market since April 2001.

2 Basis of presentation of the financial statements

True and fair view

The 2003 financial statements, which were prepared from the Company's accounting records, are presented in accordance with the Spanish National Chart of Accounts and other applicable legislation and, accordingly, give a true and fair view of the net worth, financial position, results of operations and funds obtained and applied in 2003. These financial statements, which were prepared by the Company's directors, will be submitted for approval by the Shareholders' Meeting, and it is considered that they will be approved without any changes.

3 Distribution of income

The proposed distribution of 2003 income that the Company's Board of Directors will submit for approval by the Shareholders' Meeting is as follows: €10,576 thousand to the legal reserve, a dividend of €0.03 per share and the remainder to voluntary reserves.

4 Valuation standards

The main valuation methods applied by the Company in preparing its financial statements for 2003, in accordance with the Spanish National Chart of Accounts, were as follows:

a) Intangible assets

Leased assets are recorded as intangible assets at the cost of the related asset and the total debt for lease payments plus the amount of the purchase option are recorded as a liability. The interest expenses on the transaction are recorded under the "Deferred Charges" caption in the balance sheet and are allocated to income each year by the interest method.

Leased assets are amortized by the same methods as those used to depreciate similar items of property, plant and equipment.

The acquisition cost and the related accumulated amortization of aircraft leased under financial lease contracts are adjusted each year pursuant to a Ministerial Order dated December 18, 2001 (and were adjusted prior to that date pursuant to a Ministerial Order dated March 23, 1994), by the net amount of the exchange differences arising on the adjustment to official year-end exchange rates of the principal of the foreign currency lease payments outstanding on the aircraft recorded as intangible assets in the reporting year and in the four preceding years.

As a result of the application of this valuation method, in 2003 the net book value of the aircraft leased under financial lease contracts was reduced by €4,413 thousand, €4,749 thousand of which relate to cost and €336 thousand to accumulated amortization.

In total, the exchange differences included in intangible assets pursuant to the aforementioned regulations have given rise to a cumulative reduction of approximately €6,662 thousand in the net book value of the aircraft leased under financial lease contracts.

Computer software is recorded at acquisition or production cost and is amortized on a straight-line basis over an estimated useful life of five years.

Intellectual property, which relates to the rights to use various trademarks, is carried at cost and is amortized on a straight-line basis over ten years.

b) Property, plant and equipment

Property, plant and equipment is carried at cost revalued pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1996.

Pursuant to a Ministerial Order dated December 18, 2001, the acquisition cost and accumulated depreciation of the aircraft which, recorded as property, plant and equipment in the reporting year or in the four years immediately prior thereto, were financed through foreign currency loans, are adjusted by the net amount of the differences arising on the adjustment of these loans to official year-end exchange rates.

As a result of the application of this valuation method, in 2003 the cost of the aircraft and the related accumulated depreciation were reduced by €1,219 thousand and €174 thousand, respectively.

As of December 31, 2003, the net book value of the owned aircraft included cumulative exchange differences totaling approximately €69,326 thousand.

The Company depreciates the depreciable cost of its property, plant and equipment by the straight-line method at annual rates based on the years of estimated useful life of the related assets.

The years of estimated useful life of the property, plant and equipment items are as follows:

| ▶▶ YEARS OF ESTIMATED USEFUL LIFE | |
|-----------------------------------|---------|
| | YEARS |
| AIRCRAFT | 20 - 22 |
| BUILDINGS AND OTHER STRUCTURES | 20 - 50 |
| MACHINERY, FIXTURES AND TOOLS | 10 - 15 |
| LAND TRANSPORT EQUIPMENT | 7 - 10 |
| FURNITURE | 10 |
| COMPUTER HARDWARE | 5 - 7 |
| ROTATABLE PARTS | 18 |
| REPAIRABLE PARTS | 8 - 10 |
| FLIGHT SIMULATORS | 10 - 14 |

In 2003, taking into account the more up-to-date technology used in the new aircraft and the working condition of the aircraft after the systematic application of the established periodic maintenance programs, the Company reestimated the useful lives of the aircraft and, in general, it increased them by four years from 18 to 22 years, except in the case of the MD-87 aircraft, the depreciation period of which was set at 20 years, and of the aircraft acquired from Aviación y Comercio, S.A., which are being depreciated over 12 years (MD-88) and 10 years (MD-87).

Also, due to the changes that have taken place in the secondhand aircraft market, Iberia, Líneas Aéreas de España, S.A., which, in general, had been assuming a residual value for the aircraft of 20% of their acquisition cost, started to treat the full acquisition cost as depreciable, thereby eliminating the residual value.

These measures were implemented from November 2003, after the Company's proposal had been accepted by the tax authorities.

The effect of this recalculation of the useful lives of the aircraft on the 2003 statement of income is not material.

Assets subject to administrative concession whose years of useful life exceed the term for which the Company has been granted the concession are depreciated over the term of the concession.

The estimated residual value of the rotatable parts (those assigned to specific types of aircraft) ranges from 10% to 20% of acquisition cost, depending on the type of aircraft. The estimated residual value of the other (repairable) aircraft spare parts is 10% of acquisition cost. The Company depreciates in full the acquisition cost of other items of property, plant and equipment.

In order to recognize the unrealized losses arising as a result of the obsolescence of spare parts, the Company has recorded an allowance for decline in value of these parts. As of December 31, 2003, the balance of this allowance was €2,560 thousand.

In addition, the Company records reversible allowances in order to adjust the net book value of aircraft ready for sale to their estimated realizable value based on current market prices in the used aircraft market.

Improvements to aircraft leading to an increase in their capacity or efficiency or to a lengthening of their useful lives are capitalized to the acquisition cost of the aircraft.

In general, property, plant and equipment upkeep and maintenance costs are expensed currently. However, for the purpose of ensuring the uniformity of the charges to income each year for the expenses of periodic inspections and repairs of the fuselages of the B-747, B-757, A-319, A-320, A-321, A-340 and MD-88 aircraft, the Company records an allowance based on the total estimated cost to be incurred, and allocates this cost to income on a straight-line basis during the period elapsing between two successive major repairs (see Note 13).

The costs of repairs to engines and of all repairs to the MD-87 aircraft are expensed currently, since the annual expenses tend to be uniform.

c) Long- and short-term investments

Investments in Group or associated companies and other equity securities, generally unlisted shares, are carried in the balance sheet at the lower of cost or market. The market value is taken to be the underlying book value of the investment at year-end adjusted, where appropriate, by the amount of the unrealized gains disclosed at the time of subscription or acquisition and still existing at the date of subsequent valuation.

In order to recognize the unrealized losses on the investments (if cost is higher than market value), the related allowances are recorded.

However, the holdings in the capital stock of the Iberbus companies (see Note 7) are recorded at their acquisition cost because, under the agreements entered into, the other shareholder of these companies guarantees for Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of the investments made.

The effect of applying consolidation criteria to the Company's 2003 financial statements would be to increase assets, income for the year and reserves by €231,255 thousand, €40,090 thousand and €159,845 thousand, respectively.

Loans to Group and associated companies and other loans and credits granted are recorded at the amounts delivered and not yet repaid. In order to cover the related bad debt risk, the Company has recorded allowances for bad debts calculated on the basis of the probability of recovering the accounts receivable based on their age and on the solvency of the debtor in question.

Deposits and guarantees given are recorded at the amount delivered. These deposits include the amounts delivered under the terms of the contracts for the acquisition of new aircraft, which will be refunded on delivery of the aircraft (see Note 7).

The Company generally invests its short-term cash surpluses in short-term financial assets that are recorded at the amounts effectively disbursed. The interest on these transactions is recorded as a revenue when earned and unmatured interest at year-end is reflected as an addition to the balance of the "Short-Term Investments" caption in the balance sheet.

d) Treasury stock

Treasury stock is carried at cost, which is lower than the average market price in the last quarter of the year and the market price at year-end.

e) Foreign currency transactions and balances

Foreign currency transactions and the resulting accounts receivable and payable are recorded at their equivalent euro value at the transaction date.

The balances of accounts receivable and payable denominated in foreign currencies are translated to euros at the exchange rates ruling at December 31 of each year. However, following customary airline practice, the balance of the liability for unused traffic documents is reflected in the balance sheet at the exchange rate ruling in the month of the sale, as set by the International Air Transport Association (IATA). The IATA exchange rate for each month is the average exchange rate for the last five working days prior to the 20th day of the preceding month.

Exchange losses arising as a result of the difference between the official exchange rates at year-end and the exchange rates at which the foreign currency receivables and payables were translated to euros are charged to the "Exchange Losses" caption in the statement of income, whereas exchange gains are deferred through the date on which the related accounts receivable or payable fall due, and are recorded under the "Deferred Revenues" caption in the balance sheet, unless negative exchange differences arising on the same currency for the same or a higher amount have been charged to income in the current year or in prior years.

Exchange differences arising at the date of collection or payment of foreign currency receivables and payables are allocated to the "Exchange Gains" or "Exchange Losses" captions, as appropriate, in the statement of income.

Notwithstanding the foregoing, the positive or negative translation and exchange differences arising from the financing in foreign currencies of certain of the Company's aircraft are given a special accounting treatment pursuant to a Ministerial Order dated December 18, 2001 (see Notes 4-a and 4-b).

f) Inventories

Inventories, basically aeronautical supplies and fuel, are valued at average acquisition cost, and the related allowances for decline in value are recorded.

The Company has recorded the necessary allowances to recognize the unrealized losses arising in connection with certain obsolescent and slow-moving warehouse goods.



g) Recognition of revenues and expenses

Revenues and expenses are recognized on an accrual basis, i.e. when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises.

Ticket sales and sales of the traffic documents for cargo and other services are initially credited to "Customer Advances" in the balance sheet. The balance of this caption reflects the liability for tickets and traffic documents sold prior to December 31, 2003, but not yet used as of that date. The revenues relating to these items are recognized when the transport or service is performed.

The Company occasionally sells aircraft which it continues to operate under dry lease arrangements (in which the aircraft is leased without crew for a given period of time). The gains obtained on these sale transactions are taken to income on a straight-line basis over the term of the related lease contract. The "Deferred Revenues" caption in the accompanying balance sheet as of December 31, 2003, includes, inter alia, the gains obtained on transactions of this kind not yet allocated to income.

The Company has introduced the "Iberia Plus" card as an ongoing promotional tool whereby the holder of the card accumulates points for taking certain flights, using certain hotels, renting cars or making credit card purchases with credit cards covered by the program. The points can be exchanged for free tickets or other services offered by the companies included in the program. The "Accounts Payable for Purchases and Services" caption in the accompanying balance sheet as of December 31, 2003, includes a provision of €56,292 thousand in this connection, based on the estimated redemption value of the unused points accumulated as of that date.

h) Obligations to personnel

Under the collective labor agreements currently in force, on reaching the age of 60 flight personnel cease to discharge their duties and are placed on the reserve, although their employment relationship remains in place through their regulatory retirement date. The Company recognizes the costs of personnel placed on special reserve over the active working life of each employee based on the related actuarial studies.

The "Provisions for Contingencies and Expenses – Provisions for Obligations to Personnel" caption in the accompanying balance sheet as of December 31, 2003, includes the liabilities incurred in this connection.

The collective labor agreements currently in force also provide that flight personnel who meet certain conditions may take early retirement (special leave). The Company is required to pay certain amounts of compensation to these employees until they reach the regulatory retirement age. The Company records, with a charge to the statement of income in the year in which this circumstance arises, the provision required, calculated on the basis of actuarial studies, to supplement the provisions already recorded for employees placed on the special reserve in order to meet the future payment commitments to the employees concerned. 228 employees are currently on special leave, of whom 11 took special leave in 2003.

The liabilities incurred in this connection are recorded under the "Provisions for Contingencies and Expenses – Provisions for Pensions" caption.

The aforementioned amounts were calculated on the basis of actuarial studies conducted by independent actuaries using the projected unit credit method and based on an assumed interest rate of 3.5%, PERM/F-2000 P life expectancy tables and an estimated annual CPI variation of 2%.

All liabilities subject to mandatory externalization arising in connection with the retirement or early retirement of ground personnel in the circumstances provided for in the collective labor agreements were externalized in August 2001.

i) Montepío de Previsión Social Loreto

The main purpose of the Montepío de Previsión Social Loreto is to pay retirement pensions to its members (who include the Company's employees) and other welfare benefits in certain circumstances (death and permanent disability).

Under the current collective labor agreements, the Company and its employees make the statutory contributions (defined contributions) to the Montepío, as established in these labor agreements. The Montepío's bylaws limit the Company's liability to the payment by it of the statutory contributions.

The Company's contributions of €21,157 thousand in 2003 were recorded under the "Personnel Expenses" caption in the accompanying statement of income for 2003.

j) Provision for third-party liability

The Company records under the "Provision for Third-Party Liability" caption in the balance sheet the estimated amount required for probable or certain third-party liability arising from legal proceedings and litigation in progress or from outstanding indemnity payments or obligations of undetermined amount, and collateral and other similar guarantees provided by the Company. These provisions are recorded when the liability arises or becomes known. This caption also includes the provisions for the estimated costs, based on actuarial studies conducted by independent actuaries using the same assumptions as those indicated in Note 4-h above, of the layoff plan initiated in 1999 and implemented in 2000 and 2001 and of the labor force reduction plan authorized by the Ministry of Employment and Social Affairs on December 26, 2001, and implemented since 2002. This labor force reduction plan, which initially concluded on December 31, 2002, was extended with the prior authorization of the Ministry of Employment and Social Affairs through December 31, 2004, for ground personnel, cabin crew, and flight engineers up to the limit of the structural target headcount for each group of employees.



k) Corporate income tax

The corporate income tax of each year is calculated on the basis of the book income before taxes, increased or decreased, as appropriate, by the permanent differences from taxable income, net of tax relief and tax credits, excluding tax withholdings and prepayments.

l) Futures and other similar instruments

The Company uses these instruments in transactions to hedge its asset and liability positions and its future flows of collections and payments. It only carries out "nongenuine" hedging transactions (i.e. those arranged between two parties, establishing in each case the contractual terms of the transactions agreed upon between them) (see Note 16).

The price differences arising during the term of futures and similar instruments are recorded as follows:

1. In the case of transactions arranged to hedge exchange rates relating to asset or liability positions, the related balances are discounted to present value at each year-end based on the gains or losses that arise.

2. For the other exchange and interest rate transactions, the price differences are recorded in the statement of income when the transactions involving futures or similar instruments are cancelled or finally settled.

m) Environmental activities

In general, environmental activities are those the purpose of which is to prevent, reduce or redress damage to the environment.

Investments made in connection with environmental activities are valued at acquisition cost and are capitalized as an addition to fixed assets in the year in which the related expenses are incurred, using the methods described in Note 4-b above.

The expenses arising from environmental protection and enhancement measures are charged to income in the year in which they are incurred, regardless of when the resulting monetary or financial flow arises.

The provisions for probable or certain third-party liability, litigation in progress and outstanding environmental indemnity payments or obligations of undetermined amount not covered by the insurance policies taken out are recorded, where appropriate, when the liability or obligation giving rise to the indemnity or payment arises.

n) Classification of debt

In the accompanying balance sheet debts maturing in 12 months or less from year-end are classified as current liabilities and those maturing at over 12 months as long-term debt.

5 Intangible assets

The variations in 2003 in intangible asset accounts and in the related accumulated amortization were as follows:

| 2003 | | THOUSANDS OF EUROS | | | | |
|---|-----------------|--------------------------|--------------|----------------------------|--|------------------|
| | 12-31-02 | ADDITIONS AND PROVISIONS | RETIREMENTS | MINISTERIAL ORDER 12-18-01 | TRANSFERS TO PROPERTY, PLANT AND EQUIPMENT | 12-31-03 |
| COST: | | | | | | |
| RIGHTS ON LEASED ASSETS | 478,846 | 5,623 | - | (4,749) | (37,444) | 442,276 |
| COMPUTER SOFTWARE | 67,363 | 19,993 | (242) | - | - | 87,114 |
| INTELLECTUAL PROPERTY | 551 | - | - | - | - | 551 |
| LEASEHOLD ASSIGNMENT RIGHTS AND OTHER INTANGIBLE ASSETS | 400 | - | (6) | - | - | 394 |
| | 547,160 | 25,616 | (248) | (4,749) | (37,444) | 530,335 |
| ACCUMULATED AMORTIZATION: | | | | | | |
| RIGHTS ON LEASED ASSETS | (58,632) | (22,743) | - | 336 | 16,483 | (64,556) |
| COMPUTER SOFTWARE | (27,569) | (14,363) | 111 | - | - | (41,821) |
| INTELLECTUAL PROPERTY | (81) | (55) | - | - | - | (136) |
| LEASEHOLD ASSIGNMENT RIGHTS AND OTHER INTANGIBLE ASSETS | (400) | - | 6 | - | - | (394) |
| | (86,682) | (37,161) | 117 | 336 | 16,483 | (106,907) |
| NET VALUE | 460,478 | (11,545) | (131) | (4,413) | (20,961) | 423,428 |

As of December 31, 2003, the cost of the Company's fully amortized intangible assets amounted to €10,919 thousand, the detail being as follows:

| DECEMBER 31, 2003 | | THOUSANDS OF EUROS |
|-----------------------------|--|--------------------|
| LEASEHOLD ASSIGNMENT RIGHTS | | 394 |
| COMPUTER SOFTWARE | | 10,525 |
| TOTAL | | 10,919 |

The additions in 2002 to the "Computer Software" caption relate basically to investments in systems integration projects and new developments.

Also, in 2003 the purchase options on one leased B-757 aircraft and on certain leased airport equipment and computer hardware were exercised and, accordingly, the cost and related accumulated amortization of these assets were reclassified to property, plant and equipment accounts. The B-757 aircraft on which the purchase option was exercised has been mortgaged, and the net book value of the fuselage as of December 31, 2003, was €16,527 thousand.

The general features of the financial lease contracts (relating mainly to aircraft) in force as of December 31, 2003, some of which provide for floating interest and lease payments denominated in foreign currencies, are as follows:

| DECEMBER 31, 2003 | THOUSANDS OF EUROS |
|---|---------------------------|
| COST OF THE LEASED FIXED ASSETS | 451,924 |
| AMOUNT OF LEASE PAYMENTS PAID - IN PRIOR YEARS | 128,061 |
| - IN 2003 | 66,240 |
| AMOUNT OF LEASE PAYMENTS OUTSTANDING AT DECEMBER 31 (NOTE 14) | 204,065 (a) |
| AMOUNT OF PURCHASE OPTIONS (NOTE 14) | 238,412 (a) |

(a) As of December 31, 2003, these amounts included €74,490 thousand of unaccrued interest at that date, the balancing entry for which is included under the "Deferred Charges" caption in the accompanying balance sheet as of December 31, 2003.

The due dates for the financial lease contract payments outstanding as of December 31, 2003, which include the amount of the purchase options, are as follows:

| DECEMBER 31, 2003 | LEASE PAYMENTS DUE IN: | THOUSANDS OF EUROS |
|--------------------------|-------------------------------|---------------------------|
| | 2004 | 42,437 |
| | 2005 | 40,447 |
| | 2006 | 33,415 |
| | 2007 | 156,748 |
| | 2008 - 2012 | 169,430 |
| | | 442,477 |

6 Property, plant and equipment

The variations in 2003 in property, plant and equipment accounts and in the related accumulated depreciation and allowances were as follows:

| | THOUSANDS OF EUROS | | | | | |
|-------------------------------------|--------------------|----------------|------------------|------------------|----------------------|------------------|
| | 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | EXCHANGE DIFFERENCES | 12-31-03 |
| COST | | | | | | |
| AIRCRAFT | 1,730,296 | 110,892 | (365,830) | 35,833 | (1,219) (a) | 1,509,972 |
| ADVANCES ON AIRCRAFT (NOTE 7) | 155,267 | - | - | (155,267) | - | - |
| | 1,885,563 | 110,892 | (365,830) | (119,434) | (1,219) | 1,509,972 |
| OTHER TANGIBLE FIXED ASSETS: | | | | | | |
| LAND | 2,520 | - | - | - | - | 2,520 |
| BUILDINGS AND OTHER STRUCTURES | 161,765 | 165 | (3,020) | - | - | 158,910 |
| MACHINERY, FIXTURES AND TOOLS | 406,547 | 9,728 | (25,011) | 2,813 | - | 394,077 |
| TRANSPORT EQUIPMENT | 22,579 | 3,263 | (169) | 92 | - | 25,765 |
| FURNITURE | 19,199 | 1,002 | (834) | 24 | - | 19,391 |
| COMPUTER HARDWARE | 65,821 | 22,943 | (1,939) | 744 | - | 87,569 |
| SPARE PARTS | 250,829 | 117,581 | (109,879) | - | - | 258,531 |
| FLIGHT SIMULATORS | 63,336 | 512 | (748) | 1,716 | - | 64,816 |
| CONSTRUCTION IN PROGRESS | 14,540 | 18,867 | (16,467) | (6,215) | (880) | 9,845 |
| | 1,007,136 | 174,061 | (158,067) | (826) | (880) | 1,021,424 |

(a) Effect of applying the Ministerial Order dated 12/18/01.

| | THOUSANDS OF EUROS | | | | | |
|--|--------------------|---------------|------------------|---------------|-------------------------------|----------------|
| | 12-31-02 | PROVISIONS | RETIREMENTS | TRANSFERS | MINISTERIAL ORDER OF 12-18-01 | 12-31-03 |
| ACCUMULATED DEPRECIATION AND ALLOWANCES | | | | | | |
| ACCUMULATED DEPRECIATION: | | | | | | |
| AIRCRAFT | 962,724 | 80,270 | (183,296) | 12,284 | (174) | 871,808 |
| OTHER TANGIBLE FIXED ASSETS: | | | | | | |
| BUILDINGS AND OTHER STRUCTURES | 104,689 | 3,629 | (935) | - | - | 107,383 |
| MACHINERY, FIXTURES AND TOOLS | 286,913 | 19,616 | (23,001) | 1,094 | - | 284,622 |
| TRANSPORT EQUIPMENT | 13,483 | 2,652 | (137) | 46 | - | 16,044 |
| FURNITURE | 13,236 | 987 | (774) | 5 | - | 13,454 |
| COMPUTER HARDWARE | 45,137 | 10,399 | (1,526) | 376 | - | 54,386 |
| SPARE PARTS | 123,466 | 17,038 | (16,939) | - | - | 123,565 |
| FLIGHT SIMULATORS | 41,072 | 2,137 | (748) | - | - | 42,461 |
| | 627,996 | 56,458 | (44,060) | 1,521 | - | 641,915 |
| ALLOWANCES: | | | | | | |
| AIRCRAFT | 74,110 | 11,426 | (35,969) | - | - | 49,567 |
| OTHER TANGIBLE FIXED ASSETS | 2,617 | - | - | - | - | 2,617 |

The transfers reflected in the foregoing table include those from intangible assets (see Note 5) and the amounts reclassified to long-term investments (see Note 7).

Aircraft: Period additions

The main period additions are summarized as follows:

| PERIOD ADDITIONS | | THOUSANDS OF EUROS |
|-----------------------|--|--------------------|
| ADDITIONS OF AIRCRAFT | | 122,283 |
| ADDITIONS OF ENGINES | | 5,038 |
| REFURBISHMENTS | | 24,417 |
| LESS- | | |
| DEPOSITS ON AIRCRAFT | | (39,055) |
| OTHER | | (1,791) |
| | | 110,892 |

In 2003 the Company acquired and subsequently sold and leased back under operating lease contracts, one A-320 aircraft and two A-321 aircraft for €36,726 thousand and €85,557 thousand, respectively. The contracts for the acquisition of these aircraft provided for the payment of advances amounting to €39,055 thousand.

Aircraft: Period retirements

The main retirements in 2003 were as follows:

(a) Including the sale of 2 DC-9 engines, 6 DC-10 aircraft and 19 DC-10 engines, 2 B-727 engines, 1 B-747 engine and 3 A-300 engines.

(b) Including 7 DC-9 engines, 17 DC-9 aircraft, 6 B-727 engines, 4 B-727 aircraft, 1 B-747 aircraft and 1 A-300 engine.

| PERIOD RETIREMENTS | | | | | | THOUSANDS OF EUROS |
|---|---------------|---------|--------------------------|------------|------------------------|--------------------|
| DISPOSALS | SELLING PRICE | COST | ACCUMULATED DEPRECIATION | ALLOWANCES | ALLOWANCES FOR REPAIRS | |
| DISPOSALS (a) | 13,116 | 148,385 | (120,205) | (16,003) | (9,046) | |
| SALES FOR SUBSEQUENT LEASEBACK UNDER AN OPERATING LEASE | 121,400 | 122,283 | (592) | - | - | |
| AIRCRAFT SCRAPPED (b) | - | 66,760 | (41,711) | (18,011) | (5,198) | |
| OTHER RETIREMENTS | - | 28,402 | (19,395) | (1,955) | - | |

Allowances

In order to recognize possible losses arising from the retirements of aircraft planned for the near future, the Company has recorded the related allowances for decline in value to adjust the net book value of these aircraft to their estimated realizable value. The provisions recorded to the allowances and the amounts used in 2003 were as follows:

| ALLOWANCES | | | | | THOUSANDS OF EUROS |
|------------------|---------------------|-------------------------------|-----------------|---------------------|--------------------|
| | BALANCE AT 12-31-02 | PERIOD PROVISIONS (NOTE 19-h) | AMOUNTS USED | BALANCE AT 12-31-03 | |
| AIRCRAFT: | | | | | |
| DC-9 | 11,313 | 2,137 | (13,306) | 144 | |
| DC-10 | 15,600 | - | (14,916) | 684 | |
| A-300 | 2,533 | - | (1,153) | 1,380 | |
| B-727 | 6,564 | 289 | (6,594) | 259 | |
| B-747 | 38,100 | 9,000 | - | 47,100 | |
| | 74,110 | 11,426 | (35,969) | 49,567 | |

Commitments and other guarantees on aircraft

The Company is using three aircraft under financial lease contracts (one A-320 and two A-321 aircraft) and 15 aircraft under operating lease contracts (seven A-320 and eight B-757 aircraft) the payments under which are securing, together with the aircraft, a bond issue amounting to €496,473 thousand launched by the lessor in the European market in 2000.

The Company is currently implementing a fleet renewal plan instrumented through two agreements entered into with Airbus Industrie G.I.E. (Airbus) in 1998 (A-320-type aircraft) and 2002 (A-340-type aircraft), to which various subsequent amendments have been made, and an agreement entered into with International Lease Finance Corporation in 2003.

The aircraft not yet delivered as of December 31, 2003, and the year in which they are scheduled to be added to Iberia's fleet pursuant to the agreements entered into are as follows:

▶▶ AIRCRAFT SUBJECT TO FIRM PURCHASE COMMITMENT

| TYPE OF AIRCRAFT | 2004 | 2005 | 2006 | TOTAL |
|------------------|-----------|-----------|----------|-----------|
| A-319 | 3 | - | - | 3 |
| A-320 | 7 | 2 | 2 | 11 |
| A-321 | 4 | 5 | - | 9 |
| A-340/600 | 3 | 4 | - | 7 |
| | 17 | 11 | 2 | 30 |

▶▶ AIRCRAFT SUBJECT TO PURCHASE OPTION

| TYPE OF AIRCRAFT | 2005 | 2006 | 2007 | TOTAL |
|------------------|----------|-----------|----------|-----------|
| A-319 | 4 | 5 | - | 9 |
| A-320 | 2 | 2 | - | 4 |
| A-321 | - | 6 | - | 6 |
| A-340/600 | - | 3 | 2 | 5 |
| | 6 | 16 | 2 | 24 |

Also, the agreement entered into with Airbus in 2002 provides for purchase rights on a further three aircraft, which must be exercised prior to December 31, 2004.

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered as of December 31, 2003, amounted to €1,924 million, of which €1,009 million relate to the A-340-type aircraft and €915 million to the A-320-type aircraft.

Aircraft in service

Following is a summary of the Company's aircraft in service as of December 31, 2003:

AIRCRAFT IN SERVICE AS OF DECEMBER 31, 2003

| TYPE OF AIRCRAFT | OWNED | UNDER FINANCIAL LEASE | UNDER OPERATING LEASE | TOTAL |
|------------------|-----------|-----------------------|-----------------------|------------|
| B-747 | 4 (a) | - | 2 | 6 |
| B-757 | 1 | - | 16 | 17 |
| A-319 | - | - | 4 | 4 |
| A-320 | 10 (b) | 10 | 36 | 56 |
| A-321 | - | 2 | 5 | 7 |
| A-340/300 | - | - | 18 | 18 |
| A-340/600 | - | - | 3 | 3 |
| MD-87 | 19 | - | 5 | 24 |
| MD-88 | 13 | - | 1 | 14 |
| | 47 | 12 | 90 | 149 |

(a) Excluding one aircraft which was grounded as of December 31, 2003, because it was to be sold or scrapped. The net book value of this aircraft, after deducting the allowances recorded, is zero.

(b) Excluding one damaged A-320 aircraft in Bilbao for which the Company will receive, free of charge, another A-320 in 2004.

Aircraft operated under operating lease contracts

In 2003 one A-320 aircraft, two A-321 aircraft, three A-340/600 aircraft and one MD-88 aircraft were leased under an operating lease arrangement. Also, one B-747 aircraft and two B-757 aircraft the lease contracts for which expired in 2003 were returned.

- Boeing aircraft

B-757

As of December 31, 2003, the Company was leasing 16 B-757 aircraft from various companies (a different company for each plane). The lease contracts expire in 2004 and 2005, although for six of these aircraft an extension of the contracts through 2006 is being negotiated. At the end of the lease term the aircraft will be returned to the lessors, which also have a residual value guarantee from International Lease Finance Corporation.

The lease contracts require that certain overhauls be performed on the engines and other parts of these aircraft before they are definitively returned. To cover the cost of these repairs, which the Company estimates at approximately €39 million (including the expenses relating to two A-320 aircraft and five MD-87 aircraft which are scheduled to be returned when the related contracts expire in 2004 and 2005), a provision of €19,780 thousand has been recorded under the "Provision for Third-Party Liability" caption, of which €14,200 thousand were recorded in 2003 (see Note 19-h). The remaining amount will be recorded in 2004 and 2005, periods in which these aircraft will continue to fly until they are returned.

B-747

As of December 31, 2003, the Company was leasing two B-747 aircraft under operating lease contracts with Air Atlanta, S.A. These contracts will expire in 2005 (with an option to extend the lease for an additional nine months) and the Company has deposited a completion bond of €950 thousand in connection with this transaction (see Note 7).

- Airbus aircraft

A-340/600

As of December 31, 2003, the Company was operating three A-340/600 aircraft under operating lease contracts with different companies which expire in 2015. The contracts provide for a purchase option for these aircraft or for their return in 2013 or 2015. At the end of the related lease term the lessor of the aircraft has a residual value guarantee from International Lease Finance Corporation.

A-340/300

As of December 31, 2003, the Company was operating 18 A-340/300 aircraft under operating lease contracts, of which four planes have been leased for nine-year periods, the contracts for which expire in 2009 and 2010, at which time the Company may opt to purchase the planes for a predetermined price or to return them to the lessor. The contracts for a further three planes expire in 2014 (two planes) and in 2015 (one plane), at which time the Company may opt to purchase the aircraft for a predetermined price or to return them to the lessor. In the case of the contract which expires in 2015, the purchase option may be exercised when the contract expires or two years prior to this date.

The remaining eleven planes are leased from the "Iberbus" companies (see Note 7), in which the Company has ownership interests. The basic conditions of the lease contracts for these aircraft are summarized as follows:

▶▶ **SUMMARY**

| RELATED IBERBUS COMPANY | TERMS AND CONDITIONS |
|--|---|
| CONCHA, LTD.; ROSALÍA, LTD. Y CHACEL, LTD. (b) | THE LEASES FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2003 AND WERE EXTENDED FOR AN ADDITIONAL FIVE YEARS. IF THE COMPANY EXERCISES THE PURCHASE OPTIONS AGREED ON FOR THE A-340/600 PLANES, THE CONTRACTS WILL BE EXTENDED FOR A FURTHER THREE YEARS (a). |
| ARENAL, LTD. (b) | THE LEASE INITIALLY EXPIRED IN 2003, BUT WAS EXTENDED FOR AN ADDITIONAL FIVE YEARS. |
| TERESA, LTD., EMILIA, LTD. (b) | THE LEASE FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2004 BUT IT WAS EXTENDED TO 2009. ADDITIONALLY, IF THE COMPANY EXERCISES THE PURCHASE OPTIONS AGREED ON FOR THE A-340/600 AIRCRAFT, THE CONTRACTS WILL BE EXTENDED FOR A FURTHER THREE YEARS (a). |
| AGUSTINA, LTD; BEATRIZ, LTD. (b) | THE LEASE FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2005 BUT IT WAS EXTENDED FOR AN ADDITIONAL FIVE YEARS. |
| MARÍA PITA, LTD. (b) | THE LEASE ORIGINALLY EXPIRED IN 2007 BUT WAS EXTENDED TO 2012. |
| JUANA INÉS, LTD.; MARÍA DE MOLINA, LTD. (c) | THE LEASES FOR THESE AIRCRAFT EXPIRE IN 2006 AND 2007, RESPECTIVELY. |

(a) In the event of the second extension, the Company will receive a credit memorandum.
 (b) When the lease contracts expire, the Company can either exercise the purchase option or return the aircraft.
 (c) When the lease expires, the Company can extend it for three or eight years, in which case it must exercise the purchase option at the end of the extension period, or exercise the purchase option or return the aircraft. In this last case, if the owner does not find a buyer for the aircraft, the Company is obliged to extend the lease for a further two years.

A-319, A-320 and A-321

As of December 31, 2003, the Company was operating five A-321 aircraft, thirty six A-320 aircraft and four A-319 aircraft under operating lease contracts, the main features of which are as follows:

1. Twelve A-320 aircraft and four A-319 aircraft are leased under a contract with International Lease Finance Corporation, expiring in 2005 (five aircraft) and 2006 (eleven aircraft). When the lease term expires, the Company may extend them twice for one- or five-year periods, provided that the two extensions do not total more than six additional years, or it may return the aircraft. At the end of the extension period the Company can either exercise a purchase option or return the aircraft.

As a result of having entered into this contract, the Company had deposited a completion bond of €9,897 thousand, and this amount is recorded under the "Long-Term Deposits and Guarantees Given" caption in the accompanying balance sheet as of December 31, 2003 (see Note 7).

2. Two A-320 aircraft are leased under two contracts expiring in 2004, when the Company may renew the contracts for a maximum of six further years or return the aircraft.

3. Nine A-320 aircraft are leased under contracts expiring between 2012 and 2014, when the Company will return the aircraft to the lessor. However, the Company may choose to exercise the purchase option on the aircraft for a predetermined price provided for in the contracts on certain dates: September 30, 2007 (one aircraft), March 30, 2008 (two aircraft), September 30, 2009 (four aircraft) and September 15, 2011 (two aircraft).

4. The contracts relating to six A-320 aircraft expire in 2006 (three aircraft) and 2007 (three aircraft). When the contracts expire, the Company may extend them for a further five years, provided that it notifies the lessor of its decision 12 months prior to the expiration of the original lease term, or return the aircraft.

5. Six A-320 aircraft are leased under contracts with the following expiration dates: one aircraft in 2006, three aircraft in 2007 and two aircraft in 2008. When the lease term ends, the Company has to return the aircraft to the lessor.

6. Three A-321 aircraft are leased under lease contracts expiring between 2013 and 2018. These contracts provide for the possibility of exercising the purchase option prior to their definitive expiration (two aircraft in 2012 and one aircraft in 2013); should the purchase option not be exercised on the dates established, the Company will return the aircraft on expiration of the related contracts.

7. One A-320 aircraft is leased from Cygnus Aviation, and the lease contract expires in 2015. The lease contract establishes a purchase option for the aircraft that can be exercised in 2014. At the end of the lease term, the lessor has a residual value guarantee from Airbus G.I.E.

8. The lease contracts relating to two A-321 aircraft expire in 2016 and provide for purchase options that can be exercised in 2012 and 2013. For one of these aircraft, at the end of the lease term, the lessor has a residual value guarantee from General Electric Company and Société Nationale d'Etude et de Construction de Moteurs d'Aviation (SNECMA).

MD-87

As of December 31, 2003, the Company was operating five MD-87 aircraft under operating lease contracts. The term of the lease contracts is 96 months (expiring in 2005), at the end of which the Company may exercise the purchase option provided for in the contract or return the planes.

MD-88

On February 6, 2003, an operating lease contract was entered into for one MD-88 aircraft which initially expired in April 2004. As envisaged in the contract, in January 2004 the Company extended the lease term until May 2006.

Lease expenses

The lease payments accrued in 2003 for the operating lease of the aforementioned B-747, B-757, A-319, A-320, A-321, A-340, MD-87 and MD-88 aircraft amounted to €325,485 thousand, and this amount is included under the "Other Operating Expenses" caption in the statement of income (see Note 19-g). The detail of the approximate total operating lease payments payable for these aircraft and of the related due dates is as follows:

▶▶ LEASE EXPENSES

| DUE DATES | MILLIONS OF EUROS |
|--------------|-------------------|
| 2004 | 320 |
| 2005 | 289 |
| 2006 | 215 |
| 2007 | 169 |
| 2008 TO 2018 | 746 |
| | 1,739 (*) |

(*)Equivalent to US\$ 2,196 million at the year-end exchange rate. A portion of these lease payments are hedged with derivatives (see Note 16).

As of the date of preparation of these financial statements, the Company's directors did not intend to exercise the purchase options on the aircraft that as of December 31, 2003, were being operated by Iberia, Líneas Aéreas de España, S.A. under operating lease contracts.

Also, most of the operating lease contracts in force stipulate that the lessee must bear the periodic repair and inspection costs. The Company has recorded the related provision of €55,720 thousand under the "Provision for Major Repairs" caption (see Note 13).



Subsequent agreements relating to aircraft

In January 2004 the Company entered into a new operating lease contract for one A-321 aircraft that expires in 2017 and has a residual value guarantee from General Electric Company and Société Nationale d'Étude et de Construction de Moteurs d'Aviation (SNECMA). The contract provides for the possibility of exercising a purchase option in 2014.

Other tangible fixed assets

The buildings constructed on land owned by the Government, mainly at Spanish airports, and the related fixtures had a net book value of €24,763 thousand as of December 31, 2003. The concessions relating to these assets expire in the period from 2004 to 2009.

In 2003 the Company sold two buildings located in Barcelona and Rome, for a total amount of €11,763 thousand. This transaction gave rise to a gain of €9,337 thousand, and this amount is included under the "Gains on Disposals of Fixed Assets and Control Portfolio" caption in the accompanying 2003 statement of income.

Also, on November 6, 2003, the Company entered into an earnest money contract whereby it agreed the sale of a building located in Barcelona and set a selling price of €30,800 thousand, of which €3,080 thousand were collected as earnest money. The net book value as of December 31, 2003, of this building and its related fixtures amounted to €1,640 thousand. This transaction was formalized in February 2004.

The incorporation of spare parts into the aircraft in 2003 gave rise to the retirement of items with a net book value of €80,527 thousand, and this amount is included under the "Procurements" caption in the accompanying statement of income (see Note 19-e).

Also, the costs incurred in refurbishing the cabins of aircraft added to the fleet under operating lease contracts gave rise to retirements from the "Construction in Progress" account amounting to €16,467 thousand. Of this amount, €15,915 thousand were returned by the lessor of the planes after the related operating lease contracts were formalized.

Revaluation reserve Royal Decree-Law 7/1996

On December 31, 1996, the Company revalued its property, plant and equipment pursuant to Royal Decree-Law 7/1996, and paid the single 3% tax. The Company had previously availed itself of other revaluation legislation. The revalued assets had a net book value of €14,626 thousand as of December 31, 2003, and the effect on the depreciation expense was not significant.

The revaluation surplus, net of the single 3% tax, was credited to the "Revaluation Reserve" caption, with a charge to the appropriate revalued asset accounts, without altering the recorded accumulated depreciation amount. On January 22, 1998, the tax authorities checked and approved the balance of the revaluation reserve and, accordingly, as permitted by current legislation, it was agreed to use the aforementioned reserve to offset accumulated losses.

Fully depreciated assets

As of December 31, 2003, the cost of the Company's fully depreciated property, plant and equipment amounted to €310,568 thousand, the detail being as follows:

| DECEMBER 31, 2003 | THOUSANDS OF EUROS |
|-------------------------------|---------------------------|
| STRUCTURES | 59,489 |
| MACHINERY, FIXTURES AND TOOLS | 165,788 |
| FURNITURE | 9,724 |
| COMPUTER HARDWARE | 27,621 |
| FLIGHT SIMULATORS | 38,636 |
| TRANSPORT EQUIPMENT | 2,590 |
| AIRCRAFT | 6,720 |
| TOTAL | 310,568 |

Insurance coverage

The Company has arranged insurance policies for its property, plant and equipment and intangible assets which sufficiently covered the net book value thereof as of December 31, 2003. Also, the Company has arranged insurance policies for the aircraft leased from third parties, in accordance with the conditions stipulated in the related lease contracts.

7 Long-term investments

Investments in Group and associated companies

The variations in 2003 in the balance of the "Investments in Group and Associated Companies" caption and in the related allowance were as follows:

| GROUP AND ASSOCIATED COMPANIES | | THOUSANDS OF EUROS | |
|---------------------------------------|----------------|--------------------|--|
| | COST | ALLOWANCE | |
| BALANCE AT 12-31-02 | 120,890 | (94,472) | |
| ADDITIONS OR PROVISIONS | 802 | (1,576) | |
| TRANSFERS | 4 | - | |
| BALANCE AT 12-31-03 | 121,696 | (96,048) | |

In 2003 the Company subscribed, in proportion to its ownership interest, to the capital increase at Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A. (Iberia Cards) and disbursed €800 thousand in this connection.

The information relating to the most representative Group and associated companies as of December 31, 2003, drawn from their audited financial statements, which have not yet been approved by the respective Shareholders' Meetings, or from provisional financial statements in the case of the Amadeus Group and Touroperador Viva Tours, S.A., is as follows:

| CORPORATE NAME / ADDRESS / CORPORATE PURPOSE | PERCENTAGE OF DIRECT AND INDIRECT OWNERSHIP | COST | ALLOWANCE | CAPITAL STOCK |
|--|---|--------|-----------|---------------|
| COMPAÑÍA AUXILIAR AL CARGO EXPRES, S.A. CENTRO DE CARGA AÉREA PARCELA 2 P.5 NAVE 6; MADRID CARGO TRANSPORT | 75.00 | 670 | - | 192 |
| CARGOSUR, S.A. (b) VELÁZQUEZ, 130; MADRID AIR TRANSPORT OF CARGO | 100.00 | 8,685 | (3,674) | 6,058 |
| IBER-SWISS CATERING, S.A. CTRA. DE LA MUÑOZA, S/N; MADRID PREPARATION AND MARKETING OF FOOD AND OTHER SERVICES FOR AIRCRAFT | 70.00 | 3,569 | - | 3,005 |
| AMADEUS GLOBAL TRAVEL DISTRIBUTION, S.A. SALVADOR DE MADARIAGA, 1; MADRID MANAGEMENT AND OPERATION OF AN AUTOMATED BOOKING SYSTEM | 27.92 (c) | 9,902 | - | 27,898 |
| VENEZOLANA INTERNACIONAL DE AVIACIÓN, S.A. (VIASA) ÓSCAR M. ZULOAGA, S/N; CARACAS AIR PASSENGER AND CARGO TRANSPORT | 45.00 | 88,446 | (88,446) | (a) |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJES, S.A. (SAVIA) VELÁZQUEZ, 130; MADRID COMPUTER SERVICES APPLICABLE TO THE TRAVEL AND TOURISM INDUSTRIES | 75.49 (c) | 198 | - | 301 |
| TOUROPERADOR VIVA TOURS, S.A. TRESPADERNE, 29; MADRID MANAGEMENT OF PACKAGE TOURS | 49.00 | 3,642 | (3,154) | 2,760 |
| SOCIEDAD CONJUNTA PARA LA EMISIÓN Y GESTIÓN DE MEDIOS DE PAGO EFC, S.A. VELÁZQUEZ, 94; MADRID ISSUANCE AND MANAGEMENT OF PAYMENT INSTRUMENTS | 40.00 | 4,038 | (674) | 6,000 |

| RESERVES | INCOME (Loss) | | DIVIDENDS RECEIVED |
|----------|---------------|---------------|--------------------|
| | TOTAL | EXTRAORDINARY | |
| 2,204 | 707 | (38) | 231 |
| (1,021) | (26) | (33) | - |
| 8,229 | 2,204 | (189) | 723 |
| 725,202 | 150,100 | 3,628 | 5,658 |
| (a) | (a) | (a) | - |
| 10,608 | 5,106 | (1,386) | 4,552 |
| 20 | (1,784) | (75) | - |
| 2,337 | 72 | - | - |

(a) Venezolana Internacional de Aviación, S.A.'s operations were discontinued in January 1997 and in March 1997 this company filed for "suspensión de pagos" (Chapter 11-type insolvency proceedings - hereinafter "suspension of payments") and the process of liquidation commenced. The Company does not have any recent financial statements for Venezolana Internacional de Aviación, S.A. The risks relating to this holding were provisioned in full in the accompanying balance sheet as of December 31, 2003.

(b) The related financial information refers to Cargosur, S.A.'s individual financial statements, since this company, which as of December 31, 2003, had holdings in Campos Velázquez, S.A. and VIVA, Vuelos Internacionales de Vacaciones, S.A., does not present consolidated financial statements because it is not required to do so because the three companies are consolidated in the Iberia Group.

(c) The dividend rights relating to the Amadeus Group and Sistemas Automatizados Agencias de Viaje, S.A. amount to 18.28% and 72.22%, respectively. In February 2004 one of the founding shareholders of the Amadeus Group disposed of a significant portion of its holding, thereby reducing its voting rights. Accordingly, Iberia, Líneas Aéreas de España, S.A.'s holding was increased to 33.80% and its dividend rights remained unchanged. Also, the holding in Sistemas Automatizados Agencias de Viaje, S.A. was increased to 77.49%.



In December 2003 the Company entered into an agreement for the sale of the shares that it owns in its investee Touroperador Viva Tours, S.A. and of the "Viva Tours" brand names owned by it. This transaction was formalized in February 2004 and the prices set were €1,864 thousand for the shares and €15 million for the brand names.

Also, in December 2003 the Company signed a memorandum of understanding for the sale of its ownership interest in Iberswiss Catering, S.A. for which a base selling price of €23.5 million was set. This agreement is subject to obtainment of the related authorization from the antitrust authorities and, accordingly, as of the date of preparation of these financial statements the agreements entered into had not yet come into force.

Lastly, in February 2004 the Company subscribed to a capital increase at Servicios de Instrucción de Vuelo, S.L., whose main business activity is the operation of flight simulators. The ownership interest acquired was 19.9%.

Loans to Group and associated companies

This caption in the accompanying balance sheet as of December 31, 2003, reflects the loans granted in prior years to Venezolana Internacional de Aviación, S.A. (VIASA). These loans have been provisioned in full.

Long-term investment securities

The detail of the variations in this caption in the accompanying balance sheet as of December 31, 2003, and in the related allowances is as follows:

| LONG-TERM INVESTMENT SECURITIES | | | | | | | THOUSANDS OF EUROS |
|--|----------------------------------|------------------------|-----------------|----------------|----------------|------------------------|--------------------|
| | % OF OWNERSHIP AT 12-31-03 | BALANCE AT 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | BALANCE AT 12-31-03 | |
| FIXED-INCOME SECURITIES: | | | | | | | |
| IBERBOND PLC 1999 | - | 34,320 | - | - | (1,170) | 33,150 | |
| GOVERNMENT DEBT | - | 3,333 | - | (2,576) | - | 757 | |
| EQUITY SECURITIES: | | | | | | | |
| INTERINVEST, S.A. | 0.1438 | 30,244 | - | - | - | 30,244 | |
| IBERBUS COMPANIES | (a) | 24,930 | - | - | - | 24,930 | |
| OPODO, LTD. | 9.14 | 17,676 | 1,570 | - | - | 19,246 | |
| ADQUIRA ESPAÑA, S.A. (c) | 10.00 | 3,583 | - | - | - | 3,583 | |
| CORDIEM | (b) | 2,352 | - | - | - | 2,352 | |
| OTHER | - | 935 | - | (457) | (4) | 474 | |
| TOTAL COST | | 117,373 | 1,570 | (3,033) | (1,174) | 114,736 | |
| ALLOWANCES | | (37,496) | (16,166) | - | - | (53,662) | |

(a) The percentages of ownership in these companies range from 40% to 45.45%.

(b) Holdings of 1.86% in Cordiem LLC and of 2.07% in Cordiem, Inc.

This investment had been provisioned in full as of December 31, 2003.

(c) An allowance amounting to €1,716 thousand was recorded for this investment.

The main period additions arose from the subscription, in proportion to the Company's ownership interest, to successive capital increases at Opodo, Ltd. The amounts disbursed in this connection totaled €1,570 thousand. An allowance of €19,246 thousand has been recorded for this investment.

Fixed income securities

In September 1999 the Company subscribed to bonds issued by Iberbond PLC 1999 for €39,000 thousand. These bonds form part of an issue relating to the acquisition of six A-320 aircraft which were subsequently leased to the Company under a financial lease contract.

The bonds subscribed to by the Company earn annual interest of 5.90% which is settled every six months. 3% of the principal is payable each year through the final maturity on September 1, 2007, when the remaining 85% becomes payable. As of December 31, 2003, the Company had recorded the €1,170 thousand maturing in 2004 under the "Short-Term Investments" caption in the balance sheet (see Note 11).

The interest earned in 2003 amounted to €2,080 thousand and was recorded under the "Other Interest and Similar Revenues" caption in the accompanying statement of income; of this amount, €718 thousand relate to unmatured accrued interest as of December 31, 2003, which was recorded under the "Short-Term Investments" caption in the balance sheet.

Equity securities

The Company's holding in Interinvest, S.A. (the majority shareholder of Aerolíneas Argentinas, S.A.) was provisioned in full in 1999 due to the accumulated losses incurred by Aerolíneas Argentinas, S.A.

The information relating to the Iberbus companies, which own most of the A-340/300 aircraft operated by the Company (see Note 6), as of December 31, 2003, drawn from their respective provisional financial statements, is as follows:

| IBERBUS COMPANIES | | THOUSANDS OF EUROS | | | | | |
|--------------------------------|-----------------------------------|--------------------------------|---------------|---------|----------|---------------|--|
| GROUP AND ASSOCIATED COMPANIES | ADDRESS | PERCENTAGE OF DIRECT OWNERSHIP | COST | CAPITAL | RESERVES | ORDINARY LOSS | |
| IBERBUS CONCHA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,029 | 5,428 | (1,581) | (384) | |
| IBERBUS ROSALÍA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,056 | 5,387 | (3,265) | (267) | |
| IBERBUS CHACEL, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,283 | 5,967 | (5,494) | - | |
| IBERBUS ARENAL, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,362 | 6,105 | (7,782) | (491) | |
| IBERBUS TERESA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,504 | 5,520 | (1,727) | (177) | |
| IBERBUS EMILIA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,497 | 5,544 | (1,890) | (134) | |
| IBERBUS AGUSTINA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,587 | 5,546 | (259) | (128) | |
| IBERBUS BEATRIZ, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,556 | 5,564 | (104) | (168) | |
| IBERBUS JUANA INÉS, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 1,896 | 3,318 | (3,779) | (802) | |
| IBERBUS MARÍA DE MOLINA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 1,983 | 3,490 | (4,074) | (1,043) | |
| IBERBUS MARÍA PITA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 2,177 | 3,674 | (3,667) | (1,345) | |
| | | | 24,930 | | | | |



The majority shareholder of these companies, Airbus Industrie Financial Services, has guaranteed for Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of its investments in and loans to the Iberbus companies, and, accordingly, no allowances are recorded for the investments in these companies.

In 2003 the Company sold its holding in Tiempo Libre, S.A., the cost of which amounted to €457 thousand, and various Mundicolor brand names related with this holding, the net book value of which was zero. As a result of this transaction, the Company recorded a gain of €11,543 thousand under the "Other Interest and Similar Revenues" caption in the accompanying 2003 statement of income.

Other loans

The detail of variation in the balance of this caption in the balance sheet is as follows:

| | THOUSANDS OF EUROS | | | |
|-------------------------------------|------------------------|-----------------------------|--------------|------------------------|
| | BALANCE AT 12-31-02 | EXCHANGE DIFFERENCES (*) | OTHER | BALANCE AT 12-31-03 |
| LOANS TO IBERBUS COMPANIES | 188,853 | (32,043) | - | 156,810 |
| LOAN TO AEROLÍNEAS ARGENTINAS, S.A. | 3,914 | - | (125) | 3,789 |
| OTHER | 8,095 | - | (96) | 7,999 |
| TOTAL COST | 200,862 | (32,043) | (221) | 168,598 |
| ALLOWANCES | (7,758) | - | - | (7,758) |

(*) Recorded under the "Exchange Losses" caption in the statement of income and covered by hedging transactions (see Note 16).

In 1999 the Company granted Aerolíneas Argentinas, S.A. two loans of €3,537 thousand and €2,352 thousand. These loans earn interest at 5.25% and their final maturity is in 2006 and 2000, respectively.

Most of the principal of these loans and the related interest, amounting to €6,123 thousand, were outstanding as of December 31, 2003, of which the portion classified as short term under the "Short-Term Investments" caption (see Note 11) relates to the principal and interest which were not paid on maturity.

Also, the Company has trade accounts receivable from and payable to Aerolíneas Argentinas, S.A. for a net amount receivable of approximately €23,233 thousand.

In addition, the Company provided a guarantee to Banesto, S.A. for Aerolíneas Argentinas, S.A. under which it undertook, in the event of default by the latter, to pay the outstanding amounts of a mortgage loan secured by two B-747 aircraft. Banesto, S.A. initiated proceedings to execute this guarantee and claimed €47,114 thousand from Iberia, Líneas Aéreas de España, S.A. In order to meet this claim, the Company has set up a restricted deposit which is recorded under the "Long-Term Deposits and Guarantees Given" caption. As of December 31, 2003, the balance of this deposit amounted to €48,030 thousand.

Furthermore, the Company had provided another guarantee (in U.S. dollars) for Aerolíneas Argentinas, S.A. amounting to US\$ 6 million.

In view of the suspension of payments of Aerolíneas Argentinas, S.A., the Company has recorded a provision of €80,209 thousand to cover the possible bad debts and third-party liability that might arise from the aforementioned transactions. This amount was recorded under the "Provision for Third-Party Liability" caption in the balance sheet (see Note 13).

The Company has granted a loan to each of its Iberbus investees. The principal ranges, depending on the company in question, from US\$ 11,049 thousand to US\$ 22,101 thousand. These loans were granted for a period equal to the term of the operating lease for the related A-340/300 aircraft and earn annual interest ranging from 4% to 6%. These loans are repayable at one time when they mature, which, depending on the company concerned, will take place in the period from 2006 to 2012.

The amounts not yet repaid in this connection, by maturity, are as follows:

▶▶ DECEMBER 31, 2003

| | MATURING IN | THOUSANDS OF EUROS |
|--|--------------|--------------------|
| | 2006 | 8,748 |
| | 2007 | 9,200 |
| | 2008 | 65,611 |
| | 2009 | 31,715 |
| | 2010 | 31,850 |
| | 2012 | 9,686 |
| | TOTAL | 156,810 |

Long-term deposits and guarantees given

The variations in 2003 in the items composing this caption in the balance sheet were as follows:

▶▶ LONG-TERM DEPOSITS AND GUARANTEES GIVEN

| | THOUSANDS OF EUROS | | | | | |
|---|------------------------|----------------|-----------------|----------------|-------------------------|------------------------|
| | BALANCE AT 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | EXCHANGE DIFFERENCES | BALANCE AT 12-31-03 |
| DEPOSIT FOR AEROLINEAS ARGENTINAS, S.A. | 47,114 | 916 | - | - | - | 48,030 |
| DEPOSIT FOR CONVERTIBLE DEBENTURES (NOTE 15) | 22,573 | 27,532 | - | (22,573) | - | 27,532 |
| DEPOSITS AND GUARANTEES FOR OPERATION OF AIRCRAFT LEASED FROM ILFC (NOTE 6) | 10,012 | 1,806 | - | - | (1,921) | 9,897 |
| DEPOSITS AND GUARANTEES FOR OPERATION OF AIRCRAFT UNDER DRY LEASE ARRANGEMENTS (NOTE 6) | 2,332 | - | (552) | - | (318) | 1,462 |
| DEPOSITS FOR ACQUISITION OF AIRCRAFT (NOTE 6) | - | 224,012 | (28,589) | 155,022 | (43,078) | 307,367 |
| OTHER | 4,400 | 181 | (391) | - | (396) | 3,794 |
| | 86,431 | 254,447 | (29,532) | 132,449 | (45,713) | 398,082 |

The amounts included in the "Deposits for Acquisition of Aircraft" account relate to the amounts paid on account pursuant to the conditions established in the contracts to acquire the aircraft. Since these amounts are repayable on the basis of the system finally used to incorporate the plane into the fleet in service, to improve their presentation in 2003 they were reclassified from the "Property, Plant and Equipment" caption to the "Long-Term Investments" caption.

In March 2002 an agreement was entered into by Iberia, Airbus and their respective insurance companies, whereby Iberia sold an A-320 aircraft grounded in Bilbao as a result of an accident to Airbus for the symbolic amount of US\$ 1 and will receive a similar aircraft in exchange, free of charge, in July 2004. As a result of this transaction, the Company transferred the net book value of this aircraft, amounting to €36,583 thousand (€39,261 thousand relating to cost and €2,678 thousand relating to accumulated depreciation), from the "Property, Plant and Equipment" caption, since the Company will foreseeably recover this amount when the new aircraft comes into service under an operating lease.

The detail of the balance as of December 31, 2003, of the "Deposits for Acquisition of Aircraft" account is as follows:

| DEPOSITS FOR ACQUISITION OF AIRCRAFT, DECEMBER 31, 2003 | | | THOUSANDS OF EUROS |
|--|--|-------------------------------------|--------------------|
| TYPE OF AIRCRAFT | AIRCRAFT SUBJECT TO FIRM PURCHASE COMMITMENT | AIRCRAFT SUBJECT TO PURCHASE OPTION | |
| A-319 | 19,202 | 1,069 | |
| A-320 | 103,469 | 1,664 | |
| A-321 | 62,189 | 1,781 | |
| A-340 | 109,572 | 5,146 | |
| | 294,432 | 9,660 | |

This account also includes advances for the acquisition of engines amounting to €3,275 thousand.

8 Treasury stock

The variations in 2002 in the "Treasury Stock" caption in the accompanying balance sheet as of December 31, 2003, were as follows:

| TREASURY STOCK | | THOUSANDS OF EUROS |
|-------------------------------------|--|--------------------|
| BALANCE AT DECEMBER 31, 2002 | | 31,896 |
| ADDITIONS | | 4,315 |
| REDUCTIONS | | (16,145) |
| BALANCE AT DECEMBER 31, 2003 | | 20,066 |

The 14,851,798 shares of treasury stock held by the Company as of December 31, 2003, represent 1.6% of its capital stock, with an overall par value of €11,584 thousand and an average acquisition cost of €1.35 per share. The balance of €20,066 thousand of the "Reserve for Treasury Stock" account as of December 31, 2003, covers in full the net book value of the aforementioned shares.

The sale of shares of treasury stock in 2003, the only item included in "Reductions" in the foregoing table, gave rise to gains totaling €8,347 thousand, which were recorded under the "Gains on Transactions Involving Treasury Stock" caption in the statement of income.

9 Inventories

The detail of the balance of this caption in the balance sheet as of December 31, 2003, is as follows:

| INVENTORIES | THOUSANDS OF EUROS |
|--|--------------------|
| RAW MATERIALS AND OTHER SUPPLIES | 77,302 |
| MERCHANDISE | 8,554 |
| WORK-IN PROCESS AND SEMIFINISHED GOODS | 7,339 |
| ADVANCES TO SUPPLIERS | 2,454 |
| ALLOWANCES | (19,930) |
| TOTAL | 75,719 |

10 Accounts receivable

The breakdown of the "Accounts Receivable" caption in the accompanying balance sheet as of December 31, 2003, is as follows:

| ACCOUNTS RECEIVABLE AS OF DECEMBER 31, 2003 | THOUSANDS OF EUROS |
|--|--------------------|
| RECEIVABLE FROM PASSENGER AND CARGO AGENCIES | 170,042 |
| RECEIVABLE FROM PUBLIC AUTHORITIES | 53,306 |
| RECEIVABLE FROM AIRLINES | 23,366 |
| RECEIVABLE FROM CUSTOMERS AT SALES OFFICES | 24,504 |
| CREDIT CARD RECEIVABLES | 14,944 |
| OTHER TRADE RECEIVABLES FOR SALES AND SERVICES | 122,194 |
| SUNDRY ACCOUNTS RECEIVABLE | 54,134 |
| DOUBTFUL RECEIVABLES | 23,311 |
| TAXES RECEIVABLE (NOTE 18) | 70,406 |
| ALLOWANCES | (26,888) |
| | 529,319 |

11 Short-term investments

The detail of the balance of this caption in the accompanying balance sheet as of December 31, 2003, is as follows:

| SHORT-TERM INVESTMENTS | THOUSANDS OF EUROS |
|--|--------------------|
| SHORT-TERM FINANCIAL ASSETS | 1,262,062 |
| EXCHANGE DIFFERENCES DUE TO HEDGING TRANSACTIONS | 43,728 |
| DEPOSIT FOR CONVERTIBLE DEBENTURES (NOTE 15) | 22,573 |
| OTHER SHORT-TERM DEPOSITS AND GUARANTEES | 6,586 |
| UNMATURED INTEREST RECEIVABLE | 8,296 |
| LOANS TO AEROLÍNEAS ARGENTINAS, S.A. (NOTE 7) | 2,334 |
| IBERBOND BONDS (NOTE 7) | 1,170 |
| OTHER SHORT-TERM INVESTMENTS | 359 |
| | 1,347,108 |

The "Exchange Differences Due to Hedging Transactions" account relates to the net balance resulting from the valuation as of December 31, 2003, of the transactions to hedge asset and liability positions (see Note 16).

The short-term financial assets, relating mainly to Eurodeposits and Eurocommercial paper, earned average annual interest of 2.48% in 2003.

12 Shareholders' equity

The variations in the Company's equity accounts in 2003 were as follows:

| SHAREHOLDERS' EQUITY | | | | | | | | | | | THOUSANDS OF EUROS |
|-------------------------------------|----------------|----------------------------|---------------------|---------------|--------------------|----------------------------|-----------------|--------------------------------------|---------------------|---------------|--------------------|
| | CAPITAL STOCK | ADDITIONAL PAID-IN CAPITAL | REVALUATION RESERVE | LEGAL RESERVE | VOLUNTARY RESERVES | RESERVE FOR TREASURY STOCK | MERGER RESERVES | ADJUSTMENT OF CAPITAL STOCK TO EUROS | INCOME FOR THE YEAR | DIVIDENDS | |
| BALANCE AT DECEMBER 31, 2002 | 712,110 | 96,454 | 38 | 61,352 | 111,327 | 31,896 | 165 | 1,201 | 143,188 | - | |
| DISTRIBUTION OF 2002 INCOME | - | - | - | 14,319 | 93,261 | - | - | - | (143,188) | 35,608 | |
| CAPITAL INCREASE | 4,723 | 2,483 | - | - | - | - | - | - | - | - | |
| RESERVE FOR TREASURY STOCK | - | - | - | - | 11,830 | (11,830) | - | - | - | - | |
| 2003 INCOME | - | - | - | - | - | - | - | - | 105,762 | - | |
| BALANCE AT DECEMBER 31, 2003 | 716,833 | 98,937 | 38 | 75,671 | 216,418 | 20,066 | 165 | 1,201 | 105,762 | 35,608 | |

In any evaluation of the Company's net worth as of December 31, 2003, the value of its treasury stock should be deducted from the equity balance shown in the accompanying balance sheet.

Capital stock

In 2001 the Company launched a stock option plan aimed at all its employees. Under the terms of the plan, once the period for waiver had ended, the number of options accepted amounted to 25,291,842, for which the employees disbursed €0.30 per option as an advance payment. The advance payments not yet refunded amounting to €5,690 thousand are recorded under the "Other Nontrade Payables" caption in the accompanying balance sheet. The option exercise price was established at €1.19, and the employees can exchange 25% of the options subscribed, in the proportion of one to one in 2003, and the remaining 75% of the options in equal parts, on each of the following dates: February 3, 2004, June 3, 2004 and October 3, 2004. On each of these dates, the employees can opt to postpone the exercise of their rights and accumulate them, provided that the market price of the shares on that date is lower than the exercise price; otherwise, the right will be forfeited.

In order to cater for the commitments to employees in connection with the stock option plan described above, in 2002 the Company issued debentures convertible into shares (see Note 15).

Based on the redemption dates established, in 2003 the holders of the convertible debentures requested the conversion of 6,054,859 convertible debentures into 6,054,859 common shares of the Company. Consequently, the Company increased its capital stock by €4,722,790, through the issuance of 6,054,859 common shares of €0.78 par value each plus additional paid-in capital of €0.41 per share.

Also, the holders of 268,101 convertible debentures redeemed the debentures subscribed early.

Also, in February 2004 the Board of Directors resolved to increase capital stock by €4,779 thousand, through the issuance of 6,127,649 common shares of €0.78 par value each plus additional paid-in capital of €0.41 per share, to cater for the requests from their holders to convert 6,127,649 debentures into shares. On this exercise date the holders of 195,311 convertible debentures redeemed them early.

As of December 31, 2003, the Company's capital stock consisted of 919,016,894 fully subscribed and paid shares of €0.78 par value each traded by the book-entry system.

As of December 31, 2003, the Company's shareholders were as follows:

COMPANY'S SHAREHOLDERS

| | NUMBER OF SHARES | PERCENTAGE |
|--|--------------------|---------------|
| BA & AA HOLDINGS LIMITED | 91,296,204 | 9.93 |
| CAJA DE AHORROS Y MONTE DE PIEDAD DE MADRID | 91,290,716 | 9.93 |
| BANCO BILBAO VIZCAYA ARGENTARIA, S.A. | 68,945,483 | 7.50 |
| COMPAÑÍA DE DISTRIBUCIÓN INTEGRAL LOGISTA, S.A. | 61,164,780 | 6.66 |
| SOCIEDAD ESTATAL DE PARTICIPACIONES INDUSTRIALES | 49,212,526 | 5.35 |
| CORPORACIÓN FINANCIERA DE GALICIA | 32,404,254 | 3.53 |
| EL CORTE INGLÉS, S.A. | 27,387,215 | 2.98 |
| OTHER, INCLUDING EMPLOYEES | 497,315,716 | 54.12 |
| TOTAL | 919,016,894 | 100.00 |

On June 6, 2002, the Shareholders' Meeting approved a stock option plan involving shares of the Company for executives directors, certain managers and other line personnel, which will be instrumented through the issuance of debentures convertible into shares of Iberia, Líneas Aéreas de España, S.A. In order to cater for this new stock option plan, in 2003 the Company issued convertible debentures. The option exercise price was set at €1.62, pursuant to the terms established by the Shareholders' Meeting (see Note 15). The 16,995,400 options can be exchanged on various dates in the period from April 26, 2005 to April 25, 2008.

Additional paid-in capital

The revised Corporations Law expressly permits the use of the additional paid-in capital balance to increase capital and establishes no specific restrictions as to its use.

Legal reserve

Under the revised Corporations Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of capital stock.

The legal reserve can be used to increase capital provided that the remaining reserve balance does not fall below 10% of the increased capital stock amount. Otherwise, until the legal reserve exceeds 20% of capital stock, it can only be used to offset losses, provided that sufficient other reserves are not available for this purpose.

Differences due to the adjustment of capital stock to euros

In the redenomination of the capital stock to euros, which was approved by the Board of Directors in 1999, the difference arising as a result of the rounding off made it necessary to reduce capital and to record a restricted reserve in accordance with current legislation.

Revaluation reserve and merger reserve

As a result of the merger by absorption of Aviación y Comercio, S.A. in 2000, a merger reserve was recorded.

Also, Aviación y Comercio, S.A., in its merger balance sheet as of January 31, 2000, had recorded a revaluation reserve as a result of the revaluation made pursuant to Royal Decree-Law 7/1996. Pursuant to current legislation, the Company recorded a revaluation reserve equal to the amount obtained by applying to the merger reserve the percentage of Aviación y Comercio, S.A.'s total equity as of January 31, 2000, represented by the revaluation reserve recorded by it.

13 Provisions for contingencies and expenses

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

| PROVISIONS FOR CONTINGENCIES AND EXPENSES | | | | | | | THOUSANDS OF EUROS |
|--|------------------------|----------------------|------------------|-----------|-----------------|------------------------|--------------------|
| | BALANCE AT 12-31-02 | PERIOD PROVISIONS | AMOUNTS USED | TRANSFERS | REVERSALS | BALANCE AT 12-31-03 | |
| PROVISIONS FOR PENSIONS (NOTE 4-h) | 41,367 | 4,137 | (10,861) | 1,752 | - | 36,395 | |
| PROVISIONS FOR OBLIGATIONS TO PERSONNEL (NOTE 4-h) | 452,157 | 66,799 | (13,453) | (17,974) | - | 487,529 | |
| PROVISION FOR MAJOR REPAIRS (NOTE 4-b) | 109,775 | 36,900 | (19,856) | - | (21,913) | 104,906 | |
| PROVISION FOR THIRD-PARTY LIABILITY (NOTE 4-j) | 656,679 | 43,448 | (70,836) | 16,222 | (26,852) | 618,661 | |
| | 1,259,978 | 151,284 | (115,006) | - | (48,765) | 1,247,491 | |

The provisions recorded in 2003 under the "Provisions for Pensions" and "Provisions for Obligations to Personnel" captions relate to the amounts accrued in 2003 and the interest generated by the provisions recorded as of December 31, 2003 (see Note 4-h), and were charged to the "Personnel Expenses" caption (€2,689 thousand and €50,974 thousand, respectively) and the "Financial and Similar Expenses" caption (€1,448 thousand and €15,825 thousand, respectively) in the 2003 statement of income.

The balance as of December 31, 2003, of the "Provision for Third-Party Liability" caption includes €345,309 thousand relating to the estimated amount per the actuarial studies performed by independent actuaries of future payments to cater for the obligations to employees who have taken early retirement under the conditions envisaged in the labor force rejuvenation plan implemented in March 2000 (806 employees) and the voluntary labor force reduction plan approved in 2001 and implemented in 2002 and 2003 (3,088 employees).

The provisions recorded to cover the liabilities arising from the extension and updating of the labor force reduction plan in 2003 amounted to €24,995 thousand (see Note 19-h). In 2003 623 employees availed themselves of the labor force reduction plan.

The other provisions for third-party liability in 2003, which were also mainly recorded with a charge to the "Extraordinary Expenses" caption in the accompanying statement of income (see Note 19-h), relate to the amount estimated by the directors required for sundry probable third-party liability.

The transfers shown in the foregoing table relate mainly to amounts for flight personnel who availed themselves of the labor force reduction plan.

Also, the amounts used relate mainly, inter alia, to payments made in 2003 arising from the labor force downsizing plans described above and other payments, and the reversals relate mainly to certain litigation resolved in the Company's favor.

14 Payable to credit institutions

The breakdown, by maturity, of the payables to credit institutions as of December 31, 2003 (which related to loans and financial lease transactions -see Note 5), is as follows:

| PAYABLE TO CREDIT INSTITUTIONS AS OF DECEMBER 31, 2003 | | | | | | | THOUSANDS OF EUROS |
|--|-----------------------|---------------|---------------|---------------|----------------|---------------|--------------------|
| | | D U E I N : | | | | | |
| | CURRENCY | 2004 | 2005 | 2006 | 2007 | 2008 | SUBSEQUENT YEARS |
| IN EUROS: | PRINCIPAL | 30,365 | 29,277 | 23,365 | 147,695 | 32,355 | 93,981 |
| | INTEREST | 16,043 | 14,808 | 13,687 | 12,690 | 4,592 | 6,634 |
| IN FOREIGN CURRENCIES: | | | | | | | |
| | PRINCIPAL U.S. DOLLAR | - | - | - | - | - | 29,204 |
| | INTEREST U.S. DOLLAR | 50 | 58 | 58 | 58 | 58 | 9,998 |
| | | 46,458 | 44,143 | 37,110 | 160,443 | 37,005 | 139,817 |

The Company has arranged credit lines with a limit of €241,909 thousand, against which €241,629 thousand had not been drawn down as of December 31, 2003.

The weighted annual average interest rates on the aforementioned loans in 2003 were 4.03% for euro loans and 3.46% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

15 Convertible debenture issue

In 2002 the Company issued debentures convertible into shares of €1.19 par value each, in the proportion of one to one, for a total amount of €30,097 thousand. The unmatured amount, €22,573 thousand (see Note 12), is recorded under the "Current Liabilities – Convertible Debentures" caption. These debentures bear interest of three-month Euribor plus a spread. The Company has set up a restricted deposit for an amount equal to that of the unmatured portion of the issue (see Note 11).

As described in Note 12, in 2003 the Company issued debentures convertible into shares of €1.62 par value each, in the proportion of one to one, for a total amount of €27,532 thousand, which were recorded under the "Long-Term Debt - Convertible Debentures" caption in the accompanying balance sheet as of December 31, 2003.

The main characteristics of the new debenture issue are:

1. Interest rate: three-month Euribor plus a spread.
2. Maturity dates: April 26, 2005, September 19, 2005, March 10, 2006, September 10, 2006, March 10, 2007, September 10, 2007 and April 25, 2008.
3. Security: The Company has set up a restricted deposit for an amount equal to that of the issue (see Note 7).

16 Financial risk management

In order to control and reduce the potential adverse impact of exchange rate, interest rate and fuel price fluctuations on its earnings, Iberia has a medium-term plan to manage these risks.

I) EXCHANGE RATE RISK

1.- Balance-sheet hedging positions:

BALANCE-SHEET HEDGING POSITIONS

| UNDERLYING | CURRENCY | AMOUNT (MILLIONS OF FOREIGN CURRENCY) | TYPE OF HEDGE | NOMINAL AMOUNT (MILLIONS OF FOREIGN CURRENCY) |
|--------------------------------------|-------------|---|----------------------|---|
| a.- LOAN TO IBERBUS COMPANIES | US\$ | 198 | CROSS CURRENCY SWAPS | 198 |
| b.- ADVANCES ON AIRCRAFT AND ENGINES | US\$ | 336 | CROSS CURRENCY SWAPS | 285 |
| | | | Fx SWAPS | 47 |
| c.- GUARANTEES | | 14 | | |
| | US\$ | 548 | | 530 |

2.- Hedging of 2004 flows:

HEDGING OF 2004 FLOWS

| UNDERLYING | CURRENCY | AMOUNT (MILLIONS OF FOREIGN CURRENCY) | TYPE OF HEDGE | NOMINAL AMOUNT (MILLIONS OF FOREIGN CURRENCY) |
|----------------------------------|----------|---|----------------------|---|
| a.- FOREIGN CURRENCY PAYMENTS | US\$ | (556) | CROSS CURRENCY SWAPS | 139 |
| | | | OPTIONS | |
| | | | US\$ PUTS SOLD | 133 |
| | | | US\$ CALLS BOUGHT | 133 |
| | | | US\$ CALLS SOLD | (97) |
| b.- FOREIGN CURRENCY REVENUES | GBP | 94 | OPTIONS | |
| | | | GBP CALLS SOLD | (50) |
| | | | GBP PUTS BOUGHT | (25) |
| | | | GBP PUTS SOLD | 25 |
| | | | Fx FORWARDS | (18.7) |
| | CHF | 83 | CROSS CURRENCY SWAPS | (44) |
| | | | Fx FORWARDS | (3.5) |
| c.- ACQUISITIONS OF NEW AIRCRAFT | US\$ | (382) | OPTIONS | |
| | | | US\$ PUTS SOLD | 272 |
| | | | US\$ CALLS BOUGHT | 133 |
| | | | US\$ CALLS SOLD | (133) |
| | | | Fx FORWARDS | 105 |

All the US\$ cross currency swaps (balance-sheet and cash flow hedging) were arranged at exchange rates of between US\$ 0.860/€1 and US\$ 1.230/€1. Regarding the flexible option structures, the average price of the US\$ puts sold was US\$ 1.150/€1, that of the US\$ calls bought was US\$ 1.045/€1 and that of the US\$ calls sold was US\$ 0.995/€1. The US\$-buying Fx forwards were arranged at exchange rates of between US\$ 1.060/€1 and US\$ 1.110/€1.

II) INTEREST RATE RISK

1.- Balance-sheet hedging positions:

BALANCE-SHEET HEDGING POSITIONS

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | IBERIA | | NOMINAL AMOUNT AT 12/31/03 (*) | NOMINAL AMOUNT AT 12/31/04 (*) |
|---|---------------|-----------|--------------------------------------|--------------------------------------|
| | RECEIVES | PAYS | | |
| CROSS CURRENCY SWAPS | | | | |
| FROM FLOATING TO FLOATING | RECEIVES EUR | PAYS US\$ | 622,722 | 78,057 |
| | RECEIVES US\$ | PAYS EUR | 145,827 | - |

(*) The amounts are recorded in the currency in which the Company pays.

BALANCE-SHEET HEDGING POSITIONS

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | CURRENCY | IBERIA | | NOMINAL AMOUNT AT 12/31/05 | NOMINAL AMOUNT AT 12/31/06 |
|---|----------|----------|--------|----------------------------------|----------------------------------|
| | | RECEIVES | PAYS | | |
| INTEREST RATE SWAPS | | | | | |
| FROM FIXED TO FLOATING (1) | EUR | 61,302 | 56,282 | 51,261 | 49,141 |

(1) Iberia pays a floating interest rate and receives a fixed rate.

2.- Payment flow hedging:

PAYMENT FLOW HEDGING

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | IBERIA | | NOMINAL AMOUNT AT 12/31/03 (*) | NOMINAL AMOUNT AT 12/31/04 (*) | NOMINAL AMOUNT AT 12/31/05 (*) | NOMINAL AMOUNT AT 12/31/06 (*) | NOMINAL AMOUNT AT 12/31/07 (*) | NOMINAL AMOUNT AT 12/31/08 (*) |
|---|---------------|-----------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| | RECEIVES | PAYS | | | | | | |
| CROSS CURRENCY SWAPS | | | | | | | | |
| FROM FIXED TO FLOATING (1) | RECEIVES EUR | PAYS US\$ | 40,273 | 40,273 | 40,273 | 40,273 | 40,273 | 34,140 |
| | RECEIVES US\$ | PAYS EUR | 180,545 | 57,636 | - | - | - | - |
| FROM FLOATING TO FIXED (2) | RECEIVES US\$ | PAYS EUR | 389,802 | 185,639 | 146,619 | 132,036 | 52,852 | - |
| | RECEIVES EUR | PAYS CHF | 283,997 | 90,662 | - | - | - | - |
| FROM FLOATING TO FLOATING | RECEIVES US\$ | PAYS EUR | 846,469 | 615,462 | 372,499 | 262,600 | 149,852 | - |
| | RECEIVES US\$ | PAYS CHF | 249,443 | 113,043 | - | - | - | - |
| | RECEIVES EUR | PAYS CHF | 81,030 | 75,522 | - | - | - | - |
| FROM FIXED TO FIXED | RECEIVES US\$ | PAYS EUR | 160,335 | 143,356 | 135,625 | 127,484 | - | - |

(1) Iberia pays a floating interest rate and receives a fixed rate.

(2) Iberia pays a fixed interest rate and receives a floating rate.

(*) The amounts are recorded in the currency in which Iberia pays.

PAYMENT FLOW HEDGING

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | CURRENCY | NOMINAL AMOUNT AT 12/31/03 | NOMINAL AMOUNT AT 12/31/04 | NOMINAL AMOUNT AT 12/31/05 | NOMINAL AMOUNT AT 12/31/06 |
|---|----------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| INTEREST RATE SWAPS | | | | | |
| FROM FIXED TO FLOATING (3) | US\$ | 194,942 | 154,241 | - | - |
| FROM FLOATING TO FIXED (4) | US\$ | 548,445 | 369,428 | 146,244 | 137,981 |
| FROM FLOATING TO FLOATING (*) | EUR | 72,966 | - | - | - |
| INTEREST RATE SWAP + CAP (KO) | | | | | |
| FROM FLOATING TO FLOATING | US\$ | 40,273 | 40,273 | 40,273 | - |
| INTEREST RATE SWAP + COLLAR | | | | | |
| FROM FLOATING TO FLOATING | US\$ | 140,040 | 96,120 | 87,840 | - |

(3) Iberia pays a floating interest rate and receives a fixed rate.

(4) Iberia pays a fixed interest rate and receives a floating rate.

(*) IRS Quanto, Iberia pays interest in EUR tied to Libor in CHF.

The average fixed interest rates of the interest rate hedges are: euro 3.20%, U.S. dollar 3.04% and Swiss franc 2.43%.

Iberia Líneas Aéreas de España, S.A. had arranged interest rate swap transactions as part of the Japanese Operating Lease (JOL) internal structures for a notional amount of US\$ 760.6 million as of December 31, 2003.

III) FUEL PRICE RISK

FUEL PRICE RISK

| UNDERLYING | COMMODITY | VOLUME (MT) | HEDGE | NOMINAL (MT) |
|--------------------------------------|------------------|----------------|------------------------|-----------------|
| CONSUMPTION OF AIRCRAFT FUEL (MT) | JET KERO CIF-NWE | 2,128,033 | COMBINATION OF OPTIONS | 1,140,000 |

To date Iberia, Líneas Aéreas de España, S.A. has directly hedged the price of kerosene using a combination of financial tools (swaps and options). The outstanding hedges as of December 31, 2003, would give an average Brent-equivalent price range of between US\$ 23 and US\$ 26 per barrel.

17 Balances and transactions with Group and associated companies

The detail of the receivables from and payables to the Iberia Group and associated companies as of December 31, 2003, is as follows:

| DECEMBER 31, 2003 | | THOUSANDS OF EUROS | |
|--|---------------------------|------------------------|--|
| COMPANY | RECEIVABLES SHORT-TERM | PAYABLES SHORT-TERM | |
| VUELOS INTERNACIONALES DE VACACIONES, S.A. | - | 1,323 | |
| COMPañIA AUXILIAR AL CARGO EXPRES, S.A. | 7,670 | 419 | |
| IBER-SWISS CATERING, S.A. | 194 | 1,387 | |
| IBERIA TECNOLOGÍA, S.A. | 162 | 1,275 | |
| SAVIA | 2,187 | - | |
| CARGOSUR, S.A. | - | 2,403 | |
| AMADEUS GROUP | 2,032 | - | |
| BINTER FINANCE B.V. | 9,472 | - | |
| TOUOPERADOR VIVA TOURS, S.A. | 1,257 | - | |
| VENEZOLANA INTERNACIONAL DE AVIACIÓN, S.A. (a) | - | 2,473 | |
| IBERAMÉRICA AEROSPACE LLC | 3,453 | 25 | |
| MULTISERVICIOS AEROPORTUARIOS, S.A. | 1 | 1,326 | |
| OTHER | 83 | 1,012 | |
| | 26,511 | 11,643 | |

(a) The Company has recorded a short-term account receivable of €29,302 thousand from Venezolana Internacional de Aviación, S.A. for which a provision has been recorded in full.

The Company's main transactions with Group and associated companies in 2003 were as follows:

| 2003 | | THOUSANDS OF EUROS | | |
|---|-------------------|----------------------------------|-------------------|--------------------|
| COMPANY | SERVICES PROVIDED | FINANCIAL REVENUES AND DIVIDENDS | SERVICES RECEIVED | FINANCIAL EXPENSES |
| COMPañIA AUXILIAR AL CARGO EXPRES, S.A. | 19,393 | 231 | 2,646 | - |
| IBER-SWISS CATERING, S.A. | 325 | 723 | 63,319 | - |
| SAVIA | 12,092 | 4,552 | 326 | - |
| AMADEUS GROUP | 24,849 | 5,658 | 107,432 | - |
| TOUOPERADOR VIVA TOURS, S.A. | 737 | - | - | - |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | 71 | - | 2,440 | - |
| MULTISERVICIOS AEROPORTUARIOS, S.A. | - | 51 | 8,014 | - |
| BINTER FINANCE | 110 | 1,646 | 306 | - |
| OTHER | 139 | 90 | - | 32 |

The services received from Iber-Swiss Catering, S.A. relate to catering services and materials. The Amadeus Group bills the Company for tickets booked through its system and the Company receives a commission for each ticket issued by it through that system.

The services rendered to SAVIA relate mainly to the charge for the license to use the trademark, IT services and rent.

The services rendered to Compañía Auxiliar al Cargo Exprés, S.A. relate to cargo transport.

18 Tax matters

The "Accounts Receivable" and "Other Nontrade Payables" captions in the accompanying balance sheet as of December 31, 2003, include the accounts receivable from and payable to, respectively, public authorities, the detail being as follows:

| TAX MATTERS | THOUSANDS OF EUROS |
|---|--------------------|
| RECEIVABLE (NOTE 10): | |
| DEFERRED TAX ASSET | 37,193 |
| RECEIVABLE FROM FOREIGN TAX AUTHORITIES | 3,065 |
| VAT REFUNDABLE | 742 |
| OTHER TAXES RECEIVABLE | 29,406 |
| | 70,406 |
| PAYABLE: | |
| PERSONAL INCOME TAX WITHHOLDINGS | 27,944 |
| AIRPORT TAKEOFF AND SAFETY LEVIES | 15,775 |
| PAYABLE TO FOREIGN TAX AUTHORITIES | 24,877 |
| ACCRUED SOCIAL SECURITY TAXES PAYABLE | 40,362 |
| OTHER PAYABLES TO PUBLIC AUTHORITIES | 6,344 |
| | 115,302 |

Corporate income tax is calculated on the basis of the income per books, which does not necessarily coincide with the taxable income.

Since January 1, 2002, the Company (as the Parent Company) has filed consolidated tax returns under the tax regime provided for in Chapter VII of Title VIII of Corporate Income Tax Law 43/1995.

The reconciliation of the income per books for 2003 to the taxable income for corporate income tax purposes is as follows:



(a) Relating mainly to the provisions for pensions and other obligations to personnel, deferred income arising from credit memorandums and provisions relating to aircraft.

(b) Relating basically to amounts used of provisions recorded in prior years for pensions and other obligations to personnel and for other contingencies and expenses and the use of income arising from credit memorandums.

2003

THOUSANDS OF EUROS

| | INCREASE | DECREASE | AMOUNT |
|--|-------------|---------------|----------------|
| INCOME FOR THE YEAR PER BOOKS (BEFORE TAXES) | - | - | 148,795 |
| PERMANENT DIFFERENCES | 1,809 | (678) | 1,131 |
| TIMING DIFFERENCES: | | | |
| ARISING IN THE YEAR | 134,650 (a) | (995) | 133,655 |
| ARISING IN PRIOR YEARS | - | (145,441) (b) | (145,441) |
| TAXABLE INCOME | - | - | 138,140 |

The balance of the "Corporate Income Tax" caption in the accompanying 2003 statement of income is as follows:

2003

THOUSANDS OF EUROS

| | Loss / (INCOME) |
|--|-----------------|
| APPLICATION OF THE 35% TAX RATE TO INCOME PER BOOKS ADJUSTED BY PERMANENT DIFFERENCES | 52,474 |
| ADD / (LEES): | |
| TAX CREDITS | (12,512) |
| REGULARIZATION OF 2002 CORPORATE INCOME TAX | (2,815) |
| OTHER | 5,886 |
| CORPORATE INCOME TAX | 43,033 |

The "Regularization of 2002 Corporate Income Tax" account relates mainly to certain tax credits not recorded in the Company's tax estimate. The "Other" account includes the provision recorded by the Company to regularize the deferred tax assets that are expected to be recovered in more than ten years.

The tax assets and liabilities were recorded, on the basis of the recovery date, under the "Accounts Receivable", "Long-Term Receivables" and "Other Payables" captions in the accompanying balance sheet as of December 31, 2003, the detail being as follows:

DECEMBER 31, 2003

THOUSANDS OF EUROS

| | RECEIVABLE | | | PAYABLE | | |
|---|---------------|--------------------|----------------|------------|--------------|--------------|
| | SHORT TERM | LONG TERM | TOTAL | SHORT TERM | LONG TERM | TOTAL |
| TIMING DIFFERENCES ARISING IN THE YEAR | - | 41,241 | 41,241 | - | 348 | 348 |
| UNALLOCATED TIMING DIFFERENCES, ARISING IN PRIOR YEARS | 37,193 | 262,448 | 299,641 | - | 1,882 | 1,882 |
| TOTAL | 37,193 | 303,689 (*) | 340,882 | - | 2,230 | 2,230 |

(*) Relating basically to deferred tax assets arising from provisions recorded to cater for obligations to personnel and other provisions.

The estimated years of recovery of the long-term tax assets as of December 31, 2003, are as follows:

| YEAR OF RECOVERY | THOUSANDS OF EUROS |
|---------------------------|--------------------|
| 2005 | 42,300 |
| 2006 | 42,300 |
| 2007 AND SUBSEQUENT YEARS | 219,089 |
| | 303,689 |

The Company's directors consider that all these assets will be recovered in not more than ten years.

Current corporate income tax regulations provide certain tax incentives to encourage investment and contributions to employees mutual funds. The Company availed itself of certain tax benefits and recorded tax credits of €1,677 thousand in this connection.

The Company recorded domestic and international double taxation tax credits amounting to €6,013 thousand in 2003.

In 2003 the Company reinvested the sale price of investments which gave rise to gains of €31,516 thousand relating to the tax credit of €4,822 thousand. The amounts reinvested in the last three years and the related tax credits are as follows:

| 2003 | THOUSANDS OF EUROS | |
|------|--------------------|------------|
| | REINVESTMENT | TAX CREDIT |
| 2001 | 13,818 | 1,224 |
| 2002 | 72,794 | 4,423 |
| 2003 | 31,516 | 4,822 (a) |

(a) Including tax credits of €1,993 thousand not yet taken.

As a result of successive tax audits, the tax inspection authorities issued certain assessments, which were contested and appealed against by the Company, for 1993 through 1997 (mainly VAT and personal income tax withholdings).

Also, the Company filed an appeal against the assessments issued in connection with customs duties for 1998 (second six months), 1999 and 2000 (first five months).

Furthermore, in relation to Aviación y Comercio, S.A. (absorbed by the Company in 2000) a decision has yet to be handed down on the appeals against the tax assessments issued in connection with the returns for certain taxes for 1989, 1990, 1993, 1994, 1996, 1997 and 1998.

The directors of Iberia, Líneas Aéreas de España, S.A. consider that no tax liabilities additional to those recorded in the financial statements for 2003 will arise from the resolution of the various appeals described above.

Also, the directors of Iberia, Líneas Aéreas de España, S.A. do not expect any tax contingencies that would materially affect the financial statements to arise in connection with the years open for review by the tax inspection authorities, which are 1999 through 2003 for corporate income tax and 2000 through 2003 for the other taxes applicable to the Company, and the years since 1999 for corporate income tax and January 2000 for the other taxes for Aviación y Comercio, S.A.

Pursuant to Article 107 of Corporate Income Tax Law 43/1995, it is hereby stated that the information relating to the merger of the Company with Aviación y Comercio, S.A. is included in Note 19 to the 2000 financial statements.

19 Revenues and expenses

a) Net sales

The breakdown, by activity, of the Company's net sales in 2003 and 2002 is as follows:

| BY ACTIVITY | THOUSANDS OF EUROS | |
|--|--------------------|------------------|
| | 2003 | 2002 |
| PASSENGER TICKET REVENUES (a) | 3,615,508 | 3,775,996 |
| CARGO REVENUES | 232,302 | 234,080 |
| HANDLING (AIRCRAFT DISPATCHING AND AIRPORT SERVICES) | 271,136 | 233,858 |
| TECHNICAL ASSISTANCE TO AIRLINES | 103,997 | 91,333 |
| OTHER REVENUES | 98,617 | 72,530 |
| | 4,321,560 | 4,407,797 |

(a) Including other revenues (recovery of unused tickets, commercial agreements, etc.) amounting to €258,714 thousand in 2003 and €294,604 thousand in 2002.

The Company is the leading operator in Spain in handling services by virtue of the contract awarded to it in a public call for tenders organized by the Spanish public airports and aviation agency (AENA). This contract expired in March 2003; and AENA has not yet organized another public call for tenders.

The breakdown of passenger ticket revenues, by network, is as follows:

| | THOUSANDS OF EUROS | |
|------------------|--------------------|------------------|
| | 2003 | 2002 |
| SPAIN AND EUROPE | 2,453,273 | 2,543,623 |
| ATLANTIC | 1,069,341 | 1,148,745 |
| AFRICA AND ASIA | 92,894 | 83,628 |
| | 3,615,508 | 3,775,996 |

b) Other operating revenues

The detail of the balances of the "Other Operating Revenues" caption in the accompanying 2003 and 2002 statements of income is as follows:

| | THOUSANDS OF EUROS | |
|--------------------------------------|--------------------|----------------|
| | 2003 | 2002 |
| COMMISSIONS | 120,943 | 108,521 |
| ROYALTIES | 8,251 | 7,933 |
| RENT | 9,182 | 9,725 |
| DEFERRED REVENUES CREDITED TO INCOME | 17,175 | 16,834 |
| OTHER SUNDRY REVENUES | 73,657 | 82,307 |
| | 229,208 | 225,320 |

The revenues from commissions relate basically to the commissions on the sale of tickets for other airlines, the commissions arising from the franchise agreement with Air Nostrum and the commissions obtained as a result of the agreements entered into with Mundicolor and Touroperador VivaTours, S.A.

c) Extraordinary revenues

The detail of the balance of the "Extraordinary Revenues" caption in the accompanying 2003 statement of income is as follows:

| | THOUSANDS OF EUROS | |
|--|--------------------|--|
| | | |
| RECOVERY OF PROVISIONS FOR THIRD-PARTY LIABILITY (NOTE 13) | 26,777 | |
| COLLECTION OF INDEMNITY PAYMENTS | 2,394 | |
| OTHER | 5,836 | |
| | 35,007 | |

d) Prior years' revenues and income

The revenues recorded under this caption relate mainly to the adjustment of accounts payable for airport taxes and overestimates of certain expenses accrued in 2002, mainly insurance.

e) Procurements

The detail of the "Procurements" caption in the accompanying 2003 and 2002 statements of income is as follows:

| | THOUSANDS OF EUROS | |
|----------------------|--------------------|----------------|
| | 2003 | 2002 |
| AIRCRAFT FUEL | 556,841 | 553,241 |
| AIRCRAFT SPARE PARTS | 135,899 | 142,963 |
| CATERING MATERIALS | 26,972 | 30,904 |
| OTHER PURCHASES | 17,300 | 15,307 |
| | 737,012 | 742,415 |

The "Aircraft Spare Parts" account includes the spare parts initially recorded under fixed assets, which were used to replace others in the related aircraft during the year, the net book value of which at the date of use is recognized as an expense under this caption in the accompanying statement of income.

The aircraft fuel expense in 2003 totaled €576,444 thousand. However, the related futures transactions reduced this expense by €19,603 thousand.

f) Headcount and personnel expenses

The breakdown of the balances of the "Personnel Expenses" caption in the accompanying statements of income for 2003 and 2002 is as follows:

| | THOUSANDS OF EUROS | |
|--------------------------------------|--------------------|------------------|
| | 2003 | 2002 |
| WAGES, SALARIES AND SIMILAR EXPENSES | 1,028,406 | 989,495 |
| EMPLOYEE WELFARE EXPENSES | 327,310 | 321,118 |
| | 1,355,716 | 1,310,613 |

The average number of employees, by professional category, in 2003 and 2002 was as follows:

| | 2003 | | 2002 | |
|--|---------------|--|---------------|--|
| | | | | |
| GROUND PERSONNEL: | | | | |
| SENIOR MANAGERS AND OTHER LINE PERSONNEL | 1,264 | | 1,270 | |
| CLERICAL STAFF | 6,464 | | 6,358 | |
| OTHER | 10,335 | | 10,047 | |
| | 18,063 | | 17,675 | |
| FLIGHT PERSONNEL: | | | | |
| PILOTS | 1,917 | | 1,859 | |
| FLIGHT ENGINEERS | 97 | | 115 | |
| CABIN CREW | 4,364 | | 4,395 | |
| | 6,378 | | 6,369 | |
| | 24,441 | | 24,044 | |

g) Other operating expenses

The detail of the balances of this caption in the accompanying 2003 and 2002 statements of income is as follows:

| | THOUSANDS OF EUROS | |
|----------------------------------|--------------------|------------------|
| | 2003 | 2002 |
| OTHER OPERATING EXPENSES | | |
| COMMERCIAL EXPENSES | 437,828 | 463,861 |
| AIRCRAFT LEASE PAYMENTS (NOTE 6) | | |
| DRY LEASE (a) | 348,243 | 366,297 |
| CARGO | 15,973 | 17,222 |
| OTHER | 4,941 | 7,479 |
| AIR TRAFFIC SERVICES | 332,247 | 322,645 |
| STOPOVER EXPENSES | 40,850 | 42,932 |
| INCIDENT EXPENSES | 12,867 | 19,467 |
| NAVIGATION CHARGES | 257,593 | 226,586 |
| AIRCRAFT MAINTENANCE (b) | 104,708 | 96,666 |
| GENERAL MAINTENANCE | 30,344 | 27,326 |
| BOOKING SYSTEM EXPENSES | 128,164 | 126,322 |
| IN-FLIGHT SERVICES | 94,255 | 104,879 |
| OTHER RENT (c) | 67,442 | 71,083 |
| OTHER (d) | 269,450 | 283,160 |
| | 2,144,905 | 2,175,925 |

(a) The aircraft lease payments amounted to €325,485 thousand and €370,332 thousand in 2003 and 2002, respectively. The related futures transactions increased these expenses by €22,758 thousand in 2003 and reduced them by €4,035 thousand in 2002.

(b) Including the expenses for subcontracted maintenance work and the provision for major repairs.

(c) Including cargo hold lease expenses amounting to €4,563 thousand in 2003 and €4,825 thousand in 2002.

(d) The fees for financial statement audit services provided to Iberia, Líneas Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related thereto in 2003 amounted to €396 thousand. Additionally, the fees for other professional services provided to Iberia, Líneas Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related thereto in 2003 amounted to €271 thousand.

h) Extraordinary expenses

The detail of the balance of the "Extraordinary Expenses" caption in the accompanying 2003 statement of income is as follows:

| | THOUSANDS OF EUROS |
|--|--------------------|
| PROVISIONS FOR EXTENSION OF THE LABOR FORCE REDUCTION PLAN (NOTE 13) | 24,995 |
| PROVISIONS FOR AIRCRAFT (NOTE 6) | 11,426 |
| PERIOD PROVISIONS FOR THIRD-PARTY LIABILITY (NOTES 6 AND 13) | 18,003 |
| OTHER EXTRAORDINARY EXPENSES | 2,907 |
| | 57,331 |

20 Directors' compensation and other benefits

The detail of the compensation of all kinds earned by the members of the Board of Directors in 2003 is as follows:

| DIRECTORS' COMPENSATION | THOUSANDS OF EUROS |
|--|---------------------------|
| FIXED COMPENSATION PAID TO THE BOARD MEMBERS | 600 |
| ATTENDANCE FEES | 468 |
| COMPENSATION IN KIND | 23 |
| TOTAL COMPENSATION | 1,091 |

Iberia, Líneas Aéreas de España, S.A. incurred expenses of €11 thousand, mainly for insurance premiums, in relation to the discharge by its nonexecutive directors of their duties.

Also, the detail of the compensation paid to the executive directors in 2003 is as follows:

| EXECUTIVE DIRECTORS | THOUSANDS OF EUROS |
|--|---------------------------|
| FIXED COMPENSATION | 961 |
| VARIABLE COMPENSATION | 744 |
| COMPENSATION IN KIND | 43 |
| SETTLEMENT AND SURRENDER OF INSURANCE POLICY | 1,935 |

The social security costs, insurance and other expenses recorded by Iberia, Líneas Aéreas de España, S.A. in relation to the activities performed by the executive directors amounted to €467 thousand.

In 2003 no advances or loans were granted to the members of the Board of Directors and there are no pension commitments to them.

21 Detail of the equity interests held by the directors in companies engaging in similar activities and performance by them, for their own account or the account of others, of similar activities

Pursuant to Article 127 ter. of the Spanish Corporations Law, introduced by Law 26/2003, which amends Securities Market Law 24/1988, and the revised Spanish Corporations Law, in order to reinforce the transparency of listed corporations, following is a detail of the activities carried on, for their own account or for the account of others, by the various members of the Board of Directors that are identical, similar or complementary to the activity that constitutes the corporate purpose of Iberia, Líneas Aéreas de España, S.A.:

▶▶ DETAIL OF THE EQUITY INTEREST

| NAME | ACTIVITY | TYPE OF ARRANGEMENT | COMPANY | POSITIONS HELD / FUNCTIONS |
|------------------|---------------|-----------------------|-----------------------------|---------------------------------------|
| ROGER MAYNARD | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | BRITISH AIRWAYS | DIRECTOR OF ALLIANCES AND INVESTMENTS |
| | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | BRITISH AIRWAYS CITIEXPRESS | CHAIRMAN |
| | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | QANTAS | DIRECTOR |
| LORD GAREL-JONES | HANDLING | FOR ACCOUNT OF OTHERS | ACCIONA | DIRECTOR |

Also, pursuant to the aforementioned Law, it is hereby stated that the only member of the Board of Directors who own an equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the corporate purpose of Iberia, Líneas Aéreas de España, S.A is Mr Roger Maynard (holder of 4.545 British Airways share).

Lastly, the members of the Board of Directors (or persons acting on their behalf) have not entered into transactions other than ordinary business transactions or in conditions other than normal market conditions with Iberia, Líneas Aéreas de España, S.A. or with other Iberia Group companies.

22 Environmental information

Within the framework of its environmental policy, Iberia, Líneas Aéreas de España, S.A. continued to undertake various activities and projects in 2003 in order to guarantee the proper management of the main environmental impacts of the air transport business as a whole.

In 2003 the Company incurred environmental expenses of €2,033 thousand, the detail being as follows:

▶▶ ENVIRONMENTAL INFORMATION

THOUSANDS OF EUROS

| | |
|--|--------------|
| ENVIRONMENTAL REPAIRS, UPKEEP AND TRANSPORT | 808 |
| ENVIRONMENTAL TECHNICAL SERVICES | 309 |
| SPONSORSHIP, PUBLICATIONS AND OTHER ENVIRONMENTAL EXPENSES | 57 |
| PERSONNEL EXPENSES RELATING TO ENVIRONMENTAL MANAGEMENT | 694 |
| ENVIRONMENTAL TAXES | 165 |
| TOTAL | 2,033 |

As of December 31, 2003, the acquisition cost and accumulated depreciation of the environmental assets, which include, inter alia, waste water treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, amounted to €33,495 thousand and €16,799 thousand, respectively.

With respect to its aircraft, Iberia, Líneas Aéreas de España, S.A. continued to implement an ongoing renewal policy based on the requirements disclosed at any particular time, in which the environment is an important factor to be borne in mind. Accordingly, Iberia, Líneas Aéreas de España, S.A. is continuing to add A-320 aircraft to its fleet for short- and medium-haul routes as part of a renewal plan initiated in the mid-1990s. These aircraft reduce fuel consumption by up to 20%, with the concomitant reduction in the volume of air emissions, compared to earlier generation aircraft. With respect to long-haul aircraft, in 2003 Iberia added three new A-340/600 aircraft to its fleet and retired two B-747 aircraft.

As far as ground operations are concerned, the improvements undertaken in 2003 included the implementation of a water-recycling project in the engine-cleaning line, and an exhaustive periodic control continues to be exercised over water discharges and air emissions caused by maintenance activities.

The Company considers that any possible environmental contingencies that might arise are covered sufficiently by its third-party liability insurance policies and by the provisions relating to probable or certain third-party liability arising from litigation in progress or from outstanding indemnity payments or obligations of undetermined amount.

23 2003 and 2002 statements of changes in financial position

Following are the Company's statements of changes in financial position for 2003 and 2002:

| | THOUSANDS OF EUROS | |
|--|--------------------|----------------|
| | 2003 | 2002 |
| START-UP EXPENSES | 81 | - |
| FIXED ASSET ADDITIONS: | | |
| INTANGIBLE ASSETS | 25,616 | 150,915 |
| PROPERTY, PLANT AND EQUIPMENT | 204,426 | 121,708 |
| LONG-TERM INVESTMENTS IN GROUP AND ASSOCIATED COMPANIES | 802 | 6,176 |
| OTHER INVESTMENTS | 228,570 | 56,221 |
| DEFERRED CHARGES | 2,401 | 14,549 |
| DIVIDENDS PAID | 35,608 | 8,925 |
| REPAYMENT OR TRANSFER TO SHORT TERM OF LONG-TERM DEBT: | | |
| LOANS | 47,502 | 95,160 |
| OTHER ACCOUNTS PAYABLE | 5,885 | 687 |
| PROVISION FOR MAJOR REPAIRS | 5,912 | 226 |
| PROVISIONS FOR PENSIONS | 10,861 | 11,726 |
| PROVISIONS FOR OBLIGATIONS TO EMPLOYEES | 13,453 | 13,174 |
| PROVISION FOR THIRD-PARTY LIABILITY | 70,836 | 103,340 |
| TOTAL FUNDS APPLIED | 651,953 | 582,807 |
| FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED (INCREASE IN WORKING CAPITAL) | 112,147 | 489,473 |

SOURCE OF FUNDS

THOUSANDS OF EUROS

| | 2003 | 2002 |
|--|----------------|------------------|
| FUNDS OBTAINED FROM OPERATIONS | 536,551 | 564,752 |
| CAPITAL INCREASE | 5,388 | - |
| LONG-TERM DEBT: | | |
| OTHER COMPANIES | 3,511 | 140,146 |
| DISPOSALS OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS | 168,500 | 291,817 |
| DISPOSALS OF LONG-TERM INVESTMENTS | 14,579 | 51,284 |
| EARLY REDEMPTION OR TRANSFER TO SHORT TERM OF OTHER INVESTMENTS: | | |
| OTHER INVESTMENTS | 31,014 | 10,390 |
| DEFERRED REVENUES | 4,209 | 9,240 |
| PROVISION FOR CONTINGENCIES AND EXPENSES | - | 4,231 |
| LONG-TERM DEFERRED TAX LIABILITY | 348 | 420 |
| TOTAL FUNDS OBTAINED | 764,100 | 1,072,280 |
| FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED (DECREASE IN WORKING CAPITAL) | - | - |

VARIATION IN WORKING CAPITAL

THOUSANDS OF EUROS

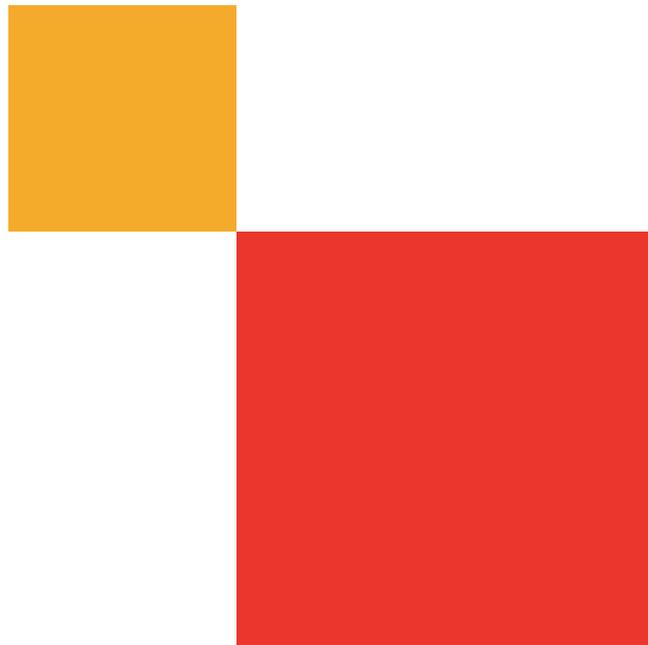
| | 2003 | | 2002 | |
|-------------------------------------|----------------|---------------|----------------|---------------|
| | INCREASE | DECREASE | INCREASE | DECREASE |
| TREASURY STOCK | - | 11,830 | 16,826 | - |
| INVENTORIES | - | 13,295 | - | 967 |
| ACCOUNTS RECEIVABLE | 10,050 | - | 33,436 | - |
| CURRENT LIABILITIES | - | 21,680 | 165,841 | - |
| SHORT-TERM INVESTMENTS | 148,737 | - | 285,090 | - |
| CASH | 5,191 | - | - | 6,649 |
| ASSET ACCRUAL ACCOUNTS | - | 5,026 | - | 4,104 |
| TOTAL | 163,978 | 51,831 | 501,193 | 11,720 |
| VARIATION IN WORKING CAPITAL | 112,147 | - | 489,473 | - |

The reconciliation of the income per books to the funds obtained from operations is as follows:

| RECONCILIATION | THOUSANDS OF EUROS | |
|--|--------------------|----------------|
| | 2003 | 2002 |
| INCOME PER BOOKS | 105,762 | 143,188 |
| ADD / (LESS): | | |
| DEPRECIATION AND AMORTIZATION EXPENSE AND FIXED ASSET ALLOWANCES | 202,549 | 226,502 |
| PERIOD PROVISIONS FOR CONTINGENCIES AND EXPENSES | 151,284 | 154,000 |
| DEFERRED INTEREST EXPENSES AND DEFERRED CHARGES | 30,924 | 25,004 |
| TAX ASSET RECOVERABLE AT LONG TERM | 47,878 | 25,578 |
| NET EXCHANGE DIFFERENCES ON LONG-TERM ITEMS | 5,968 | 4,563 |
| NET EXCHANGE DIFFERENCES ON FIXED ASSET REVALUATIONS | 72,666 | 64,690 |
| DEFERRED INTEREST REVENUES | (17,613) | (17,446) |
| NET GAINS ON FIXED ASSET DISPOSALS | (11,014) | (31,083) |
| RECOVERY OF EXCESS PROVISIONS AND DEPRECIATION AND AMORTIZATION | (51,853) | (30,244) |
| | 536,551 | 564,752 |

24 Explanation added for translation to English

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



Management Report

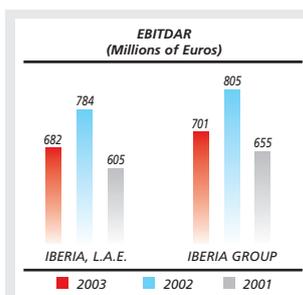
*Translation of a report originally issued in spanish.
In the event of a discrepancy,
the Spanish-language version prevails.*



Main Aggregates

IBERIA, L.A.E.

| | 2003 | 2002 | % VARIATION |
|---|---------|---------|-------------|
| INCOME (MILLIONS OF €) | | | |
| OPERATING REVENUES | 4,550.8 | 4,633.1 | (1.8) |
| EBITDAR | 681.7 | 783.8 | (13.0) |
| OPERATING INCOME | 139.2 | 228.7 | (39.1) |
| INCOME BEFORE TAXES | 148.8 | 168.8 | (11.8) |
| NET INCOME FOR THE YEAR | 105.8 | 143.2 | (26.1) |
| NET EARNINGS PER SHARE (€ CENTS) (1) | 11.51 | 15.68 | (26.6) |
| DIVIDEND PER SHARE (€ CENTS) (1) | 3.0 | 4.0 | - |
| PASSENGER TRAFFIC: PRODUCTION AND REVENUES | | | |
| MILLIONS OF ASKS | 56,145 | 55,405 | 1.3 |
| MILLIONS OF RPKS | 42,100 | 40,470 | 4.0 |
| PASSENGER LOAD FACTOR (%) | 74.99 | 73.04 | 1.95 p. |
| PASSENGER TICKET REVENUES (MILLIONS OF €) | 3,356.8 | 3,481.4 | (3.6) |
| AVERAGE YIELD (€ CENTS) | 7.97 | 8.60 | (7.3) |
| FINANCIAL AGGREGATES AND RATIOS | | | |
| SHAREHOLDERS' EQUITY (MILLIONS OF €) | 1,235.1 | 1,157.7 | 6.7 |
| NET DEBT (MILLIONS OF €) (2) | (925.6) | (710.2) | 30.3 |
| EBITDAR MARGIN (%) | 15.0 | 16.9 | (1.9) p. |
| OPERATING INCOME MARGIN (%) | 3.1 | 4.9 | (1.8) p. |
| OPERATING REVENUES PER ASK (€ CENTS) | 8.11 | 8.36 | (3.0) |
| OPERATING COST PER ASK (€ CENTS) | 7.86 | 7.95 | (1.1) |
| RESOURCES | | | |
| EQUIVALENT AVERAGE NO. OF FULL-TIME EMPLOYEES | 24,441 | 24,044 | 1.7 |
| PRODUCTIVITY (THOUSANDS OF ASKS PER EMPLOYEE) | 2,297 | 2,304 | (0.3) |
| OPERATING AIRCRAFT AT DECEMBER 31 | 149 | 146 | 2.1 |
| USAGE OF COMPANY AIRCRAFT (B.H. PER AIRCRAFT PER DAY) | 8.78 | 8.78 | 0.0 |



IBERIA GROUP

| | 2003 | 2002 | % VARIATION |
|--|---------|---------|-------------|
| INCOME (MILLIONS OF €) | | | |
| OPERATING REVENUES | 4,619.3 | 4,699.5 | (1.7) |
| EBITDAR | 700.7 | 804.8 | (12.9) |
| OPERATING INCOME | 160.7 | 249.1 | (35.5) |
| INCOME BEFORE TAXES | 201.7 | 194.1 | 3.9 |
| NET INCOME ATTRIBUTED TO THE COMPANY | 143.6 | 157.1 | (8.6) |
| FINANCIAL AGGREGATES AND RATIOS | | | |
| SHAREHOLDERS' EQUITY (MILLIONS OF €) | 1,432.8 | 1,317.7 | 8.7 |
| NET DEBT (MILLIONS OF €) (2) | (938.5) | (714.8) | 31.3 |
| EBITDAR MARGIN (%) | 15.2 | 17.1 | (1.9) p. |
| OPERATING INCOME MARGIN (%) | 3.5 | 5.3 | (1.8) p. |

(1) Number of shares as of December 31: 919,016,894 in 2003 and 912,962,035 in 2002.

(2) Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding interest on financial lease contracts).

1 2003 Highlights

In the first year in which its Master Plan 2003/2005 was implemented, the Iberia Group met the basic profitability and quality improvement objectives set for 2003 and maintained its outstanding position as one of the most solid airlines and one of those which creates most shareholder value. Thus, the Group reported net income before taxes of €201.7 million in 2003, up €7.6 million on 2002. Also, the market value of Iberia, Líneas Aéreas de España, S.A. ("Iberia, L.A.E.") shares rose by 62.9% in 2003, which was one of the largest increases in the IBEX 35 index and in the air transport industry.

The adverse economic cycle, the tensions existing in the lead-up to the war, the Iraq war itself (which broke out on March 20), and the effect of the SARS virus delayed the anticipated recovery of international air traffic, which was confirmed only in the last quarter of the year. According to information from the Association of European Airlines (AEA), scheduled passenger traffic increased by 1.2% in 2003 with respect to 2002 (as compared with the decreases of 4.6% in 2002 and 4.7% in 2001). This prolonged situation of weak demand, the appreciation of the euro and the pressure exerted by no-frills airlines led to an across-the-board drop in unit revenues in the industry.

In this difficult situation, Iberia, L.A.E.'s flexibility to tailor its capacity to market trends proved once again to be a differentiating factor. In early 2003 demand was weak, particularly in the European markets and, accordingly, Iberia reduced the capacity that it had programmed for March and subsequent months, and it decided to put on hold the delivery of three new aircraft earmarked for the medium-haul network. In the first half of 2003 the number of available seat-kilometers (ASKs) decreased by 2.1% with respect to the same period in 2002. From the summer onwards, in line with market trends, the Iberia Group gradually increased its production, above all on long-haul routes, and the number of ASKs increased by 4.7% in the second half of the year. Therefore, in 2003 taken as a whole, production increased by 1.3% with respect to the preceding year, and revenue passenger kilometers (RPKs) rose by 4%. Accordingly, the load factor of 75.0% in 2003 represented an all-time high for the Company and was 1.9 percentage points up on 2002. The load factor improved progressively each quarter, which demonstrates the success of the measures taken to tailor supply to demand.

This significant improvement in the load factor and the increase in revenues not generated by traffic partially offset the 7.3% drop in the average yield triggered by exchange rate fluctuations (which varied by more than 2.5 percentage points) and strong competition. Therefore, the Iberia Group's operating revenues were only 1.7% lower in 2003 than in 2002.

In 2003 the Company continued to implement cost-cutting measures which, combined with the fall in the value of the U.S. dollar and lower interest rates, meant that total operating expenses were practically unchanged with respect to the preceding year, and that the unit cost was 1.1% lower than in 2002. In addition, the trend in unit costs was very positive in 2003, based on the variations in each quarter with respect to the preceding year (see graph).

The Iberia Group reported earnings before depreciation and amortization and aircraft lease expenses (EBITDAR) of €700.7 million in 2003, and its EBITDAR as a percentage of revenues was 15.2%. The net income after taxes and minority interests of €143.6 million in 2003 was only €13.5 million below the excellent result achieved in 2002.

Improved service quality

In line with one of the main objectives established in the 2003/05 Master Plan, the Company implemented a global service quality improvement plan, which consists of various measures: continuous improvement of punctuality; a training plan for all employees who come into direct contact with customers; the implementation of a global knowledge and customer relationship management system (Customer Relationship Management – CRM); centralized management of customer service, complaints and suggestions; improved service quality in the process relating to bookings and direct sales through the information hotline (Serviberia) and the Company's Internet website (Iberia.com); increased use of self-service check-in machines and electronic ticketing; together with improvements in the Iberia Plus loyalty-building program.

In 2003 Iberia, L.A.E.'s flight punctuality was 83.8%, 8.4 percentage points higher than the average for 2002, making it the most punctual network airline in Europe according to the AEA. This achievement was made possible by the implementation, at the beginning of the year, of the Integral Punctuality Improvement Plan, coordinated by the Punctuality Committee, the purpose of which is to detect and prevent the possible causes for delays, and to seek and analyze new initiatives that will make it possible to improve procedures and the coordination of operations. The significant improvement in punctuality reduced operating and indemnity expenses and increased customer satisfaction.

In 2003 Iberia, L.A.E. initiated the process to implement and geographically deploy the CRM project, which is key to being able to achieve the objective of strengthening relations with customers and acknowledging their value to the Company. The CRM system, supported by advanced computer systems, makes interaction with customers possible at all the Company's points of contact, and it is complemented by an ambitious employee training plan. The benefits provided by the CRM system are as follows: it provides the necessary information in real-time to Company employees in contact with customers so that they can provide an individualized service that increases customer satisfaction; it facilitates the implementation of loyalty-building measures; it serves as a support for customer service management, making it possible to reduce the time required to carry out certain processes; it enables information to be stored in a single database; and it unifies processes, making it possible for information to be shared among different departments.



2003 was the first full year of operations of the new Customer Service Center, which since 2002 year-end has been managing on a centralized and integrated basis all the telephone and written communications with the Company's customers. This has reduced response times, standardized customer service and integrated all the information, analysis of which makes it possible to detect the aspects of the services in which customers consider that there is room for improvement.

Iberia, L.A.E. also continued to strengthen its relationships with its best customers. In this regard, in 2003 it introduced a new process for the proactive handling of incidents involving High-Value Customers (mainly Iberia Plus Platino, Iberia Plus Oro and Club Fiesta Iberia customers), which the Company is aiming to use to preempt complaints and claims from customers when they suffer significant incidents.

In 2003 the number of Iberia Plus cardholders increased by almost 26% to stand at 1,685,000 at year-end. In addition, new companies joined the Iberia Plus program, the aim of which is to reward and foster the loyalty of customers.

The quality certifications obtained by the Iberia Group in 2003 evidence its commitment to the continuous improvement of all its operations. In July the Cargo Division received ISO 9001:2000 certification for all its booking, space control, goods acceptance, flight preparation and cargo terminal goods delivery activities from Asociación Española de Normalización y Certificación (AENOR). In August the Systems Division received ISO 9001:2000 certification for its information system development, production and maintenance activities. Lastly, in November the Company's Maintenance Division obtained further quality certification from AENOR, under the ISO 9001:2000 standard (once the transition had been made to the new standard from the previous standard, ISO 9002:1994).

Cost reduction

In April and May 2003 the Company revised the 2003/2005 Master Plan that had been prepared at the end of 2002, in order to reinforce the strategic measures established in the Plan, bringing forward initiatives that will give rise to further cost reductions and increases in employee productivity and the usage of the aircraft. The adjustments made aim to provide a response to the rapid expansion of low-cost operators in Europe and to the growing competition in the domestic market.

Of the total cost saving envisaged in the Master Plan, estimated at between €350 million and €400 million for 2005, more than a quarter (between €100 million and €110 million will be saved as a result of the introduction of the New System for Remunerating Travel Agencies in Spain, which was negotiated in the second half of 2003 and came into force on January 1, 2004. The basic commission that Iberia, L.A.E. pays to travel agencies in Spain will be reduced progressively over an 18-month period to 1% from July 2005 onwards. Also, certain issuance and management charges that the agencies will receive directly from the customers for their services were established. The price of the travel is thus separated from the distribution cost. Under the New Remuneration System, the variable remuneration system in place in 2003 will be maintained and gradually extended to the other European markets in which tickets are issued.

The new agreement reached lends continuity to the process of progressively reducing distribution costs that Iberia, L.A.E. has been implementing in recent years and will enable the targets set for 2005 to be met.

Another salient aspect envisaged in the revision of the 2003/05 Master Plan is the new in-flight service model, the first phase of which was implemented in the second half of 2003 and consisted basically of simplifying the service provided in tourist class on short-and medium-haul flights, while improving the in-flight service offered in business class. In March 2004 the second phase commenced, which consists of the introduction of a new pay in-flight service in tourist class on certain domestic and international medium-haul flights, in order to enable customers to pay for only what they actually consume.

The Directorate-General of Employment authorized Iberia, L.A.E. to extend to December 31, 2004, the period in which ground employees, cabin crew members and flight technicians can voluntarily avail themselves of the Labor Force Reduction Plan that had been approved at the end of 2001. The Company, with the agreement of the labor unions, applied for this extension because of the large number of requests that it had not been possible to deal with in the initial one-year duration of the Plan. In 2003 623 employees availed themselves of the possibilities established in the Labor Force Reduction Plan: early retirement, deferred outplacement, voluntary redundancy and contract novation. Also, 149 employees abroad left the Company.

The targets set for 2003 in the Investment and Cost Rationalization and Optimization Plan (PROICO), in its second year of implementation, were also surpassed. The introduction of new action plans, of which 888 expense reduction plans were initiated, gave rise to a cost saving of €73 million in 2003, to which must be added the €60 million of consolidated cost savings arising from programs that had been initiated in 2002, giving total savings of €133 million in 2003 (as compared with the target of €108 million).

The Iberia Group's unit operating cost was €c7.94/ASK in 2003, a decrease of 1.1% with respect to 2002, despite the significant increase in fuel prices and navigation charges. As indicated above, the trend in unit costs was very positive in 2003 taken as a whole since, compared with 2002, it increased by 2.4% in the first half of 2003 but fell by a cumulative 4.3% in the last six months of the year.

Risk management

Iberia, L.A.E. has in place a global nonoperating risk management program aimed at limiting the possible impact of exchange rate, interest rate and aviation fuel price fluctuations on the Company's earnings.



As regards fuel costs, the war in Iraq had a significant effect on the energy industry in 2003. The year was characterized by major fuel price volatility, with very high prices that were substantially higher than in 2002. The average price was US\$ 29/barrel in 2003, up 15% on 2002, which also saw major price hikes. The Company hedged the price of around 80% of the volume of kerosene used in the first half of the year and of approximately 70% of that used in the second half of the year, in bands of between US\$ 23 and US\$ 26 per barrel. This hedging policy and of the drop in the value of the U.S. dollar against the euro enabled Iberia, L.A.E. to reduce its unit fuel cost by 0.7% with respect to 2002 to €c0.99/ASK in 2003.

Fleet Renewal Plan

As a result of the Fleet Renewal Plan the Company can offer its passengers greater comfort and more services and reduce the number of different types of aircraft, thereby increasing the use of the aircraft and crew productivity, significantly reducing unit operating costs and contributing to a reduction in environmental impact.

Since June 2002 the Company has been operating only three types of medium-haul aircraft (A-320-type, MD-87/88 and B-757 aircraft), as compared with the seven that it was operating when it introduced its Fleet Renewal Plan in 1998. In 2003 four new aircraft operated under an operating lease arrangement were added to the medium-haul fleet: three Airbus aircraft (one A-320 and two A-321) and one MD-88 aircraft.

In January 2003, having analyzed the latest bids submitted by the manufacturers Airbus and Boeing, Iberia, L.A.E. chose the Airbus A-340/600 aircraft for the renewal of its long-haul fleet. Accordingly, it entered into a purchase contract with Airbus that will make it possible to gradually replace all the Boeing B-747 planes known as "Jumbos" with new A-340/600 aircraft. Economic and financial factors were decisive in the choice, although another factor behind this decision was aircraft uniformity. The A-340/600 is the most modern and largest of the Airbus A-340 family, since in the configuration for Iberia, L.A.E. it has 350 seats, around 100 more than the A-340/300, of which Iberia, L.A.E. already operates 18. These two types of A-340 aircraft share the same certification, which enables pilots to fly either model with the same license.

In 2003 the Company added three Airbus A-340/600 aircraft to its long-haul fleet. Iberia, L.A.E. has entered into agreements with International Lease Finance Corporation (ILFC) and Airbus for the addition of a further seven new A-340/600 aircraft in 2004 and 2005 and it holds purchase options on another five of the same type. The agreement with Airbus stipulates that all the A-340/600 to be added are covered by a guarantee provided by Airbus in relation to their residual value at the end of a given period. Not only does this arrangement lead to cost savings and financing options, but it also provides a high degree of flexibility and makes it possible to more efficiently adapt the number of aircraft to demand trends. When all the B-747 aircraft have been retired, a process that commenced in 2003, Iberia, L.A.E. will be operating only one type of aircraft on long-haul routes.

At the end of 2003, the Iberia Group had 149 aircraft: 122 for its short- and medium-haul network and 27 for its long-haul network.

New technologies

The Iberia Group is continuing to apply new technologies to its business in order to improve service and reduce costs.

In 2003 Iberia L.A.E. achieved a significant increase in the use of the electronic ticket, known as the "cyberticket", an initiative aimed at making life easier for the customer. This new type of ticket consists of an electronic file in a database which, because there is no printed support, simplifies the booking and purchasing processes to the maximum, eliminates the need to travel to buy the ticket and, thanks to promotions, on many occasions leads to cash savings for the customer. In 2003 the Company increased the number of destinations for which the cyberticket can be used and, accordingly, at year-end it was possible to use them for flights operated by Iberia, L.A.E. from anywhere in Spain to destinations in 30 countries and on all domestic routes except the Madrid-Barcelona Shuttle. In 2003 almost 3,370,000 cybertickets were issued, which is more than 4.5 times the number issued in 2002. In sales originating in Spain in 2003, cybertickets accounted for 30% of the total number of tickets issued.

In 2002 Iberia, L.A.E. started to install self-service check-in machines at the main Spanish airports. This way, passengers who travel with only hand baggage can reduce their waiting time by obtaining their boarding passes by themselves instead of having to queue at the conventional check-in desks. In 2003 these machines started to be installed at other Spanish airports and hotels. The Madrid - Barajas and Barcelona - El Prat terminals now also have an automatic check-in system for the Madrid - Barcelona Shuttle, with which passengers can obtain their tickets, boarding pass and receipt all in one go.

At the beginning of 2003 the new Iberia.com platform was launched in order to improve sales and customer relations, providing value-added in all areas of the various on-line booking, purchasing and information processes, and through the various different products and services that Iberia, L.A.E. offers its customers, in a personalized fashion based on their profile and preferences, giving rise to a more personal approach that increases customer satisfaction. The new design of the Internet website of Iberia, L.A.E. has simplified the booking process and includes new features in the on-line booking and purchasing processes, together with improvements in the information and communications for customers, the users of Iberia.com and the Company's shareholders. In 2003, the volume of business of Iberia.com grew significantly. The Company sold almost 935,000 tickets through this own channel in 2003, 85.8% more than in 2002. These sales amounted to over €159.5 million, representing an increase of close to 60% with respect to 2002, making it the website with the highest volume of sales in Spain.



Iberia, L.A.E. was once again the pioneer in Spain in introducing a new information system so that customers can ascertain flight timetables and arrivals for all its flights through SMS text messages to wireless telephones. This service has been operational since 2003 for all the telephone companies that operate in Spain (Amena, Movistar and Vodafone). The purpose of the new service was to cater for customers' needs and, in addition, to improve the productivity of Serviberia, because automating some of the calls that only required information on flight times or arrivals enabled more resources to be focused on attending calls that gave rise to sales.

With the arrival of the new Airbus A-340/600 aircraft in 2003, Iberia, L.A.E. introduced a new package of satellite communications services that can be used by both passengers and crew. Thanks to this leading-edge technology, first- and business-class passengers can communicate with the ground, not only through the on-board telephone, but also through SMS text messages and e-mails.

Commercial agreements

On December 10, 2003, the European Commission formally approved the alliance between Iberia, L.A.E., British Airways and its franchised airline GB Airways and guaranteed the three companies exemption from Article 81(3) of the European Treaty for six years, subject to the conditions deemed necessary to maintain competition on the routes between Spain and the U.K.

The airlines had forged an alliance in 2002, subject to approval by the European authorities, to work together in a more coordinated fashion in their global networks, including the competitive market between Spain and the U.K.

The alliance agreement approved envisages the possibility of coordinating and eventually integrating the airlines' commercial and marketing strategies and their distribution practices and procedures.

The areas covered by this cooperation agreement include most notably the following:

- Joint planning of flight networks, adapting and optimizing the capacities of the two airlines to customer demand.
- Gradual combination of sales activity.
- Use of profit-sharing and other economic cooperation mechanisms.
- Joint management of cargo operations, even as regards prices, capacity management, sales and handling activities.

The alliance will make it possible to harness significant synergies for the airlines and will lead to benefits for their customers, who will be able to fly to more destinations at more convenient times of day, will have greater access to VIP lounges, and will benefit from better connections. The airlines' networks are largely complementary, signifying that the Iberia Group's customers will have access to a larger number of routes to the Middle and Far East, while British Airways customers will have a greater choice of routes to Latin America.

In 2003 Iberia, L.A.E. reaped the benefits of various profitable agreements with its franchised airline Air Nostrum, which once again was named (for the third time in four years) "Regional Airline of the Year 2003-2004" by the European Regions Airline Association (ERA), the most important regional airline association in the world.

Iberia Regional Air Nostrum continued to expand rapidly, increasing frequencies and adding new routes to its flight network in the domestic and European markets. This regional airline is simultaneously renewing and expanding its fleet of aircraft.

Outsourcing of functions and divestments

In 2003, based on the strategy defined in the Master Plan in force, Iberia, L.A.E. entered into various agreements to sell holdings in companies and other assets that were not directly associated with its core air transport business or which would enable it to increase its profits and efficiency by outsourcing functions.

In October 2003 Iberia, L.A.E. and CAE entered into an agreement to create an aeronautical training joint venture where the crew members of Iberia, L.A.E. and other airlines will be trained. Under the agreement, CAE contributed its assets in Alcalá de Henares (Madrid) and Iberia, L.A.E. contributed its assets at Barajas Airport (also Madrid), together with their respective associated liabilities, in order to create the new joint venture. Iberia, L.A.E. and CAE will have ownership interests of approximately 20% and 80%, respectively, in the new company, which will foreseeably commence operations in the first few months of 2004, after it has obtained the necessary licenses.

CAE is a leading provider of integrated training solutions and advanced simulation and control technologies for both civil and military aviation customers.

As part of the redesign of the new in-flight service model and of the other activities relating thereto, in December 2003 Iberia, L.A.E. announced the sale of its 70% holding in Iber-Swiss Cátering, S.A. to Gate Gourmet International, which owned the remaining 30% of the capital stock and is one of the leading catering services companies in the world. At the date of this report, this sale, which amounted to €23.5 million, was pending approval by the Spanish antitrust authorities. The agreement reached provides for both the sale of the aforementioned shares and the establishment of a contract for services whereby Gate Gourmet International will provide Iberia, L.A.E. with general catering services throughout the world for seven years. The agreement also envisages cooperation in various areas associated with in-flight catering and, in particular, in the new pay in-flight service that Iberia, L.A.E. has introduced on certain short- and medium-haul flights since March 2004.

On December 12, 2003, Iberia, L.A.E. and Iberojet entered into a purchase agreement whereby the Company undertook to sell its holding in Touroperador Viva Tours, S.A. and the "Viva Tours" brand name to Iberojet. This transaction was approved by the antitrust authorities in February 2004. With this transaction, the total price for which amounted to €16,9 million, the Iberia Group outsourced its tour operator activities under an outsourcing agreement with one of the leading specialists in Spain, which will design the Viva Tours product for the Company on a competitive basis.



In June 2003 Iberia, L.A.E. entered into an agreement with the Marsans Group company Teinver for the sale by the Company of the "Mundicolor" brand name and of its 18.7% holding in the tour operator Tiempo Libre. This sale, which amounted to €12 million (€6 million for the brand name and €6 million for the holding) and was approved by the antitrust authorities) gave rise to a gross capital gain of €11.5 million. The agreements entered into will enable the Iberia Group to maintain its current position as regards the number of seats and prices offered to Tiempo Libre.

Corporate Social Responsibility

The Iberia Group is one of the Spanish companies that is most firmly committed to social responsibility and protecting the environment.

The Company's social actions are based on three fundamental pillars: social action in conjunction with employees, including most notably the work carried out by the NGO Mano a Mano and by Asociación de Empleados Padres de Minusválidos (APMIB), and Fundación Tutelar APMIB; the support afforded to institutions through sponsorship agreements (such as those with AECE, ONT, the Ministry of Social Affairs and Fundación Ilusiones, among others); and cooperation projects with customers (the Spanish Red Cross, the Special Olympics, etc.).

Iberia, L.A.E. also supports major cultural events. The actions carried out in 2003 include most notably the agreement reached with the Galicia Autonomous Community government to sponsor "Xacobeo 2004", the agreement with Fundación Gala-Salvador Dalí, under which the Iberia Group joined the Promotional Council of "Año Dalí 2004" and the agreement to become a sponsor of "Forum Barcelona 2004".

The wide-reaching fleet renewal plan being implemented by Iberia, L.A.E. constitutes a key factor in the objective of reducing environmental impact. Also, the Company continued to work towards achieving efficient environmental management in all its ground operations. Accordingly, in September 2003 Iberia, L.A.E. received AENOR certification under the UNE-EN ISO 14001 for its Environmental Management System in relation to the handling services that it provides at 39 Spanish airports (see the specific report on environmental activities).

Changes in the Governing Bodies

On June 12, 2003, following the approval of the Shareholders' Meeting, Fernando Conte García replaced Xabier De Irala as the Chairman of Iberia, L.A.E., pursuant to the resolution adopted by the Board of Directors on May 9, 2003.

On September 25, 2003, the Board of Directors of Iberia, L.A.E. decided to restructure the Audit, Appointments and Compensation, and Security Committees in order to make them more effective. Therefore, the independent directors Antonio Masa Godoy and José Manuel Fernández Norniella joined the Appointments and Compensation Committee, and the Audit Committee was expanded with the appointment of Gregorio Villalabeitia Galarraga, a director appointed by BBVA. The Security Committee was also strengthened with the appointment of Jorge Pont Sánchez, a director appointed by El Corte Inglés (see specific report).

2 Operating Performance of the Management Areas

2.1. TRANSPORT

Set forth below are statistics on the evolution of the passenger and cargo air transport business of Iberia, L.A.E. in 2003.

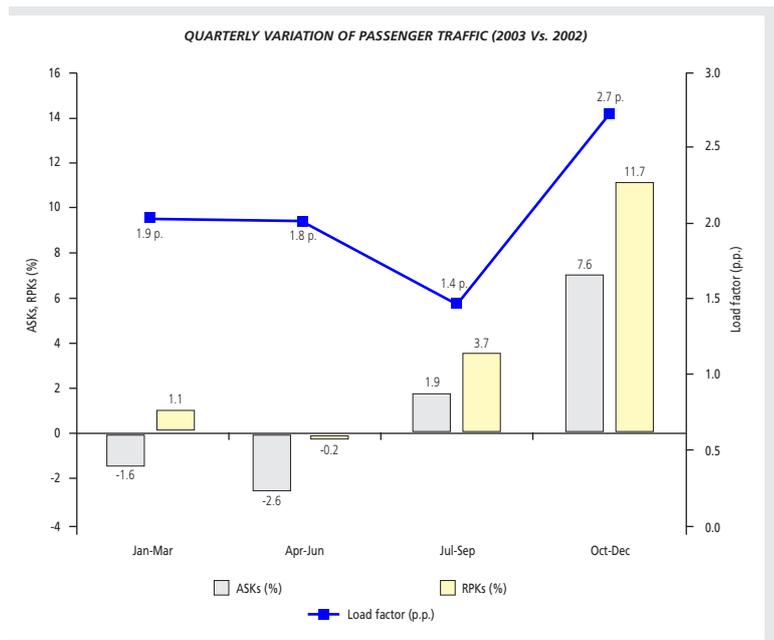
Since January 2003 Iberia, L.A.E. has prepared its passenger traffic statistics by extending the segment-oriented approach, i.e. grouping legs together geographically, to the Company's entire network. In order to be able to compare the data for 2003 and 2002, those for 2002 published in this report are also presented in accordance with this new segment-oriented approach. Therefore, based on the former criterion, a passenger flying from Barcelona to Miami via Madrid was classified as having taken two long-haul flights, whereas under the new approach the Barcelona-Madrid leg is classified as a domestic flight and the Madrid-Miami leg as belonging to the long-haul segment.

2.1.1. PRODUCTION AND PASSENGER TRAFFIC

2003 was a difficult year for the air transport industry, which once again evidenced its well-known dependence on external factors. In the first few months of the year the recovery in air traffic, which had experienced the worst crisis in its history following the terrorist attacks of September 11, 2001, was held back by the uncertainty brought about by the lead up to the war and by the lackluster economic situation in the U.S. and in certain European countries. The outbreak of war in Iraq on March 20 was quickly followed by the unexpected appearance of the SARS (Severe Acute Respiratory Syndrome) virus, which hit the air transport industry particularly hard, above all in the second quarter of the year. In the second half of the year, as these difficulties were overcome and the economic situation improved, world air traffic recovered gradually, with across-the-board growth in the last quarter which, however, was not sufficient to result in positive figures for the year as a whole.

According to the statistics of the International Air Transport Association (IATA), international passenger transport demand was 2.4% lower than in 2002, as compared with a slight increase (0.1%) in supply and, accordingly, the load factor dropped by 1.8 percentage points with respect to the preceding year to stand at 72.2%.

Against this complicated backdrop, Iberia, L.A.E.'s RPK's increased by 4.0% in 2003 taken as a whole, with an increase in capacity, in terms of ASKs, of 1.3% with respect to 2002. Therefore, the Company's passenger load factor improved by 1.9 percentage points to 75.0%. These good figures were achieved as a result of the Company's flexibility and its success in tailoring its supply to the variations in demand in the various markets. Iberia, L.A.E.'s low exposure to the worst-hit areas mentioned above (the Far East, North America and the Middle East) was also a positive factor behind this sound performance. Traffic grew progressively in the second half of 2003.



Compared with the preceding year, Iberia, L.A.E.'s supply fell in the first six months of 2003 and increased progressively in the second half of the year. Over the year as a whole, the number of ASKs increased moderately in the three segments, although the largest increase (1.5%) was seen on international medium-haul routes. The average passenger haul grew slightly by (0.2%) with respect to 2002 to 1,644 km.

Having analyzed the trend in demand in the various markets, in March the Company made cutbacks in the schedules originally planned, particularly on international medium-haul routes, where traffic had dropped and competition was fierce. Consequently, the Company decided to put on hold the delivery of three new aircraft earmarked for the medium-haul network. Subsequently, the Company made monthly tactical adjustments to this reduced schedule in order to adapt it to market demand trends.

Accordingly, Iberia, L.A.E. delayed the launch of certain routes and reduced the frequency of certain weekend domestic flights and of some of the European trunk flights, although it increased frequencies to the European destinations with the highest demand. Iberia, L.A.E. started to operate certain new such as Madrid – Athens direct; Seville – Paris; Madrid – Bologna; and Madrid – Tangier (the last two routes had previously been operated directly by Iberia Regional Air Nostrum) and frequencies were increased to other destinations such as Paris and Venice.

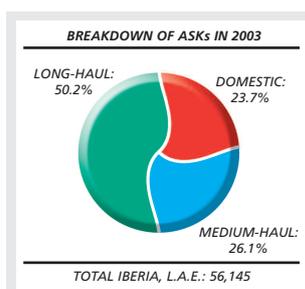
In the long-haul network, certain adjustments were made on Latin American routes in the first half of the year, specifically to Argentina and, above all, Venezuela, where traffic had dropped as a result of the instability there. These reductions were progressively eliminated in the second half of the year as the situation improved.

In the domestic segment, in 2003 Iberia, L.A.E. continued with the strategy implemented in 2002 of making additional cutbacks in flights between the Spanish mainland and the Canary Islands. However, production was increased on the routes to and from the Balearic Islands and, above all, on routes linking Madrid and Barcelona with other destinations in mainland Spain. Iberia, L.A.E. also temporarily increased the density of frequencies between the mainland and the Balearic and Canary Islands during the Easter, summer and Christmas vacation periods.

The detail, by sector, of the ASKs is as follows:

| SUPPLY | | MILLIONS OF ASKs | | |
|-----------------------------|---------------|------------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| MADRID-BARCELONA | 1,937 | 1,890 | 47 | 2.5 |
| MAINLAND CANARIES | 5,010 | 5,155 | (145) | (2.8) |
| MADRID-MAINLAND (*) | 3,008 | 2,863 | 145 | 5.1 |
| OTHER DOMESTIC | 3,368 | 3,289 | 79 | 2.4 |
| DOMESTIC | 13,323 | 13,197 | 126 | 1.0 |
| AFRICA AND MIDDLE EAST | 974 | 848 | 126 | 14.9 |
| EU | 12,687 | 12,666 | 21 | 0.2 |
| OTHER EUROPEAN COUNTRIES | 961 | 894 | 67 | 7.5 |
| MEDIUM-HAUL | 14,622 | 14,408 | 214 | 1.5 |
| NORTH AMERICA | 6,511 | 6,323 | 188 | 3.0 |
| CENTRAL AMERICA | 13,369 | 13,563 | (194) | (1.4) |
| SOUTH AMERICA | 7,312 | 6,896 | 416 | 6.0 |
| SOUTHERN AFRICA AND OTHER | 1,008 | 1,018 | (10) | (1.0) |
| LONG-HAUL | 28,200 | 27,800 | 400 | 1.4 |
| TOTAL IBERIA, L.A.E. | 56,145 | 55,405 | 740 | 1.3 |

(*) All mainland connections except Barcelona.



Iberia, L.A.E. and the regional airline Air Nostrum continued to implement the franchise agreement that has made them commercial allies since 1997. Iberia Regional Air Nostrum continued to increase its European production by increasing frequencies and launching new routes, such as those between Barcelona and Basel, Hamburg, Pisa, Stuttgart, those between Madrid and Brussels, Hanover, Nice, Toulouse and Turin; and the Alicante-Paris, Santiago de Compostela-Paris and Valencia-Zurich

routes. In the domestic market, Iberia Regional Air Nostrum started to operate, from June 2003, the Santiago de Compostela-Valencia route; from September, the Barcelona-La Rioja route and, from October, the Madrid-La Rioja and Santiago de Compostela-Seville routes. Also, the regional airline also operated additional flights during the vacation periods.

In 2003 Iberia, L.A.E.'s commercial network, including the flights operated by its franchised airline Air Nostrum, encompassed most Spanish destinations and a total of 65 international destinations in 41 countries.

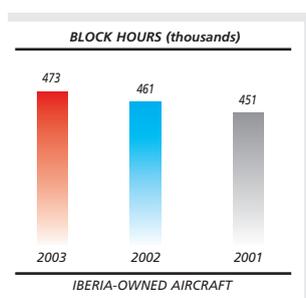
Also, in 2003 Iberia, L.A.E. continued to implement the code-sharing agreements entered into previously with other companies, which enable it to increase the number of destinations offered to its customers. New routes were included in the agreements with British Airways and GB Airways, giving a total of 57. The number of shared-code flights under the agreements with TAP Air Portugal, Lan Chile, Swiss and SN Brussels was also increased. In addition, Iberia, L.A.E. entered into a new code-sharing agreement with the Danish company Maersk-DM to fly to Copenhagen from Barcelona and Madrid.

Iberia, L.A.E.'s production measured in block hours was 2.7% higher than in 2002.

PRODUCTION

PASSENGER AIRCRAFT BLOCK HOURS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--------------------------|----------------|----------------|-----------------|-------------|
| IBERIA-OWNED AIRCRAFT | 472,855 | 460,588 | 12,267 | 2.7 |
| WET LEASE | - | - | - | - |
| OTHER LEASE TRANSACTIONS | 12 | 116 | (104) | (89.7) |
| IBERIA, L.A.E. | 472,867 | 460,704 | 12,163 | 2.6 |



In 2003, in its network as a whole, Iberia, L.A.E. carried 3.8% more passengers than in 2002, due mainly to the higher load factors. The number of passengers carried increased by 2.1% on international flights and by 5.1% on domestic flights. In the latter case the increase was augmented by the higher relative importance of domestic mainland routes.

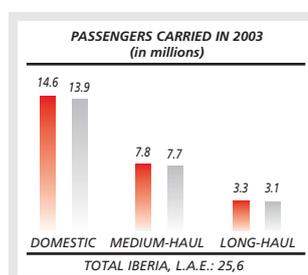
The breakdown of the number of passengers carried is as follows:

PASSENGERS CARRIED

THOUSANDS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|-----------------------------|---------------|---------------|-----------------|-------------|
| MADRID-BARCELONA | 2,793 | 2,720 | 73 | 2.7 |
| MAINLAND-CANARIES | 2,213 | 2,204 | 9 | 0.4 |
| MADRID-MAINLAND (*) | 5,129 | 4,725 | 404 | 8.6 |
| OTHER DOMESTIC | 4,446 | 4,225 | 221 | 5.2 |
| DOMESTIC | 14,581 | 13,874 | 707 | 5.1 |
| AFRICA AND MIDDLE EAST | 281 | 217 | 64 | 29.5 |
| EU | 6,977 | 6,976 | 1 | 0.0 |
| OTHER EUROPEAN COUNTRIES | 498 | 471 | 27 | 5.7 |
| MEDIUM-HAUL | 7,756 | 7,664 | 92 | 1.2 |
| NORTH AMERICA | 784 | 762 | 22 | 2.9 |
| CENTRAL AMERICA | 1,745 | 1,749 | (4) | (0.2) |
| SOUTH AMERICA | 644 | 534 | 110 | 20.6 |
| SOUTHERN AFRICA AND OTHER | 103 | 98 | 5 | 5.1 |
| LONG-HAUL | 3,276 | 3,143 | 133 | 4.2 |
| TOTAL IBERIA, L.A.E. | 25,613 | 24,681 | 932 | 3.8 |

(*) All mainland connections except Barcelona.



In 2003 Revenue passenger kilometers (RPKs) increased by 3.6% in the domestic segment and by 4.2% on international flights taken as a whole. The demand growth of 5.4% on long-haul flights was due mainly to the sharp increase in traffic in the South Atlantic market. Demand in the domestic market was more stable throughout the year.

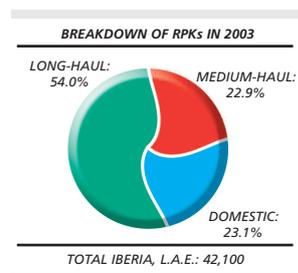
The breakdown of the RPKs is as follows:

▶▶ **TRAFFIC**

| | MILLIONS OF RPKs | | | |
|-----------------------------|------------------|---------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| MADRID-BARCELONA | 1,346 | 1,311 | 35 | 2.7 |
| MAINLAND-CANARIES | 3,908 | 3,899 | 9 | 0.2 |
| MADRID-MAINLAND (*) | 2,061 | 1,895 | 166 | 8.8 |
| OTHER DOMESTIC | 2,403 | 2,275 | 128 | 5.6 |
| DOMESTIC | 9,718 | 9,380 | 338 | 3.6 |
| AFRICA AND MIDDLE EAST | 639 | 528 | 111 | 21.0 |
| EU | 8,448 | 8,459 | (11) | (0.1) |
| OTHER EUROPEAN COUNTRIES | 568 | 544 | 24 | 4.4 |
| MEDIUM-HAUL | 9,655 | 9,531 | 124 | 1.3 |
| NORTH AMERICA | 5,242 | 5,072 | 170 | 3.4 |
| CENTRAL AMERICA | 10,549 | 10,628 | (79) | (0.7) |
| SOUTH AMERICA | 6,105 | 5,065 | 1,040 | 20.5 |
| SOUTHERN AFRICA AND OTHER | 831 | 794 | 37 | 4.7 |
| LONG-HAUL | 22,727 | 21,559 | 1,168 | 5.4 |
| TOTAL IBERIA, L.A.E. | 42,100 | 40,470 | 1,630 | 4.0 |

(*) All mainland connections except Barcelona.

Iberia, L.A.E.'s average passenger load factor of 75.0% for all the flights operated in 2003 was more than 1.9 percentage points higher than in 2002 and represented the highest load factor ever achieved by the Company. The Company also achieved record load factors in August, November and December.

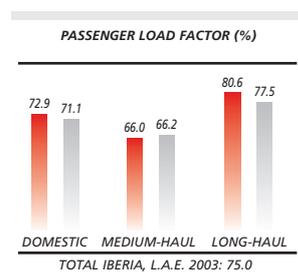


▶▶ **PASSENGER LOAD FACTOR**

| | PERCENTAGE | | |
|-----------------------------|-------------|-------------|----------------------|
| | 2003 | 2002 | VARIATION 03/02 (**) |
| MADRID-BARCELONA | 69.5 | 69.4 | 0.1 |
| MAINLAND CANARIES | 78.0 | 75.6 | 2.4 |
| MADRID-MAINLAND (*) | 68.5 | 66.2 | 2.3 |
| OTHER DOMESTIC | 71.4 | 69.2 | 2.2 |
| DOMESTIC | 72.9 | 71.1 | 1.9 |
| AFRICA AND MIDDLE EAST | 65.5 | 62.2 | 3.3 |
| EU | 66.6 | 66.8 | (0.2) |
| OTHER EUROPEAN COUNTRIES | 59.1 | 60.9 | (1.8) |
| MEDIUM-HAUL | 66.0 | 66.2 | (0.1) |
| NORTH AMERICA | 80.5 | 80.2 | 0.3 |
| CENTRAL AMERICA | 78.9 | 78.4 | 0.5 |
| SOUTH AMERICA | 83.5 | 73.4 | 10.0 |
| SOUTHERN AFRICA AND OTHER | 82.4 | 77.9 | 4.5 |
| LONG-HAUL | 80.6 | 77.5 | 3.0 |
| TOTAL IBERIA, L.A.E. | 75.0 | 73.0 | 1.9 |

(*) All mainland connections except Barcelona.

(**) The differences in terms of percentages appear not to add up as a result of the rounding-off effect.



The figures achieved in the year as a whole included most notably the increase of 3% in the load factor on intercontinental routes to 80.6%. The load factor improved by ten points in the South American market. The load factor on international medium-haul routes performed the best in 2003 as a whole, following a poor first quarter and, accordingly, the cumulative percentage remained practically unchanged with respect to 2002. On domestic routes, the load factor was 72.9%, up 1.9 percentage points on 2002.

2.1.2. PASSENGER TRAFFIC REVENUES

Iberia, L.A.E.'s yield decreased by 7.3% in 2003. The appreciation of the euro against other currencies, in particular the U.S. dollar, was the main reason for the drop in the yield on long-haul flights, whereas surplus capacity, fierce competition from low-cost airlines and the drop in business traffic were the factors behind the fall in the yield on international medium-haul routes. Also, competition brought greater pressure to bear on prices in the domestic market, which led Iberia, L.A.E. to introduce a new fare structure for its domestic flights from March onwards. However, the yield performed better in the second half of the year with respect to the cumulative figure for the first six months of 2003.

The detail, by commercial sector, of the average yield in 2003 and 2002 is as follows:

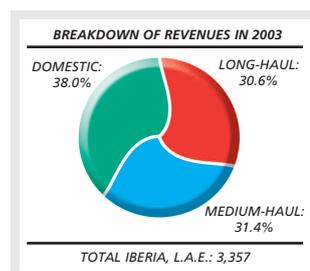
| | € CENTS/RPK | | | |
|----------------------------|-------------|-------------|-----------------|--------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| DOMESTIC | 13.12 | 13.62 | (0.50) | (3.7) |
| MEDIUM-HAUL | 10.91 | 11.82 | (0.91) | (7.7) |
| LONG-HAUL | 4.52 | 5.00 | (0.48) | (9.6) |
| TOTAL IBERIA, L.A.E | 7.97 | 8.60 | (0.63) | (7.3) |

The average revenue per ASK for the Company's network as a whole dropped by 4.8% in 2003, although this decrease was cushioned by the 1.9% increase in the load factor.

The detail of the average revenues per ASK by segment is as follows:

| | € CENTS | | | |
|----------------------------|-------------|-------------|-----------------|--------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| DOMESTIC | 9.57 | 9.68 | (0.11) | (1.1) |
| MEDIUM-HAUL | 7.20 | 7.82 | (0.62) | (7.9) |
| LONG-HAUL | 3.65 | 3.88 | (0.23) | (5.9) |
| TOTAL IBERIA, L.A.E | 5.98 | 6.28 | (0.30) | (4.8) |

Iberia, L.A.E.'s passenger revenues were 3.6% lower in 2003 than in 2002. Passenger revenues dropped by 6.5% and 4.6% on international medium-haul and long-haul routes, respectively, although the decrease was more moderate (0.2%) on domestic flights.



The detail, by segment, of the passenger revenues is as follows:

| PASSENGER REVENUES | MILLIONS OF EUROS | | | |
|----------------------------|-------------------|----------------|-----------------|--------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| DOMESTIC | 1,275.3 | 1,277.3 | (2.0) | (0.2) |
| MEDIUM-HAUL | 1,053.4 | 1,126.5 | (73.1) | (6.5) |
| LONG-HAUL | 1,028.1 | 1,077.6 | (49.5) | (4.6) |
| TOTAL IBERIA, L.A.E | 3,356.8 | 3,481.4 | (124.6) | (3.6) |

2.1.3. CARGO

In 2003 Iberia Cargo had to deal with the persistent weakness of the economy, particularly in the first nine months of the year. This scenario of economic stagnation affected the U.S. and certain Southern Cone countries, which adversely affected this business unit's activity. As the world economy started to pick up, the situation of Iberia Cargo began to improve, and there were promising signs of a recovery in the last quarter of the year. As a result, over the year as a whole there was an increase in activity of 2.1% in terms of TKTs with respect to 2002.

The weakness of the export markets of the main European countries, which was particularly evident in the first half of the year and which had already started to emerge at the end of 2002, led to a 3.0% drop in traffic revenues with respect to the preceding year.

Unit revenues were affected by the depreciation of the U.S. dollar against the euro, since around 25% of Iberia Cargo's revenues are denominated in U.S. dollars. Therefore, traffic revenues decreased by €6.9 million in 2003, despite the increase in the volume of cargo carried.

Iberia Cargo continued to use Havana as a transit platform for flights to other destinations in this area, such as Mexico and Central America.

In March 2003 the Board of Directors of the Spanish Postal Authorities awarded Iberia Cargo the contract for the air mail transport service between the Spanish mainland and the Canary Islands, in order to guarantee the quality and speed of the transportation, handling and distribution of the correspondence that the Spanish Postal Authorities carries during the year between the mainland and the Canary Islands.

On July 28, 2003, Iberia Cargo obtained quality certification under the ISO 9001:2000 standard for all its booking, space control, goods acceptance, flight preparation and cargo terminal goods delivery activities from Asociación Española de Normalización y Certificación (AENOR). The new rules contain new requirements, including most notably: a better quality system structure which guarantees continuous improvement of products and services; an improved definition of the human resources training required, as well as the analysis of the effectiveness of this training; strengthening of the importance of the role of customers in processes relating to the cargo activity, improvement of the communications channels required to ascertain customers' opinions on products and services, customer satisfaction and the degree of effectiveness attained in resolving customer claims.

As regards systems development, in 2003 work concluded on the implementation of the cargo revenue management system. Also, Iberia Cargo introduced a new computer system that makes it possible to continuously monitor the status of mail carried by plane from Spain. Very soon this system will be applied to all destinations in Europe and in the future it will be extended to intercontinental destinations.

The main parameters of this business unit were as follows:

| IBERIA CARGO | | | | |
|--------------------------------------|-------------|-------------|------------------------|--------------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| MILLIONS OF ATKs | 1,269 | 1,307 | (38) | (2.9) |
| IN HOLDS | 1,151 | 1,200 | (49) | (4.1) |
| IN CARGO AIRCRAFT | 118 | 107 | 11 | 10.3 |
| MILLIONS OF TKTS | 868 | 850 | 18 | 2.1 |
| IN HOLDS | 814 | 798 | 16 | 2.0 |
| IN CARGO AIRCRAFT | 54 | 52 | 2 | 3.8 |
| LOAD FACTOR (%) | 68.4 | 65.0 | 3.4 | 5.1 |
| IN HOLDS | 70.6 | 66.5 | 4.1 | 6.2 |
| IN CARGO AIRCRAFT | 46.4 | 48.6 | (2.2) | (4.5) |
| AVERAGE YIELD (CENTS/TKT) | 25.47 | 26.81 | (1.3) | (5.0) |
| TOTAL CARGO REVENUES (MILLIONS OF €) | 221.1 | 228.0 | (6.9) | (3.0) |
| EQUIVALENT FULL-TIME EMPLOYEES | 1,079 | 1,104 | (25) | (2.3) |

2.2. HANDLING

In 2003 total handling activity, measured in terms of weighted planes handled, increased by 5.5% with respect to 2002. The volume of business increased for all groups of companies (Spanish, foreign and Iberia, L.A.E. itself), as a result of the progressive recovery in air traffic following the prolonged crisis sparked by the events of September 11. The number of aircraft handled for third parties increased by almost 17,900 weighted planes, which represents an increase of 8.6% over 2002, while the number of planes handled for Iberia, L.A.E. itself rose by more than 5,700 weighted planes (2.6%).

Operating revenues (including internal billings to the "Airline" business) exceeded €530 million in 2003, up €46 million (9.6%) on 2002. This notable increase was due to the upturn in business, to the billings for a greater number of supplementary services derived from the new EU legislation on baggage handling, and to price adjustments.

In 2003 there was a considerable increase in the "H Tariff" introduced by AENA (the Spanish public airports and aviation agency) in January 2002 as a charge for the use of airport space and facilities, which affected both revenues and expenses, since the "Handling" area passes on this cost in full, without any margin, to the companies that it serves.

The number of equivalent full-time employees increased by 617 in 2002, with an increase of 278 in the number of equivalent full-time permanent employees and a decrease of 592 in the number of equivalent temporary employees. The increase in the headcount was due mainly to the growth in the volume of business and to the new functions performed, such as the handling of baggage for security functions, which involved 161,991 contracted hours, and the "counting" of baggage (211,146 hours).

Initiatives were taken to improve all Iberia Handling's quality parameters, namely punctuality, check-in waiting times and baggage reclaim times.

In September 2003, after almost two years' work, Iberia, L.A.E. obtained Certification for its Environmental Quality System under the de AENOR UNE-EN ISO 14001 standard, which was implemented simultaneously at the 39 Spanish airports where it carries on passenger and ramp handling activities.

The targets set in the PROICO Plan were 102% met, and significant cost savings were achieved thanks to the expense reduction programs implemented and to the across-the-board drop in the number of incidents at airports.

The following table shows the main operating aggregates of Iberia Handling:

| IBERIA HANDLING | | | | |
|---|-------------|-------------|------------------------|--------------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| WEIGHTED PLANES HANDLED (WPH) (THOUSANDS) | 454.9 | 431.4 | 23.5 | 5.4 |
| THIRD-PARTY HANDLING REVENUES (MILLIONS OF €) | 270.0 | 232.9 | 37.1 | 15.9 |
| OPERATING REVENUES (MILLIONS OF €) | 530.8 | 484.2 | 46.6 | 9.6 |
| OPERATING REVENUES/WPH (€) | 1,166.7 | 1,122.5 | 44.2 | 3.9 |
| PRODUCTIVITY (HOURS/WPH) | 32.09 | 31.40 | 0.7 | 2.2 |
| EQUIVALENT FULL-TIME EMPLOYEES | 8,523 | 7,906 | 617 | 7.8 |

2.3. MAINTENANCE

Iberia Maintenance is responsible for maintaining the Company's aircraft and also provides technical assistance services to third parties, including more than 50 Spanish and foreign airlines.

As a result of the maintenance of the various aircraft, the hanger occupancy rate was higher in 2003, and around 100 C, D, E and IL major overhauls were carried out. Of the total major overhauls, approximately 15% were carried out for third parties.

In conjunction with the scheduled overhauls, other necessary activities were carried out in order to guarantee air safety and to comply with the new regulations introduced by the air transport authorities. In this regard, all the cockpits were reinforced in order to avoid unauthorized access thereto during flights. These regulations affected all the aircraft.

In 2003 the fourth chain of major overhauls for MD-80-type aircraft was introduced in hangar 6. This made it possible to expedite the work on densification and the installation of new navigation, clear ice protection, insulation blanket and class C hold systems in order to adapt to and comply with the applicable legislation.

As regards the Engine Workshop, 117 engine overhauls were carried out in 2003, which was an all-time high in the production capacity of these facilities, and the measures taken to increase the range of engines that can be serviced were completed with the introduction of services for the CF34-3A/-3B engine.

With a view to integrating computer processes and facilitating the availability of information and data processing, the SAPR/3 Aerospace & Defense system was introduced, which makes it possible to improve customer service, expedite processes and unify the system with the standard system in the industry.

The work performed in the Development and Sales Department was aimed at consolidating the customer roster, seeking out new markets and attracting new customers. Noteworthy in the third-party market was the signing of new contracts with AAR Aircraft Component Services, Air Nostrum, Iberworld, LTE International Airways, LTU, Meridiana, MK International Airways, OMNI Air International, Onur Air, Olympic Airways, Spanair, TACA International Airlines, Transmeridian Airlines and Turkmenistan Airlines.

Under the already existing contracts, engine, aircraft and spare part maintenance work was performed for the following operators, manufacturers and lessors, among others: Air Anatolia, Air Luxor, Alianza Summa, Atlas International, Cameroon Airlines, Cebu Pacific, Fly Air, Free Bird Airlines, GAMCO, General Electric, Gulf Air, Irán Air, Polar Air Cargo, Rolls Royce, Royal Jordanian, Royal Nepal Airlines, Santa Barbara, TAP Air Portugal, the CIT Group and Yemenia.

As regards certification, in November Iberia, L.A.E. received from AENOR ISO 9001:2000 certification (once the transition had been made to the new standard from the previous standard, ISO 9002:1994 under which the Maintenance Division had been certified since 2002 and the related certification audit had been passed). In addition to retaining the certifications already held by the Maintenance Division in 2002, new certifications were obtained by the Company's customers from the air transport authorities (e.g. the Chilean Directorate-General of Civil Aviation License and the inclusion of the A340 aircraft under the Chinese Civil Aviation Certificate).

The variations in the main operating aggregates were as follows:

▶▶ IBERIA MAINTENANCE

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---|-------|-------|-----------------|-------------|
| NUMBER OF OVERHAULS | 244 | 210 | 34 | 16.2 |
| THOUSANDS OF PRODUCTION HOURS OF IN-HOUSE PERSONNEL | 2,804 | 2,697 | 107 | 4.0 |
| INDIRECT/DIRECT LABOR (%) | 36.0 | 50.2 | (14.2) | (28.3) |
| TECHNICAL ASSISTANCE REVENUES (MILLIONS OF €) | 104.0 | 91.3 | 12.7 | 13.9 |
| EXTERNAL OPERATING REVENUES (MILLIONS OF €) | 112.5 | 97.5 | 15.0 | 15.4 |
| EQUIVALENT FULL-TIME EMPLOYEES | 3,898 | 3,831 | 67 | 1.7 |

2.4. SYSTEMS

The most significant project undertaken in 2003 was carried out in the Maintenance area with the start-up of "IMAGINA", which entailed the implementation of an ERP tool (SAP R/3) to provide support for production, with the following functions: centralized planning; financial management, billing and economic control; materials management; engine workshop management; technical documentation management and business information management. The implementation of this ERP tool led to the complete renewal and modernization of the Maintenance Division's processes model.

Also noteworthy in the Customer Relations area was the start-up of the new Customer Relationship Management (CRM) system, which provides support for all marketing measures, including personalized marketing, with, inter alia, actions targeted at each individual customer based on his or her relationship with the Company or consumption behavior.

In the Human Resources area, a new version of the employee Intranet portal was developed and integrated with the corporate portal, which now has new functions. Also, the specific area of services for crew members came into service, which enables them to carry out all the functions required by them, such as making consultations regarding services or scheduling while away from home from any PC connected to the Internet anywhere in the world. A new payroll system for executives based on a SAP ERP tool was also brought into service.

In the Control and Administration area, the new Fixed Asset and Accounts Payable and Receivable system was introduced, thereby culminating the implementation of the ORACLE ERP, which provides support for the whole of the Company's accounting area. The new system for the preparation of the Company's budgets was also brought into service.

2003 saw the start-up of a new Data Warehouse with Amadeus booking information, which facilitates the obtainment of the information required by the Commercial Department in order to take decisions. Also, a new reimbursement system was introduced for Spanish travel agencies, thereby increasing the efficiency and productivity of these processes.

Lastly, the most significant event in the Systems area was the inauguration of a new support center for dealing with contingencies, which makes it possible for service to be provided without interruption in the event of any contingency or accident.

In accordance with the Company's Quality policy, ISO 9000:2000 certification was achieved for both the Development and the Production areas (the latter had already achieved certification under the former standard).

In 2003 2,007 desktop PCs and 50 laptops were installed, an all-time high for Iberia, L.A.E., due to the need for new workstations arising from the implementation of the IMAGINA and CRM systems.

In 2003 number of equivalent full-time employees of Iberia Systems remained unchanged from 2002 at 528 employees.

2.5. PROJECTS

2.5.1. CRM

The main aim of the CRM ("Customer Relationship Management") project is to acknowledge the value of our customers at all their points of contact with the Company in order to improve service quality and thereby increase profitability.

In 2003 work was completed on the design and development of the principal functions of the model and the geographical implementation and deployment phase commenced.

The initial results achieved by Iberia, L.A.E. included the integration of the customer-related information housed in a large number of applications in a single large database which is able to:

- Improve the Company's knowledge of its customers.
- Facilitate the implementation of loyalty-building measures, including most notably the launch of relational of marketing campaigns with specific value proposals for the Company's customers.
- Guarantee that the Company's employees have the necessary information at all the points of contact in order to be able to provide a better service to our customers.
- Ensure the online integration of the features of the IB Plus program in Iberia.com.

Also, an ambitious training program was introduced aimed at employees who have contact with customers (6,000 employees), which covers areas relating to both attitudes in relationships with customers and operating and procedural processes.

Implementation of the functions of the CRM project commenced in September 2003 at Valencia airport and with the start-up of the Telephone Sales Call Center, with highly satisfactory results. The geographical deployment of the project throughout the network is scheduled for the first half of 2004, although the project will initially be introduced at Madrid and Barcelona airports.

Through 2003 a total of €14.7 million had been invested in this project. An additional investment of €1.6 million will be made in 2004 in order to complete the geographical deployment of the main tool, including the related software and hardware, and to develop the additional features that were included in the project during the initial phase of implementation.

2.5.2. QUALITY IMPROVEMENT

One of the strategic objectives defined in the 2003/2005 Master Plan is to increase service quality and strengthen relationships with high-value customers. To this end, in parallel with the implementation of the CRM project, the Company set in motion a global service quality improvement plan.

The target of the Iberia Group is, in addition to achieving profitability, to satisfy its customers, an area in which punctuality is a very important factor. In 2003 punctuality was 83.8%, 8.4 percentage points above the average for 2002, making Iberia, L.A.E. the most punctual network airline in Europe. This achievement was neither an accident or circumstantial, but rather fruit of the implementation, at the beginning of the year, of the Integral Punctuality Improvement Plan, coordinated by the Punctuality Committee. The aim of the Committee is to prevent and detect the possible causes of delays, and to seek and analyze new initiatives that will make it possible to improve procedures and coordinate operations. The Committee members include senior executives from all the operating areas, including the commercial, handling, crew, in-flight service, maintenance and cargo areas. The new measures and rules implemented facilitate flight punctuality, which will increase customer satisfaction and contribute to a decrease in expenses.

Another initiative aimed at improving service quality was the introduction of a training plan for all employees who come into direct contact with customers, which constitutes a necessary supplementary factor that makes it possible to fully harness the potential of the CRM project. In this regard, Iberia, L.A.E. designed a wide-reaching training program, under which 6,000 employees working in the customer service area received courses on the rules and recommendations that they must take into account when providing their services. To supplement these courses, the Company published a Style Guide reminding the employees of the importance of the professionalism of all the employees who deal directly with the Company's customers. The Guide is an excellent work tool, since, in addition to providing information on the Company and its products and services, it offers a detailed description of the way in which employees should treat customers.



2003 was the first full year in which communications with all the customers in Iberia, L.A.E.'s network were managed on a centralized and integrated basis, following the completion in November 2002 of the centralization of the functions assumed by the Customer Relations Department, which manages the Customer Service Center and the Baggage Information Hotline, which work together in close cooperation.

In 2003 the Customer Service Center received all the telephone and written communications from the Company's customers, such as in-flight suggestion sheets, letters and e-mail messages from all parts of the world. The communications are processed at a single center with the appropriate computer media, thereby achieving response times that are considerably better than those obtained through a decentralized system. The average length of time taken to respond to these communications fell from more than 20 days in 2000 to 13.5 days in 2002 and to 7.11 days in 2003. Also, this system enables the Company to respond to all its customers in an integrated and consistent fashion. Customer indemnity and compensation payments (including those relating to incidents, baggage and all other events) were also unified and centralized. In addition, in 2003 a new process for the handling of incidents involving High-Value Customers (mainly Iberia Plus Platino, Iberia Plus Oro and Club Fiesta Iberia customers) was introduced, which the Company is aiming to use to preempt complaints and claims from customers when they suffer significant incidents.

Also, in 2003 the Company started to inform all the areas involved in customer service about the main reasons for which customers lodge complaints, which were disclosed by an analysis of the communications received, which gave rise to the formation of work groups, in which the areas involved are participating, which have started to review the service processes relating to the main reasons for customer dissatisfaction from the qualitative and quantitative standpoints, with a view to improving customer service.

Work continued in 2003 on strengthening Iberia Plus, a program designed to reward and foster the loyalty of customers who fly with Iberia, L.A.E. or use the services of the companies included under the program. In 2003 the number of Iberia Plus cardholders increased by almost 26% to stand at 1,685,000 at year-end. The airlines that have joined the program are as follows: American Airlines, British Airways, Cathay Pacific, Qantas, Air Lingus, Finnair, Lanchile and Swiss Air— all of which are members of the oneworld alliance— as well as Air Nostrum, Binter Canarias, Tap Air Portugal and SN Brussels (the agreement with the latter came into force on January 1, 2003). Nine important hotel chains have also joined the program. Barceló and Pousadas de Portugal joined the program in 2003. The program also includes four car hire companies and another seven companies from various industries, namely Iberia Cards, American Express, Telefónica, Amena, Viva Tours, Tienda a Bordo and Tienda Directa (the latter of which joined in 2003).

Other new features aimed at improving the service provided to the Company's customers were the publishing in June 2003 of the "Excelente Business Class" magazine; the creation of a specific area within the Call Center in order to serve Iberia Plus Platino and Iberia Plus Oro cardholders; and the cooperation agreement between Iberia, L.A.E. and Cima Clece (a joint venture that manages the Business Center in Terminal 2 of Barajas Airport) for a 25% discount for Iberia Plus, Club Fiesta and Visa Iberia cardholders when they use the Business Center's meeting rooms and general services.

2.5.3. NEW DISTRIBUTION CHANNELS

Iberia.com

In 2003 Iberia.com's volume of business grew considerably. The Company sold 935,000 tickets through this own channel in 2003, 85.8% more than in 2002. These sales amounted to over €159.5 million, representing an increase of 60% with respect to 2002.

At the beginning of 2003 the new Iberia.com platform was launched in order to improve sales and customer relations, providing value-added in all areas of the various on-line booking, purchasing and information processes. Also, Iberia, L.A.E. offers its customers various different products and services that, in a personalized fashion based on their profile and preferences, lead to a more personal approach that increases customer satisfaction.

The new web-based platform has the following new features: a more modern design, new functionalities, a more powerful search engine for flights and prices, management tools, the integration of the database of Iberia Plus cardholders in Iberia.com, personalization rules on the basis of the features of each customer and customer profile management.

Through the website, customers can obtain information on flights, fares and available seats; make bookings and buy tickets, and request, if they so wish, an e-ticket, send it to the appropriate address or collect it at an Iberia, L.A.E. office or at any travel agency.

The new design of the Iberia, L.A.E. Internet website has simplified the booking process and includes new features and services such as: "Iberia Plus Online", where users of the loyalty-building program can consult balances and personalized statements, request points, buy tickets with their accumulated points, benefit from special promotions and donate points through "Proyecto Cruz Roja" ("Red Cross Project"); "Compras Online y Partners" ("Online Sales and Partners"), which includes the Iberia.com store in collaboration with and with the quality and service of El Corte Inglés, travel insurance and Viva Tours package tours; "Comunicación a los clientes" ("Customers Communications"), through e-bulletins and direct information in real time for passengers; "Comunicación de la compañía" ("Company Communications"), with information for shareholders and on corporate social responsibility, among other links.

In 2003 the Company continued to extend its Internet network with the inauguration of three new websites in Greece, Israel and Chile. The aim of this international expansion is to create specific websites in all the countries in which the Company has a presence. Currently, 18 countries, including Spain, have their own website.

Iberia, L.A.E. continues to be the leader in e-commerce in Spain, with an average of 101,000 website hits each working day in 2003.



Serviberia

Serviberia is a centralized end customer service hotline that offers ticket sales with the choice of either a cyberticket or home delivery, as well as information 24 hours a day, 365 days a year. Serviberia centralizes this service for the whole of Spain and, through Serviberia Europa, for customers in the U.K., Ireland, Portugal, France, Belgium, Italy, Germany, Austria, Switzerland and the Netherlands. This effective centralization of the various booking centers in Europe has made it possible to unify and improve the service offered, by standardizing passenger service procedures, and to reduce costs through economies of scale.

In 2003 Serviberia introduced certain technological changes that led to a significant improvement in service quality. In the initial phase, the telephone switchboard was changed in order to better cater for current market needs. Subsequently, the calls were integrated in a database that recognizes customers by their telephone number and, lastly, a new unit known as VRU was installed, where an answerphone-type operator, with a human voice, provides customers with all manner of information on flight arrivals and departures. This has made it possible to provide an optimum information service to the Company's customers on a more personal basis, while at the same time freeing up resources to enable direct sales to continue to grow.

As a result of these improvements and to the evolution of customer behavior, an increasing number of people are making their purchases through direct channels and Serviberia has ceased to be a mere information channel. This is evidenced by the growth of 36% in the number of tickets sold in 2003 to almost 717,000. In addition, the degree of penetration of the cyberticket in this channel was 70% in 2003. Serviberia's total sales increased by 9% with respect to 2002 to nearly €159 million in 2003, and a total of almost 4,840,000 calls were taken, up 1% on 2002.

2.5.4. STRATEGIC PURCHASING MANAGEMENT

Work continued in 2003 on the implementation of the Strategic Purchasing Management project.

The main objective of this project is to progressively reduce purchasing and procurement costs, for which purpose a new purchasing methodology and strategy has been introduced. The Company's purchasers now have access to new electronic negotiating tools and those requesting goods and services have access to procurement tools. These tools ensure compliance with in-house rules while at the same time optimizing the goods and service ordering and receiving process.

Within the framework of the Strategic Purchasing Management project, new information systems have been developed that will improve the management of the purchasing function and enable stricter expense control to be exercised.

2.5.5. PARTICIPATION IN B2B MARKETS

Cordiem

The Board of Directors of Cordiem decided that this company would cease operations from February 28, 2003. The main reason behind this decision was the failure by the shareholders, mainly U.S. shareholders, to contribute the funds required to undertake the business plan for 2003 proposed by the management team, and no other viable alternative was found.

In July 2003 Cordiem IP (Intellectual Property) was incorporated to safeguard the portal's intellectual property.

Cordiem was created in March 2001 by a group of aeronautical manufacturers (United Technologies, Honeywell and BF Goodrich) and airlines (American Airlines, Air France, British Airways, Continental, Delta, Iberia, SwissAir Group, United Airlines and UPS), together with the technology partner i2, to develop a B2B market to serve the aerospace and air transport industries.

Iberia's strategy in the B2B area will not be affected at short term by the closure of Cordiem, since the electronic trading projected under this project has been redirected to the Adqira platform.

Adqira

As scheduled, 2003 was the consolidation of this company. Although the company still reported a loss in 2003, all its aggregates improved with respect to the preceding year.

The number of suppliers attracted increased and the target set was amply surpassed, although part of the increase was due to the transfer of electronic transactions originally meant for Cordiem to Adqira. The targets relating to the number of transactions and the volume of trading were also reached with ease. Iberia, L.A.E. carried out 82 electronic transactions through Adqira in 2003, as compared with 38 in 2002. The volume of trading on Adqira amounted to €75 million and related to a broad range of products and services, such as, inter alia, building maintenance, construction work, transport and in-flight services.

B2B commerce continues to grow in Spain at a slower rate than that predicted by analysts, and the related technologies are being incorporated in the industry very slowly. From the standpoint of competition in the industry, there is a very active group of small suppliers of sourcing and trading tools and services that are competing directly with Adqira. However, its major direct competitors have either disappeared or are working on an exclusive basis of their founding shareholders, which will leave the marketplace services market in the hands of Adqira if it is able to consolidate its position as the benchmark supplier of services of this type.



2.6. CORPORATE SOCIAL RESPONSIBILITY

2.6.1. COMMUNITY WORK

Iberia, L.A.E.'s strategy as regards community work currently focuses on supporting social welfare entities by providing its normal services. Its main programs deal with disabled people access to employment, employee voluntary work, transport of passengers needing any kind of help and the granting of blocked space in the cargo holds aimed to humanitarian help.

The Company's social actions are based on three fundamental pillars: social action in conjunction with employees (Mano a Mano, APMIB); the support afforded to institutions through sponsorship agreements (such as those with the Spanish International Aid Agency, the Spanish National Transplant Organization, the Ministry of Employment and Social Affairs and Fundación Ilusiones, among others); and cooperation projects with customers (the Spanish Red Cross, the Special Olympics, etc.).

The many projects carried out in 2003 include most notably the following:

- Mano a Mano (Hand in Hand), an NGO created by Iberia employees in 1994, carries out development aid work in, among other countries, Ecuador, Peru, Equatorial Guinea, Honduras and El Salvador. During its ten years of existence, thanks to the Company's support, Mano a Mano has distributed more than 1,000 tonnes of humanitarian aid in the form of food, clothing, footwear, medicines and health supplies, learning materials and toys. In 2003 alone more than 250 tonnes of humanitarian aid were transported in aircraft holds or in crew members' luggage.

- Asociación de Empleados Padres de Minusválidos (APMIB) (Iberia Parents of Handicapped Children Employees' Association), which was created by the Company's employees in 1977, now has seven special care centers catering for more than 1,600 handicapped persons. Iberia, L.A.E. is the main customer of the Special Work Center and provides it with around 61% of its income. The production of in-flight socks; the wrapping of cutlery and condiments and gardening, printing and laundry services are examples of the work carried out for the Company.

- Fundación Tutelar APMIB (APMIB Guardian Foundation) is continuing with its work on the Imhotep project with the creation of an integral socio-employment care center for the handicapped. Its mission is to provide residential care and training to the handicapped and to promote research into disabilities.

- The Company endeavors to involve its customers in the various social welfare projects. The main activities in this area include most notably the possibility of donating the points accumulated with the Iberia Plus card to Spanish Red Cross in order to cooperate in its Family Regrouping project and the campaign to collect coins from passengers on international flights to support the Special Olympics, under which more than €40,000 were collected in 2003.

- Each year Iberia, L.A.E. enters into agreements with the Spanish Ministry of Employment and Social Affairs and the Spanish International Aid Agency whereby it offers special prices on its flights to NGOs, foundations and associations working in the aid sector in Spain and abroad.

Iberia, L.A.E. provides information on its community work through various channels, such as the Corporate Social Responsibility Yearbook, published annually; the Ronda Iberia, Iberiavión and Iberia Plus magazines and the In-Flight Video; the Internet, through the Company's website (www.iberia.com); and the Intranet, which is available to all the Company's employees.

2.6.2. ENVIRONMENTAL POLICY

In line with its environmental policy, in Iberia, L.A.E. continued to undertake various activities and projects derived from the air transport business as a whole, in order to guarantee that the main environmental impacts of this business are properly managed.

The Environmental Unit, which forms part of the corporate area, coordinates environmental programs and measures, with the support of the members of the internal environmental management group, which is made up of the environmental managers in the main business areas that have a significant environmental impact.

As regards the main measures taken, one of the key aspects for an airline's efficient environmental management is the adequate management of its aircraft, since it is its flights which have the greatest environmental impact, and the objective in this connection is to ensure the efficient operation of the aircraft from the environmental standpoint. Therefore, Iberia, L.A.E. has an ongoing fleet renewal policy based on the needs detected at any given time, in which this aspect is afforded particular attention.

In this regard, Iberia, L.A.E. continued to add A-320-type aircraft to its fleet for short- and medium-haul routes, under the fleet renewal plan initiated in the mid-nineties, which represent a reduction of up to 20% in fuel consumption, with the concomitant reduction in the volume of air emissions, with respect the aircraft of previous generations. As regards long-haul routes, in 2003 three new A-340-600 aircraft were added to Iberia, L.A.E.'s fleet and two B-747 were retired. These new aircraft comply with the noise limits envisaged in the future regulations approved by ICAO (the International Civil Aviation Organization) which will apply to aircraft manufactured from 2006 onwards.

As regards ground operations, in 2003 AENOR certified the Environmental Management System under the ISO 14001 standard, which was implemented simultaneously at the 39 Spanish airports, for the Passenger and Ramp Handling activities. In 2003 more than 45 internal and external audits were conducted to ensure that the System was working properly at all the locations. Also, 2003 saw the initiation of the process for the certification of the Environmental Management System in the aircraft maintenance area at the industrial facilities owned by Iberia in Madrid (Industrial Area II). In this area, other improvements were made such as the implementation of a water-recycling project in the engine cleaning line, and periodic exhaustive control continues to be exercised over water discharges and air emissions caused by maintenance activities.



Two of the fundamental activities for ensuring appropriate environmental management are the training of employees and making them aware of environmental issues in the performance of their work, mainly when such work can have a significant impact on the environment. In this regard, in recent years Iberia, L.A.E. has been implementing a wide-reaching training plan, for which it was awarded the Environmental Prize awarded by Expansión and Garrigues Medio Ambiente in 2003, in the "Environmental Training and Education" category.

Following current trends in the environmental accounting area, Iberia, L.A.E. made an additional effort to improve the available information and disclose it in its general asset and liability accounts, in order to progressively integrate the environmental management area into the Company's overall management.

Following is a detail of the environmental expenses incurred in 2003, broken down in accordance with the environmental accounting system that started to be implemented in 2002. The expenses incurred were higher than in 2002 due, in part, to the improvements made to internal procedures in order to define and identify the accounts deemed to be of an environmental nature.

| ENVIRONMENTAL EXPENSES 2003 | THOUSANDS OF EUROS |
|---|---------------------------|
| ENVIRONMENTAL REPAIRS, UPKEEP AND TRANSPORT | 808 |
| ENVIRONMENTAL TECHNICAL SERVICES | 309 |
| SPONSORSHIP, PUBLICATIONS AND OTHER ENVIRONMENTAL EXPENSES | 57 |
| PERSONNEL EXPENSES ASSOCIATED WITH ENVIRONMENTAL MANAGEMENT | 694 |
| ENVIRONMENTAL LEVIES | 165 |
| TOTAL | 2,033 |

Iberia, L.A.E. has published its Environmental Yearbook since 1994. In 2002 this was included in the Social Responsibility Yearbook, in order to include, in addition to environmental information, aspects of the internal and external social management and economic issues such as the creation of wealth, all of which are key to sustainable management, in line with the methodology contained in the document entitled "Sustainability Reporting Guidelines 2002" of the "Global Reporting Initiative" (GRI) organization.

3 Resources

3.1. FLEET

The detail of the passenger aircraft operated by Iberia, L.A.E. as of December 31, 2003, is as follows:

| FLEET | | | | |
|------------------|-----------|--------------------------------|--------------------------------|----------------|
| AIRCRAFT TYPE | OWNED | AIRCRAFT UNDER FINANCIAL LEASE | AIRCRAFT UNDER OPERATING LEASE | TOTAL OPERATED |
| B-747 | 4 | - | 2 | 6 |
| B-757 | 1 | - | 16 | 17 |
| A-319 | - | - | 4 | 4 |
| A-320 | 10 | 10 | 36 | 56 |
| A-321 | - | 2 | 5 | 7 |
| A-340 | - | - | 18 | 18 |
| A-340/600 | - | - | 3 | 3 |
| MD-87 | 19 | - | 5 | 24 |
| MD-88 | 13 | - | 1 | 14 |
| TOTAL (a) | 47 | 12 | 90 | 149 |

(a) Excluding grounded aircraft.

As of December 31, 2002, the Company had 146 available passenger aircraft. The following list shows the additions and retirements in 2003, explaining the net increase of three aircraft in service:

Additions

- 1 A-320 aircraft under operating lease
- 2 A-321 aircraft under operating lease
- 3 A-340/600 aircraft under operating lease
- 1 MD-88 aircraft under operating lease

Retirements

- 2 B-747 aircraft owned outright
- 2 B-757 aircraft under operating lease

Also, in 2003 Iberia, L.A.E. transferred one B-757 that had been operated under a financial lease to the fleet owned outright.

In March 2003 Iberia, L.A.E. received a new Airbus A-320 aircraft, giving it a total of 56 A-320 aircraft. These aircraft are designed to carry 150 passengers on short- and medium-haul flights. The Iberia Group also received two new Airbus A-321 planes in March and October 2003. Accordingly, it now has seven aircraft of this type, which are designed to carry 186 passengers on Spanish and European high-density traffic routes. The two types of aircraft share the same certification and are equipped with state-of-the-art technology in the aeronautical industry.

Also, in the first quarter of 2003 the Company added one MD-88 to its short-haul fleet under an operating lease.

As a result of the difficult circumstances facing the air transport industry and the objective of making capacity more flexible and adapting it to the situation in the market, in the first few months of the year it was decided to put on hold until 2004 the delivery of three new A-320-type aircraft that were scheduled for delivery in mid-2003. Subsequent events showed once again just how correct this decision had been.

On January 30, 2003, the Board of Directors of Iberia, L.A.E. authorized the purchase of new A-340/600 aircraft to replace the B-747 aircraft. The A-340/600 aircraft, which have four engines and a range of 13,900 km, is the longest A-340-type plane, since it has 350 seats, compared with the 249 on the A-340/300 aircraft, of which Iberia operates 18. The A-340/600 aircraft consume less fuel, are more efficient, have larger holds and are quieter and more comfortable than the B-747 aircraft. In addition, the new A-340/600 aircraft are equipped with state-of-the-art communications and entertainment systems for the passengers.

In June 2003 the Iberia added the first Airbus A-340/600 aircraft to its long-haul fleet, which was followed by another two in August and October. The Company has entered into agreements with International Lease Finance Corporation (ILFC) and Airbus for the addition of a further seven new A-340/600 aircraft in 2004 and 2005 and it holds purchase options on another five aircraft of the same type. When all the B-747 aircraft have been retired, Iberia, L.A.E. will be operating only one type of aircraft on long-haul routes.

The average utilization of Iberia, L.A.E.'s aircraft in 2003 in terms of block hours per aircraft per day was similar to that in 2002. The decrease in production from March with respect to the schedule initially envisaged, in order to adjust it to the demand weakness witnessed, made it impossible to achieve the planned improvement in the average utilization of the aircraft.

| | AVERAGE UTILIZATION OF THE AIRCRAFT | | BH/AIRCRAFT/DAY |
|--|-------------------------------------|-------------|-----------------|
| | 2003 | 2002 | |
| AVERAGE SHORT- AND MEDIUM-HAUL UTILIZATION | 7.90 | 7.90 | |
| AVERAGE LONG-HAUL AIRCRAFT UTILIZATION | 12.85 | 12.93 | |
| TOTAL AVERAGE AIRCRAFT UTILIZATION | 8.78 | 8.78 | |

3.2. PERSONNEL

3.2.1. HEADCOUNT

The detail of Iberia, L.A.E.'s average headcount in 2003 and 2002 is as follows:

▶ AVERAGE HEADCOUNT

| | GROUND | | FLIGHT | | TOTAL | |
|-------------------------|---------------|---------------|--------------|--------------|---------------|---------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| AIRLINE | 3,228 | 3,507 | 6,378 | 6,369 | 9,606 | 9,876 |
| CARGO | 1,079 | 1,104 | - | - | 1,079 | 1,104 |
| HANDLING | 8,523 | 7,906 | - | - | 8,523 | 7,906 |
| MAINTENANCE | 3,898 | 3,831 | - | - | 3,898 | 3,831 |
| SYSTEMS | 528 | 528 | - | - | 528 | 528 |
| CENTRAL SERVICES | 807 | 799 | - | - | 807 | 799 |
| IBERIA, L.A.E. | 18,063 | 17,675 | 6,378 | 6,369 | 24,441 | 24,044 |
| VARIATION 2003/2002 (%) | 2.2% | | 0.1% | | 1.7% | |

In 2003 the Company's average headcount increased by 1.7% to 24,441 equivalent full-time employees. The number of flight personnel remained practically unchanged with respect to the preceding year, with a slight (0.7%) drop in the number of cabin crew members and a 2.0% increase in the number of flight technicians. This increase was the result of the fleet renewal plan and the additions made to the long-haul fleet. The average ground staff headcount increased by 2.2%, mainly as a result of the 7.8% increase in the number of Iberia Handling equivalent full-time employees, due to contracts tailored to production rates as a result of the increase in the number of planes handled for third parties and to the provision of new services (mainly security). Disregarding the handling employees, the number of ground employees of the Company was 2.3% lower in 2003 than in 2002.

The Directorate-General of Employment authorized Iberia, L.A.E. to extend for two years the period in which ground employees, flight technicians and cabin crew members can voluntarily avail themselves of the Labor Force Reduction Plan. The Company, with the agreement of the labor unions, applied for this extension because of the large number of requests that it had not been possible to deal with in the initial duration of the Plan. In 2003 623 employees availed themselves of the possibilities established in the Labor Force Reduction Plan, which include early retirement, deferred outplacement, voluntary redundancy and contract novation. Since this last measure entails the reduction of the employees' working hours by 50%, the Labor Force Reduction Plan led to a decrease of 615 equivalent full-time employees.

Also, the Company continued to implement the plan to reduce the number of personnel in the commercial organization abroad, as a result of which 149 employees left the Company in 2003 who, added to the labor force reductions under the Labor Force Reduction Plan, gave rise to a total decrease of 764 employees.

3.2.2. PRODUCTIVITY

The productivity of Iberia, L.A.E.'s labor force in 2003 was almost 2.3 million ASKs per employees in 2003, a slight drop with respect to 2002. Productivity in terms of block hours per crew member fell by 0.2% in the case of pilots and increased by 3.0% in the case of cabin crew member. Excluding the handling personnel in both years, the increase in which is not linked with the air transport activity of Iberia, L.A.E. and, therefore, who do not contribute ASKs to the production figure, the productivity of ground personnel increased by 3.8%.

The variations in 2003 in the productivity of the various groups of employees were as follows.

▶▶ PRODUCTIVITY OF IBERIA, L.A.E. EMPLOYEES

| | 2003 | 2002 | % VARIATION |
|---|-------|-------|-------------|
| TOTAL LABOR FORCE (THOUSANDS OF ASKS PER EMPLOYEE) | 2,297 | 2,304 | (0.3) |
| GROUND PERSONNEL (THOUSANDS OF ASKS PER EMPLOYEE) | 3,108 | 3,135 | (0.9) |
| GROUND STAFF EXCLUDING HANDLING EMPLOYEES (THOUSANDS OF ASKS PER EMPLOYEE) | 5,885 | 5,671 | 3.8 |
| TECHNICAL CREW (BH PER CREW MEMBER) | 250.1 | 250.6 | (0.2) |
| CABIN CREW (BH PER CREW MEMBER) | 110.1 | 106.9 | 3.0 |

In December 2003 the Company entered into three important agreements with the labor unions UGT, CCOO and ASETMA in relation to the aircraft maintenance employees, which came into force on January 1, 2004. These agreements will permit greater flexibility in the use of resources and provide for the implementation of the Labor Regulations of the aircraft maintenance employees, which reduce from nine to four the labor specialties, establish measures to foster multi-tasking and increase the requirements for being able to rise to managerial posts, as well as for measures to increase flexibility and productivity.

4 Financial Performance

4.1. OPERATING INCOME

The detail of Iberia, L.A.E.'s 2003 and 2002 operating income statements for management accounting purposes, which differ from the statements of income in the annual report because the revenue and expense items are aggregated using management accounting criteria, is as follows:

| OPERATING INCOME | | MILLIONS OF EUROS | | |
|---------------------------------------|----------------|-------------------|-----------------|---------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| OPERATING REVENUES | | | | |
| PASSENGER REVENUES (a) | 3,587.5 | 3,743.3 | (155.8) | (4.2) |
| CARGO REVENUES | 232.0 | 237.4 | (5.4) | (2.3) |
| HANDLING REVENUES | 271.1 | 233.9 | 37.2 | 15.9 |
| MAINTENANCE REVENUES | 104.0 | 91.3 | 12.7 | 13.9 |
| SALES COMMISSIONS | 121.0 | 108.5 | 12.5 | 11.5 |
| CATERING SALES | 12.3 | 15.1 | (2.8) | (18.5) |
| OTHER OPERATING REVENUES (a) | 222.9 | 203.6 | 19.3 | 9.5 |
| | 4,550.8 | 4,633.1 | (82.3) | (1.8) |
| OPERATING EXPENSES | | | | |
| PERSONNEL EXPENSES | 1,355.7 | 1,310.6 | 45.1 | 3.4 |
| FUEL | 556.8 | 553.2 | 3.6 | 0.7 |
| COMMISSIONS | 437.8 | 463.9 | (26.1) | (5.6) |
| AIRCRAFT LEASE EXPENSES | 373.7 | 395.8 | (22.1) | (5.6) |
| TRAFFIC SERVICES | 386.0 | 385.0 | 1.0 | 0.3 |
| AIRCRAFT MAINTENANCE | 235.5 | 239.6 | (4.1) | (1.7) |
| NAVIGATION CHARGES | 257.6 | 226.6 | 31.0 | 13.7 |
| DEPRECIATION AND AMORTIZATION EXPENSE | 173.4 | 164.1 | 9.3 | 5.7 |
| BOOKING SYSTEMS | 128.2 | 126.3 | 1.9 | 1.5 |
| IN-FLIGHT SERVICES (b) | 115.8 | 127.6 | (11.8) | (9.2) |
| INSURANCE | 50.8 | 75.8 | (25.0) | (33.0) |
| OTHER OPERATING EXPENSES (b) | 340.3 | 335.9 | 4.4 | 1.3 |
| | 4,411.6 | 4,404.4 | 7.2 | 0.2 |
| OPERATING INCOME (LOSS) | 139.2 | 228.7 | 89.5 | (39.1) |

(a) In 2003 the balance of the "Security Charge Revenues" was included under the "Passenger Revenues" caption, based on the same criterion, the amount relating to 2002 (€14.8 million) was transferred from "Other Operating Revenues" to "Passenger Revenues".

(b) Also, the catering expenses were included in the "In-Flight Services" account in 2003. In order to make the figures uniform, the amount relating to 2002 (€22.7 million), which had previously been included under the "Other Operating Expenses" caption, was transferred to "In-Flight Services".

In 2003 Iberia, L.A.E.'s operating income amounted to €139.2 million. The difficulties that the air transport industry had to negotiate, such as the weakness of the economy, the war in Iraq and the SARS virus combined to prevent the earnings from reaching the high figure of €228.7 million achieved in 2002. However, the Company's earnings with respect to the quarterly figures for the preceding year increased, and in the fourth quarter of the year the Company reported an increase of almost €10 million in its operating income.

The unit operating cost was €7.86/ASK in 2003, a decrease of 1.1% with respect to 2002. The decrease was partially offset by the 3.0% reduction in the unit operating revenue, which amounted to €8.11 per ASK.

4.1.1. OPERATING REVENUES

Iberia, L.A.E.'s operating revenues of €4,550.8 million in 2003 were 1.8% lower than in 2002. Passenger revenues, which accounted for 78.8% of the Company's total operating revenues, fell by 4.2% with respect to the preceding year. The aggregate amount of the other operating revenues, which totaled €963.3 million in 2003, up €73.5 million (8.3%) on 2002, partially offset the decrease in passenger revenues.

PASSENGER REVENUES

Passenger revenues amounted to €3,587.5 million in 2003. The difference between this figure and that shown in the "Main Aggregates" and "Traffic Revenues" (section 2.1.2.) tables is due to the fact that the latter relates directly to the actual production for each year and does not reflect accounting adjustments and revaluations or the revenues derived from the unused ticket recovery process, which are included in the operating income statement.

The detail of the €155.8 million drop in passenger revenues in 2003 is as follows:

| PASSENGER REVENUES | | | | | | MILLIONS OF EUROS |
|-----------------------|---|-----------------------|--------------|---------------|---------------|---|
| | VARIATION IN PASSENGER REVENUES 03/02 | REASONS FOR VARIATION | | | OTHER | VARIATION IN REVENUES PER BOOKS 03/02 |
| | | PRICE | VOLUME | PARITY | | |
| DOMESTIC | (2.0) | (40.6) | 45.5 | (6.9) | - | - |
| MEDIUM-HAUL | (73.1) | (65.6) | 13.1 | (20.6) | - | - |
| LONG-HAUL | (49.5) | (37.8) | 56.2 | (67.9) | - | - |
| IBERIA, L.A.E. | (124.6) | (144.0) | 114.8 | (95.4) | (31.2) | (155.8) |

The main reason for this decrease was the 7.3% drop in the average yield, which was partially offset by the 1.9% rise in the load factor. The decrease in the average revenue was due, on the one hand, to the appreciation of the euro against other currencies, in particular the pound and, above all, the U.S. dollar, and, on the other, to the fall in prices as a result of the late recovery in demand and the increase in competition.

Long-haul revenues dropped by €49.5 million, since they were particularly badly hit by the depreciation of the U.S. dollar, the average value of which with respect to the euro decreased by almost 16% with respect to 2002. However, this factor had a net positive effect on earnings.

There was a larger drop in international medium-haul revenues (€73.1 million), as a result of the war in Iraq, the weakness of business traffic, which did not show signs of a recovery until the last quarter of the year, the appreciation of the euro against other currencies, surplus capacity and the significant growth of new operators in Europe whose only competitive argument is price.

Competition as regards prices also increased in the domestic market, which prompted Iberia, L.A.E. to introduce a new price structure for its flights from March onwards. The drop in the average yield was offset substantially in full by the increase in traffic.

"Other Passenger Revenues" (i.e. those not related to operations) amounted to €230.7 million in 2003, down €31.2 million from 2002, mainly as a result of the lower monthly unused ticket recoveries.

CARGO REVENUES

Cargo revenues amounted to €232 million in 2003. The difference between this figure and that shown in the table in section 2.1.3. is due to the fact that the latter figure includes both cargo and mail transportation revenues, but excludes revenues from excess baggage and other minor items.

Cargo revenues decreased by €5.4 million (2.3%) with respect to 2002, due mainly to the depreciation of the U.S. dollar against the euro, since approximately 25% of cargo revenues are earned in U.S. dollars.

| | VARIATION IN CARGO REVENUES 03/02 | REASONS FOR VARIATION | | | OTHER | MILLIONS OF EUROS VARIATION IN REVENUES PER BOOKS 03/02 |
|-----------------------|---|-----------------------|------------|---------------|------------|--|
| | | PRICE | VOLUME | PARITY | | |
| | | | | | | |
| IBERIA, L.A.E. | (6.9) | 0.2 | 4.0 | (11.1) | 1.5 | (5.4) |

HANDLING REVENUES

Airport handling revenues were €37.2 million (15.9%) higher in 2003 than in 2002, due to the increase in the handling services provided to other airlines, which in terms of the weighted planes handled was 8.6%, the increase in the volume of supplementary services as a result of ground security-related work, and to the rise in the average unit price of the services provided, which was partly due to the aforementioned increase in security-related work.

MAINTENANCE REVENUES

Revenues from technical assistance services provided to third parties increased by €12.7 million (13.9%) in 2003. The salient features of the year were the increase in the work performed for the Ministry of Defense and the recovery of the production for third parties of the Engine Workshop.

SALES COMMISSIONS

Sales commissions increased by €12.5 million with respect to 2002, due mainly to the increase in passenger ticket commissions as a result of the code-sharing and franchise agreements entered into by Iberia, L.A.E. with third-party airlines.

OTHER OPERATING REVENUES

Aggregate catering sales revenues and "Other Operating Revenues" totaled €235.2 million in 2003, up 7.5% on 2002. These revenues included most notably: revenues from handling and cargo services, which amounted to more than €43 million, revenues from billings for the use of the various booking systems, which amounted to over €38 million; and "Other Traffic Revenues", derived mostly from commercial agreements with other airlines, most of which belong to the oneworld alliance, amounting to over €34 million.

"Other Operating Revenues" include "Adjustment of Traffic Revenues Not Allocable to Passenger Routes" and "Other Traffic Revenues", which are included under "Passenger Revenues" in the notes to financial statements. The aggregate balances of these accounts were €28.1 million in 2003 and €32.7 million in 2002 (excluding revenues from security and safety charges).

Also, the "Other Operating Revenues" caption includes the balance of the "Adjustment of Traffic Revenues Not Allocable to Cargo Routes" account, which in the notes to financial statements are included under "Cargo Revenues" and which totaled €0.3 million in 2003 and -€3.3 million in 2002.

4.1.2. OPERATING EXPENSES

Operating expenses amounted to €4,411.6 million in 2003, only 0.2% up on 2002. The factors that led to the greatest increases in expenses in 2003 were as follows: the increase in operating costs, particularly in relation to fuel prices and navigation charges; the increase in the volume of air transport activity (of 1.3% in terms of ASKs); and the increase in the handling services provided for third parties, which made it necessary to increase the labor force at airports. The impact of these factors was offset substantially in full by various other factors: the positive effect of the depreciation of the U.S. dollar; the decrease in the commissions paid to travel agencies; the change in tourist-class in-flight services on short- and medium-haul flights; the savings achieved through the application of the labor force reduction plan and the programs included under PROICO Plan; the drop in air transport insurance premiums; and lower interest rates.

PERSONNEL EXPENSES

Personnel expenses amounted to €1,355.7 million in 2003, up 3.4% on 2002. Of this amount, €1,028.4 million related to wages, salaries and similar items and the remaining €327.3 million to social security costs, contributions to employee pension funds and other employee welfare expenses.

The application of the labor force reduction plan led to a decrease in the average salary, giving rise to a saving of approximately 5% in personnel expenses; it also made it possible to reduce the headcount in most of the areas of the Company.

However, overall the number of equivalent full-time employees of Iberia, L.A.E. increased by 1.7% with respect to 2002. On the one hand, the increase in the volume of services provided to third parties and the provision of new airport handling services, relating basically to security, made it necessary to increase the handling staff headcount by 7.8% and, on the other, the number of technical crew members rose by 2.0% as a result of the introduction of second pilots sufficiently in advance to cater for the increase in the Company's volume of business.

In addition to this increase in the number of employees, personnel expenses rose as a result of the effect of promotions and the application of the measures agreed on in the collective labor agreements, i.e. the increase in salaries of 2.6% (equal to the actual increase in the CPI in 2003), the additional payments relating to the earnings targets met in 2002 and 2003 (1.6%), and the "Profit-Sharing Due to the Improvement in Earnings in 2003" (1.7%). A portion of these significant increases relating to profit-sharing due to the improvement in earnings and the achievement of certain earnings levels have accrued since January 2004.



FUEL

The fuel expense in 2003 was €3.6 million (0.7%) higher than in 2002, which reflects the equal strengths of the various factors that influence increases and decreases in fuel prices. The detail of the variation is as follows:

| | REASONS FOR VARIATION | | | | VARIATION IN FUEL EXPENSE 03/02 |
|-----------------------|-----------------------|------------|---------------|------------|---------------------------------|
| | PRICE | VOLUME | PARITY | EFFICIENCY | |
| | MILLIONS OF EUROS | | | | |
| IBERIA, L.A.E. | 81.3 | 9.5 | (92.0) | 4.8 | 3.6 |

Excluding the effect of the increase in activity, fuel costs actually fell slightly in 2003. The unit cost per ASK was €c0.99 in 2003, a drop of 0.7% with respect to 2002.

As a result of historically low fuel stocks, the instability in Venezuela and, above all, the pre-war tensions, the international market price of a barrel of Brent crude increased sharply between November 2002 and March 2003 to stand at over US\$ 34. After the Iraq war, the U.S. dollar price of a barrel of crude oil was highly volatile and remained at high levels until the end of the year. Through active fuel risk management policies, Iberia, L.A.E. managed to confine the rise in the average annual price to around 15% with respect to the already high price registered in 2002. However, this price increase was offset in full by the depreciation of the U.S. dollar against the euro.

COMMERCIAL EXPENSES

Commercial expenses amounted to €437.8 million in 2003, down 5.6% from 2002.

Almost 90% of the total commercial expenses in 2003 related to commissions, sales bonuses and other development and promotion expenses. The aggregate cost of these items was €38 million (8.8%) lower in 2003 than in 2002. This drop was due to the 4.1% decrease in passenger and cargo revenues and to the savings achieved as a result of the various commercial measures adopted, namely, the application throughout 2003 of the agreement relating to the remuneration of Spanish travel agencies, which came into force in June 2002; the reduction in commercial costs abroad, with specific actions in each country, which in general terms reduced the basic commission and optimized the incentive system; and, in addition, the extension of the system of fares net of commissions and the increased use of new direct selling systems, such as Iberia.com and Serviberia.

Advertising and promotion expenses amounted to €44.2 million in 2003, almost €12.0 million higher than the expenses incurred in 2002, due in part to the fact that in 2002 these expenses had been particularly low as a result of the sharp cutback in expenditure due to the introduction of the Anticrisis Plan and, above all, to the launch of the advertising campaign aimed at publicizing the new Iberia service model.

Net commercial costs (commercial expenses net of commercial revenues) fell by 10.8% in 2003. Net commercial costs as a percentage of traffic revenues continued to improve and stood at 8.3% in 2003, down 0.6 percentage points from 2002.

AIRCRAFT LEASE EXPENSES

Aircraft lease expenses amounted to €373.7 million in 2003, down €22.1 million (5.6%) from 2002. Most of this amount (€353.2 million) related to the lease of passenger aircraft, the cost of which decreased by 5.5%, despite the lease of new aircraft, due to the appreciation of the euro and, above all, to the fall in interest rates.

The expense relating to cargo aircraft lease contracts totaled €16.0 million in 2003, a reduction of €1.2 million with respect to the previous year, whereas the cost of leasing cargo holds fell by €0.3 million to €4.6 million for 2003 as a whole. The expense incurred in the lease of cargo holds is recorded under the "Other Rent" caption in the notes to financial statements.

TRAFFIC SERVICE COSTS

Traffic service costs totaled €386 million in 2003, practically unchanged (an increase of only 0.3%) with respect to 2002.

The cost of the items included under this caption relates to the variation in air transport activity, which increased by 1.3% in terms of ASKs and by 2.9% in terms of the number of take-offs. The cost incurred in relation to landing charges, which increased by 2% in Spain, rose by 3.9% with respect to 2002 to stand at €117.5 million in 2003. The 4.3% increase in aircraft dispatching costs to €85.6 million in 2003 was due in part to the impact of the sharp increases in AENA's H1 and H2 tariffs.

In contrast, expenses derived from incidents such as lost luggage, interrupted journeys and lost connections decreased in 2003 by €6.6 million (almost 34% with respect to 2002), thanks to improved service quality. Also, the flight personnel accommodation cost fell by 5.7% as a result of the negotiation of new contracts and of the ongoing improvement of crew scheduling.

AIRCRAFT MAINTENANCE

Aircraft maintenance expenses, which include the cost of aircraft spare parts used, maintenance outsourcing costs and the provision recorded for major repairs, amounted to €235.5 million in 2003, a decrease of 1.7% with respect to 2002.



The spare parts used amounted to €130.8 million in 2003, down 8.5% as a result of the depreciation of the U.S. dollar and the greater uniformity of the aircraft. The outside upkeep and repair services of €67.8 million in 2003 were 16.1% higher than in 2002, due mainly to the increase in the volume of work performed for third parties and to the total outsourcing of work on the A-340/600 aircraft engines. The provisions recorded for major aircraft repairs amounted to €36.9 million in 2003, a decrease of 3.6% with respect to the preceding year.

Discounting the revenues from technical assistance from the aggregate amount of the annual maintenance expenses, the net maintenance expense amounted to €131.5 million in 2003, down 11.3% from the figure for 2002, in line with the targets established in the Master Plan for 2003.

The unit cost of the aforementioned aircraft maintenance work fell by 3.0% from the previous year to €c0.42 per ASK.

The balance of the aircraft spare parts used in 2003 included in the management statement of income is €5.1 million lower than the expense included in the statutory financial statements as a result of the use of allowances for obsolescence.

NAVIGATION CHARGES

There was an increase in air traffic control expenses (such as in-flight navigation assistance and airport approach expenses) of €31.0 million (13.7%) in 2003 with respect to 2002.

Navigation charges increased by €25.5 million (14.1%) in 2003, due mainly to the significant increases in the prices charged by Eurocontrol. This agency, which operates in 30 countries, increased its reference unit prices for the Spain-Continental and Spain-Canary Islands flight regions by around 17% in January 2003, which must be added to the increase of approximately 25.5% in April 2002. The price hikes in the other European flight regions were lower.

In 2003 approach charges rose by €5.5 million (12%) with respect to 2002, and the increase in these charges at Spanish airports was 4%.

DEPRECIATION AND AMORTIZATION EXPENSE

The depreciation and amortization expense for 2003 amounted to €173.4 million, up €9.3 million on 2002. The highest increases related to aircraft, engines and computer hardware and software.

BOOKING SYSTEM AND IN-FLIGHT SERVICE COSTS

In contrast with the increase of 3.8% in bookings and the rise of around 2.9% in the prices for the various computer reservation systems (CRSs), the annual booking system expense increased by only €1.9 million (1.5%) with respect to 2002. This was made possible by the improvement in the expense audit, control and management procedures and tools, by the increase in the market share of bookings of Amadeus to the detriment of Galileo and Sabre and by the depreciation of the U.S. dollar against the euro. Therefore, in 2003 the average cost per booking billed fell by 2.3% with respect to 2002.

IN-FLIGHT SERVICES

The in-flight service expense amounted to decreased by €11.8 million (9.2%) with respect to 2002. The decrease in the average cost per passenger was even greater (12.6%), and was achieved as a result of the adoption of various incentives aimed at simplifying the service provided in tourist class on short- and medium-haul routes.

INSURANCE AND OTHER OPERATING EXPENSES

Following the terrorist attacks of September 11, 2001, aircraft and passenger insurance costs soared. In 2003 the aviation market revised its charges downward, helped by a moderate level of claims. In this context, Iberia, L.A.E.'s insurance expense for 2003 was 33% lower than in 2002.

The aggregate balance of the "Other Operating Expenses" caption increased by €4.4 million (1.3%) in 2003. This caption includes numerous items of a very diverse nature, including rent, utilities, repair and upkeep services, communications, security and surveillance services, computer software, severance costs, travel expenses and ancillary services.

4.2. FINANCIAL AND EXTRAORDINARY RESULTS

Iberia, L.A.E. reported income before taxes of €148.8 million in 2003, representing a decrease of €20 million from 2002. Both financial and extraordinary results improved with respect to the preceding year, as shown in the following table:

| FINANCIAL AND EXTRAORDINARY RESULTS | | MILLIONS OF EUROS | | | |
|--|--------------|-------------------|-----------------|---------------|--|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| OPERATING INCOME | 139.2 | 228.7 | (89.5) | (39.1) | |
| FINANCIAL REVENUES | 64.0 | 64.1 | (0.1) | (0.2) | |
| FINANCIAL EXPENSES | 50.2 | 38.9 | 11.3 | 29.0 | |
| EXCHANGE LOSSES | (6.7) | (33.4) | 26.7 | 79.9 | |
| FINANCIAL INCOME (LOSS) | 7.1 | (8.2) | 15.3 | 186.6 | |
| EXTRAORDINARY REVENUES | 85.2 | 65.7 | 19.5 | 29.7 | |
| EXTRAORDINARY EXPENSES | 82.7 | 117.4 | (34.7) | (29.6) | |
| EXTRAORDINARY INCOME (LOSS) | 2.5 | (51.7) | 54.2 | 104.8 | |
| NET INCOME BEFORE TAXES | 148.8 | 168.8 | (20.0) | (11.8) | |
| TAXES | (43.0) | (25.6) | (17.4) | 68.0 | |
| INCOME AFTER TAXES | 105.8 | 143.2 | (37.4) | (26.1) | |

Overall, the financial revenues remained stable with respect to the preceding year. The figure for 2003 includes the gross capital gain of €11.5 million obtained on the sale of the Mundicolor brand name and the shareholding in the tour operator Tiempo Libre. This gain offset the decrease in the other financial revenues with respect to 2002 triggered mainly by the fall in interest rates.

In 2003 the financial revenues include €16.2 million relating to the increase in the investment valuation allowances, due mainly to the provisions recorded to cover the full amount of Iberia, L.A.E.'s holdings in Opodo and Cordiem. The decrease in the financial expenses incurred on the debt in the balance sheet partially offset the effect of these provisions.

The net effect of exchange differences improved by €26.7 million with respect to 2002. It should be noted that the devaluation of the Argentine peso and the situation in Argentina (the so-called "corralito" effect) had a negative impact of approximately €16 million on the results for 2002.

The extraordinary income of €2.5 million reported in 2003 contrasted with the extraordinary loss of €51.7 million incurred in 2002, when provisions were recorded to reduce the carrying value of the aircraft in the process of being retired, which gave rise to an additional expense of €60 million.

The extraordinary revenues recorded in 2003, include most notably, in addition to the recovery of various unused provisions, those arising from the sale of inactive aircraft (DC-9, B-727, DC-10 and A-300 engines), which amounted to €12.1 million, the sale of premises in Barcelona and Rome, which gave rise to revenues of €9.3 million, and the gains of €8.3 million obtained on transactions involving treasury stock. The extraordinary expenses included a provision of €25.0 million aimed mainly at topping up the funds available for the labor force reduction plan and for the extension and renewal of the plan in 2003, together with other expenses and depreciation and amortization charges relating to the fleet renewal plan.

Iberia, L.A.E. posted net income after taxes of €105.8 million in 2003.

4.3. INVESTMENTS

In 2003 the expenditure (net of divestments) on property, plant and equipment and intangible assets had a negative balance of approximately €112 million. The investments made in the year included most notably the purchases of rotatable and repairable parts; various changes made to the MD-87/88, B-747, B-757, A-320, A-321 and A-340 aircraft; and the purchase of computer hardware and the development of software. The divestments related to the retirement of 17 DC-9, 4 B-727, 6 DC-10 and 1 B-747 aircraft as a result of their sale, scrapping and donation. Also, two A-321 and one A-320 aircraft were sold and subsequently leased back, and certain rotatable and repairable parts were retired from the accounts.

In order to adapt the accounts to International Accounting Standards, in 2003 the advances relating to the new A-319, A-320, A-321, A-340 aircraft and engines were transferred from "Construction in Progress" to "Long-Term Investments". Thus, the balance of the "Long-Term Investments - Long-Term Deposits and Guarantees Given" caption at 2003 year-end included €307.4 million relating to advances on aircraft.

In 2003 the net additions to long-term investments exceeded €277 million. In addition to the aforementioned increase in long-term deposits as a result of aircraft purchases, another noteworthy addition to this caption related to a restricted deposit of €27.5 million paid in connection with the Iberia, L.A.E. stock option plan for executives, directors and other management personnel, instrumented through the issue of debentures convertible into Company shares.

4.4. BALANCE SHEET

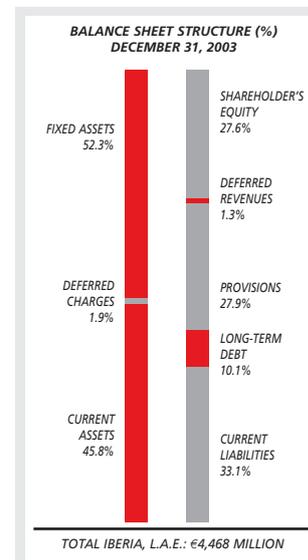
As of December 31, 2003, Iberia, L.A.E.'s shareholders' equity amounted to €1,235.1 million, an increase of €77.4 million with respect to 2002 year-end, as a result of the increase in reserves. In 2003 the Company paid a dividend of €0.04 gross per share out of 2002 income, signifying that a total amount of €35,6 million was allocated to shareholder remuneration.

The balance of the provisions for contingencies and expenses amounted to €1,247.5 million at 2003 year-end. This figure includes: €104.9 million of provisions for major aircraft repairs; €523.9 million of provisions for pensions and other obligations to employees; and €618.7 million of provisions for third-party liability. The aggregate balance dropped by €12.5 million in 2003, as a result of the use or release of provisions amounting to €163.8 million and the recording of new provisions totaling €151.3 million, of which €54.7 million relate to provisions for and transfers to provisions for pensions and other obligations to employees.

The balance of the "Long-Term Debt" caption decreased by €60.4 million in 2003, due mainly to the reduction in payables to credit institutions. However, the balance of the "Current Liabilities" caption increased by €21.7 million due to the increase in trade accounts payable.

Current assets increased by €133.8 with respect to 2002 year-end, due principally to the Company's higher volume of short-term investments and cash.

The net debt of Iberia, L.A.E. decreased significantly from -€710.2 million as of 2002 year-end to -€925.6 million as of December 31, 2003. In both years the short-term financial receivables exceeded the accounts payable to credit institutions (excluding the interest on financial lease transactions).



4.5. NON OPERATING RISK MANAGEMENT

Iberia, L.A.E. has in place a global nonoperating risk management program aimed at controlling and reducing the possible impact of exchange rate, interest rate and fuel price fluctuations on the Company's earnings.

For this purpose, Iberia, L.A.E. uses a VAR (Value at Risk) model in order to assess probabilistically the possible impact of these market variables on its earnings, and it defines the maximum volatility targets and the hedging program required to achieve them.

Hedging program

l) Exchange rate risk

In view of the nature of its business activities, Iberia, L.A.E. is exposed to exchange risk, at both operating (flows) and balance-sheet level.

Flows

The Company has a short U.S. dollar position of approximately US\$ 550 million, since the revenues in U.S. dollars (18% of the total) are lower than the expenses in U.S. dollars (30% of the total).

In accordance with the hedging program, this position is hedged as follows:

- 50% with strategic hedges with a term of up to five years, in the form of swaps on aircraft lease payments to other currencies, mainly the euro and the Swiss franc, and option structures with terms and amounts associated with the income flows hedged.

- The remaining 50% is managed through tactical transactions with a time horizon of one year or less, which can be adapted to market trends and which are also associated with the Company's actual flows of U.S. dollar payments.

As of December 31, 2003, Iberia, L.A.E. had hedged 49% of its U.S. dollar flow position for 2004.

Balance sheet

The Company has assets denominated in U.S. dollars amounting to US\$ 548 million relating to the loans granted to the Iberbus companies and the advances paid to aircraft and engine suppliers. This position is practically neutralized through swaps or U.S. dollar financing in order to avoid translation differences and, accordingly, the end result was close to zero. The residual impact relates to the increase in value of working capital items and to the the industry's practice of recording IATA changes on a monthly basis, the balancing item for which is recorded in revenue and expense accounts for the preceding or subsequent months.

Aircraft additions

In order to mitigate the volatility of currency markets and the impact thereof on the financing and acquisition of new aircraft, the Company sometimes hedges the exchange risk relating to aircraft financing/additions through forward purchase transactions and option structures that make it possible to assure a given level or range.

II) Interest rate risk

Although Iberia, L.A.E. has a negative net debt in its balance sheet, if the Spanish debt relating to operating lease payments (multiplying by eight the aircraft lease payments and making the related adjustments) is included, the adjusted total net debt amounts to €1,856 million. As of December 31, 2003, 78% of this amount bore fixed-rate interest, 19% floating-rate interest and 3% floating-rate interest with a cap. In the future the Company expects to maintain at least 75% of this debt at a fixed or protected interest rate in order to avoid the adverse impact of interest rate rises.

In 2003, taking advantage of the low interest rates, the Company increased the volume of its hedged fixed-rate net debt from 60% at 2002 year-end to 78% as of December 31, 2003. The sensitivity to a 1% increase in interest rates is €3.8 million.

Liquidity risk

The Company has a policy of maintaining a cash position approximately equal to three months' revenues. As of December 31, 2003, this position amounted to €1,362 million (cash plus short-term investments), and this amount has been invested in highly liquid short-term instruments, debt repos, eurodeposits, commercial paper and securitization transactions with leading financial institutions, in accordance with the counterparty risk policy in force. All the investments mature within one year and have an average maturity of six months.

In addition to its short-term investments and cash position, Iberia, L.A.E. has credit facilities totaling €242 million to guarantee its liquidity needs.

III) Fuel price risk

Iberia, L.A.E. controls aircraft fuel costs through active risk management policies. These policies involve fuel price hedging transactions which mitigate the effect of fluctuations in international kerosene market prices and serve to limit variances in this connection with respect to the Company's budget.

Iberia, L.A.E.'s current fleet of aircraft consume around 2 million metric tonnes of fuel per year, which, based on the average prices for 2003, entails a cost of approximately €560 million. This expense is directly tied to fluctuations in oil prices, which in recent years has given rise to high monthly averages within a fluctuation range of US\$ 18 -US\$ 32 per barrel.



To date the Company has directly hedged the price of kerosene using a combination of financial tools, such as, inter alia, swaps and options and caps and collars.

The main features of the Company's hedging policy are based, on the one hand, on a strategic hedging program. Through long-term contracts, Iberia, L.A.E. can hedge up to 50% of the volume of fuel that it expects to consume over a three-year period and, on the other, on a tactical hedging plan, established on an annual basis and aimed at hedging an additional 25%-30% of the volume of fuel consumed. In 2003 the fuel price hedging transactions covered around 80% of the volume of kerosene used in the first half of the year and of approximately 70% of that used in the second half of the year, in bands of between US\$ 23 and US\$ 26 per barrel.

4.6. OUTLOOK

Passenger and cargo air traffic experienced a clear recovery in practically all markets from the autumn of 2003. IATA's latest projections for 2004 predict growth of 7.5% in world international air traffic.

Expectations also point towards an across-the-board improvement in the world economies. Analysts expect Spain's GDP to grow by 2.9% in 2004; that of the euro-zone countries by 1.7% and that of Latin America to increase by over 4% in 2003. If these predictions are borne out and there are no exceptional events, traffic in these areas should be in line with the good performance seen in recent months, with particularly significant growth on South Atlantic routes.

Iberia, L.A.E. predicts an increase in its production of around 8% for 2004, in order to meet the foreseeable increase in demand. Most of this growth is fruit of the increase in capacity in the latter part of 2003. The increase in capacity will be greater on international routes (above 10%) than on domestic routes (estimated at around 3%). Based on the good market prospects, the Company expects to maintain the high load factors that it achieved in 2003.

In addition, the implementation of Iberia, L.A.E.'s fleet renewal plan will enable it to grow with flexibility and will provide it with the resources required to take advantage of the significant increase in the capacity of Madrid and Barcelona airports. Per AENA projections, the two new runways at Madrid-Barajas airport will be operational from the summer of 2004 onwards.

Based on the strategies established in the 2003/05 Master Plan, the Iberia Group will continue to adopt measures to enable it to reduce costs and adapt to demand preferences, with a view to strengthening its position vis-à-vis the growing competition from low-cost operators. As a result of this competition, prices will foreseeably continue to drop in 2004, above all in Europe, albeit to a lesser extent than in 2003.

The collective labor agreements for Iberia, L.A.E. employees expire at the end of 2004 and negotiations will be held during the year to renew them.

5 Iberia Shares

5.1. SHARE PERFORMANCE

| SHARE PERFORMANCE | EUROS |
|--|-----------|
| MARKET PRICE ON DECEMBER 30, 2003 | 2.28 |
| MARKET PRICE ON DECEMBER 30, 2002 | 1.40 |
| AVERAGE ANNUAL MARKET PRICE | 1.72 |
| HIGH | 2.32 |
| LOW | 1.13 |
| AVERAGE DAILY TRADING VOLUME (NO. OF SHARES) | 4,180,945 |

The market price of the Iberia L.A.E. shares rose by 62.9% in 2003, following the 27% rise in 2002. The market price of the shares was affected in the first half of the year by the war in Iraq and the outbreak of the SARS virus in South-East Asia, as a result of which the market price of airlines' shares fared relatively badly with respect to the related reference indexes. The end of the war and of the SARS virus led to a gradual increase in the volume of traffic, which had a positive impact on the share price of companies in the air transport industry.

In 2003 Iberia, L.A.E. was successfully tailored its capacity to the prevailing market conditions and, therefore, its traffic and earnings figures were higher than those of its competitors. As a result, analysts identified the Iberia, L.A.E. shares as among their most favored shares, which gave rise to a continuous rise in the share price.

At the beginning of the year the value of Iberia on the stock market was €1,278 million, whereas at the end of 2003 its stock market capitalization was €2,095 million. At the beginning of November, as a result of the stock option plan for employees, 6,054,859 new shares were admitted to listing.



5.2. TREASURY STOCK

On June 26, 2003, the Board of Directors of Iberia, L.A.E. decided to limit the number of shares of treasury stock that can be held to 3% of total capital stock, which is below the limit of 5% established by the Shareholders' Meeting on June 12, 2003.

As of December 31, 2003, the Parent Company held 14,851,798 shares of treasury stock, representing 1.616% of its capital stock, with an overall par value of €11,584.4 thousand and an average acquisition cost of €1.351/share.

Iberia L.A.E. recorded the mandatory reserve for treasury stock in its balance sheet as of December 31, 2002.



Governing Bodies



BOARD OF DIRECTORS OF IBERIA, L.A.E. AS OF DECEMBER 31, 2003

CHAIRMAN & CHIEF EXECUTIVE OFFICER

Mr. FERNANDO CONTE GARCÍA

VICE-PRESIDENT

Mr. MIGUEL BLESA DE LA PARRA

CHIEF OPERATING OFFICER

Mr. ÁNGEL MULLOR PARRONDO

MEMBERS

Mr. JOSÉ MANUEL FERNÁNDEZ NORNIELLA

LORD GAREL -JONES

Mr. PABLO ISLA ÁLVAREZ DE TEJERA

D. ANTONIO MASA GODOY

MR. ROGER PAUL MAYNARD

Mr. JOSÉ PEDRO PÉREZ-LLORCA RODRIGO

D. JORGE PONT SÁNCHEZ

D. JOSÉ B. TERCEIRO LOMBA

Mr. GREGORIO VILLALABEITIA GALARRAGA

SECRETARY

Mrs. LOURDES MÁIZ CARRO

COMMITTEES OF THE BOARD AS OF DECEMBER 31, 2003

EXECUTIVE COMMITTEE

Mr. FERNANDO CONTE GARCÍA (CHAIRMAN)

Mr. MIGUEL BLESA DE LA PARRA

Mr. ROGER PAUL MAYNARD

Mr. ÁNGEL MULLOR PARRONDO

Mr. JOSÉ B. TERCEIRO LOMBA

Mr. GREGORIO VILLALABEITIA GALARRAGA

Mrs. LOURDES MÁIZ CARRO (SECRETARY)

APPOINTMENTS AND REMUNERATION COMMITTEE

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Mr. JOSÉ MANUEL FERNÁNDEZ NORNIELLA

Mr. ANTONIO MASA GODOY

Mr. JORGE PONT SÁNCHEZ

Mrs. LOURDES MÁIZ CARRO (SECRETARY)

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LORD GAREL-JONES

Mr. JOSÉ PEDRO PÉREZ-LLORCA RODRIGO

Mr. GREGORIO VILLALABEITIA GALARRAGA

Mrs. LOURDES MÁIZ CARRO (SECRETARY)

SAFETY COMMITTEE

Mr. JOSÉ PEDRO PÉREZ-LLORCA RODRIGO (CHAIRMAN)

Mr. ROGER PAUL MAYNARD

Mr. ÁNGEL MULLOR PARRONDO

Mr. JORGE PONT SÁNCHEZ

Mrs. LOURDES MÁIZ CARRO (SECRETARY)

MANAGEMENT BOARD

MEMBERS

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CHAIRMAN & CHIEF EXECUTIVE OFFICER

Mr. ÁNGEL MULLOR PARRONDO
CHIEF OPERATING OFFICER

Mr. ENRIQUE DONAIRE RODRÍGUEZ
GENERAL DIRECTOR OF THE AIRLINE

Mr. LUIS DÍAZ GÜELL
CORPORATE COMMUNICATIONS MANAGER

Mr. ENRIQUE DUPUY DE LÔME CHÁVARRI
FINANCIAL MANAGER

Mr. JOSÉ MARÍA FARIZA BATANERO
CONTROL AND ADMINISTRATION MANAGER

Mr. JUAN LOSA MONTAÑÉS
IMPROVEMENT, INVESTMENT AND COST REDUCTION PROJECT MANAGER

Mrs. LOURDES MÁIZ CARRO
LEGAL AFFAIRS MANAGER AND BOARD SECRETARY

Mrs. ELVIRA HERRERO MATEO
INTERNATIONAL RELATIONS MANAGER

Mr. SERGIO TURRIÓN BARBADO
HUMAN RESOURCES MANAGER

Mr. JUAN BUJÍA LORENZO
FLIGHT CREW MANAGER

Mr. FÉLIX GARCÍA VIEJOBUENO
CUSTOMER RELATIONSHIP MANAGER

Mr. MANUEL LÓPEZ COLMENAREJO
COMMERCIAL MANAGER

Mr. ENRIQUE PÉREZ DE VILLAAMIL
OPERATIONS MANAGER

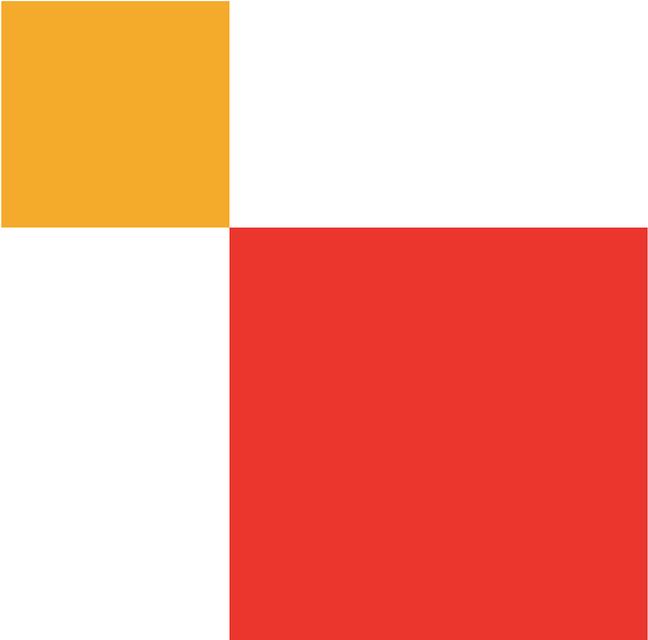
Mr. JAVIER ÁLVAREZ GONZÁLEZ
MAINTENANCE AND ENGINEERING MANAGER

Mr. ANTONIO BUGALLO SIEGEL
INFORMATION TECHNOLOGY MANAGER

Mr. ALFONSO FUERTES SUÁREZ
CARGO MANAGER

Mr. FERNANDO SARMENTERO VIDAL
AIRPORTS MANAGER

Mr. MARTÍN CUESTA VIVAR
TECHNICAL SECRETARY GENERAL



Legal Information



Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain. In the event of a discrepancy, the Spanish-language version prevails.

AUDITORS' REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders of
Iberia, Líneas Aéreas de España, S.A.

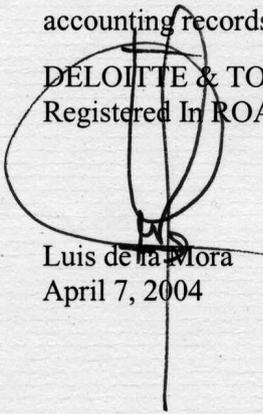
We have audited the consolidated financial statements of IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A. and SUBSIDIARIES comprising the consolidated balance sheet as of December 31, 2003, and the related consolidated statement of income and notes to consolidated financial statements for the year then ended. The preparation of these consolidated financial statements is the responsibility of the Parent Company's directors. Our responsibility is to express an opinion on the consolidated financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the consolidated financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made.

For comparison purposes the Parent Company's directors present, in addition to the 2003 figures for each item in the consolidated balance sheet and consolidated statement of income, the figures for 2002. Our opinion refers only to the 2003 consolidated financial statements. Our auditors' report dated April 7, 2003, on the 2002 consolidated financial statements contained an unqualified opinion.

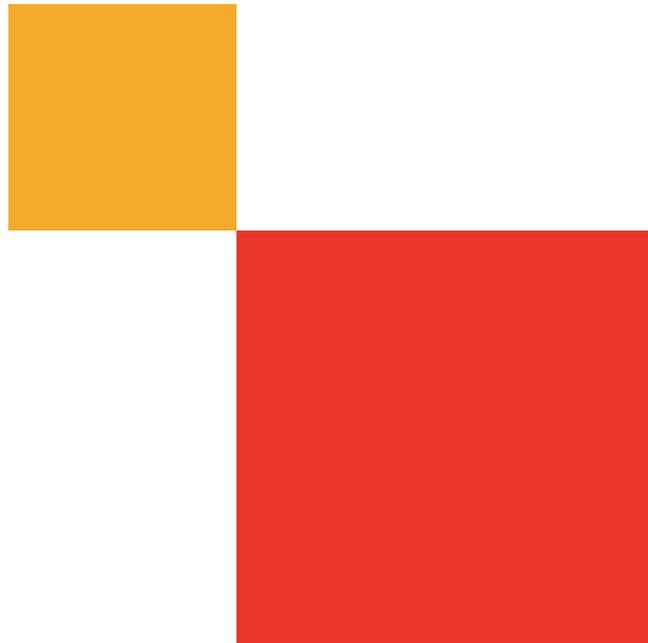
In our opinion, the 2003 consolidated financial statements referred to above present, in all material respects, a true and fair view of the net worth and financial position of Iberia, Líneas Aéreas de España, S.A. and Subsidiaries as of December 31, 2003, and of the results of their operations in the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with generally accepted accounting principles and standards applied on a basis consistent with that of the preceding year.

The accompanying consolidated management report for 2003 contains the explanations which the directors consider appropriate about the Group's situation, the evolution of its business and other matters, but is not an integral part of the consolidated financial statements. We have checked that the accounting information in the consolidated management report is consistent with that contained in the consolidated financial statements for 2003. Our work as auditors was confined to checking the consolidated management report with the aforementioned scope, and did not include a review of any information other than that drawn from the companies' accounting records.

DELOITTE & TOUCHE ESPAÑA, S.L.
Registered In ROAC under no. S0692



Luis de la Hoya
April 7, 2004



Consolidated Financial Statements



Consolidated Balance Sheets as of December 31, 2003 and 2002. (Thousands of Euros).

The accompanying Notes 1 to 25 are an integral part of the consolidated balance sheet as of December 31, 2003.

| ASSETS | THOUSANDS OF EUROS | |
|---|--------------------|------------------|
| | 2003 | 2002 |
| FIXED AND OTHER NONCURRENT ASSETS: | | |
| START-UP EXPENSES (NOTE 6-b) | 98 | 303 |
| INTANGIBLE ASSETS (NOTE 7) | 430,422 | 465,281 |
| PROPERTY, PLANT AND EQUIPMENT (NOTE 8) | 931,763 | 1,168,015 |
| AIRCRAFT: | | |
| COST | 1,532,068 | 1,972,126 |
| ACCUMULATED DEPRECIATION AND ALLOWANCES | (992,699) | (1,196,616) |
| | 539,369 | 775,510 |
| OTHER TANGIBLE FIXED ASSETS: | | |
| COST | 1,075,487 | 1,058,651 |
| ACCUMULATED DEPRECIATION AND ALLOWANCES | (683,093) | (666,146) |
| | 392,394 | 392,505 |
| LONG-TERM INVESTMENTS (NOTE 9) | 763,238 | 474,999 |
| INVESTMENTS IN COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | 142,729 | 114,289 |
| LONG-TERM INVESTMENT SECURITIES | 203,703 | 207,045 |
| OTHER LOANS | 194,220 | 226,508 |
| LONG-TERM DEPOSITS AND GUARANTEES GIVEN | 398,174 | 86,578 |
| ALLOWANCES | (175,588) | (159,421) |
| LONG-TERM RECEIVABLES (NOTE 19) | 303,703 | 351,731 |
| TOTAL FIXED AND OTHER NONCURRENT ASSETS | 2,429,224 | 2,460,329 |
| CONSOLIDATION GOODWILL (NOTE 6-a) | 98,098 | 104,711 |
| DEFERRED CHARGES (NOTE 7) | 85,347 | 122,229 |
| CURRENT ASSETS: | | |
| SHARES OF THE PARENT COMPANY (NOTE 10) | 20,066 | 31,896 |
| INVENTORIES (NOTE 11) | 77,055 | 89,964 |
| ACCOUNTS RECEIVABLE | 582,153 | 587,622 |
| SHORT-TERM INVESTMENTS (NOTE 12) | 1,358,027 | 1,204,683 |
| CASH | 18,086 | 11,957 |
| ACCRUAL ACCOUNTS | 31,205 | 36,089 |
| TOTAL CURRENT ASSETS | 2,086,592 | 1,962,211 |
| TOTAL ASSETS | 4,699,261 | 4,649,480 |

SHAREHOLDERS' EQUITY AND LIABILITIES

THOUSANDS OF EUROS

| | 2003 | 2002 |
|---|------------------|------------------|
| SHAREHOLDERS' EQUITY (NOTE 13): | | |
| CAPITAL STOCK | 716,833 | 712,110 |
| ADDITIONAL PAID-IN CAPITAL | 98,937 | 96,454 |
| DIFFERENCES DUE TO THE ADJUSTMENT OF CAPITAL STOCK TO EUROS | 1,201 | 1,201 |
| RESERVES OF THE PARENT COMPANY | 312,358 | 204,778 |
| LEGAL RESERVE | 75,671 | 61,352 |
| MERGER RESERVE | 165 | 165 |
| REVALUATION RESERVE | 38 | 38 |
| RESERVE FOR TREASURY STOCK | 20,066 | 31,896 |
| VOLUNTARY RESERVES | 216,418 | 111,327 |
| RESERVES AT FULLY CONSOLIDATED COMPANIES | 76,235 | 75,721 |
| RESERVES AT COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | 83,894 | 70,476 |
| TRANSLATION DIFFERENCES | (284) | (123) |
| INCOME ATTRIBUTABLE TO THE PARENT COMPANY (NOTE 21) | 143,586 | 157,120 |
| CONSOLIDATED INCOME FOR THE YEAR | 145,852 | 159,825 |
| INCOME ATTRIBUTED TO MINORITY INTERESTS (NOTES 14 AND 21) | (2,266) | (2,705) |
| TOTAL SHAREHOLDERS' EQUITY | 1,432,760 | 1,317,737 |
| MINORITY INTERESTS (NOTE 14) | 9,204 | 9,242 |
| NEGATIVE CONSOLIDATION DIFFERENCE | 1,494 | 1,494 |
| DEFERRED REVENUES (NOTE 6-i) | 56,805 | 70,475 |
| PROVISIONS FOR CONTINGENCIES AND EXPENSES (NOTE 15) | 1,250,042 | 1,261,455 |
| LONG-TERM DEBT: | | |
| CONVERTIBLE DEBENTURES (NOTE 17) | 27,532 | 22,573 |
| PAYABLE TO CREDIT INSTITUTIONS (NOTE 16) | 419,375 | 480,105 |
| OTHER PAYABLES (NOTE 19) | 20,447 | 23,297 |
| TOTAL LONG-TERM DEBT | 467,354 | 525,975 |
| CURRENT LIABILITIES: | | |
| CONVERTIBLE DEBENTURES (NOTE 17) | 22,573 | 7,524 |
| PAYABLE TO CREDIT INSTITUTIONS (NOTE 16) | 46,930 | 102,011 |
| CUSTOMER ADVANCES (NOTE 6-i) | 413,854 | 423,845 |
| ACCOUNTS PAYABLE FOR PURCHASES AND SERVICES | 689,341 | 616,218 |
| OTHER NONTRADE PAYABLES (NOTE 19) | 157,479 | 148,817 |
| COMPENSATION PAYABLE | 150,982 | 163,970 |
| ACCRUAL ACCOUNTS | 443 | 717 |
| TOTAL CURRENT LIABILITIES | 1,481,602 | 1,463,102 |
| TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES | 4,699,261 | 4,649,480 |

Consolidated Statements of Income for 2003 and 2002. (Thousands of Euros).

The accompanying Notes 1 to 25 are an integral part of the consolidated statement of income for 2003.

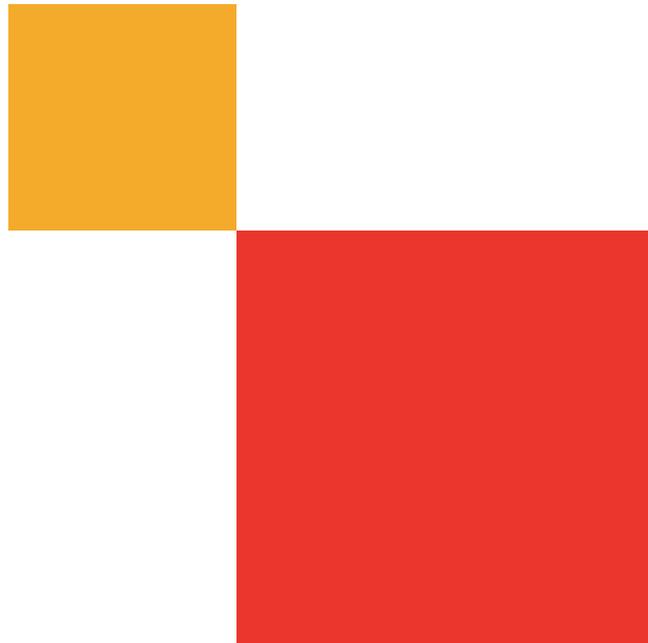
| DEBIT | THOUSANDS OF EUROS | |
|---|---------------------------|------------------|
| | 2003 | 2002 |
| EXPENSES: | | |
| PROCUREMENTS (NOTE 20) | 759,290 | 762,132 |
| PERSONNEL EXPENSES (NOTE 20) | 1,402,731 | 1,353,734 |
| DEPRECIATION AND AMORTIZATION EXPENSE (NOTES 6-b, 7 AND 8) | 170,835 | 164,702 |
| VARIATION IN OPERATING ALLOWANCES | 2,074 | 13,333 |
| OTHER OPERATING EXPENSES (NOTE 20) | 2,123,719 | 2,156,523 |
| | 4,458,649 | 4,450,424 |
| OPERATING INCOME | 160,681 | 249,109 |
| FINANCIAL AND SIMILAR EXPENSES (NOTES 15 AND 16) | 34,474 | 39,345 |
| VARIATION IN INVESTMENT VALUATION ALLOWANCES | 16,166 | 15 |
| EXCHANGE LOSSES | 106,742 | 119,528 |
| | 157,382 | 158,888 |
| SHARE IN LOSSES OF COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD (NOTE 9) | 875 | 715 |
| AMORTIZATION OF CONSOLIDATION GOODWILL (NOTE 6-a) | 6,613 | 6,613 |
| INCOME FROM ORDINARY ACTIVITIES | 183,570 | 240,671 |
| LOSSES ON FIXED ASSETS (NOTE 8) | 22,664 | 10,777 |
| VARIATION IN FIXED ASSET ALLOWANCES | 2 | 55 |
| EXTRAORDINARY EXPENSES (NOTE 20) | 59,283 | 103,407 |
| PRIOR YEARS' EXPENSES AND LOSSES | 2,521 | 5,342 |
| | 84,470 | 119,581 |
| EXTRAORDINARY INCOME | 18,113 | - |
| CONSOLIDATED INCOME BEFORE TAXES | 201,683 | 194,081 |
| CORPORATE INCOME TAX (NOTE 19) | 55,831 | 34,256 |
| CONSOLIDATED INCOME FOR THE YEAR | 145,852 | 159,825 |
| INCOME ATTRIBUTED TO MINORITY INTERESTS (NOTES 14 AND 21) | 2,266 | 2,705 |
| INCOME FOR THE YEAR ATTRIBUTED TO THE PARENT COMPANY | 143,586 | 157,120 |

**CREDIT**

THOUSANDS OF EUROS

| | 2003 | 2002 |
|---|--------------|---------------|
| REVENUES: | | |
| NET SALES (NOTE 20) | 4,402,447 | 4,485,716 |
| OTHER OPERATING REVENUES (NOTE 20) | 216,883 | 213,817 |
| | 4,619,330 | 4,699,533 |
| REVENUES FROM EQUITY INVESTMENTS | 75 | 1,608 |
| REVENUES FROM OTHER MARKETABLE SECURITIES | - | 855 |
| OTHER INTEREST AND SIMILAR REVENUES (NOTE 12) | 52,878 | 48,772 |
| EXCHANGE GAINS | 100,034 | 86,134 |
| | 152,987 | 137,369 |
| FINANCIAL LOSS | 4,395 | 21,519 |
| SHARE IN THE INCOME OF COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD (NOTE 9) | 34,772 | 20,409 |
| | | |
| GAINS ON FIXED ASSET DISPOSALS (NOTES 7 AND 8) | 38,695 | 47,821 |
| GAINS ON TRANSACTIONS INVOLVING SHARES OF THE PARENT COMPANY (NOTE 10) | 8,347 | 1,982 |
| EXTRAORDINARY REVENUES (NOTE 20) | 35,121 | 13,134 |
| PRIOR YEARS' REVENUES AND INCOME | 20,420 | 10,054 |
| | 102,583 | 72,991 |
| EXTRAORDINARY LOSS | - | 46,590 |





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

Consolidated Financial Statements



1 Description of the Parent Company and of the Group

Iberia, Líneas Aéreas de España, S.A. engages mainly in the air transport of passengers and cargo and, additionally, carries on other supplementary activities, including most notably handling, aircraft maintenance (of both proprietary aircraft and aircraft owned by other companies) and distribution through its equity interest in the Amadeus Group, which owns the Amadeus central booking system.

As a carrier of passengers and cargo, Iberia, Líneas Aéreas de España, S.A. operates through a large network serving three major markets: Spain, Europe and the Americas.

Iberia, Líneas Aéreas de España, S.A. is a fully-fledged member of the Oneworld megacARRIER, one of the two largest airline groups in the world, which facilitates the globalization of its air transport business.

In addition to the activities carried on directly by the Company and in order to supplement these activities or to cater for certain market segments or specific needs, various companies have been incorporated that form part of the Iberia Group of which Iberia, Líneas Aéreas de España, S.A. is the Parent Company.

Last year, Group management designed the 2003-2005 Master Plan. The strategic objectives of this Master Plan, which was approved by the Company's Board of Directors on December 4, 2002, are as follows:

1. To increase the Company's routes and flights in order to maintain and strengthen its leading position at the Madrid and Barcelona hubs.
2. To endow the Company with operational and financial flexibility to enable it to adapt growth to market trends.
3. To improve competitiveness through a substantial reduction of unit costs.
4. To implement a distribution strategy capable of reducing marketing costs.
5. To implement a new in-flight service model with leading price-service ratios for each customer segment.
6. To enhance service quality and strengthen the Company's relationship with high-value customers by improving the level of punctuality.
7. To maintain a portfolio approach in the management of the businesses.
8. To reduce financing costs by controlling operational and financial risks.
9. To bolster the competitiveness of the Company's human resources.
10. To capitalize on the Company's alliances in order to sharpen its competitive edge.

This Master Plan was revised at the beginning of 2003 in view of the new circumstances in the airline industry. The aforementioned strategic objectives were maintained, and the measures aimed at reducing costs and expediting the implementation of the main initiatives were strengthened.

Iberia, Líneas Aéreas de España, S.A.'s registered office is in Madrid. The Company's shares have been listed on the stock market since April 2001.

2 Group companies

Subsidiaries in which the Parent Company has a majority of the voting rights or, alternatively, over whose governing bodies' decisions it exercises effective control, are deemed to be Group companies. Effective control is generally considered to exist when the holding in the company in question exceeds 50%.

The information on the fully consolidated companies making up the Iberia Group is as follows:

| GROUP COMPANIES | | THOUSANDS OF EUROS | | | |
|---|---|--------------------|----------|-------------------------|--|
| CORPORATE NAME ADDRESS CORPORATE PURPOSE | PERCENTAGE OF DIRECT AND INDIRECT OWNERSHIP | CAPITAL STOCK | RESERVES | (b) INCOME (Loss) | |
| COMPañÍA AUXILIAR AL CARGO EXPRES, S.A. CENTRO DE CARGA AÉREA. PARCELA 2 P5 NAVE 6; MADRID TRANSPORT OF CARGO | 75.00 | 192 | 2,204 | 707 | |
| CARGOSUR, S.A. VELÁZQUEZ, 130; MADRID AIR TRANSPORT OF CARGO | 100.00 | 6,058 | (1,021) | (26) | |
| IBER-SWISS CATERING, S.A. CTRA. DE LA MUÑOZA, S/N; MADRID PREPARATION AND MARKETING OF FOOD AND OTHER SERVICES FOR AIRCRAFT | 70.00 | 3,005 | 8,229 | 2,204 | |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJES, S.A. (SAVIA) VELÁZQUEZ, 130; MADRID COMPUTER SERVICES APPLICABLE TO TRAVEL AND TOURISM INDUSTRIES | 75.49(a) | 301 | 10,608 | 5,106 | |
| VIVA VUELOS INTERNACIONALES DE VACACIONES, S.A. CAMINO DE LA ESCOLLERA, 5; PALMA DE MALLORCA AIRCRAFT MAINTENANCE | 99.47 | 644 | 784 | 167 | |
| CAMPOS VELÁZQUEZ, S.A. VELÁZQUEZ, 34; MADRID ACQUISITION AND OWNERSHIP OF URBAN PROPERTIES | 100.00 | 902 | 203 | 13 | |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. CENTRO DE CARGA AÉREA. PARCELA 2 P5 NAVE 6; MADRID TRANSPORT OF CARGO | 75.00 | 180 | 21 | 56 | |
| IBERIA TECNOLOGÍA, S.A. VELÁZQUEZ, 130; MADRID AIR MAINTENANCE SERVICES | 100.00 | 1,442 | 134 | 76 | |
| CONSULTORES HANSA, S.A. VELÁZQUEZ, 130; MADRID MARKET CONSULTING SERVICES - INACTIVE | 99.47 | 60 | (2) | - | |

(a) The dividend rights conferred by this holding amount to 72.22%, which includes the 66% holding owned directly by Iberia, Líneas Aéreas de España, S.A. and the 6.22% holding owned indirectly through the Amadeus Group.
(b) The accounting close of all these companies was performed on December 31, 2003.

In December 2003 the Parent Company signed a memorandum of understanding for the sale of its ownership interest in Iberswiss Catering, S.A. for which a base selling price of €23.5 million was set. This agreement is subject to obtaining of the related authorization from the antitrust authorities and, accordingly, as of the date of preparation of these consolidated financial statements the agreements entered into had not yet come into force.

3 Associated companies

Subsidiaries in which the Parent Company has a significant influence over management but does not have a majority of the voting rights and which are not effectively managed by it are deemed to be associated companies. Significant influence is generally considered to exist when the Group's holding in the subsidiary in question exceeds 20% but is less than 50%.

Certain subsidiaries over whose management the Parent Company exercises effective control but whose volume of assets and business account for a scant proportion of the Group's operations as a whole were also deemed to be associated companies.

The associated companies accounted for by the equity method, whose accounting information was obtained from their respective financial statements as of December 31, 2003, are as follows:

| CORPORATE NAME ADDRESS CORPORATE PURPOSE | | PERCENTAGE OF DIRECT AND INDIRECT OWNERSHIP | CAPITAL | RESERVES | INCOME (Loss) |
|--|--|---|---------|----------|------------------|
| AMADEUS GROUP (b) SALVADOR DE MADARIAGA, 1; MADRID MANAGEMENT AND OPERATION OF A COMPUTERIZED BOOKING SYSTEM | | 27.92(a) | 27,898 | 725,202 | 150,100 |
| TOUOPERADOR VIVA TOURS, S.A. TRESPADERNE, 29; MADRID MANAGEMENT AND PACKAGE TOURS | | 49.00 | 2,760 | 22 | (1,784) |
| MULTISERVICIOS AEROPORTUARIOS, S.A. BRAVO MURILLO, 52; MADRID PROVISION OF AUXILIARY AIRPORT SERVICES | | 49.00 | 130 | 3,177 | 554 |
| IBER-AMÉRICA AEROSPACE LLC MIAMI, FLORIDA PURCHASE AND SALE OF AIRCRAFT COMPONENTS AND ENGINES | | 49.00 | 913 | - | 392 |
| EMPRESA LOGÍSTICA DE CARGA AÉREA, S.A. (ELCA) AEROPUERTO JOSÉ MARTÍ. CIUDAD DE LA HABANA OPERATION OF A CARGO TERMINAL AT HAVANA AIRPORT | | 50.00 | 317 | (18) | 29 |
| EMPRESA HISPANO CUBANA DE MANTENIMIENTO DE AERONAVES IBECA, S.A. AEROPUERTO JOSÉ MARTÍ. CIUDAD DE LA HABANA AIRCRAFT MAINTENANCE | | 50.00 | 79 | 88 | 499 |
| HANDLING GUINEA ECUATORIAL, S.A. (HANGESA) MALABO HANDLING SERVICES AT MALABO AIRPORT | | 50.73 | 305 | 160 | 1,291 |
| SOCIEDAD CONJUNTA PARA LA EMISIÓN Y GESTIÓN DE MEDIOS DE PAGO EFC, S.A. (IBERIA CARDS) VELÁZQUEZ, 130; MADRID ISSUANCE AND MANAGEMENT OF MEANS OF PAYMENT | | 40.00 | 6,000 | 2,336 | 72 |

(a) The dividend rights conferred by this holding amount to 18.28%, which is the percentage used in consolidation.

(b) Comprising Amadeus Global Travel Distribution, S.A. (the parent company) and its investees. In February 2004 one of the founding shareholders of the Amadeus Group disposed of a significant portion of its holding, thereby reducing its voting rights. Accordingly, Iberia, Líneas Aéreas de España, S.A.'s holding was increased to 33.80% and its dividend rights remained unchanged. Also, the holding in Sistemas Automatizados Agencias de Viaje, S.A. was increased to 77.49%.

In December 2003 the Group entered into an agreement for the sale of the shares that it owns in its investee Touoperador Viva Tours, S.A. and of the "Viva Tours" brand names owned by it. This transaction was formalized in February 2004 and the prices set were €1,864 thousand for the shares and €15 million for the brand names.

As a result of the commitments assumed by the majority shareholder under the contracts entered into for the formation of the Iberbus companies (see Note 9) which guarantee for Iberia, Líneas Aéreas de España, S.A. the full recovery of the amounts invested, these companies were excluded from consolidation in 2000.

4 Basis of presentation of the consolidated financial statements

a) True and fair view

The 2003 consolidated financial statements, which were prepared by the directors of the Parent Company from the accounting records and individual financial statements of Iberia, Líneas Aéreas de España, S.A. and from those of its fully consolidated subsidiaries, which were prepared by their respective directors, are presented in accordance with the standards established by the Spanish National Chart of Accounts and Royal Decree 1815/1991 on the preparation of consolidated financial statements and, accordingly, give a true and fair view of the consolidated net worth, financial position and consolidated results of operations for 2003.

The companies accounted for by the equity method (mainly the Amadeus Group and Touroperador Viva Tours, S.A.) were consolidated on the basis of their provisional financial statements as of December 31, 2003.

The individual and consolidated financial statements of Iberia, Líneas Aéreas de España, S.A. and the Iberia Group, respectively, and the financial statements of the investees included in consolidation have not yet been approved by the respective Shareholders' Meetings. However, the directors of the Parent Company consider that no changes will be made to these consolidated financial statements as a result of the approval process.

b) Consolidation principles

The equity of minority interests in the net worth of the fully consolidated companies as of December 31, 2003, is reflected under the "Minority Interests" caption in the consolidated balance sheet. Also, the balance of the "Income Attributed to Minority Interests" caption in the consolidated statement of income relates to the equity of minority interests in the results obtained in the year by the fully consolidated companies.

The Group's equity in the net worth and results for the year of the companies accounted for by the equity method is reflected under the "Investments in Companies Accounted for by the Equity Method" caption in the consolidated balance sheet and under the "Share in Losses/Share in the Income of Companies Accounted for by the Equity Method" captions in the consolidated statement of income.

The various captions in the financial statements of the foreign companies included in consolidation were translated to euros as follows:

- Assets and liabilities were translated at the official exchange rates ruling at year-end.
- The capital stock and reserves of the subsidiary were translated at the historical exchange rates.
- Income-statement items were translated at the average exchange rates for the year.

The exchange difference arising from application of these translation methods was recorded under the "Shareholders' Equity - Translation Differences" caption.

All material accounts and transactions between the fully consolidated companies were eliminated in consolidation.

When a new subsidiary is included in the Group, any positive or negative differences that arise between the acquisition cost and the underlying book value of the holding which cannot be assigned to specific assets or liabilities are recorded under the "Consolidation Goodwill" caption or the "Negative Consolidation Difference" captions, respectively, and are amortized systematically over the period in which it is estimated that they will contribute to the obtainment of income by the Group in the case of the consolidation goodwill or, in the case of negative consolidation differences, are allocated to income when the loss implicit in the acquisition is disclosed.

The accounting principles and methods used by the consolidated companies were unified in consolidation. The impact of this unification on the consolidated net worth was not material.

5 Distribution of the Parent Company's income

The directors of Iberia, Líneas Aéreas de España, S.A. propose that the Company's income for 2003 be distributed as follows: €10,576 thousand to the legal reserve, a dividend of €0.03 per share and the remainder to voluntary reserves.

6 Valuation standards

The main valuation methods applied in preparing the consolidated financial statements for 2003, in accordance with the Spanish National Chart of Accounts, were as follows:

a) Goodwill

Goodwill was calculated as the positive difference between the amount paid by Iberia, Líneas Aéreas de España, S.A. for the acquisition of a 67% holding in Aviación y Comercio, S.A. and the underlying book value of the holding as of December 31, 1997.

The goodwill is being amortized on a straight-line basis over 20 years. €6,613 thousand of amortization of goodwill were charged to the consolidated statement of income in 2003.

b) Start-up expenses

These expenses relate basically to public deed and registration expenses incurred in connection with capital increases at Group companies, and are amortized at an annual rate of 20%.

€286 thousand of amortization of start-up expenses were charged to the accompanying 2003 consolidated statement of income.

c) Intangible assets

Leased assets are recorded as intangible assets at the cost of the related assets, and the total debt for lease payments plus the amount of the purchase option are recorded as a liability. The interest expenses on the transaction are recorded under the "Deferred Charges" caption in the consolidated balance sheet and are allocated to income each year by the interest method.

Leased assets are amortized by the same methods as those used to depreciate similar items of property, plant and equipment.

The acquisition cost and the related accumulated amortization of aircraft leased under financial lease contracts is adjusted each year pursuant to a Ministerial Order dated December 18, 2001 (and was adjusted prior to that date pursuant to a Ministerial Order dated March 23, 1994), by the net amount of the exchange differences arising on the adjustment to official year-end exchange rates of the principal of the foreign currency lease payments outstanding on the aircraft recorded as intangible assets in the reporting year and in the four preceding years.

As a result of the application of this valuation method, in 2003 the net book value of the aircraft leased under financial lease contracts was reduced by €4,413 thousand, €4,749 thousand of which relate to cost and €336 thousand to accumulated amortization.

In total, the exchange differences included in intangible assets pursuant to the aforementioned regulations have given rise to a cumulative reduction of approximately €6,662 thousand in the net book value of the aircraft leased under financial lease contracts.

Computer software is recorded at acquisition or production cost and is amortized on a straight-line basis over an estimated useful life of five years.

Intellectual property, which relates mainly to the rights to use various trademarks, is carried at cost and is amortized on a straight-line basis over ten years.

d) Property, plant and equipment

Property, plant and equipment is carried at cost revalued pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1996.

Pursuant to a Ministerial Order dated December 18, 2001, the acquisition cost and accumulated depreciation of the aircraft which, recorded as property, plant and equipment in the reporting year or in the four years immediately prior thereto, were financed through foreign currency loans, are adjusted by the net amount of the differences arising on the adjustment of these loans to official year-end exchange rates.

As a result of the application of this valuation method, in 2003 the cost of the aircraft and the related accumulated depreciation were reduced by €1,219 thousand and €174 thousand, respectively.

As of December 31, 2003, the net book value of the owned aircraft included cumulative exchange differences totaling approximately €69,326 thousand.

The Group companies depreciate the depreciable cost of their property, plant and equipment by the straight-line method at annual rates based on the years of estimated useful life of the related assets.

The years of estimated useful life of the property, plant and equipment items are as follows:

▶▶ YEARS OF ESTIMATED USEFUL LIFE

| | YEARS |
|--------------------------------|---------|
| AIRCRAFT | 20 - 22 |
| BUILDINGS AND OTHER STRUCTURES | 20 - 50 |
| MACHINERY, FIXTURES AND TOOLS | 10 - 15 |
| TRANSPORT EQUIPMENT | 7 - 10 |
| FURNITURE | 10 |
| COMPUTER HARDWARE | 5 - 7 |
| REPAIRABLE PARTS | 8 - 10 |
| ROTATABLE PARTS | 18 |
| FLIGHT SIMULATORS | 10 - 14 |

In 2003, taking into account the more up-to-date technology used in the new aircraft and the working condition of the aircraft after the systematic application of the established periodic maintenance programs Iberia, Líneas Aéreas de España, S.A., reestimated the useful lives of the aircraft and, in general, it increased them by four years from 18 to 22 years, except in the case of the MD-87 aircraft, the depreciation period of which was set at 20 years, and of the aircraft acquired from Aviación y Comercio, S.A., which are being depreciated over 12 years (MD-88) and 10 years (MD-87).

Also, due to the changes that have taken place in the secondhand aircraft market, Iberia, Líneas Aéreas de España, S.A., which, in general, had been assuming a residual value for the aircraft of 20% of their acquisition cost, started to treat the full acquisition cost as depreciable, thereby eliminating the residual value.

These measures were implemented from November 2003, after the Company's proposal had been accepted by the tax authorities.

The effect of this recalculation of the useful lives of the aircraft on the 2003 consolidated statement of income is not material.

Assets subject to administrative concession whose years of useful life exceed the term for which the related company has been granted the concession are depreciated over the term of the concession.

The estimated residual value of the rotatable parts (those assigned to specific types of aircraft) ranges from 10% to 20% of acquisition cost, depending on the type of aircraft. The estimated residual value of the other (repairable) aircraft spare parts is 10% of acquisition cost. The Group companies depreciate in full the acquisition cost of other items of property, plant and equipment.

In order to recognize the unrealized losses arising as a result of the obsolescence of spare parts, the Group companies have recorded an allowance for decline in value of these parts. As of December 31, 2003, the balance of this allowance was €2,560 thousand.

In addition, the Group records reversible allowances in order to adjust the net book value of aircraft ready for sale to their estimated realizable value based on current market prices in the used aircraft market.

Improvements to aircraft leading to an increase in their capacity or efficiency or to a lengthening of their useful lives are capitalized to the acquisition cost of the aircraft.

In general, property, plant and equipment upkeep and maintenance costs currently. However, for the purpose of ensuring the uniformity of the charges to income each year for the expenses of periodic inspections and repairs of the fuselages of the B-747, B-757, A-319, A-320, A-321, A-340 and MD-88 aircraft, the Group records an allowance based on the total estimated cost to be incurred, and allocates this cost to income on a straight-line basis during the period elapsing between two successive major repairs (see Note 15).

The costs of repairs to engines and of all repairs to the MD-87 aircraft are expensed currently, since the annual expenses tend to be uniform.

e) Long- and short-term investments

Investments in nonconsolidated companies are carried at the lower of either cost or market value. The market value is taken to be the underlying book value of the investment at year-end adjusted, where appropriate, by the amount of the unrealized gains disclosed at the time of subscription or acquisition and still existing at the date of subsequent valuation.

In order to recognize the unrealized losses on the investments (if cost is higher than market value), the related allowances are recorded.

However, the holdings in the capital stock of the Iberbus companies (see Note 9) are recorded at their acquisition cost because, under the agreements entered into, the other shareholder of these companies guarantees for Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of the investments made.

Loans to associated companies and other loans and credits granted are recorded at the amounts delivered and not yet repaid. In order to cover the related bad debt risk, the Group has recorded allowances for bad debts calculated on the basis of the probability of recovering the accounts receivable based on their age and on the solvency of the debtor in question.

Deposits and guarantees given are recorded at the amount delivered. These deposits include the amounts delivered under the terms of the contracts for the acquisition of new aircraft, which will be refunded on delivery of the aircraft (See Note 9).

The Group generally invests its short-term cash surpluses in fixed-term financial assets that are recorded at the amounts effectively disbursed. The interest on these transactions is recorded as a revenue when earned and unmatured interest at year-end is reflected as an addition to the balance of the "Short-Term Investments" caption in the consolidated balance sheet.

f) Shares of the Parent Company

Treasury stock is carried at cost, which is lower than the average market price in the last quarter of the year and the market price at year-end.

g) Foreign currency transactions and balances

Foreign currency transactions and the resulting accounts receivable and payable are recorded at their equivalent euro value at the transaction date.

The balances of accounts receivable and payable denominated in foreign currencies are translated to euros at the exchange rates ruling at December 31 of each year. However, following customary airline practice, the balance of liabilities for unused traffic documents is reflected in the consolidated balance sheet at the exchange rate ruling in the month of the sale, as set by the International Air Transport Association (IATA). The IATA exchange rate for each month is the average exchange rate for the last five working days prior to the 20th day of the preceding month.

Exchange losses arising as a result of the difference between the official exchange rates at year-end and the exchange rates at which foreign currency receivables and payables were translated to euros are charged to the "Exchange Losses" caption in the consolidated statement of income, whereas exchange gains are deferred through the date on which the related accounts receivable or payable fall due, and are recorded under the "Deferred Revenues" caption in the consolidated balance sheet, unless negative exchange differences arising on the same currency for the same or a higher amount have been charged to income in the current year or in prior years.

Exchange differences arising at the date of collection or payment of foreign currency receivables and payables are allocated to the "Exchange Gains" or "Exchange Losses" captions, as appropriate, in the consolidated statement of income.

Notwithstanding the foregoing, the positive or negative translation and exchange differences arising from the financing in foreign currencies of certain of the Group's aircraft are given a special accounting treatment pursuant to a Ministerial Order dated December 18, 2001 (see Notes 6-c and 6-d).

h) Inventories

Inventories, basically aeronautical supplies and fuel, are valued at average acquisition cost, and the related allowances for decline in value are recorded.

The Group companies have recorded the necessary allowances to recognize the unrealized losses arising in connection with certain obsolescent and slow-moving warehouse goods.

i) Recognition of revenues and expenses

Revenues and expenses are recognized on an accrual basis, i.e. when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises.

Ticket sales and sales of the traffic documents for cargo and other services are initially credited to "Customer Advances" in the consolidated balance sheet. The balance of this consolidated balance-sheet caption reflects the liability for tickets and traffic documents sold prior to December 31, 2003, but not yet used as of that date. Revenues relating to these items are recognized when transport or service is performed.



The Parent Company occasionally sells aircraft which it continues to operate under dry lease arrangements (in which the aircraft is leased without crew for a given period of time). The gains obtained on these sale transactions are taken to consolidated income on a straight-line basis over the term of the related lease contract. The "Deferred Revenues" caption in the accompanying consolidated balance sheet as of December 31, 2003, includes, inter alia, the gains obtained on transactions of this kind not yet allocated to income.

Iberia, Líneas Aéreas de España, S.A. has introduced the "Iberia Plus" card as an ongoing promotional tool whereby the holder of the card accumulates points for taking certain flights, using certain hotels, renting cars or making credit card purchases with credit cards covered by the program. These points can be exchanged for free tickets or other services offered by the companies included in the program. The "Accounts Payable for Purchases and Services" caption in the accompanying consolidated balance sheet as of December 31, 2003, includes a provision for €56,292 thousand in this concept, based on the estimated redemption value of the unused points accumulated as of that date.

j) Obligations to personnel

Under the collective labor agreements in force at the Parent Company, on reaching the age of 60 flight personnel cease to discharge their duties and are placed on the reserve, although their employment relationship remains in place through their regulatory retirement date. The Parent Company recognizes the costs of personnel placed on special reserve over the active working life of each employee based on the related actuarial studies.

The "Provisions for Contingencies and Expenses - Provisions for Obligations to Personnel" caption (see Note 15) in the accompanying consolidated balance sheet as of December 31, 2003, includes the liabilities incurred in this concept.

The collective labor agreements in force at the Parent Company also provide the opportunity for flight personnel who meet certain conditions to take early retirement (special leave). The Company is required to pay certain amounts of compensation to these employees until they reach the regulatory retirement age. The Parent Company records, with a charge to the consolidated statement of income in the year in which this circumstance arises, the provision required, calculated on the basis of actuarial studies, to supplement the provisions already recorded for employees placed on the special reserve in order to meet the future payment commitments to the employees concerned. 228 employees are currently on special leave, of whom 11 took special leave in 2003.

The liabilities incurred in this concept are recorded under the "Provisions for Contingencies and Expenses - Provisions for Pensions" caption.

The aforementioned amounts were calculated on the basis of actuarial studies conducted by independent actuaries using the projected unit credit method and based on an assumed interest rate of 3.5%, PERM/F-2000 P life expectancy tables and an estimated annual CPI variation of 2%.

All liabilities subject to mandatory externalization arising in connection with the retirement or early retirement of ground personnel in the circumstances provided for in the collective labor agreements were externalized in August 2001.

k) Montepío de Previsión Social Loreto

The main purpose of the Montepío de Previsión Social Loreto is to pay retirement pensions to its members (who include the employees of Iberia, Líneas Aéreas de España, S.A. and of its subsidiary Sistemas Automatizados Agencias de Viaje, S.A.) and other welfare benefits in certain circumstances (death and permanent disability).

Under the current collective labor agreements, the aforementioned companies and their employees make the statutory contributions (defined contributions) to the Montepío, as established in these labor agreements. Montepío's bylaws limit these companies' liability to the payment of the statutory contributions.

The Group's contributions of €21,179 thousand in 2003 were recorded under the "Personnel Expenses" caption in the accompanying consolidated statement of income.

l) Provision for third-party liability

The "Provision for Third-Party Liability" caption (see Note 15) in the consolidated balance sheet includes the estimated amount required for probable or certain third-party liability arising from legal proceedings and litigation in progress or from outstanding indemnity payments or obligations of undetermined amount, and collateral and other similar guarantees provided by the consolidated companies. These provisions are recorded when the liability arises or becomes known. This caption also includes the provisions for the estimated costs, based on the actuarial studies conducted by independent actuaries using the same assumptions as those indicated in Note 6-j above, of the layoff plan initiated in 1999 and implemented in 2000 and 2001 and of the labor force reduction plan authorized by the Ministry of Employment and Social Affairs on December 26, 2001, and implemented since 2002. This labor force reduction plan, which initially concluded on December 31, 2002, was extended with the prior authorization of the Ministry of Employment and Social Affairs until December 31, 2004, for ground personnel, cabin crew, and flight engineers up to the limit of the structural target headcount for each group of employees.

m) Corporate income tax

The corporate income tax of each year for each consolidated company is calculated on the basis of the book income before taxes, increased or decreased, as appropriate, by the permanent differences from taxable income, net tax relief and tax credits, excluding tax withholdings and prepayments.

n) Futures and other similar instruments

Iberia, Líneas Aéreas de España, S.A. uses these instruments in transactions to hedge its asset and liability positions and its future flows of collections and payments (see Note 18). It only carries out "nongenuine" hedging transactions (i.e. those arranged between two parties, establishing in each case the contractual terms of the transactions agreed upon between them).

Price differences arising during the term of futures and similar instruments are recorded as follows:

1. In the case of transactions arranged to hedge exchange rates relating to asset or liability positions, the related balances are discounted to present value at each year-end based on the gains or losses that arise.

2. For the other exchange and interest rate transactions, the price differences are recorded in the consolidated statement of income when the transactions involving futures or similar instruments are cancelled or finally settled.

o) Environmental activities

In general, environmental activities are those the purpose of which is to prevent, reduce or redress damage to the environment.

Investments made in connection with environmental activities are valued at acquisition cost and are capitalized as an addition to fixed assets in the year in which the related expenses are incurred, using the methods described in Note 6-d above.

Expenses arising from environmental protection and enhancement measures are charged to income in the year in which they are incurred, regardless of when the resulting monetary or financial flow arises.

The provisions for probable or certain third-party liability, litigation in progress and outstanding environmental indemnity payments or obligations of undetermined amount not covered by the insurance policies taken out are recorded, where appropriate, when the liability or obligation giving rise to the indemnity or payment arises.

p) Classification of debt

In the accompanying consolidated balance sheet debts maturing in under 12 months from year-end are classified as current liabilities and those maturing at over 12 months as long-term debt.

7 Intangible assets

The variations in 2003 in intangible asset accounts and in the related accumulated amortization were as follows:

| | | THOUSANDS OF EUROS | | | | |
|---|----------------|--------------------------|--------------|-------------------------------|------------------------------------|----------------|
| | 12-31-02 | ADDITIONS AND PROVISIONS | RETIREMENTS | MINISTERIAL ORDER OF 12-18-01 | TRANSFERS TO TANGIBLE FIXED ASSETS | 12-31-03 |
| RIGHTS ON LEASED ASSETS | 483,935 | 10,291 | - | (4,749) | (39,750) | 449,727 |
| COMPUTER SOFTWARE | 71,295 | 20,318 | (247) | - | (2) | 91,364 |
| INTELLECTUAL PROPERTY AND LEASEHOLD ASSIGNMENT RIGHTS | 844 | 11 | (6) | - | - | 849 |
| ACCUMULATED AMORTIZATION | (90,793) | (38,838) | 123 | 336 | 17,654 | (111,518) |
| NET VALUE | 465,281 | (8,218) | (130) | (4,413) | (22,098) | 430,422 |

As of December 31, 2003, the cost of the Group companies' fully amortized intangible assets amounted to €11,009 thousand, the detail being as follows:

| DECEMBER 31, 2003 | | THOUSANDS OF EUROS |
|-----------------------------|--|--------------------|
| LEASEHOLD ASSIGNMENT RIGHTS | | 394 |
| COMPUTER SOFTWARE | | 10,615 |
| TOTAL | | 11,009 |

The additions in 2003 to the "Computer Software" caption relate basically to investments in systems integration projects and new developments.

Also, in 2003 purchase options on one leased B-757 aircraft and on certain leased airport equipment and computer hardware were exercised and, accordingly, the cost and related accumulated amortization of these assets were reclassified to property, plant and equipment accounts (see Note 8). The B-757 aircraft on which the purchase option was exercised has been mortgaged, and the net book value of the fuselage as of December 31, 2003, was €16,527 thousand.

The general features of the financial lease contracts (relating mainly to aircraft) in force as of December 31, 2003, some of which provide for floating interest and lease payments denominated in foreign currencies, are as follows:

| DECEMBER 31, 2003 | | THOUSANDS OF EUROS | |
|---|--|--------------------|---|
| COST OF THE LEASED FIXED ASSETS | | 459,373 | (a) As of December 31, 2003, these amounts included €74,730 thousand of unaccrued interest at that date, the balancing entry for which is included under the "Deferred Charges" caption in the accompanying consolidated balance sheet as of December 31, 2003. |
| AMOUNT OF LEASE PAYMENTS PAID - IN PRIOR YEARS | | 131,560 | |
| - IN 2003 | | 67,467 | |
| AMOUNT OF LEASE PAYMENTS OUTSTANDING AT DECEMBER 31 (NOTE 16) | | 209,325 (a) | |
| AMOUNT OF PURCHASE OPTIONS (NOTE 16) | | 238,451 (a) | |

The due dates for the lease payments outstanding as of December 31, 2003, which include the amount of the purchase options, are as follows:

▶▶ **DECEMBER 31, 2003**

| LEASE PAYMENTS DUE IN | THOUSANDS OF EUROS |
|-----------------------|--------------------|
| 2004 | 44,361 |
| 2005 | 42,246 |
| 2006 | 34,471 |
| 2007 | 157,210 |
| 2008 - 2012 | 169,488 |
| | 447,776 |

8 Property, plant and equipment

The variations in 2003 in property, plant and equipment accounts and in the related accumulated depreciation and allowances were as follows:

▶▶ **COST**

| | THOUSANDS OF EUROS | | | | | |
|--------------------------------|--------------------|----------------|------------------|------------------|----------------------|------------------|
| | 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | EXCHANGE DIFFERENCES | 12-31-03 |
| AIRCRAFT | 1,816,859 | 110,892 | (430,297) | 35,833 | (1,219)(a) | 1,532,068 |
| ADVANCES ON AIRCRAFT (NOTE 9) | 155,267 | - | - | (155,267) | - | - |
| | 1,972,126 | 110,892 | (430,297) | (119,434) | (1,219) | 1,532,068 |
| OTHER TANGIBLE FIXED ASSETS: | | | | | | |
| LAND | 4,105 | - | - | - | - | 4,105 |
| BUILDINGS AND OTHER STRUCTURES | 169,318 | 165 | (3,020) | - | - | 166,463 |
| MACHINERY, FIXTURES AND TOOLS | 421,738 | 10,188 | (25,256) | 2,813 | - | 409,483 |
| TRANSPORT EQUIPMENT | 28,947 | 3,598 | (202) | 2,325 | - | 34,668 |
| FURNITURE | 20,265 | 1,048 | (873) | 97 | - | 20,537 |
| COMPUTER HARDWARE | 83,866 | 23,131 | (2,474) | 744 | - | 105,267 |
| SPARE PARTS | 250,830 | 117,582 | (109,880) | - | - | 258,532 |
| FLIGHT SIMULATORS | 63,336 | 511 | (748) | 1,716 | - | 64,815 |
| OTHER TANGIBLE FIXED ASSETS | 1,707 | 74 | (9) | - | - | 1,772 |
| CONSTRUCTION IN PROGRESS | 14,539 | 18,868 | (16,467) | (6,215) | (880) | 9,845 |
| | 1,058,651 | 175,165 | (158,929) | 1,480 | (880) | 1,075,487 |

(a) Effect of applying the Ministerial Order dated 12-08-01.

ACCUMULATED DEPRECIATION AND ALLOWANCES

THOUSANDS OF EUROS

| | 12-31-02 | ADDITIONS | RETIREMENTS | MINISTERIAL ORDER OF 12-18-01 | TRANSFERS | 12-31-03 |
|----------------------------------|----------------|---------------|-----------------|-------------------------------------|--------------|----------------|
| ACCUMULATED DEPRECIATION: | | | | | | |
| AIRCRAFT | 1,115,407 | 72,827 | (257,212) | (174) | 12,284 | 943,132 |
| OTHER TANGIBLE FIXED ASSETS | | | | | | |
| BUILDINGS AND OTHER STRUCTURES | 107,921 | 3,926 | (935) | - | - | 110,912 |
| MACHINERY, FIXTURES AND TOOLS | 296,741 | 20,484 | (23,246) | - | 1,094 | 295,073 |
| TRANSPORT EQUIPMENT | 18,607 | 3,043 | (167) | - | 1,145 | 22,628 |
| FURNITURE | 13,781 | 1,062 | (809) | - | 76 | 14,110 |
| COMPUTER HARDWARE | 60,599 | 11,562 | (2,264) | - | 363 | 70,260 |
| SPARE PARTS | 123,409 | 17,038 | (16,939) | - | - | 123,508 |
| FLIGHT SIMULATORS | 41,072 | 2,136 | (747) | - | - | 42,461 |
| OTHER TANGIBLE FIXED ASSETS | 1,399 | 138 | (13) | - | - | 1,524 |
| | 663,529 | 59,389 | (45,120) | - | 2,678 | 680,476 |
| ALLOWANCES: | | | | | | |
| AIRCRAFT | 81,209 | 11,426 | (43,068) | - | - | 49,567 |
| OTHER TANGIBLE FIXED ASSETS | 2,617 | - | - | - | - | 2,617 |

The transfers reflected in the foregoing table include those from intangible assets (see Note 7) and the amounts reclassified to long-term investments (see Note 9).

Aircraft: Period additions

The main period additions are summarized as follows:

PERIOD ADDITIONS

THOUSANDS OF EUROS

| | |
|-----------------------|----------------|
| ADDITIONS OF AIRCRAFT | 122,283 |
| ADDITIONS OF ENGINES | 5,038 |
| REFURBISHMENTS | 24,417 |
| LESS- | |
| DEPOSITS ON AIRCRAFT | (39,055) |
| OTHER | (1,791) |
| | 110,892 |

In 2003 the Group acquired and subsequently sold and leased back under operating lease contracts, one A-320 aircraft and two A-321 aircraft for €36,726 thousand and €85,557 thousand, respectively. The contracts for the acquisition of these aircraft provided for the payment of advances amounting to €39,055 thousand.

Period retirements

The main retirements in 2003 were as follows:

| PERIOD RETIREMENTS | | | | | THOUSANDS OF EUROS |
|---|---------------|---------|--------------------------|------------|-----------------------|
| DISPOSALS | SELLING PRICE | COST | ACCUMULATED DEPRECIATION | ALLOWANCES | ALLOWANCE FOR REPAIRS |
| DISPOSALS (a) | 13,116 | 148,385 | (120,205) | (16,003) | (9,046) |
| SALES FOR SUBSEQUENT LEASEBACK UNDER AN OPERATING LEASE | 121,400 | 122,283 | (592) | - | - |
| AIRCRAFT SCRAPPED (b) | - | 131,227 | (105,823) | (20,206) | (5,198) |
| OTHER RETIREMENTS | - | 28,402 | (19,395) | (6,859) | - |

(a) Including the sale of 2 DC-9 engines, 6 DC-10 aircraft and 19 DC-10 engines, 2 B-727 engines, 1 B-747 engine and 3 A-300 engines.
(b) Including 7 DC-9 engines, 17 DC-9 aircraft, 6 B-727 engines, 4 B-727 aircraft, 1 B-747 aircraft and 1 A-300 engine.

Allowances

In order to recognize possible losses arising from the retirements of aircraft planned for the near future, Iberia, Líneas Aéreas de España, S.A. has recorded the related allowances for decline in value to adjust the net book value of these aircraft to their estimated realizable value. The provisions recorded to the allowances and the amounts used in 2003 were as follows:

| ALLOWANCES | | | | | THOUSANDS OF EUROS |
|------------------|---------------------|-------------------------------|-----------------|---------------------|--------------------|
| | BALANCE AT 12-31-02 | PERIOD PROVISIONS (NOTE 20-h) | AMOUNTS USED | BALANCE AT 12-31-03 | |
| AIRCRAFT: | | | | | |
| DC-9 | 18,412 | 2,137 | (20,405) | 144 | |
| DC-10 | 15,600 | - | (14,916) | 684 | |
| A-300 | 2,533 | - | (1,153) | 1,380 | |
| B-727 | 6,564 | 289 | (6,594) | 259 | |
| B-747 | 38,100 | 9,000 | - | 47,100 | |
| | 81,209 | 11,426 | (43,068) | 49,567 | |

Commitments and other guarantees on aircraft

Iberia, Líneas Aéreas de España, S.A. is using three aircraft under financial lease contracts (one A-320 and two A-321 aircraft) and 15 aircraft under operating lease contracts (seven A-320 and eight B-757 aircraft) the payments under which are securing, together with the aircraft, a bond issue amounting to €496,473 thousand in the European market launched by the lessor in 2000.

Iberia, Líneas Aéreas de España, S.A. is currently implementing a fleet renewal plan instrumented through two agreements entered into with Airbus Industrie G.I.E. (Airbus) in 1998 (A-320-type aircraft) and 2002 (A-340-type aircraft), to which various subsequent amendments have been made, and an agreement entered into with Internacional Lease Financial Corporation in 2003.

The aircraft not yet delivered as of December 31, 2003, and the year in which they are scheduled to be added to Iberia's fleet pursuant to the agreements entered into are as follows:

▶▶ **AIRCRAFT SUBJECT TO FIRM PURCHASE COMMITMENT**

| TYPE OF AIRCRAFT | 2004 | 2005 | 2006 | TOTAL |
|------------------|-----------|-----------|----------|-----------|
| A-319 | 3 | - | - | 3 |
| A-320 | 7 | 2 | 2 | 11 |
| A-321 | 4 | 5 | - | 9 |
| A-340/600 | 3 | 4 | - | 7 |
| | 17 | 11 | 2 | 30 |

▶▶ **AIRCRAFT SUBJECT TO PURCHASE OPTION**

| TYPE OF AIRCRAFT | 2005 | 2006 | 2007 | TOTAL |
|------------------|----------|-----------|----------|-----------|
| A-319 | 4 | 5 | - | 9 |
| A-320 | 2 | 2 | - | 4 |
| A-321 | - | 6 | - | 6 |
| A-340/600 | - | 3 | 2 | 5 |
| | 6 | 16 | 2 | 24 |

Also, the agreement entered into with Airbus in 2002 provides for purchase rights on a further three aircraft, which must be exercised prior to December 31, 2004.

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered as of December 31, 2003, amounted to €1,924 million, of which €1,009 million relate to the A-340-type aircraft and €915 million to the A-320-type aircraft.

Aircraft in service

Following is a summary of the Company's aircraft in service as of December 31, 2003:

▶▶ **AIRCRAFT IN SERVICE AS OF DECEMBER 31, 2003**

| TYPE OF AIRCRAFT | OWNED | UNDER FINANCIAL LEASE | UNDER OPERATING LEASE | TOTAL |
|------------------|-----------|-----------------------|-----------------------|------------|
| B-747 | 4 (a) | - | 2 | 6 |
| B-757 | 1 | - | 16 | 17 |
| A-319 | - | - | 4 | 4 |
| A-320 | 10 (b) | 10 | 36 | 56 |
| A-321 | - | 2 | 5 | 7 |
| A-340/300 | - | - | 18 | 18 |
| A-340/600 | - | - | 3 | 3 |
| MD-87 | 19 | - | 5 | 24 |
| MD-88 | 13 | - | 1 | 14 |
| | 47 | 12 | 90 | 149 |

(a) Excluding one aircraft which was grounded as of December 31, 2003, because it was to be sold or scrapped. The net book value of this aircraft, after deducting the allowances recorded, is zero.

(b) Excluding one damaged A-320 aircraft in Bilbao for which the Parent Company will receive, free of charge, another A-320 in 2004.

Aircraft operated under operating lease contracts

In 2003 one A-320 aircraft, two A-321 aircraft, three A-340/600 aircraft and one MD-88 aircraft were leased under an operating lease arrangement. Also, one B-747 aircraft and two B-757 aircraft the lease contracts for which expired in 2003 were returned.

- Boeing aircraft

B-757

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was leasing 16 B-757 aircraft from various companies (a different company for each plane). The lease contracts expire in 2004 and 2005, although for six of these aircraft an extension of the contracts through 2006 is being negotiated. At the end of the lease term the aircraft will be returned to the lessors, which also have a residual value guarantee from International Lease Finance Corporation.

The lease contracts require that certain overhauls be performed on the engines and other parts of these aircraft before they are definitively returned. To cover the cost of these repairs, which the Company estimates at approximately €39 million (including the expenses relating to two A-320 aircraft and five MD-87 aircraft which are scheduled to be returned when their respective contracts expire in 2004 and 2005), a provision of €19,780 thousand has been recorded under the "Provision for Third-Party Liability" caption, of which €14,200 thousand were recorded in 2003 (see Note 20-h). The remaining amount will be recorded in 2004 and 2005, periods in which these aircraft will continue to fly until they are returned.

B-747

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was leasing two B-747 aircraft under operating lease contracts with Air Atlanta, S.A. These contracts will expire in 2005 (with an option to extend the lease for an additional nine months) and the Company has deposited a completion bond of €950 thousand in connection with this transaction (see Note 9).

- Airbus aircraft

A-340/600

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was operating three A-340/600 aircraft under operating lease contracts with different companies which expire in 2015. The contracts provided for a purchase option for these aircraft or for their return in 2013 or 2015. At the end of the related lease term the lessor of the aircraft has a residual value guarantee from the International Lease Finance Corporation.

A-340/300

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was operating 18 A-340/300 aircraft under operating lease contracts, of which, four planes have been leased for nine-year periods, the contracts for which expire in 2009 and 2010, at which time the Company may opt to purchase the planes for a predetermined price or to return them to the lessor. The contracts for a further three planes expire in 2014 (two planes) and in 2015 (one plane), at which time the Company may opt to purchase the aircraft for a predetermined price or to return them to the lessor. In the case of the contract which expires in 2015, the purchase option may be exercised when the contract expires or two years prior to this date.

The remaining eleven planes are leased from the "Iberbus" companies (see Note 9), in which the Company has ownership interests. The basic conditions of the lease contracts for these planes are summarized as follows:

| RELATED IBERBUS COMPANY | TERMS AND CONDITIONS |
|--|---|
| CONCHA, LTD.; ROSALÍA, LTD. Y CHACEL, LTD. (b) | THE LEASES FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2003 AND WERE EXTENDED FOR AN ADDITIONAL FIVE YEARS. IF THE COMPANY EXERCISES THE PURCHASE OPTIONS AGREED ON FOR THE A-340/600 PLANES, THE CONTRACTS WILL BE EXTENDED FOR A FURTHER THREE YEARS (a). |
| ARENAL, LTD. (b) | THE LEASE INITIALLY EXPIRED IN 2003, BUT WAS EXTENDED FOR AN ADDITIONAL FIVE YEARS. |
| TERESA, LTD., EMILIA, LTD. (b) | THE LEASE FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2004 BUT IT WAS EXTENDED TO 2009. ADDITIONALLY, IF THE COMPANY EXERCISES THE PURCHASE OPTIONS AGREED ON FOR THE A-340/600 AIRCRAFT, THE CONTRACTS WILL BE EXTENDED FOR A FURTHER THREE YEARS (a). |
| AGUSTINA, LTD; BEATRIZ, LTD. (b) | THE LEASE FOR THESE AIRCRAFT INITIALLY EXPIRED IN 2005 BUT IT WAS EXTENDED FOR AN ADDITIONAL FIVE YEARS. |
| MARÍA PITA, LTD. (b) | THE LEASE ORIGINALLY EXPIRED IN 2007 BUT WAS EXTENDED TO 2012. |
| JUANA INÉS, LTD.; MARÍA DE MOLINA, LTD. (c) | THE LEASES FOR THESE AIRCRAFT EXPIRE IN 2006 AND 2007, RESPECTIVELY. |

(a) In the event of the second extension, the Company will receive a credit memorandum.
(b) When the lease contracts expire the Company can either exercise the purchase option or return the aircraft.
(c) When the lease expires the Company can extend it for three or eight years, in which case it must exercise the purchase option at the end of the extension period, or exercise the purchase option or return the aircraft. In this last case, if the owner does not find a buyer for the aircraft, the Company is obliged to extend the lease for a further two years.

A-319, A-320 and A-321

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was operating five A-321 aircraft, thirty six A-320 aircraft and four A-319 aircraft under operating lease contracts, the main features of which are as follows:

1. Twelve A-320 aircraft and four A-319 aircraft are leased under a contract with International Lease Finance Corporation, expiring in 2005 (five aircraft) and 2006 (eleven aircraft). When the lease term expires, the Company may extend them twice for one- or five-year periods, provided that the two extensions do not total more than six additional years, or it may return the aircraft. At the end of the extension period the Company can either exercise a purchase option or return the aircraft.

As a result of having entered into this contract, the Company had deposited a completion bond of €9,897 thousand, and this amount is recorded under the "Long-Term Deposits and Guarantees Given" caption in the accompanying consolidated balance sheet as of December 31, 2003 (see Note 9).

2. Two A-320 aircraft are leased under two contracts expiring in 2004, when the Company may renew the contracts for a maximum of six further years or return the aircraft.

3. Nine A-320 are leased under contracts expiring between 2012 and 2014, when the Company will return the aircraft to the lessor. However, the Company may choose to exercise the purchase option on the aircraft for a predetermined price provided for in the contracts on certain dates: September 30, 2007 (one aircraft), March 30, 2008 (two aircraft), September 30, 2009 (four aircraft) and September 15, 2011 (two aircraft).

4. The contracts relating to six A-320 aircraft expire in 2006 (three aircraft) and 2007 (three aircraft). When the contracts expire, the Company may extend them for a further five years, provided that it notifies the lessor of its decision 12 months prior to the expiration of the original lease term, or return the aircraft.

5. Six A-320 aircraft are leased under contracts with the following expiration dates: one aircraft in 2006, three aircraft in 2007 and two aircraft in 2008. When the lease term ends the Company has to return the aircraft to the lessor.

6. Three A-321 aircraft are leased under three lease contracts expiring between 2013 and 2018. These contracts provide for the possibility of exercising the purchase option prior to their definitive expiration (two aircraft in 2012 and one aircraft in 2013); should the purchase option not be exercised on the dates established, the Company will return the aircraft on expiration of the related contracts.

7. One A-320 aircraft is leased from Cygnus Aviation, and the lease contract expires in 2015. The lease contract establishes a purchase option for the aircraft that can be exercised in 2014. At the end of the lease term the lessor has a residual value guarantee from Airbus G.I.E.

8. The lease contracts relating to two A-321 aircraft expire in 2016 and provide for purchase options that can be exercised in 2012 and 2013. For one of these aircraft, at the end of the lease term, the lessor has a residual value guarantee from General Electric Company and Société Nationale d'Étude et de Construction de Moteurs d'Aviation (SNECMA).

MD-87

As of December 31, 2003, Iberia, Líneas Aéreas de España, S.A. was operating five MD-87 aircraft under operating lease contracts. The term of the lease contracts is 96 months (expiring in 2005), at the end of which the Company may exercise the purchase option provided for in the contract or return the planes.

MD-88

On February 6, 2003, an operating lease contract was entered into for one MD-88 aircraft which initially expired in April 2004. As envisaged in the contract, in January 2004 Iberia, Líneas Aéreas de España, S.A. extended the lease term until May 2006.

Lease expenses

The lease payments accrued in 2003 for the operating lease of the aforementioned B-747, B-757, A-319, A-320, A-321, A-340, MD-87 and MD-88 aircraft amounted to €325,485 thousand, and this amount is included under the "Other Operating Expenses" caption in the consolidated statement of income (see Note 20-g). The detail of the approximate total operating lease payments payable for these aircraft and of the related due dates is as follows:

▶▶ LEASE EXPENSES

| DUE DATES | MILLIONS OF EUROS |
|--------------|-------------------|
| 2004 | 324 |
| 2005 | 292 |
| 2006 | 216 |
| 2007 | 169 |
| 2008 TO 2018 | 746 |
| | 1,747 (*) |

(*) Of this amount, €1,739 million are equivalent to US\$ 2,196 million at the year-end exchange rate. A portion of these lease payments are hedged with derivatives (see Note 18).

As of the date of preparation of these consolidated financial statements the Parent Company's directors did not intend to exercise the purchase options on the aircraft that as of December 31, 2003, were being operated by Iberia, Líneas Aéreas de España, S.A. under operating lease contracts.

Also, most of the operating lease contracts in force stipulate that the lessee must bear the periodic repair and inspection costs. Iberia, Líneas Aéreas de España, S.A. has recorded the related provision of €55,720 thousand under the "Provision for Major Repairs" caption (see Note 15).

Subsequent agreements relating to aircraft

In January 2004 the Parent Company entered into a new operating lease contract for one A-321 aircraft that expires in 2017 and has a residual value guarantee from General Electric Company and Société Nationale d'Etude et de Construction de Moteurs d'Aviation (SNECMA). The contract provides for the possibility of exercising a purchase option in 2014.

Other tangible fixed assets

The buildings constructed on land owned by the Government, mainly at Spanish airports, and the related fixtures had a net book value of €24,763 thousand as of December 31, 2003. The concessions relating to these assets expire in the period from 2004 to 2009.

In 2003 the Parent Company sold two buildings located in Barcelona and Rome, for a total amount of €11,763 thousand. This transaction gave rise to a gain of €9,337 thousand, and this amount is included under the "Gains on Fixed Asset Disposals" caption in the accompanying 2003 consolidated statement of income.

Also, on November 6, 2003, the Parent Company entered into an earnest money contract whereby it agreed the sale of a building located in Barcelona and set a selling price of €30,800 thousand, of which €3,080 thousand were collected as earnest money. The net book value as of December 31, 2003, of this building and its related fixtures amounted to €1,640 thousand. This transaction was formalized in February 2004.

The incorporation of spare parts into the aircraft in 2003 gave rise to the retirement of items with a net book value of €80,527 thousand, and this amount is included under the "Procurements" caption in the accompanying consolidated statement of income (See Note 20-e).

Also, the costs incurred in refurbishing the cabins of aircraft added to the fleet under operating lease contracts gave rise to retirements from the "Construction in Progress" account amounting to €16,467 thousand. Of this amount €15,915 thousand were returned by the lessor of the planes after the related operating lease contracts were formalized.

Revaluation reserve Royal Decree-Law 7/1996

On December 31, 1996, the Group revalued its property, plant and equipment pursuant to Royal Decree-Law 7/1996, and paid the single 3% tax. The Group had previously availed itself of other revaluation legislation. The detail of the revaluation surplus and the effect thereof as of December 31, 2003, is as follows:

| DECEMBER 31, 2003 | | | | THOUSANDS OF EUROS |
|--------------------------------|------------------------|-------------------|----------------|------------------------|
| | SURPLUS AT 12-31-02 | 2003 PROVISION | RETIREMENTS | BALANCE AT 12-31-03 |
| AIRCRAFT | 24,352 | (1,245) | (1,564) | 21,543 |
| LAND | 700 | - | - | 700 |
| BUILDINGS AND OTHER STRUCTURES | 7,298 | (444) | (392) | 6,462 |
| MACHINERY, FIXTURES AND TOOLS | 317 | (97) | - | 220 |
| TRANSPORT EQUIPMENT | 2 | - | - | 2 |
| FLIGHT SIMULATORS | 2 | (1) | - | 1 |
| | 32,671 | (1,787) | (1,956) | 28,928 |

The revaluation increased the 2003 depreciation expense by approximately €1,787 thousand, and will increase the 2004 depreciation expense by approximately €1,732 thousand.

The revaluation surplus, net of the single 3% tax, was credited to the "Revaluation Reserve" caption, with a charge to the appropriate revalued asset accounts, without altering the recorded accumulated depreciation amount. On January 22, 1998, the tax authorities checked and approved the balance of the revaluation reserve and, accordingly, as permitted by current legislation, it was agreed to use the aforementioned reserve to offset accumulated losses.

Fully depreciated assets

As of December 31, 2003, the cost of the Group's fully depreciated property, plant and equipment amounted to €310,612 thousand, the detail being as follows:

| FULLY DEPRECIATED ASSETS | THOUSANDS OF EUROS |
|---------------------------------|---------------------------|
| STRUCTURES | 59,489 |
| MACHINERY, FIXTURES AND TOOLS | 165,860 |
| FURNITURE | 9,761 |
| COMPUTER HARDWARE | 27,830 |
| FLIGHT SIMULATORS | 38,636 |
| TRANSPORT EQUIPMENT | 2,615 |
| AIRCRAFT | 6,720 |
| TOTAL | 310,911 |

Insurance coverage

The Group companies have arranged insurance policies for their property, plant and equipment and intangible assets which sufficiently covered their net book value as of December 31, 2003. Also, the Group has arranged insurance policies for the aircraft leased from third parties, in accordance with the conditions stipulated in the related lease contracts.

9 Long-term investments

Investments in companies accounted for by the equity method

The variations in 2003 in the balance of the "Investments in Companies Accounted for by the Equity Method" caption were as follows:

INVESTMENTS IN COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD

THOUSANDS OF EUROS

| | BALANCE AT 12-31-02 | SHARE IN INCOME (LOSSES) | DISTRIBUTION OF DIVIDENDS | ADDITIONS | OTHER | BALANCE AT 12-31-03 |
|--|------------------------|-----------------------------|------------------------------|------------|--------------|------------------------|
| AMADEUS GROUP | 107,268 | 33,347 | (5,658) | - | - | 134,957 |
| TOUROPERADOR VIVA TOURS, S.A. | 1,364 | (875) | - | - | - | 489 |
| SOCIEDAD CONJUNTA PARA LA EMISIÓN Y GESTIÓN DE MEDIOS DE PAGO EFC, S.A. | 2,535 | 29 | - | 800 (a) | - | 3,364 |
| MULTISERVICIOS AEROPORTUARIOS, S.A. | 1,671 | 271 | (51) | - | - | 1,891 |
| EMPRESA HISPANO CUBANA DE MANTENIMIENTO DE AERONAVES IBECA, S.A. | 345 | 187 | (124) | - | (75) | 333 |
| EMPRESA LOGÍSTICA DE CARGA AÉREA, S.A. | 179 | 17 | - | - | (32) | 164 |
| HANDLING GUINEA ECUATORIAL, S.A. | 296 | 703 | (108) | - | - | 891 |
| IBER-AMÉRICA AEROSPACE LLC | 631 | 218 | (90) | - | (119) | 640 |
| TOTAL | 114,289 | 33,897 | (6,031) | 800 | (226) | 142,729 |

(a) Relating to the capital increase carried out by Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A. (IBERIA-CARDS) which Iberia, Líneas Aéreas de España, S.A. subscribed in proportion to its ownership interest.

Long-term investment securities

The detail of the investments recorded under this caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

LONG-TERM INVESTMENTS SECURITIES

THOUSANDS OF EUROS

| | PERCENTAGE OF OWNERSHIP AT 12-31-03 | BALANCE AT 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | BALANCE AT 12-31-03 |
|---|---|------------------------|-----------------|----------------|----------------|------------------------|
| FIXED-INCOME SECURITIES: | | | | | | |
| IBERBOND PLC 1999 | - | 34,320 | - | - | (1,170) | 33,150 |
| GOVERNMENT DEBT | - | 3,333 | - | (2,578) | - | 755 |
| EQUITY SECURITIES: | | | | | | |
| VENEZOLANA INTERNACIONAL DE AVIACIÓN, S.A. | 45.00 | 88,446 | - | - | - | 88,446 |
| INTERINVEST, S.A. | 0.14 | 30,244 | - | - | - | 30,244 |
| IBERBUS COMPANIES | (a) | 24,930 | - | - | - | 24,930 |
| OPODO, LTD. | 9.14 | 17,676 | 1,570 | - | - | 19,246 |
| ADQUIRA ESPAÑA, S.A. | 10.00(c) | 3,583 | - | - | - | 3,583 |
| CORDIEM | (b) | 2,352 | - | - | - | 2,352 |
| OTHER | - | 2,161 | 4 | (1,168) | - | 997 |
| TOTAL COST | | 207,045 | 1,574 | (3,746) | (1,170) | 203,703 |
| ALLOWANCES | | (125,942) | (16,166) | - | (100) | (142,208) |

(a) The percentages of ownership in these companies range from 40% to 45.45%.
(b) Holdings of 1.86% in Cordiem LLC and of 2.07% in Cordiem, Inc. This investment had been provisioned in full as of December 31, 2003.
(c) An allowance amounting to €1,716 thousand was recorded for this investment.

The main period additions arose from the subscription, in proportion to its ownership interest, to successive capital increases at Opodo, Ltd. The amounts disbursed in this connection totaled €1,570 thousand. An allowance of €19,246 thousand has been recorded for this investment.

Fixed income securities

In September 1999 Iberia, Líneas Aéreas de España, S.A. subscribed to bonds issued by Iberbond PLC 1999 for €39,000 thousand. These bonds form part of an issue relating to the acquisition of six A-320 aircraft which were subsequently leased to Iberia, Líneas Aéreas de España, S.A. under a financial lease contract.

The bonds subscribed to by Iberia, Líneas Aéreas de España, S.A. earn annual interest of 5.90% which is settled every six months. 3% of the principal is payable each year through the final maturity on September 1, 2007, when the remaining 85% becomes payable. As of December 31, 2003, the Group recorded the €1,170 thousand maturing in 2004 under the "Short-Term Investments" caption in the consolidated balance sheet (see Note 12).

The interest earned in 2003 amounted to €2,080 thousand and was recorded under the "Other Interest and Similar Revenues" caption in the accompanying consolidated statement of income; of this amount, €718 thousand relate to unmatured accrued interest as of December 31, 2003, which was recorded under the "Short-Term Investments" caption in the consolidated balance sheet.

Equity securities

In January 1997 Venezolana Internacional de Aviación, S.A. discontinued its business operations. In March 1997 this company filed for "suspensión de pagos" (Chapter 11-type insolvency proceedings, hereinafter "suspension of payments") and the process of liquidation, which is still in progress, commenced. This investment has been provisioned in full. Also, since this investee is inactive and no up-to-date financial statements are available for it, it was excluded from consolidation in 2002.

Iberia, Líneas Aéreas de España, S.A.'s holding in Interinvest, S.A. (the majority shareholder of Aerolíneas Argentinas, S.A.) was provisioned in full in 1999 due to the accumulated losses incurred by Aerolíneas Argentinas, S.A.

The information relating to the Iberbus companies, which own most of the A-340/300 aircraft operated by Iberia, Líneas Aéreas de España, S.A. (see Note 8), as of December 31, 2003, drawn from their respective provisional financial statements, is as follows:

| IBERBUS COMPANIES | | THOUSANDS OF EUROS | | | | |
|--------------------------------|-----------------------------------|--------------------------------|---------------|---------|----------|---------------|
| GROUP AND ASSOCIATED COMPANIES | ADDRESS | PERCENTAGE OF DIRECT OWNERSHIP | COST | CAPITAL | RESERVES | ORDINARY LOSS |
| IBERBUS CONCHA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,029 | 5,428 | (1,581) | (384) |
| IBERBUS ROSALÍA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,056 | 5,387 | (3,265) | (267) |
| IBERBUS CHACEL, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,283 | 5,967 | (5,494) | - |
| IBERBUS ARENAL, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,362 | 6,105 | (7,782) | (491) |
| IBERBUS TERESA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,504 | 5,520 | (1,727) | (177) |
| IBERBUS EMILIA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,497 | 5,544 | (1,890) | (134) |
| IBERBUS AGUSTINA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,587 | 5,546 | (259) | (128) |
| IBERBUS BEATRIZ, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 40.00 | 2,556 | 5,564 | (104) | (168) |
| IBERBUS JUANA INÉS, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 1,896 | 3,318 | (3,779) | (802) |
| IBERBUS MARÍA DE MOLINA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 1,983 | 3,490 | (4,074) | (1,043) |
| IBERBUS MARÍA PITA, LTD. | GEORGE'S DOCK HOUSE, IFSC; DUBLÍN | 45.45 | 2,177 | 3,674 | (3,667) | (1,345) |
| | | | 24,930 | | | |

The majority shareholder of these companies, Airbus Industrie Financial Services, has guaranteed for Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of its investments in and loans to the Iberbus companies, and, accordingly, the value of the Group's ownership interest in these companies is equal to the cost for which they were acquired and they were excluded from the scope of consolidation.

In 2003 the Group sold its holding in Tiempo Libre, S.A., the cost of which amounted to €457 thousand, and various Mundicolor brand names related with this holding, the net book value of which was zero. As a result of this transaction, the Group recorded a gain of €11,543 thousand under the "Other Interest and Similar Revenues" caption in the accompanying consolidated 2003 statement of income.

The Parent Company subscribed in February 2004 to a capital increase at Servicios de Instrucción de Vuelo, S.L., whose main business activity is the operation of flight simulators. The ownership interest acquired was 19.9%.

Other loans

The detail of the balance of this caption in the consolidated balance sheet as of December 31, 2003, is as follows:

| | THOUSANDS OF EUROS | | | |
|---|------------------------|-----------------------------|--------------|------------------------|
| | BALANCE AT 12-31-02 | EXCHANGE DIFFERENCES (*) | OTHER | BALANCE AT 12-31-03 |
| LOANS TO VENEZOLA INTERNACIONAL DE AVIACIÓN, S.A. | 25,623 | - | - | 25,623 |
| LOANS TO IBERBUS COMPANIES | 188,853 | (32,043) | - | 156,810 |
| LOANS TO AEROLÍNEAS ARGENTINAS, S.A. | 3,914 | - | (125) | 3,789 |
| OTHER | 8,118 | - | (120) | 7,998 |
| TOTAL COST | 226,508 | (32,043) | (245) | 194,220 |
| ALLOWANCES | (33,479) | - | 99 | (33,380) |

(*) Recorded under the "Exchange Losses" caption in the consolidated statement of income and covered by hedging transactions (see Note 18).

The loans granted to Venezolana Internacional de Aviación, S.A. (VIASA) in prior years had been provisioned in full as of December 31, 2003.

Iberia, Líneas Aéreas de España, S.A. has granted a loan to each of its Iberbus investees. The principal ranges, depending on the company in question, from US\$ 11,049 thousand to US\$ 22,101 thousand. These loans were granted for a period equal to the term of the operating lease for the related A-340/300 aircraft (see Note 8), and earn annual interest ranging from 4% to 6%. These loans are repayable at one time when they mature, which, depending on the company concerned, will take place in the period from 2006 to 2012.

The amounts not yet repaid in this connection, by maturity, are as follows:

| DECEMBER 31, 2003 | | THOUSANDS OF EUROS |
|-------------------|--|--------------------|
| MATURING IN | | |
| 2006 | | 8,748 |
| 2007 | | 9,200 |
| 2008 | | 65,611 |
| 2009 | | 31,715 |
| 2010 | | 31,850 |
| 2012 | | 9,686 |
| TOTAL | | 156,810 |

In 1999 Iberia, Líneas Aéreas de España, S.A. granted Aerolíneas Argentinas, S.A. two loans of €3,537 thousand and €2,352 thousand. These loans earn interest at 5.25% and their final maturity was established at 2006 and 2000, respectively.

Most of the principal of these loans and the related interest, amounting to €6,123 thousand, were outstanding as of December 31, 2003, of which the portion classified as short term under the "Short-Term Investments" caption (see Note 12) relates to the principal and accrued interest which were not paid on maturity.

Also, Iberia Líneas Aéreas de España, S.A. has trade accounts receivable from and payable to Aerolíneas Argentinas, S.A. for a net amount receivable of approximately €23,233 thousand.

In addition, Iberia, Líneas Aéreas de España, S.A. provided a guarantee to Banesto, S.A. for Aerolíneas Argentinas, S.A. under which it undertook, in the event of default by the latter, to pay the outstanding amounts of a mortgage loan secured by two B-747 aircraft. Banesto, S.A. has initiated proceedings to execute this guarantee and claimed €47,114 thousand from Iberia, Líneas Aéreas de España, S.A. The Parent Company has set up a restricted deposit of €48,030 thousand, which is recorded under the "Long-Term Deposits and Guarantees Given" caption.

Furthermore, Iberia, Líneas Aéreas de España, S.A. had provided another guarantee (in U.S. dollars) for Aerolíneas Argentinas, S.A. amounting to US\$ 6 million.

In view of the suspension of payments of Aerolíneas Argentinas, S.A., the Group has recorded a provision of €80,209 thousand to cover the possible bad debts and liabilities that might arise from the aforementioned transactions. This amount was recorded under the "Provision for Third-Party Liability" caption in the consolidated balance sheet (see Note 15).

Long-term deposits and guarantees given

The variations in 2003 in the items composing this caption in the consolidated balance sheet is as follows:

| | LONG-TERM DEPOSITS AND GUARANTEES GIVEN | | | | | | THOUSANDS OF EUROS |
|---|---|----------------|-----------------|----------------|-------------------------|------------------------|--------------------|
| | BALANCE AT 12-31-02 | ADDITIONS | RETIREMENTS | TRANSFERS | EXCHANGE DIFFERENCES | BALANCE AT 12-31-03 | |
| DEPOSIT FOR AEROLÍNEAS ARGENTINAS, S.A. | 47,114 | 916 | - | - | - | 48,030 | |
| DEPOSIT FOR CONVERTIBLE DEBENTURES (NOTE 17) | 22,573 | 27,532 | - | (22,573) | - | 27,532 | |
| DEPOSITS AND GUARANTEES FOR OPERATION OF AIRCRAFT LEASED FROM ILFC (NOTE 8) | 10,012 | 1,806 | - | - | (1,921) | 9,897 | |
| DEPOSITS AND GUARANTEES FOR OPERATION OF AIRCRAFT UNDER DRY LEASE ARRANGEMENTS (NOTE 8) | 2,332 | - | (552) | - | (318) | 1,462 | |
| DEPOSITS FOR ACQUISITION OF AIRCRAFT (NOTE 8) | - | 224,012 | (28,589) | 155,022 | (43,078) | 307,367 | |
| OTHER | 4,547 | 181 | (446) | - | (396) | 3,886 | |
| | 86,578 | 254,447 | (29,587) | 132,449 | (45,713) | 398,174 | |

The amounts included in the "Deposits for Acquisition of Aircraft" account relate to the amounts paid on account pursuant to the conditions established in the contracts to acquire the aircraft. Since these amounts are repayable on the basis of the system finally used to incorporate the plane into the fleet in service, to improve their presentation in 2003 they were reclassified from the "Property, Plant and Equipment" caption to the "Long-Term Investments" caption.

In March 2002 an agreement was entered into by Iberia, Airbus and their respective insurance companies, whereby Iberia sold an A-320 aircraft grounded in Bilbao as a result of an accident to Airbus for the symbolic amount of US\$ 1 and will receive a similar aircraft in exchange, free of charge, in July 2004. As a result of this transaction, the Parent Company transferred the net book value of this aircraft, amounting to €36,583 thousand (€39,261 thousand relating to cost and €2,678 thousand relating to accumulated depreciation), from the "Property, Plant and Equipment" caption, since the Company will foreseeably recover this amount when the new aircraft comes into service under an operating lease.

The detail of the balance as of December 31, 2003, of the "Deposits for Acquisition of Aircraft" account is as follows:

| DEPOSITS FOR ACQUISITION OF AIRCRAFT | | | THOUSANDS OF EUROS |
|--------------------------------------|--|-------------------------------------|--------------------|
| TYPE OF AIRCRAFT | AIRCRAFT SUBJECT TO FIRM PURCHASE COMMITMENT | AIRCRAFT SUBJECT TO PURCHASE OPTION | |
| A-319 | 19,202 | 1,069 | |
| A-320 | 103,469 | 1,664 | |
| A-321 | 62,189 | 1,781 | |
| A-340 | 109,572 | 5,146 | |
| | 294,432 | 9,660 | |

This account also includes advances for the acquisition of engines amounting to €3,275 thousand.

10 Shares of the Parent Company

The variations in 2003 in the "Shares of the Parent Company" caption in the accompanying consolidated balance sheet as of December 31, 2003, were as follows:

| SHARES OF THE PARENT COMPANY | | THOUSANDS OF EUROS |
|-------------------------------------|--|--------------------|
| BALANCE AT DECEMBER 31, 2002 | | 31,896 |
| ADDITIONS | | 4,315 |
| REDUCTIONS | | (16,145) |
| BALANCE AT DECEMBER 31, 2003 | | 20,066 |

The 14,851,798 shares of treasury stock held by Iberia, Líneas Aéreas de España, S.A. as of December 31, 2003, represent 1.6% of its capital stock, with an overall par value of €11,584 thousand and an average acquisition cost of €1.35 per share. The balance of €20,066 thousand of the "Reserve for Treasury Stock" account as of December 31, 2003, covers in full the net book value of the aforementioned shares.

The sale of shares of treasury stock in 2003, the only item included in "Reductions" in the foregoing table, gave rise to gains totaling €8,347 thousand, which were recorded under the "Gains on Transactions Involving Shares of the Parent Company" caption in the consolidated statement of income.

11 Inventories

The detail of the balance of this caption in the consolidated balance sheet as of December 31, 2003, is as follows:

| ▶▶ INVENTORIES | THOUSANDS OF EUROS |
|--|--------------------|
| RAW MATERIALS AND OTHER SUPPLIES | 78,479 |
| MERCHANDISE | 8,554 |
| WORK-IN-PROCESS AND SEMIFINISHED GOODS | 7,423 |
| ADVANCES TO SUPPLIERS | 2,529 |
| ALLOWANCES | (19,930) |
| TOTAL | 77,055 |

12 Short-term investments

The detail of the balance of this caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

| ▶▶ SHORT-TERM INVESTMENTS | THOUSANDS OF EUROS |
|--|--------------------|
| SHORT-TERM FINANCIAL ASSETS | 1,270,233 |
| EXCHANGE DIFFERENCES DUE TO HEDGING TRANSACTIONS | 43,728 |
| DEPOSITS FOR CONVERTIBLE DEBENTURES (NOTE 17) | 22,573 |
| OTHER SHORT-TERM DEPOSITS AND GUARANTEES | 6,594 |
| UNMATURED INTEREST RECEIVABLE | 8,355 |
| LOANS TO AEROLINEAS ARGENTINAS, S.A. (NOTE 9) | 2,334 |
| IBERBOND BONDS (NOTE 9) | 1,170 |
| OTHER SHORT-TERM INVESTMENTS | 3,040 |
| | 1,358,027 |

The "Exchange Differences Due to Hedging Transactions" account relates to the net balance resulting from the valuation as of December 31, 2003, of the transactions to hedge asset and liability positions (See Note 18).

The short-term financial assets, relating mainly to Eurodeposits and Eurocommercial paper, earned average annual interest of 2.48% in 2003.

13 Shareholders' equity

The variations in equity accounts in 2003 were as follows:

| | CAPITAL STOCK | LEGAL RESERVE | RESERVE FOR TREASURY STOCK |
|--|----------------|---------------|----------------------------|
| BALANCES AT DECEMBER 31, 2002 | 712,110 | 61,352 | 31,896 |
| DISTRIBUTION OF CONSOLIDATED INCOME FOR 2002 | - | 14,319 | - |
| CAPITAL INCREASE | 4,723 | - | - |
| RESERVE FOR TREASURY STOCK | - | - | (11,830) |
| TRANSLATION DIFFERENCES | - | - | - |
| CONSOLIDATED INCOME FOR 2003, PER ACCOMPANYING CONSOLIDATED STATEMENT OF INCOME | - | - | - |
| BALANCES AT DECEMBER 31, 2003 | 716,833 | 75,671 | 20,066 |

In any evaluation of the Iberia Group's net worth as of December 31, 2003, the value of its treasury stock should be deducted from the equity balance shown in the accompanying consolidated balance sheet.

Capital stock

In 2001 Iberia, Líneas Aéreas de España, S.A. launched a stock option plan aimed at all its employees. Under the terms of the plan, once the period for waiver had ended, the number of options accepted amounted to 25,291,842, for which the employees disbursed €0.30 per option as an advance payment. The advance payments not yet refunded amounting to €5,690 thousand are recorded under the "Other Nontrade Payables" caption in the accompanying consolidated balance sheet. The option exercise price was established at €1.19, and the employees can exchange 25% of the options subscribed, in the proportion of one to one in 2003, and the remaining 75% of the options in equal parts, on each of the following dates: February 3, 2004, June 3, 2004 and October 3, 2004. On each of these dates, the employees can opt to postpone the exercise of their rights and accumulate them, provided that the market price of the shares on that date is lower than the exercise price; otherwise, the right will be forfeited.

In order to cater for the commitments to employees in connection with the stock option plan described above, in 2002 the Group's Parent Company issued debentures convertible into shares (See Note 17).

Based on the redemption dates established, in 2003 the holders of the convertible debentures requested the conversion of 6,054,859 convertible debentures into 6,054,859 common shares of the Parent Company. Consequently, the Company increased its capital stock by €4,722,790, through the issuance of 6,054,859 common shares of €0.78 par value each plus additional paid-in capital of €0.41 per share.

THOUSANDS OF EUROS

| VOLUNTARY RESERVES | OTHER RESERVES OF THE PARENT COMPANY | RESERVES AT FULLY CONSOLIDATED COMPANIES | RESERVES AT COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | TRANSLATION DIFFERENCES | INCOME FOR THE YEAR | DIVIDENDS |
|--------------------|--------------------------------------|--|--|-------------------------|---------------------|---------------|
| 111,327 | 97,858 | 75,721 | 70,476 | (123) | 157,120 | - |
| 93,261 | - | 514 | 13,418 | - | (157,120) | 35,608 |
| - | 2,483 | - | - | - | - | - |
| 11,830 | - | - | - | - | - | - |
| - | - | - | - | (161) | - | - |
| - | - | - | - | - | 143,586 | - |
| 216,418 | 100,341 | 76,235 | 83,894 | (284) | 143,586 | 35,608 |

Also, the holders of 268,101 convertible debentures redeemed the debentures subscribed early.

Also, in February 2004 the Parent Company's Board of Directors resolved to increase capital stock by €4,779 thousand, through the issuance of 6,127,649 common shares of €0.78 par value each plus additional paid-in capital of €0.41 per share, to cater for the requests from their holders to convert 6,127,649 debentures into shares. On this exercise date the holders of 195,311 convertible debentures redeemed them early.

As of December 31, 2003, the Parent Company's capital stock consisted of 919,016,894 fully subscribed and paid shares of €0.78 par value each traded by the book-entry system.

As of December 31, 2003, the Parent Company's shareholders were as follows:

▶ PARENT COMPANY'S SHAREHOLDERS

| | NUMBER OF SHARES | PERCENTAGE OF OWNERSHIP |
|--|--------------------|-------------------------|
| BA & AA HOLDINGS LIMITED | 91,296,204 | 9.93 |
| CAJA DE AHORROS Y MONTE DE PIEDAD DE MADRID | 91,290,716 | 9.93 |
| BANCO BILBAO VIZCAYA ARGENTARIA, S.A. | 68,945,483 | 7.50 |
| COMPAÑÍA DE DISTRIBUCIÓN INTEGRAL LOGISTA, S.A. | 61,164,780 | 6.66 |
| SOCIEDAD ESTATAL DE PARTICIPACIONES INDUSTRIALES | 49,212,526 | 5.35 |
| CORPORACIÓN FINANCIERA DE GALICIA | 32,404,254 | 3.53 |
| EL CORTE INGLÉS, S.A. | 27,387,215 | 2.98 |
| OTHER, INCLUDING EMPLOYEES | 497,315,716 | 54.12 |
| TOTAL | 919,016,894 | 100.00 |

On June 6, 2002, the Shareholders' Meeting approved a stock option plan involving shares of the Parent Company for executives directors, certain managers and other line personnel, which will be instrumented through the issuance of debentures convertible into shares of Iberia, Líneas Aéreas de España, S.A. In order to cater for this new stock option plan, in 2003 the Parent Company issued convertible debentures. The option exercise price was set at €1.62, pursuant to the terms established by the Shareholders' Meeting (see Note 17). The 16,995,400 options can be exchanged on various dates in the period from April 26, 2005 to April 25, 2008.

Legal reserve

Under the revised Corporations Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of capital stock.

The legal reserve can be used to increase capital provided that the remaining reserve balance does not fall below 10% of the increased capital stock amount. Otherwise, until the legal reserve exceeds 20% of capital stock, it can only be used to offset losses, provided that sufficient other reserves are not available for this purpose.

Other reserves of the Parent Company

The detail of the "Other Reserves of the Parent Company" caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

| OTHER RESERVES OF THE PARENT COMPANY | | THOUSANDS OF EUROS |
|---|----------------|--------------------|
| ADDITIONAL PAID-IN CAPITAL | 98,937 | |
| DIFFERENCES DUE TO THE ADJUSTMENT OF CAPITAL TO EUROS | 1,201 | |
| REVALUATION RESERVE | 38 | |
| MERGER RESERVE | 165 | |
| TOTAL | 100,341 | |

Additional paid-in capital

The revised Corporations Law expressly permits the use of the additional paid-in capital balance to increase capital and establishes no specific restrictions as to its use.

Differences due to the adjustment of capital stock to euros

In the redenomination of the capital stock to euros, which was approved by the Board of Directors of the Parent Company in 1999, the difference arising as a result of the rounding off made it necessary to reduce capital and to record a restricted reserve in accordance with current legislation.

Revaluation reserve and merger reserve

As a result of the merger by absorption of Aviación y Comercio, S.A. in 2000, a merger reserve was recorded.

Also, Aviación y Comercio, S.A., in its merger balance sheet as of January 31, 2000, had recorded a revaluation reserve as a result of the revaluation made pursuant to Royal Decree-Law 7/1996. Pursuant to current legislation, the Parent Company recorded a revaluation reserve equal to the amount obtained by applying to the merger reserve the percentage of Aviación y Comercio, S.A.'s total equity as of January 31, 2000, represented by the revaluation reserve recorded by it.

Reserves at fully consolidated companies and at companies accounted for by the equity method

The detail of the balance of the "Reserves at Fully Consolidated Companies" caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

| RESERVES AT FULLY CONSOLIDATED COMPANIES | THOUSANDS OF EUROS |
|---|---------------------------|
| COMPAÑÍA AUXILIAR AL CARGO EXPRES, S.A. | 2,533 |
| CAMPOS VELÁZQUEZ, S.A. | 6,319 |
| CARGOSUR, S.A. | (3,647) |
| IBER-SWISS CATERING, S.A. | 7,059 |
| VIVA VUELOS INTERNACIONALES DE VACACIONES, S.A. | (77,193) |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJES, S.A. | 20,166 |
| CONSULTORES HANSA, S.A. | - |
| IBERIA TECNOLOGÍA, S.A. | 105 |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | 31 |
| TOTAL | (44,627) |
| CONSOLIDATION ADJUSTMENTS | 120,862 |
| TOTAL | 76,235 |

The breakdown of the consolidation adjustments is as follows:

| CONSOLIDATION ADJUSTMENTS | THOUSANDS OF EUROS |
|--|---------------------------|
| NET RESERVES OF AVIACIÓN Y COMERCIO, S.A. | 56,477 |
| REVERSAL OF ALLOWANCES FOR LONG-TERM INVESTMENTS IN IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A., MADE BY SUBSIDIARIES IN PRIOR YEARS | 79,564 |
| ELIMINATION OF DIVIDENDS RECEIVED IN PRIOR YEARS | (17,315) |
| ELIMINATION OF GAINS ON FIXED ASSET DISPOSALS | 2,189 |
| OTHER | (53) |
| TOTAL | 120,862 |

The detail of the balance of the "Reserves at Companies Accounted for by the Equity Method" caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

| RESERVES AT COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | THOUSANDS OF EUROS |
|---|---------------------------|
| AMADEUS GROUP | 137,481 |
| TOUROPERADOR VIVA TOURS, S.A. | (4,416) |
| MULTISERVICIOS AEROPORTUARIOS, S.A. | 113 |
| IBER-AMERICA AEROSPACE LLC | 104 |
| EMPRESA LOGÍSTICA DE CARGA AÉREA, S.A. | (12) |
| EMPRESA HISPANO CUBANA DE MANTENIMIENTO DE AERONAVES IBECA, S.A. | 334 |
| HANDLING GUINEA ECUATORIAL, S.A. | 142 |
| SOCIEDAD CONJUNTA PARA LA EMISIÓN Y GESTIÓN DE MEDIOS DE PAGO EFC, S.A. | (703) |
| TOTAL | 133,043 |
| CONSOLIDATION ADJUSTMENTS | (49,149) |
| TOTAL | 83,894 |

The breakdown of the consolidation adjustments is as follows:

| CONSOLIDATION ADJUSTMENTS | THOUSANDS OF EUROS |
|--|---------------------------|
| REVERSAL OF ALLOWANCES FOR LONG-TERM INVESTMENTS IN IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A., MADE BY SUBSIDIARIES IN PRIOR YEARS | 3,680 |
| ELIMINATION OF DIVIDENDS RECEIVED IN PRIOR YEARS | (60,510) |
| ADDITION TO NET WORTH NET OF TAXES RELATING TO AMADEUS | 12,494 |
| ELIMINATION OF GAINS ON FIXED ASSET DISPOSALS | (6,952) |
| REVERSAL OF NEGATIVE CONSOLIDATION GOODWILL | 2,314 |
| OTHER | (175) |
| TOTAL | (49,149) |

Other matters

The restricted reserves at the consolidable Group companies amounted to €2,724 thousand as of December 31, 2003 (€1,401 thousand of revaluation reserves and €1,323 thousand of legal reserves).

The companies with holdings of 10% or more in the capital stock of the most significant subsidiaries as of December 31, 2003, were as follows:

| DECEMBER 31, 2003 | | |
|---|------------------------------------|---|
| COMPANY | PERCENTAGE OF OWNERSHIP | INVESTEES |
| MARÍTIMAS REUNIDAS, S.A. | 25.00 | COMPAÑÍA AUXILIAR AL CARGO EXPRES, S.A. |
| AMADEUS GLOBAL TRAVEL DISTRIBUTION, S.A. | 34.00 | SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJES, S.A. |
| GATE GOURMET HOLDING AG (a) | 30.00 | IBER-SWISS CATERING, S.A. |
| SOCIÉTÉ AIR FRANCE (a) | 35.69 | AMADEUS GROUP |
| LUFTHANSA COMMERCIAL HOLDING GMBH (a) | 27.92 | AMADEUS GROUP |
| SOL MELIÁ, S.A. (a) | 19.00 | TOUROPERADOR VIVA TOURS, S.A. |
| IBEROSTAR HOTELES Y APARTAMENTOS, S.A. (a) | 30.00 | TOUROPERADOR VIVA TOURS, S.A. |

(a) Subsequent to year-end there were changes to these percentages of ownership as a result of the sale transactions described in Notes 2 and 3.

14 Minority interests

The variations, by subsidiary, in the balance of the "Minority Interests" caption in the accompanying consolidated balance sheet as of December 31, 2003, were as follows:

| DECEMBER 31, 2003 | | | | | | THOUSANDS OF EUROS |
|-------------------------------------|--|---------------------------------|---|---|---|--------------------|
| | VIVA VUELOS INTERNA- CIONALES DE VACACIONES, S.A. | IBER-SWISS CATERING, S.A. | COMPAÑÍA AUXILIAR AL CARGO EXPRÉS, S.A. | SISTEMAS AUTOMA- TIZADOS AGENCIAS DE VIAJE, S.A. | AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | TOTAL |
| BALANCE AT DECEMBER 31, 2002 | (72) | 3,681 | 677 | 4,946 | 10 | 9,242 |
| DIVIDENDS | - | (310) | (78) | (1,911) | (5) | (2,304) |
| SHARE IN 2003 INCOME | 1 | 661 | 177 | 1,418 | 9 | 2,266 |
| BALANCE AT DECEMBER 31, 2003 | (71) (a) | 4,032 | 776 | 4,453 | 14 | 9,204 |

(a) An allowance had been recorded for this account receivable from minority interests as of December 31, 2003.

The breakdown, by company, of the balance of the "Minority Interests" caption as of December 31, 2003, is as follows:

| DECEMBER 31, 2003 | | | | | | THOUSANDS OF EUROS |
|--|------------------|--------------|-------------------------|--------------------|--------------|--------------------|
| | CAPITAL STOCK | RESERVES | REVALUATION RESERVES | SHARE IN INCOME | TOTAL | |
| VIVA VUELOS INTERNACIONALES DE VACACIONES, S.A. | (68) | (4) | - | 1 | (71) | |
| IBER-SWISS CATERING, S.A. | 902 | 2,050 | 419 | 661 | 4,032 | |
| COMPAÑÍA AUXILIAR AL CARGO-EXPRÉS, S.A. | 48 | 549 | 2 | 177 | 776 | |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJE, S.A. | 83 | 2,952 | - | 1,418 | 4,453 | |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | - | 5 | - | 9 | 14 | |
| | 965 | 5,552 | 421 | 2,266 | 9,204 | |

15 Provisions for contingencies and expenses

The detail of the balance of this caption in the accompanying consolidated balance sheet as of December 31, 2003, is as follows:

| PROVISIONS FOR CONTINGENCIES AND EXPENSES | | | | | | THOUSANDS OF EUROS |
|---|------------------------|----------------------|-------------------------------|--------------|------------------------|--------------------|
| | BALANCE AT 12-31-02 | PERIOD PROVISIONS | REVERSALS AND AMOUNTS USED | TRANSFERS | BALANCE AT 12-31-03 | |
| PROVISIONS FOR PENSIONS (NOTE 6-j) | 41,367 | 4,137 | (10,862) | 1,753 | 36,395 | |
| PROVISIONS FOR OBLIGATIONS TO EMPLOYEES (NOTE 6-j) | 452,406 | 66,799 | (13,644) | (17,976) | 487,585 | |
| PROVISION FOR MAJOR REPAIRS (NOTE 6-d) | 109,937 | 36,900 | (41,769) | - | 105,068 | |
| PROVISION FOR THIRD-PARTY LIABILITY (NOTE 6-l) | 657,745 | 44,689 | (99,049) | 17,609 | 620,994 | |
| TOTAL | 1,261,455 | 152,525 | (165,324) | 1,386 | 1,250,042 | |

The provisions recorded in 2003 under the "Provisions for Pensions" and "Provisions for Obligations to Employees" captions relate to the amounts accrued in 2003 and the interest generated by the provisions recorded as of December 31, 2003 (see Note 6-j), and were charged to the "Personnel Expenses" caption (€2,689 thousand and €50,974 thousand, respectively) and the "Financial and Similar Expenses" caption (€1,448 and €15,825 thousand, respectively) in the accompanying consolidated statement of income.

The balance as of December 31, 2003, of the "Provision for Third-Party Liability" caption includes €345,309 thousand relating to the estimated amount per the actuarial studies performed by independent actuaries of future payments to cater for the obligations to employees who have already taken early retirement under the conditions envisaged in the labor force rejuvenation plan implemented in March 2000 (806 employees) and the voluntary labor force reduction plan approved in 2001 and implemented in 2002 and 2003 (3,088 employees).

The provisions recorded to cover the liabilities arising from the extension and updating of the labor force reduction plan in 2003 amounted to €24,995 thousand (see Note 20-h). In 2003 623 employees availed themselves of the labor force reduction plan.

The other provisions for third-party liability in 2003, which were also mainly recorded with a charge to the "Extraordinary Expenses" caption in the accompanying consolidated statement of income (see Note 20-h), relate to the amount estimated by the directors required for sundry probable third-party liability.

The transfers shown in the foregoing table relate mainly to amounts for flight personnel who availed themselves of the labor force reduction plan.

Also, the amounts used relate mainly, inter alia, to payments made in 2003 arising from the labor force downsizing plans described above and other payments, and the reversals relate mainly to certain litigation resolved in the Group's favor.

16 Payable to credit institutions

The breakdown, by maturity, of the payables to credit institutions as of December 31, 2003 (which related to loans and financial lease transactions -see Note 7), is as follows:

| | | PAYABLES TO CREDIT INSTITUTIONS | | | | | THOUSANDS OF EUROS |
|------------------------|-------------|---------------------------------|---------------|---------------|----------------|---------------|--------------------|
| | | D U E I N : | | | | | |
| | CURRENCY | 2004 | 2005 | 2006 | 2007 | 2008 | SUBSEQUENT YEARS |
| IN EUROS: PRINCIPAL | | 30,797 | 30,061 | 23,366 | 147,695 | 32,355 | 93,980 |
| INTEREST | | 16,083 | 14,881 | 13,687 | 12,690 | 4,592 | 6,634 |
| IN FOREIGN CURRENCIES: | | | | | | | |
| PRINCIPAL | U.S. DOLLAR | - | - | - | - | - | 29,204 |
| INTEREST | U.S. DOLLAR | 50 | 58 | 58 | 58 | 58 | 9,998 |
| | | 46,930 | 45,000 | 37,111 | 160,443 | 37,005 | 139,816 |

The Company has arranged credit lines with a limit of €247,011 thousand, against which €246,729 thousand had not been drawn down as of December 31, 2003.

The weighted annual average interest rates on the aforementioned loans in 2003 were 4.03% for euro loans and 3.46% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

17 Convertible debenture issue

In 2002 the Parent Company issued debentures convertible into shares of €1.19 par value each, in the proportion of one to one, for a total amount of €30,097 thousand. The unmaturing amount, €22,573 thousand (see Note 13), is recorded under the "Current Liabilities – Convertible Debentures" caption. These debentures bear interest of three-month Euribor plus a spread. The Group's Parent Company has set up a restricted deposit for an amount equal to that of the unmaturing portion of the issue (see Note 12).

As described in Note 13, in 2003 the Parent Company issued debentures convertible into shares of €1.62 par value each, in the proportion of one to one, for a total amount of €27,532 thousand, which were recorded under the "Long-Term Debt - Convertible Debentures" caption in the accompanying consolidated balance sheet as of December 31, 2003.

The main characteristics of the new debenture issue are:

1. Interest rate: three-month Euribor plus a spread.
2. Maturity dates: April 26, 2005, September 19, 2005, March 10, 2006, September 10, 2006, March 10, 2007, September 10, 2007 and April 26, 2008.
3. Security: The Group's Parent Company has set up a restricted deposit for an amount equal to that of the issue (see Note 9).

18 Financial risk management

In order to control and reduce the potential adverse impact of exchange rate, interest rate and fuel price fluctuations on its earnings, the Group has a medium-term plan to manage these risks.

I) EXCHANGE RATE RISK

1.- Balance-sheet hedging positions:

▶▶ BALANCE-SHEET HEDGING POSITIONS

| UNDERLYING | CURRENCY | AMOUNT (MILLIONS OF FOREIGN CURRENCY) | TYPE OF HEDGE | NOMINAL AMOUNT (MILLIONS OF FOREIGN CURRENCY) |
|--------------------------------------|-------------|---|----------------------|---|
| a.- LOAN TO IBERBUS COMPANIES | US\$ | 198 | CROSS CURRENCY SWAPS | 198 |
| b.- ADVANCES ON AIRCRAFT AND ENGINES | US\$ | 336 | CROSS CURRENCY SWAPS | 285 |
| | | | Fx SWAPS | 47 |
| c.- GUARANTEES | | 14 | | |
| TOTAL | US\$ | 548 | | 530 |

2.- Hedging of 2004 flows:

▶▶ HEDGING OF 2004 FLOWS

| UNDERLYING | CURRENCY | AMOUNT (MILLIONS OF FOREIGN CURRENCY) | TYPE OF HEDGE | NOMINAL AMOUNT (MILLIONS OF FOREIGN CURRENCY) |
|----------------------------------|----------|---|----------------------|---|
| a.- FOREIGN CURRENCY PAYMENTS | US\$ | (556) | CROSS CURRENCY SWAPS | 139 |
| | | | OPTIONS | |
| | | | US\$ PUTS SOLD | 133 |
| | | | US\$ CALLS BOUGHT | 133 |
| | | | US\$ CALLS SOLD | (97) |
| b.- FOREIGN CURRENCY REVENUES | GBP | 94 | OPTIONS | |
| | | | GBP CALLS SOLD | (50) |
| | | | GBP PUTS BOUGHT | (25) |
| | | | GBP PUTS SOLD | 25 |
| | | | Fx FORWARDS | (18.7) |
| | CHF | 83 | CROSS CURRENCY SWAPS | (44) |
| | | | Fx FORWARDS | (3.5) |
| c.- ACQUISITIONS OF NEW AIRCRAFT | US\$ | (382) | OPTIONS | |
| | | | US\$ PUTS SOLD | 272 |
| | | | US\$ CALLS BOUGHT | 133 |
| | | | US\$ CALLS SOLD | (133) |
| | | | Fx FORWARDS | 105 |

All the US\$ cross currency swaps (balance-sheet and cash flow hedging) were arranged at exchange rates of between US\$ 0.860/€1 and US\$ 1.230/€1. Regarding the flexible option structures, the average price of the US\$ puts sold was US\$ 1.150/€1, that of the US\$ calls bought was US\$ 1.045/€1 and that of the US\$ calls sold was US\$ 0.995/€1. The US\$-buying Fx forwards were arranged at exchange rates of between US\$ 1.060/€1 and US\$ 1.110/€1.

II) INTEREST RATE RISK

1.- Balance-sheet hedging positions:

BALANCE-SHEET HEDGING POSITIONS

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | IBERIA | IBERIA | NOMINAL AMOUNT AT 12/31/03 (*) | NOMINAL AMOUNT AT 12/31/04 (*) |
|---|---------------|-----------|--------------------------------------|--------------------------------------|
| CROSS CURRENCY SWAPS | | | | |
| FROM FLOATING TO FLOATING | RECEIVES EUR | PAYS US\$ | 622,722 | 78,057 |
| | RECEIVES US\$ | PAYS EUR | 145,827 | - |

(*) The amounts are recorded in the currency in which Iberia pays.

BALANCE-SHEET HEDGING POSITIONS

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | CURRENCY | NOMINAL AMOUNT AT 12/31/03 | NOMINAL AMOUNT AT 12/31/04 | NOMINAL AMOUNT AT 12/31/05 | NOMINAL AMOUNT AT 12/31/06 |
|---|----------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| INTEREST RATE SWAPS | | | | | |
| FROM FIXED TO FLOATING (1) | EUR | 61,302 | 56,282 | 51,261 | 49,141 |

(1) Iberia pays a floating interest rate and receives a fixed rate.

2.- Payment flow hedging:

PAYMENT FLOW HEDGING

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | IBERIA | IBERIA | NOMINAL AMOUNT AT 12/31/03 (*) | NOMINAL AMOUNT AT 12/31/04 (*) | NOMINAL AMOUNT AT 12/31/05 (*) | NOMINAL AMOUNT AT 12/31/06 (*) | NOMINAL AMOUNT AT 12/31/07 (*) | NOMINAL AMOUNT AT 12/31/08 (*) |
|--|---------------|-----------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| CROSS CURRENCY SWAPS | | | | | | | | |
| FROM FIXED TO FLOATING (1) | RECEIVES EUR | PAYS US\$ | 40,273 | 40,273 | 40,273 | 40,273 | 40,273 | 34,140 |
| | RECEIVES US\$ | PAYS EUR | 180,545 | 57,636 | - | - | - | - |
| FROM FLOATING TO FIXED (2) | RECEIVES US\$ | PAYS EUR | 389,802 | 185,639 | 146,619 | 132,036 | 52,852 | - |
| | RECEIVES EUR | PAYS CHF | 283,997 | 90,662 | - | - | - | - |
| FROM FLOATING TO FLOATING | RECEIVES US\$ | PAYS EUR | 846,469 | 615,462 | 372,499 | 262,600 | 149,852 | - |
| | RECEIVES US\$ | PAYS CHF | 249,443 | 113,043 | - | - | - | - |
| | RECEIVES EUR | PAYS CHF | 81,030 | 75,522 | - | - | - | - |
| FROM FIXED TO FIXED | RECEIVES US\$ | PAYS EUR | 160,335 | 143,356 | 135,625 | 127,484 | - | - |

(1) Iberia pays a floating interest rate and receives a fixed rate.

(2) Iberia pays a fixed interest rate and receives a floating rate.

(*) The amounts are recorded in the currency in which Iberia pays.

PAYMENT FLOW HEDGING

| AMOUNT (THOUSANDS OF FOREIGN CURRENCY) INSTRUMENT | CURRENCY | NOMINAL AMOUNT AT 12/31/03 | NOMINAL AMOUNT AT 12/31/04 | NOMINAL AMOUNT AT 12/31/05 | NOMINAL AMOUNT AT 12/31/06 |
|---|----------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| INTEREST RATE SWAPS | | | | | |
| FROM FIXED TO FLOATING (3) | US\$ | 194,942 | 154,241 | - | - |
| FROM FLOATING TO FIXED (4) | US\$ | 548,445 | 369,428 | 146,244 | 137,981 |
| FROM FLOATING TO FLOATING (*) | EUR | 72,966 | - | - | - |
| INTEREST RATE SWAP + CAP (KO) | | | | | |
| FROM FLOATING TO FLOATING | US\$ | 40,273 | 40,273 | 40,273 | - |
| INTEREST RATE SWAP + COLLAR | | | | | |
| FROM FLOATING TO FLOATING | US\$ | 140,040 | 96,120 | 87,840 | - |

(3) Iberia pays a floating interest rate and receives a fixed rate.

(4) Iberia pays a fixed interest rate and receives a floating rate.

(*) IRS Quanto, Iberia pays interest in EUR tied to Libor in CHF.

The average interest rates of the interest rate hedges are: euro 3.20%, U.S. dollar 3.04% and Swiss franc 2.43%.

The Group had arranged interest rate swap transactions as part of the Japanese Operating Lease (JOL) internal structures for a notional amount of US\$ 760.6 million as of December 31, 2003.

III) FUEL PRICE RISK

FUEL PRICE RISK

| UNDERLYING | COMMODITY | VOLUME (MT) | HEDGE | NOMINAL (MT) |
|-----------------------------------|------------------|-------------|------------------------|--------------|
| CONSUMPTION OF AIRCRAFT FUEL (MT) | JET KERO CIF-NWE | 2,128,033 | COMBINATION OF OPTIONS | 1,140,000 |

To date the Group has directly hedged the price of kerosene using a combination of financial tools (swaps and options). The outstanding hedges as of December 31, 2003, would give an average Brent-equivalent price range of between US\$ 23 and US\$ 26 per barrel.

19 Tax matters

The corporate income tax of each of the fully consolidated companies is calculated on the basis of the income per books, which does not necessarily coincide with the taxable income for corporate income tax purposes.

Since January 1, 2002, Iberia, Líneas Aéreas de España, S.A. and certain of its subsidiaries have filed consolidated tax returns under the tax regime provided for in Chapter VII of Title VIII of Corporate Income Tax Law 43/1995. The consolidated tax group is made up of the fully consolidated companies, except for Sistemas Automatizados Agencias de Viaje, S.A. and Iber-Swiss Catering, S.A., which do not meet the legal requirements for forming part of the group.

The reconciliation of the consolidated income per books for 2003 of the companies composing the consolidable Group to the taxable income for corporate income tax purposes is as follows:

| | THOUSANDS OF EUROS | | |
|---|--------------------|---------------|----------------|
| | INCREASE | DECREASE | AMOUNT |
| INCOME FOR THE YEAR PER BOOKS (BEFORE TAXES AND AFTER MINORITY INTERESTS) | - | - | 199,417 |
| PERMANENT DIFFERENCES | 1,887 | (678) | 1,209 |
| TIMING DIFFERENCES: | | | |
| ARISING IN THE YEAR | 134,668 (a) | (994) | 133,674 |
| ARISING IN PRIOR YEARS | - | (145,658) (b) | (145,658) |
| CONSOLIDATION ADJUSTMENTS: | | | |
| PERMANENT DIFFERENCES | 8,185 | (46,112) | (37,927) |
| OFFSET OF PRIOR YEARS' TAX LOSSES | - | (167) | (167) |
| TAXABLE INCOME | - | - | 150,548 |

(a) Relating basically to the provisions for pensions and other obligations to employees and deferred income arising from credit memorandums and provisions relating to aircraft.

(b) Relating mainly to amounts used of provisions recorded in prior years for pensions and other obligations to employees and for other contingencies and expenses and the use of income arising from credit memorandums.

The balance of the "Corporate Income Tax" caption in the accompanying 2003 consolidated statement of income relates to the sum of the corporate income tax expenses recorded by each fully consolidated company, the detail being as follows:

2003

THOUSANDS OF EUROS

| | |
|--|---------------|
| APPLICATION OF THE 35% TAX RATE TO INCOME PER BOOKS ADJUSTED BY PERMANENT DIFFERENCES | 56,945 |
| ADD / (LESS): | |
| TAX CREDITS | (12,530) |
| REGULARIZATION OF 2002 CORPORATE INCOME TAX | (2,816) |
| OTHER | 14,232 |
| CORPORATE INCOME TAX | 55,831 |

The "Regularization of 2002 Corporate Income Tax" account relates mainly to certain tax credits not recorded in the Group's Parent Company's tax estimate. The "Other" account includes both the provision recorded by the Parent Company to regularize the deferred tax assets that are expected to be recovered in more than ten years, and the consolidation adjustments relating to Aviación y Comercio, S.A.

The tax assets and liabilities were recorded, on the basis of the recovery date, under the "Accounts Receivable", "Long-Term Receivables", "Other Nontrade Payables" and "Long-Term Debt - Other Payables" captions in the accompanying consolidated balance sheet, the detail being as follows:

DECEMBER 31, 2003

THOUSANDS OF EUROS

| | R E C E I V A B L E | | | P A Y A B L E | | |
|---|-----------------------|--------------------------|---------------------------------|-------------------------------|---|------------------------------|
| | ACCOUNT RECEIVABLE | LONG-TERM RECEIVABLES | TOTAL ACCOUNTS RECEIVABLE | OTHER NONTRADE PAYABLES | LONG-TERM DEBT / OTHER ACCOUNTS PAYABLE | TOTAL ACCOUNTS PAYABLE |
| TAXABLE INCOME FOR 2003 | 14 | - | 14 | 1,311 | - | 1,311 |
| TIMING DIFFERENCES ARISING IN THE YEAR | - | 41,248 | 41,248 | - | 348 | 348 |
| UNALLOCATED TIMING DIFFERENCES ARISING IN PRIOR YEARS | 37,409 | 262,455 | 299,864 | - | 1,883 | 1,883 |
| TOTAL | 37,423 | 303,703 (*) | 341,126 | 1,311 | 2,231 | 3,542 |

(*) Relating basically to deferred tax assets arising from provisions recorded to cater for obligations to employees and other provisions.

The estimated years of recovery of the long-term tax assets as of December 31, 2003, are as follows:

| YEAR OF RECOVERY | THOUSANDS OF EUROS |
|---------------------------|--------------------|
| 2005 | 42,300 |
| 2006 | 42,300 |
| 2007 AND SUBSEQUENT YEARS | 219,103 |
| | 303,703 |

The directors of the Group companies consider that all these assets will be recovered in not more than ten years.

Current corporate income tax regulations provide certain tax incentives to encourage investment and contributions to employees mutual funds. The consolidated companies availed themselves of certain tax benefits and recorded tax credits of €1,677 thousand in this connection.

The Iberia Group recorded in 2003 domestic and international double taxation tax credits amounting to €6,013 thousand.

In 2003 the Group reinvested the sale price of investments which gave rise to gains of €31,516 thousand relating to the tax credit of €4,822 thousand. The amounts reinvested in the last three years and the related tax credits are as follows:

| 2003 | THOUSANDS OF EUROS | |
|------|--------------------|------------|
| | REINVESTMENT | TAX CREDIT |
| 2001 | 13,818 | 1,224 |
| 2002 | 72,794 | 4,423 |
| 2003 | 31,516 | 4,822 (a) |

(a) Including tax credits of €1,993 thousand not yet taken.

As a result of successive tax audits, the tax inspection authorities issued certain assessments, which were contested and appealed against by the Parent Company, for 1993 through 1997 (mainly VAT and personal income tax withholdings).

Also, the Parent Company filed an appeal against the assessments issued in connection with customs duties for 1998 (second six months), 1999 and 2000 (first five months).

Furthermore, in relation to Aviación y Comercio, S.A. (which was absorbed by the Parent Company in 2000), a decision has yet to be handed down on the appeals against the tax assessments issued in connection with the returns for certain taxes for 1989, 1990, 1993, 1994, 1996, 1997 and 1998.

The directors of Iberia, Líneas Aéreas de España, S.A. consider that no tax liabilities additional to those recorded in the consolidated financial statements for 2003 will arise from the resolution of the various appeals described above.

Also, the directors of Iberia, Líneas Aéreas de España, S.A. do not expect any tax contingencies that would materially affect the consolidated financial statements to arise in connection with the years open for review by the tax inspection authorities which, in general, are 2000 through 2003 for all taxes applicable to the Parent Company and the fully consolidated companies (1999 through 2003, in general, for corporate income tax), and since 1999 for corporate income tax and January 2000 for the other taxes for Aviación y Comercio, S.A.

Pursuant to Article 107 of Corporate Income Tax Law 43/1995, it is hereby stated that the information relating to the merger of the Parent Company with Aviación y Comercio, S.A. is included in Note 22 to the 2000 consolidated financial statements.

20 Revenues and expenses

a) Net sales

The breakdown, by activity, of the consolidable Group companies' net sales in 2003 and 2002 is as follows:

| BY ACTIVITY | THOUSANDS OF EUROS | |
|--|--------------------|------------------|
| | 2003 | 2002 |
| PASSENGER TICKET REVENUES (a) | 3,615,437 | 3,775,939 |
| CARGO REVENUES | 254,857 | 253,402 |
| HANDLING (AIRCRAFT DISPATCHING AND AIRPORT SERVICES) | 272,829 | 234,804 |
| TECHNICAL ASSISTANCE TO AIRLINES | 103,997 | 91,333 |
| OTHER REVENUES | 155,327 | 130,238 |
| TOTAL | 4,402,447 | 4,485,716 |

(a) Including other revenues (recovery of unused tickets, commercial agreements, etc.) amounting to €258,714 thousand in 2003 and €294,604 thousand in 2002.

The Parent Company is the leading operator in Spain in handling services by virtue of the contract awarded to it in a public call for tenders organized by the Spanish public airports and aviation agency (AENA). This contract expired, following successive renewals, in March 2003; and AENA has not yet organized another public call for tenders.

The breakdown of passenger ticket revenues, by network, is as follows:

| BY NETWORK | THOUSANDS OF EUROS | |
|------------------|--------------------|------------------|
| | 2003 | 2002 |
| SPAIN AND EUROPE | 2,453,202 | 2,543,566 |
| ATLANTIC | 1,069,341 | 1,148,745 |
| AFRICA AND ASIA | 92,894 | 83,628 |
| TOTAL | 3,615,437 | 3,775,939 |

b) Other operating revenues

The detail of the balances of the "Other Operating Revenues" caption in the accompanying consolidated statements of income is as follows:

| OTHER OPERATING REVENUES | | THOUSANDS OF EUROS | |
|---------------------------------|----------------|--------------------|--|
| | 2003 | 2002 | |
| COMMISSIONS | 120,943 | 108,521 | |
| RENT | 8,746 | 9,480 | |
| OTHER SUNDRY REVENUES | 87,194 | 95,816 | |
| | 216,883 | 213,817 | |

The revenues from commissions relate basically to the commissions on the sale of tickets for other airlines, the commissions arising from the franchise agreement with Air Nostrum and the commissions obtained as a result of the agreements entered into with Mundicolor and Touroperador Viva Tours, S.A.

c) Extraordinary revenues

The detail of the balance of the "Extraordinary Revenues" caption in the accompanying 2003 consolidated statement of income is as follows:

| EXTRAORDINARY REVENUES | | THOUSANDS OF EUROS | |
|--|--|--------------------|--|
| RECOVERY OF PROVISIONS FOR THIRD-PARTY LIABILITY (NOTE 15) | | 26,777 | |
| COLLECTION OF INDEMNITY PAYMENTS | | 2,394 | |
| OTHER | | 5,950 | |
| | | 35,121 | |

d) Prior years' revenues and income

The revenues recorded under this caption relate mainly to the adjustment of accounts payable for airport taxes and overestimates of certain expenses accrued for 2002, mainly insurance.

e) Procurements

The detail of the "Procurements" caption in the accompanying 2003 and 2002 consolidated statements of income is as follows:

| PROCUREMENTS | | THOUSANDS OF EUROS | |
|----------------------|----------------|--------------------|--|
| | 2003 | 2002 | |
| AIRCRAFT FUEL | 556,841 | 553,241 | |
| AIRCRAFT SPARE PARTS | 135,898 | 142,963 | |
| CATERING MATERIALS | 26,975 | 30,887 | |
| OTHER PURCHASES | 39,576 | 35,041 | |
| | 759,290 | 762,132 | |

The "Aircraft Spare Parts" caption includes the spare parts initially recorded under fixed assets, which were used to replace others in the related aircraft during the year, the net book value of which at the date of use is recognized as an expense under this caption in the consolidated statement of income.

The aircraft fuel expense in 2003 totaled €576,444 thousand. However, the related futures transactions reduced this expense by €19,603 thousand.

f) Headcount and personnel expenses

The breakdown of the balances of the "Personnel Expenses" caption in the accompanying consolidated statements of income for 2003 and 2002 is as follows:

| | THOUSANDS OF EUROS | |
|--------------------------------------|--------------------|------------------|
| | 2003 | 2002 |
| WAGES, SALARIES AND SIMILAR EXPENSES | 1,064,163 | 1,022,087 |
| EMPLOYEE WELFARE EXPENSES | 338,568 | 331,647 |
| | 1,402,731 | 1,353,734 |

The average number of employees at the fully consolidated Group companies, measured in terms of equivalent average headcount, by professional category, in 2003 and 2002 was as follows:

| | 2003 | 2002 |
|--|---------------|---------------|
| GROUND PERSONNEL: | | |
| SENIOR MANAGERS AND OTHER LINE PERSONNEL | 1,316 | 1,321 |
| CLERICAL STAFF | 6,702 | 6,589 |
| OTHER | 11,806 | 11,475 |
| | 19,824 | 19,385 |
| FLIGHT PERSONNEL: | | |
| PILOTS | 1,917 | 1,859 |
| FLIGHT ENGINEERS | 97 | 115 |
| CABIN CREW | 4,364 | 4,395 |
| | 6,378 | 6,369 |
| | 26,202 | 25,754 |

g) Other operating expenses

The detail of the balances of this caption in the accompanying 2003 and 2002 consolidated statements of income is as follows:

(a) The aircraft lease payments amounted to €325,485 thousand and €370,332 thousand in 2003 and 2002, respectively. The related futures transactions increased these expenses by €22,758 thousand in 2003 and reduced them by €4,035 thousand in 2002.

(b) Including the expenses for subcontracted maintenance work and the provision for major repairs.

(c) Including cargo hold lease expenses amounting to €4,563 thousand in 2003 and 4,825 thousand in 2002.

(d) The fees for financial statement audit services provided to Iberia, Líneas Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related thereto in 2003 amounted to €396 thousand.

Additionally, the fees for other professional services provided to Iberia, Líneas Aéreas de España, S.A. and the various Group companies by the principal auditor and by other entities related thereto in 2003 amounted to €271 thousand.

| | THOUSANDS OF EUROS | |
|---------------------------------|--------------------|------------------|
| | 2003 | 2002 |
| OTHER OPERATING EXPENSES | | |
| COMMERCIAL EXPENSES | 437,813 | 464,275 |
| AIRCRAFT LEASE PAYMENTS | | |
| DRY LEASE (a) | 348,243 | 366,297 |
| CARGO | 15,973 | 17,222 |
| OTHER | 4,941 | 7,479 |
| AIR TRAFFIC SERVICES | 310,112 | 301,136 |
| STOPOVER EXPENSES | 40,850 | 42,932 |
| INCIDENT EXPENSES | 11,738 | 18,619 |
| NAVIGATION CHARGES | 257,593 | 226,586 |
| AIRCRAFT MAINTENANCE (b) | 104,708 | 96,666 |
| GENERAL MAINTENANCE | 34,076 | 30,663 |
| BOOKING SYSTEM EXPENSES | 128,164 | 126,322 |
| IN-FLIGHT SERVICES | 52,643 | 64,413 |
| OTHER RENT (c) | 75,581 | 78,184 |
| OTHER (d) | 301,284 | 315,729 |
| | 2,123,719 | 2,156,523 |

h) Extraordinary expenses

The detail of the balance of the "Extraordinary Expenses" caption in the accompanying 2003 consolidated statement of income is as follows:

| | THOUSANDS OF EUROS |
|--|--------------------|
| EXTRAORDINARY EXPENSES | |
| PROVISIONS FOR EXTENSION OF THE LABOR FORCE REDUCTION PLAN (NOTE 15) | 24,995 |
| PROVISIONS FOR AIRCRAFT (NOTE 8) | 11,426 |
| PERIOD PROVISIONS FOR THIRD-PARTY LIABILITY (NOTE 15) | 18,922 |
| OTHER EXTRAORDINARY EXPENSES | 3,940 |
| | 59,283 |

21 Contribution of Group and associated companies to consolidated income

The contribution of Group and associated companies to the 2003 and 2002 consolidated income was as follows:

| COMPANY | THOUSANDS OF EUROS | |
|---|--------------------|------------------|
| | INCOME 2003 | / (Loss) 2002 |
| IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A. | 104,081 | 128,362 |
| COMPAÑÍA AUXILIAR AL CARGO EXPRES, S.A. | 530 | 462 |
| CAMPOS VELÁZQUEZ, S.A. | 13 | 4 |
| CARGOSUR, S.A. | (26) | 1,254 |
| IBER-SWISS CATERING, S.A. | 1,542 | 1,447 |
| VIVA VUELOS INTERNACIONALES DE VACACIONES, S.A. | 167 | 780 |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJE, S.A. | 3,259 | 4,981 |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | 47 | 31 |
| IBERIA TECNOLOGÍA, S.A. | 76 | 105 |
| AMADEUS GROUP | 33,347 | 19,706 |
| TOUROPERADOR VIVA TOURS, S.A. | (875) | 10 |
| MULTISERVICIOS AEROPORTUARIOS, S.A. | 271 | 113 |
| HANDLING GUINEA ECUATORIAL, S.A. (HANGESA) | 703 | 142 |
| EMPRESA LOGÍSTICA DE CARGA AÉREA, S.A. (ELCA) | 17 | (12) |
| EMPRESA HISPANOCUBANA DE MANTENIMIENTO DE AERONAVES IBECA, S.A. | 187 | 334 |
| SOCIEDAD CONJUNTA PARA LA EMISIÓN Y GESTIÓN DE MEDIOS DE PAGO EFC, S.A. (IBERIA-CARDS) | 29 | (703) |
| IBER-AMÉRICA AEROSPACE LLC | 218 | 104 |
| INCOME ATTRIBUTED TO THE PARENT COMPANY | 143,586 | 157,120 |

The detail of the balances of the "Income Attributed to Minority Interests" caption in the accompanying 2003 and 2002 consolidated statements of income is as follows:

| INCOME ATTRIBUTED TO MINORITY INTERESTS | THOUSANDS OF EUROS | |
|---|--------------------|------------------|
| | INCOME 2003 | / (Loss) 2002 |
| COMPAÑÍA AUXILIAR AL CARGO EXPRES, S.A. | 177 | 155 |
| IBER-SWISS CATERING, S.A. | 661 | 620 |
| VIVA VUELOS INTERNACIONALES DE VACACIONES, S.A. | 1 | 4 |
| AUXILIAR LOGÍSTICA AEROPORTUARIA, S.A. | 9 | 10 |
| SISTEMAS AUTOMATIZADOS AGENCIAS DE VIAJE, S.A. | 1,418 | 1,916 |
| INCOME ATTRIBUTED TO MINORITY INTERESTS | 2,266 | 2,705 |

22 Directors' compensation and other benefits

The detail of the compensation of all kinds earned in 2003 by the members of the Board of Directors of Iberia, Líneas Aéreas de España, S.A. is as follows:

| ▶▶ DIRECTORS' COMPENSATION | THOUSANDS OF EUROS |
|--|--------------------|
| FIXED COMPENSATION PAID TO THE BOARD MEMBERS | 600 |
| ATTENDANCE FEES | 468 |
| COMPENSATION IN KIND | 23 |
| TOTAL COMPENSATION | 1,091 |

Iberia Líneas Aéreas de España, S.A. incurred expenses of €11 thousand, mainly for insurance premiums, in relation the discharge by its nonexecutive directors of their duties.

Also, the detail of the compensation paid to the executive directors in 2003 is as follows:

| ▶▶ EXECUTIVE DIRECTORS | THOUSANDS OF EUROS |
|--|--------------------|
| FIXED COMPENSATION | 961 |
| VARIABLE COMPENSATION | 744 |
| COMPENSATION IN KIND | 43 |
| SETTLEMENT AND SURRENDER OF INSURANCE POLICY | 1,935 |

The social security costs, insurance and other expenses recorded by Iberia Líneas Aéreas de España, S.A. in relation to the activities performed by the executive directors amounted to €467 thousand.

In 2003 no advances or loans were granted to the directors of Iberia, Líneas Aéreas de España, S.A. and there are no pension commitments to them.

23 Detail of the equity interests held by the directors in companies engaging in similar activities and performance by them, for their own account or the account of others, of similar activities

Pursuant to Article 127 ter.4 of the Spanish Corporations Law, introduced by Law 26/2003, which amends Securities Market Law 24/1988, and the revised Spanish Corporations Law, in order to reinforce the transparency of listed corporations, following is a detail of the activities carried on, for their own account or for the account of others, by the various members of the Board of Directors that are the identical, similar or complementary to the activity that constitutes the corporate purpose of Iberia, Líneas Aéreas de España, S.A. and subsidiaries:

▶▶ DETAIL OF THE EQUITY INTEREST

| NAME | ACTIVITY | TYPE OF ARRANGEMENT | COMPANY | POSITIONS HELD / FUNCTIONS |
|------------------|----------------------------|-----------------------|-----------------------------|---------------------------------------|
| ROGER MAYNARD | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | BRITISH AIRWAYS | DIRECTOR OF ALLIANCES AND INVESTMENTS |
| | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | BRITISH AIRWAYS CITIEXPRESS | CHAIRMAN |
| | AIR TRANSPORT | FOR ACCOUNT OF OTHERS | QANTAS | DIRECTOR |
| LORD GAREL-JONES | HANDLING | FOR ACCOUNT OF OTHERS | ACCIONA | DIRECTOR |
| PABLO ISLA | DISTRIBUTION AND LOGISTICS | FOR ACCOUNT OF OTHERS | LOGISTA | CHAIRMAN OF THE BOARD OF DIRECTORS |

Also, pursuant to the aforementioned Law, it is hereby stated that the only members of the Board of Directors who own an equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the corporate purpose of Iberia, L.A.E and subsidiaries are Mr. Roger Maynard (holder of 4.545 British Airways shares) and Mr. Pablo Isla (holder of 100 Compañía de Distribución Integral Logista, S.A. shares).

Lastly, the members of the Board of Directors (or persons acting on their behalf) have not entered into transactions other than ordinary business transactions or in conditions other than normal market conditions with Iberia, Líneas Aéreas de España, S.A. or with other Iberia Group companies.

24 Environmental information

The Group, in line with its environmental policy, continued to undertake various activities and projects in 2003 in order to guarantee the proper management of the main environmental impacts of the air transport business as a whole.

In 2003 the Group incurred environmental expenses of €2,311 thousand, the detail being as follows:

▶▶ ENVIRONMENTAL INFORMATION

| | THOUSANDS OF EUROS |
|--|--------------------|
| ENVIRONMENTAL REPAIRS, UPKEEP AND TRANSPORT | 879 |
| ENVIRONMENTAL TECHNICAL SERVICES | 309 |
| SPONSORSHIP, PUBLICATIONS AND OTHER ENVIRONMENTAL EXPENSES | 57 |
| PERSONNEL EXPENSES RELATING TO ENVIRONMENTAL MANAGEMENT | 694 |
| ENVIRONMENTAL TAXES | 165 |
| OTHER | 207 |
| TOTAL | 2,311 |

As of December 31, 2003, the acquisition cost and accumulated depreciation of the environmental assets, which include, inter alia, waste water treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, amounted to €33,495 thousand and €16,799 thousand, respectively.

With respect to its aircraft, the Group continued to implement an ongoing renewal policy based on the requirements disclosed at any particular time, in which the environment is an important factor to be taken into account. Accordingly, the Group is continuing to add A-320 aircraft to its fleet for short- and medium-haul routes as part of a renewal plan initiated in the mid-1990s. These aircraft reduce fuel consumption by up to 20%, with the concomitant reduction in the volume of air emissions, compared to earlier generation aircraft. With respect to long-haul aircraft, in 2003 Iberia added three new A-340/600 aircraft to its fleet and retired 2 B-747 aircraft.

As far as ground operations are concerned, the improvements undertaken in 2003 included the implementation of a water-recycling project in the engine-cleaning line, and periodic analytical control continues to be exercised over water discharges and air emissions caused by maintenance activities.

The Group considers that any possible environmental contingencies that might arise are covered sufficiently by its third-party liability insurance policies and by the provisions relating to probable or certain third-party liabilities arising from litigation in progress or from outstanding indemnity payments or obligations of an undetermined amount.

25 Explanation added for translation to English

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



Consolidated Management Report

Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails.



Main aggregates

IBERIA GROUP

| | 2003 | 2002 | % VARIATION |
|---|---------|---------|-------------|
| INCOME (MILLIONS OF €) | | | |
| OPERATING REVENUES | 4,619.3 | 4,699.5 | (1.7) |
| EBITDAR | 700.7 | 804.8 | (12.9) |
| OPERATING INCOME | 160.7 | 249.1 | (35.5) |
| INCOME BEFORE TAXES | 201.7 | 194.1 | 3.9 |
| NET INCOME ATTRIBUTED TO THE COMPANY | 143.6 | 157.1 | (8.6) |
| NET EARNINGS PER SHARE (€ CENTS) (1) | 15.62 | 17.21 | (9.2) |
| DIVIDEND PER SHARE (€ CENTS) (1) | 3.0 | 4.0 | - |
| PASSENGER TRAFFIC: PRODUCTION AND REVENUES (2) | | | |
| MILLIONS OF ASKS | 56,145 | 55,405 | 1.3 |
| MILLIONS OF RPKS | 42,100 | 40,470 | 4.0 |
| PASSENGER LOAD FACTOR (%) | 74.99 | 73.04 | 1.95 P. |
| PASSENGER TICKET REVENUES (MILLIONS OF €) | 3,356.8 | 3,481.4 | (3.6) |
| AVERAGE YIELD (€ CENTS) | 7.97 | 8.60 | (7.3) |
| FINANCIAL AGGREGATES AND RATIOS | | | |
| SHAREHOLDERS' EQUITY (MILLIONS OF €) | 1,432.8 | 1,317.7 | 8.7 |
| NET DEBT (MILLIONS OF €) (3) | (938.5) | (714.8) | 31.3 |
| EBITDAR MARGIN (%) | 15.2 | 17.1 | (1.9) P. |
| OPERATING INCOME MARGIN (%) | 3.5 | 5.3 | (1.8) P. |
| ROE (%) (4) | 10.1 | 12.0 | (1.9) P. |
| RESOURCES | | | |
| EQUIVALENT AVERAGE NO. OF FULL-TIME EMPLOYEES (5) | 26,202 | 25,754 | 1.7 |
| OPERATING AIRCRAFT AT DECEMBER 31 | 149 | 146 | 2.1 |
| USAGE OF AIRCRAFT (B.H. PER AIRCRAFT PER DAY) | 8.78 | 8.68 | 1.2 |

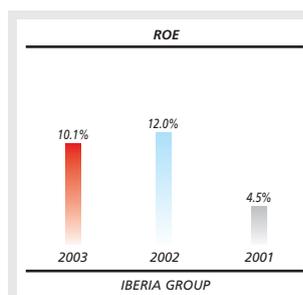
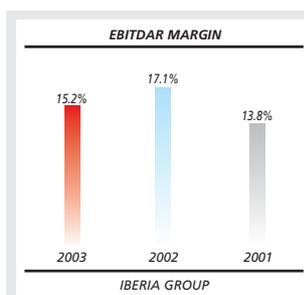
(1) Number of shares as of December 31, 2003 and 2002: 919,016,894 and 912,962,035, respectively.

(2) Data relating to Iberia, L.A.E. for 2003 and 2002.

(3) Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding interest on financial lease contracts).

(4) Return on equity: Consolidated income / (Shareholders' equity + Minority interests).

(5) Including the employees of Iberia, L.A.E., SAVIA, Iber-Swiss Catering and CACESA.



1 2003 Highlights

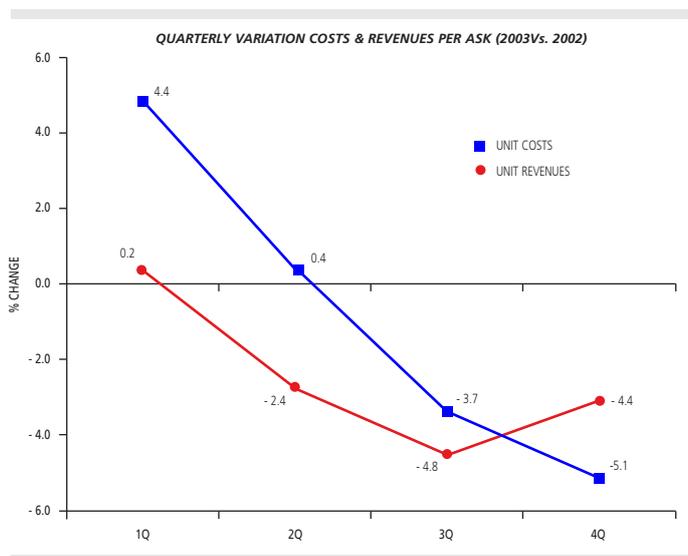
In the first year in which the 2003/2005 Master Plan was implemented, the Iberia Group met the basic profitability and quality improvement objectives set for 2003 and maintained its outstanding position as one of the most solid airlines and one of those which creates most shareholder value. Thus, the Group reported net income before taxes of €201.7 million in 2003, up €7.6 million on 2002. Also, the market value of Iberia, Líneas Aéreas de España, S.A. ("Iberia, L.A.E.") shares rose by 62.9% in 2003, which was one of the largest increases in the IBEX 35 index and in the air transport industry.

The adverse economic cycle, the tensions existing in the lead-up to the war, the Iraq war itself (which broke out on March 20), and the effect of the SARS virus delayed the anticipated recovery of international air traffic, which was confirmed only in the last quarter of the year. According to information from the Association of European Airlines (AEA), scheduled passenger traffic increased by 1.2% in 2003 if compared with 2002 (as compared with the decreases of 4.6% in 2002 and 4.7% in 2001). This prolonged situation of slow demand, the appreciation of the euro and the pressure exerted by no-frills airlines led to an across-the-board drop in unit revenues in the industry.

In this difficult situation, Iberia, L.A.E.'s flexibility to tailor its capacity to market trends proved once again to be a differentiating factor. In early 2003 demand was slow, particularly in the European markets and, accordingly, Iberia reduced the capacity that it had programmed for March and subsequent months, and it decided to put on hold the delivery of three new aircraft earmarked for the medium-haul network. In the first half of 2003 the number of available seat-kilometers (ASKs) decreased by 2.1% with respect to the same period in 2002. From the summer onwards, in line with market trends, the Iberia Group gradually increased its production, specially on long-haul routes, and the number of ASKs increased by 4.7% in the second half of the year. Therefore, in 2003 taken as a whole, production increased by 1.3% with respect to the previous year, and revenue passenger kilometers (RPKs) rose by 4%. Accordingly, the load factor of 75.0% in 2003 represented an all-time high for the Company and was 1.9 percentage points up on 2002. The load factor improved progressively each quarter, which demonstrates the success of the measures taken to tailor supply to demand.

This significant improvement in the load factor and the increase in revenues not generated by traffic partially offset the 7.3% drop in the average yield triggered by exchange rate fluctuations (which varied by more than 2.5 percentage points) and by strong competition. Therefore, the Iberia Group's operating revenues were only 1.7% lower in 2003 than in 2002.

In 2003 the Company continued to implement cost-cutting measures which, combined with the fall in the value of the U.S. dollar and lower interest rates, meant that total operating expenses were practically unchanged with respect to the previous year, and that the unit cost was 1.1% lower than in 2002. In addition, the trend in unit costs was very positive in 2003, if the variations in each quarter with respect to the previous year are taken into account (see graph).



The Iberia Group reported earnings before depreciation and amortization and aircraft lease expenses (EBITDAR) of €700.7 million in 2003, and its EBITDAR as a percentage of revenues was 15.2%. The net income after taxes and minority interests of €143.6 million in 2003 was only €13.5 million below the excellent result achieved in 2002.

Improved service quality

In line with one of the main objectives established in the 2003/05 Master Plan, the Company implemented a global service quality improvement plan, which consists of various measures: continuous improvement of punctuality; a training plan for all employees who come into direct contact with customers; the implementation of a global knowledge and customer relationship management system (Customer Relationship Management – CRM); centralized customer service, complaints and suggestions; improved service quality in the process relating to bookings and direct sales through the information hotline (Serviberia) and the Company's Internet website (Iberia.com); increased use of self-service check-in machines and electronic ticketing; together with improvements in the Iberia Plus loyalty-building program.

In 2003 Iberia, L.A.E.'s flight punctuality was 83.8%, 8.4 percentage points higher than the average for 2002, making it the most punctual network airline in Europe according to the AEA. This was made possible by the implementation, at the beginning of the year, of the Integral Punctuality Improvement Plan, coordinated by the Punctuality Committee, the purpose of which is to detect and prevent the possible causes for delays, and to seek and analyze new initiatives that could help improve procedures and the coordination of operations. The significant improvement in punctuality reduced operating and indemnity expenses and increased customer satisfaction.

In 2003 Iberia, L.A.E. initiated the process to implement and geographically deploy the CRM project, which is key to being able to achieve the objective of strengthening relations with customers and acknowledging their value to the Company. The CRM system, supported by advanced computer systems, makes interaction with customers possible at all the Company's points of contact, and it is complemented by an ambitious employee training plan. The benefits provided by the CRM system are as follows: it provides the necessary information in real-time to Company employees in contact with customers so that they can provide an individualized service that increases customer satisfaction; it facilitates the implementation of loyalty-building measures; it serves as a support for customer service management, making it possible to reduce the time required to carry out certain processes; it enables information to be stored in a single database; and it unifies processes, making it possible for information to be shared among different departments.

2003 was the first full year of operations of the new Customer Service Center, which since 2002 year-end has been managing on a centralized and integrated basis all telephone and written communications with the Company's customers. This has reduced response times, standardized customer service and integrated all the information, an analysis of which makes it possible to detect those aspects of services in which customers consider that there is room for improvement.

Iberia, L.A.E. also continued to strengthen its relationships with its best customers. In this regard, in 2003 it introduced a new process for the proactive handling of incidents involving High-Value Customers (mainly Iberia Plus Platino, Iberia Plus Oro and Club Fiesta Iberia customers), which the Company is aiming to use to preempt complaints and claims from customers when they suffer significant incidents.

In 2003 the number of Iberia Plus cardholders increased by almost 26% to stand at 1,685,000 at year-end. In addition, new companies joined the Iberia Plus program, the aim of which is to reward and foster the loyalty of customers.

The quality certificates obtained by the Iberia Group in 2003 evidence its commitment to the continuous improvement of all its operations. In July the Cargo Division received ISO 9001:2000 certificate for all its booking, space control, goods acceptance, flight preparation and cargo terminal goods delivery activities from Asociación Española de Normalización y Certificación (AENOR). In August the Systems Division received ISO 9001:2000 certificate for its information system development, production and maintenance activities. And in November the Company's Maintenance Division obtained another quality certificate from AENOR, under the ISO 9001:2000 standard (once the transition had been made to the new standard from the previous standard, ISO 9002:1994).

Cost reduction

In April and May 2003 the Company revised the 2003/2005 Master Plan that had been prepared at the end of 2002, in order to reinforce the strategic measures established in the Plan, bringing forward initiatives that will give rise to further cost reductions and increases in employee productivity and the usage of the aircraft. The adjustments made aim to provide a response to the rapid expansion of low-cost operators in Europe and to the growing competition in the domestic market.

Of the total cost saving envisaged in the Master Plan, estimated between €350 million and €400 million for 2005, more than a quarter (between €100 million and €110 million) will be saved as a result of the introduction of the New System for Remunerating Travel Agencies in Spain, which was negotiated in the second half of 2003 and came into force on January 1, 2004. The basic commission that Iberia, L.A.E. pays to travel agencies in Spain will be reduced progressively over an 18-month period to 1% from July 2005 onwards. Also, certain emission and management charges that the agencies will receive directly from the customers for their services were established. The price of the travel is thus separated from the distribution cost. Under the New Remuneration System, the variable remuneration system in place in 2003 will be maintained and gradually extended to the other European markets in which tickets are issued.

This new agreement furthers the distribution cost reduction process which Iberia, L.A.E. has been applying in recent years and it will help meet the targets set for 2005.

Another salient aspect taken into account in the revision of the 2003/05 Master Plan is the new in-flight service model, the first phase of which was implemented in the second half of 2003 and consisted basically of simplifying the service provided in tourist class on short- and medium-haul flights, while improving the in-flight service offered in business class. In March 2004 the second phase has begun. It involves the introduction of a new in-flight pay service in tourist class on certain domestic and international medium-haul flights, in order to enable customers to pay only for what they actually consume.

The Directorate-General of Employment authorized Iberia, L.A.E. to extend to December 31, 2004, the period in which ground employees, cabin crew members and flight technicians can voluntarily avail themselves of the Labor Force Reduction Plan that had been approved at the end of 2001. The Company, with the agreement of the labor unions, applied for this extension because of the large number of requests that it had not been possible to deal with in the initial one-year duration of the Plan. In 2003 623 employees availed themselves of the possibilities established in the Labor Force Reduction Plan: early retirement, deferred outplacement, voluntary redundancy and contract novation. Also, 149 employees abroad left the Company.

The targets set for 2003 in the Investment and Cost Rationalization and Optimization Plan (PROICO), in its second year of implementation, were also surpassed. The introduction of new action plans, of which 888 expense reduction plans were initiated, gave rise to a cost saving of €73 million in 2003, to which must be added the €60 million of consolidated cost savings arising from programs that had been initiated in 2002, giving total savings of €133 million in 2003 (as compared with the target of €108 million).

The Iberia Group's unit operating cost was €c7.94/ASK in 2003, a decrease of 1.1% with respect to 2002, despite the significant increase in fuel prices and navigation charges. As indicated above, the trend in unit costs was very positive in 2003 taken as a whole since, compared with 2002, it increased by 2.4% in the first half of 2003 but fell by a cumulative 4.3% in the last six months of the year.

Risk management

Iberia, L.A.E. has in place a global nonoperating risk management program aimed at limiting the possible impact of exchange rate, interest rate and aviation fuel price fluctuations on the Company's earnings.

An analysis of fuel costs shows that the war in Iraq had a significant effect on the energy industry in 2003. The year was characterized by major fuel price volatility, with very high prices that were substantially higher than in 2002. The average price was US\$ 29/barrel in 2003, up 15% on 2002, which also saw major price hikes. The Company hedged the price of around 80% of the volume of kerosene used in the first half of the year and of approximately 70% of that used in the second half of the year, in bands of between US\$ 23 and US\$ 26 per barrel. This hedging policy and the drop in the value of the U.S. dollar against the euro enabled Iberia, L.A.E. to reduce its unit fuel cost to €c0.99/ASK in 2003, 0,7% less than in 2002.

Fleet Renewal Plan

As a result of the Fleet Renewal Plan the Company can offer its passengers greater comfort and more services and reduce the number of different types of aircraft, thereby increasing the use of the aircraft and crew productivity, significantly reducing unit operating costs and contributing to a reduction in environmental impact.

Since June 2002 the Company has been operating only three types of medium-haul aircraft (A-320-type, MD-87/88 and B-757 aircraft), as compared with the seven that it was operating when it introduced its Fleet Renewal Plan in 1998. In 2003 four new aircraft under an operating lease arrangement were added to the medium-haul fleet: three Airbus aircraft (one A-320 and two A-321) and one MD-88 aircraft.

In January 2003, having analyzed the latest bids submitted by the manufacturers Airbus and Boeing, Iberia, L.A.E. chose the Airbus A-340/600 aircraft for the renewal of its long-haul fleet. Accordingly, it entered into a purchase contract with Airbus that will make it possible to gradually replace all the Boeing B-747 planes known as "Jumbos" with new A-340/600 aircraft. Economic and financial factors were decisive in the choice, although another factor behind this decision was aircraft uniformity. The A-340/600 is the most modern and largest of the Airbus A-340 family, since in the configuration for Iberia, L.A.E. it has 350 seats, around 100 more than the A-340/300, of which Iberia, L.A.E. already operates 18. These two types of A-340 aircraft share the same certificate, which enables pilots to fly either model with the same license.

In 2003 the Company added three Airbus A-340/600 aircraft to its long-haul fleet. Iberia, L.A.E. has entered into agreements with International Lease Finance Corporation (ILFC) and Airbus for the addition of a further seven new A-340/600 aircraft in 2004 and 2005 and it holds purchase options on another five of the same type. The agreement with Airbus stipulates that all the A-340/600 to be added are covered by a guarantee provided by Airbus in relation to their residual value at the end of a given period. Not only does this arrangement lead to cost savings and financing options, but it also provides a high degree of flexibility and makes it possible to more efficiently adapt the number of aircraft to demand trends. When all the B-747 aircraft have been retired, a process that commenced in 2003, Iberia, L.A.E. will be operating only one type of aircraft on long-haul routes.

At the end of 2003, the Iberia Group had 149 aircraft: 122 for its short- and medium-haul network and 27 for its long-haul network.

New technologies

The Iberia Group is continuing to apply new technologies to its business in order to improve service and reduce costs.

In 2003 Iberia L.A.E. achieved a significant increase in the use of electronic tickets, known as "cybertickets", an initiative aimed at making life easier for the customer. This new type of ticket consists of an electronic file in a database which, because there is no printed support, simplifies the booking and purchasing processes to the maximum, eliminates the need to travel to buy the ticket and, thanks to promotions, on many occasions leads to cash savings for the customer. In 2003 the Company increased the number of destinations for which the cyberticket can be used and, accordingly, at year-end it was possible to use them for flights operated by Iberia, L.A.E. from anywhere in Spain to destinations in 30 countries and on all domestic routes except the Madrid-Barcelona Shuttle. In 2003 almost 3,370,000 cybertickets were issued, which is more than 4.5 times the number issued in 2002. In sales originating in Spain in 2003, cybertickets accounted for 30% of the total number of tickets issued.

In 2002 Iberia, L.A.E. began to install self-service check-in machines at the main Spanish airports. This way, passengers who travel with only hand baggage can reduce their waiting time by obtaining their boarding passes by themselves instead of having to queue at the conventional check-in desks. In 2003 these machines started to be installed at other Spanish airports and hotels. The Madrid - Barajas and Barcelona - El Prat terminals now also have an automatic check-in system for the Madrid - Barcelona Shuttle, with which passengers can obtain their tickets, boarding pass and receipt all in one go.

At the beginning of 2003 the new Iberia.com platform was launched in order to improve sales and customer relations, providing added value to all areas of the various on-line booking, purchasing and information processes, and through the various different products and services that Iberia, L.A.E. offers its customers, in a personalized fashion based on their profile and preferences, giving rise to a more personal approach that increases customer satisfaction. The new design of the Internet website of Iberia, L.A.E. has simplified booking processes and includes new features in on-line booking and purchasing processes, together with improvements in the information and communications for customers, the users of Iberia.com and the Company's shareholders. In 2003, the volume of business of Iberia.com grew significantly. The Company sold almost 935,000 tickets through this channel in 2003, 85.8% more than in 2002. These sales amounted to over €159.5 million, representing an increase of close to 60% with respect to 2002, making it the website with the highest volume of sales in Spain.

Iberia, L.A.E. was once again the pioneer company in Spain by introducing a new information system so that customers can ascertain flight timetables and arrivals for all its flights through SMS text messages to wireless telephones. This service has been operational since 2003 for all the telephone companies that operate in Spain (Amena, Movistar and Vodafone). The purpose of the new service was to cater for customers' needs and, in addition, to improve the productivity of Serviberia. By automating some of the calls that only required information on flight times or arrivals enabled more resources to be focused on the receiving of calls that gave rise to sales.

With the arrival of the new Airbus A-340/600 aircraft in 2003, Iberia, L.A.E. introduced a new package of satellite communications services that can be used by both passengers and crew. Thanks to this leading-edge technology, first- and business-class passengers can communicate with the ground, not only through the on-board telephone, but also through SMS text messages and e-mails.

Commercial agreements

On December 10, 2003, the European Commission formally approved the alliance between Iberia, L.A.E., British Airways and its franchised airline GB Airways and guaranteed the three companies exemption from Article 81(3) of the European Treaty for six years, subject to the conditions deemed necessary to maintain competition on the routes between Spain and the U.K.

The airlines had forged an alliance in 2002, subject to approval by the European authorities, to work together in a more coordinated fashion in their global networks, including the competitive market between Spain and the U.K.

The alliance agreement approved envisages the possibility of coordinating and eventually integrating the airlines' commercial and marketing strategies and their distribution practices and procedures.

The areas covered by this cooperation agreement include most notably the following:

- Joint flight network planning, adapting and optimizing the capacities of the two airlines to customer demand.
- Gradual combination of sales activity.
- Use of profit-sharing and other economic cooperation mechanisms.
- Joint cargo operations management including prices, capacity management, sales and handling activities.

The alliance will make it possible to harness significant synergies for the airlines and will lead to benefits for their customers, who will be able to fly to more destinations at more convenient times of day, will have greater access to VIP lounges, and will benefit from better connections. The airlines' networks are largely complementary, meaning that the Iberia Group's customers will have access to a larger number of routes to the Middle and Far East, while British Airways customers will have a greater choice of routes to Latin America.

In 2003 Iberia, L.A.E. reaped the benefits of various profitable agreements with its franchised airline Air Nostrum, which once again was named (for the third time in four years) "Regional Airline of the Year 2003-2004" by the European Regions Airline Association (ERA), the most important regional airline association in the world.

Iberia Regional Air Nostrum continued to expand rapidly, increasing flight frequencies and adding new routes to its flight network in the domestic and European markets. This regional airline is both renewing and expanding its fleet of aircraft.

Outsourcing of functions and divestments

In 2003, based on the strategy defined in the Master Plan in force, Iberia, L.A.E. entered into various agreements to sell holdings in companies and other assets that were not directly associated with its core air transport business or which would enable it to increase its profits and efficiency by outsourcing functions.

In October 2003 Iberia, L.A.E. and CAE entered into an agreement to create an aeronautical training joint venture where the crew members of Iberia, L.A.E. and other airlines will be trained. Under the agreement, CAE contributed its assets in Alcalá de Henares (Madrid) and Iberia, L.A.E. contributed its assets at Barajas Airport (also Madrid), together with their respective associated liabilities, in order to create the new joint venture. Iberia, L.A.E. and CAE will have ownership interests of approximately 20% and 80%, respectively, in the new company, which will foreseeably commence operations in the first few months of 2004, after it has obtained the necessary licenses.

CAE is a leading provider of integrated training solutions and advanced simulation and control technologies for both civil and military aviation customers.

As part of the redesign of the new in-flight service model and of the other activities relating thereto, in December 2003 Iberia, L.A.E. announced the sale of its 70% holding in Iber-Swiss Cátering, S.A. to Gate Gourmet International, which owned the remaining 30% of the capital stock and is one of the leading catering services companies in the world. At the date of this report, this sale, which amounted to €23.5 million, was pending approval by the Spanish antitrust authorities. The agreement reached provides for both the sale of the aforementioned shares and the establishment of a contract for services whereby Gate Gourmet International will provide Iberia, L.A.E. with general catering services throughout the world for seven years. The agreement also envisages cooperation in various areas associated with in-flight catering and, in particular, in the new in-flight pay service that Iberia, L.A.E. has introduced on certain short- and medium-haul flights since March 2004.

On December 12, 2003, Iberia, L.A.E. and Iberojet entered into a purchase agreement whereby the Company undertook to sell its holding in Touroperador Viva Tours, S.A. and the "Viva Tours" brand name to Iberojet. This transaction was approved by the antitrust authorities in February 2004. With this transaction, the total price for which amounted to €16,9 million, the Iberia Group outsourced its tour operator activities under an outsourcing agreement with one of the leading specialists in Spain, which will design the Viva Tours product for the Company on a competitive basis.

In June 2003 Iberia, L.A.E. entered into an agreement with the Marsans Group company Teinver for the sale by the Company of the "Mundicolor" brand name and of its 18.7% holding in the tour operator Tiempo Libre. This sale, which amounted to €12 million (€6 million for the brand name and €6 million for the holding), was approved by the antitrust authorities and gave rise to a gross capital gain of €11.5 million. The agreements entered into will enable the Iberia Group to maintain its current position in regard to the number of seats and prices offered to Tiempo Libre.



Corporate Social Responsibility

The Iberia Group is one of the Spanish companies that is most firmly committed to social responsibility and protecting the environment.

The Company's social actions are based on three fundamental pillars: social action in conjunction with employees, including most notably the work carried out by the NGO Mano a Mano, Asociación de Empleados Padres de Minusválidos (APMIB), and Fundación Tutelar APMIB; the support given to institutions through sponsorship agreements (such as those with AECl, ONT, the Ministry of Social Affairs and Fundación Ilusiones, among others); and cooperation projects with customers (the Spanish Red Cross, the Special Olympics, etc.).

Iberia, L.A.E. also supports major cultural events. The actions carried out in 2003 include most notably the agreement reached with the Galicia Autonomous Community government to sponsor "Xacobeo 2004", the agreement with Fundación Gala-Salvador Dalí, under which the Iberia Group joined the Promotional Council of "Año Dalí 2004" and the agreement to become a sponsor of "Forum Barcelona 2004".

The wide-reaching fleet renewal plan being implemented by Iberia, L.A.E. constitutes a key factor in the objective of reducing environmental impact. Also, the Company continued to work towards achieving efficient environmental management in all its ground operations. Accordingly, in September 2003 Iberia, L.A.E. received AENOR certificate under the UNE-EN ISO 14001 for its Environmental Management System in relation to the handling services that it provides at 39 Spanish airports (see the specific report on environmental activities).

Changes in the Governing Bodies

On June 12, 2003, following the approval of the Shareholders' Meeting, Fernando Conte García replaced Xabier De Irala as the Chairman of Iberia, L.A.E., pursuant to the resolution adopted by the Board of Directors on May 9, 2003.

On September 25, 2003, the Board of Directors of Iberia, L.A.E. decided to restructure the Audit, Appointments and Compensation, and Security Committees in order to make them more effective. Therefore, the independent directors Antonio Masa Godoy and José Manuel Fernández Norniella joined the Appointments and Compensation Committee, and the Audit Committee was expanded with the appointment of Gregorio Villalabeitia Galarraga, a director appointed by BBVA. The Security Committee was also strengthened with the appointment of Jorge Pont Sánchez, a director appointed by El Corte Inglés (see specific report).

2 Business Performance

2.1. IBERIA GROUP PASSENGER TRANSPORT

Set below are the Iberia Group's statistics on supply, traffic and passenger revenues, broken down by company and by commercial sector (the sectors were defined by grouping routes together geographically).

The figures relating to Binter Canarias were only consolidated in those of the Iberia Group through June 2002, because the sale of this subsidiary was formalized in July 2002. Therefore, when analyzing the variations in the figures relating to the Iberia Group's operations and revenues, particularly in relation to domestic operations, it should be taken into account that the scope of consolidation in 2002 differs from that in 2003.

Section "2.1. Transport" in the management report of Iberia, L.A.E. provides more detailed information on the variations in operating statistics.

2.1.1. PRODUCTION AND TRAFFIC

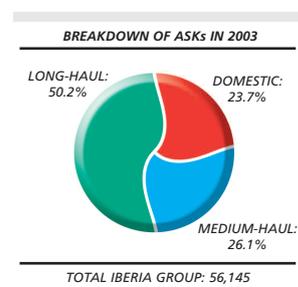
In terms of ASKs, in 2003 Iberia, L.A.E.'s supply increased by 1.3% with respect to 2002. The increase for the Group taken as a whole was only 0.9% as a result of the sale of Binter Canarias. The detail, by company, of the Iberia Group's ASKs is as follows:

| SUPPLY BY COMPANY | | MILLIONS OF ASKS | | |
|---------------------|---------------|------------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| IBERIA, L.A.E. | 56,145 | 55,405 | 740 | 1.3 |
| BINTER CANARIAS | - | 228 | (228) | N/A |
| IBERIA GROUP | 56,145 | 55,633 | 512 | 0.9 |

N/A: not applicable.

In the domestic market the number of ASKs of Iberia, L.A.E. increased by 1% with respect to 2002, although at Group level the sale of Binter Canarias led to a decrease of 0.8%. The Company's production on international flights increased by 1.5%.

| SUPPLY BY SECTOR | | MILLIONS OF ASKS | | |
|---------------------|---------------|------------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| DOMESTIC | 13,323 | 13,424 | (101) | (0.8) |
| MEDIUM-HAUL | 14,622 | 14,408 | 214 | 1.5 |
| LONG-HAUL | 28,200 | 27,800 | 400 | 1.4 |
| IBERIA GROUP | 56,145 | 55,633 | 512 | 0.9 |

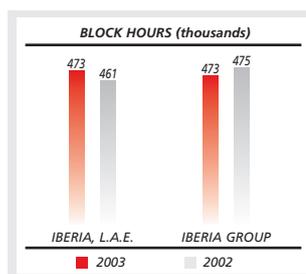


Group production in terms of block hours was 0.4% lower than in 2002, due to the sale of the aforementioned subsidiary, whose production carried greater weight in terms of block hours than in ASKs, due to the short distance of their average haul.

PRODUCTION

PASSENGER AIRCRAFT BLOCK HOURS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------|----------------|----------------|-----------------|--------------|
| IBERIA, L.A.E. | 472,867 | 460,704 | 12,163 | 2.6 |
| BINTER CANARIAS | - | 14,151 | (14,151) | N/A |
| IBERIA GROUP | 472,867 | 474,855 | (1,988) | (0.4) |



The Iberia Group carried 0.4% fewer passengers in 2003 than in 2002, although Iberia, L.A.E. carried 3.8% more passengers in 2003. The Iberia Group's traffic increased by 2.1% on international routes, as a result of the increase in supply and to the improved load factor, and it decreased by 2.2% in the domestic market due to the sale of the Canary Islands regional airline.

The following two tables show the breakdown of the Iberia Group's passengers by company and by sector:

PASSENGERS BY COMPANY

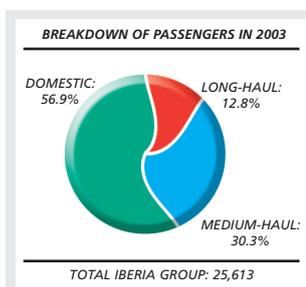
THOUSANDS OF PASSENGERS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------|---------------|---------------|-----------------|--------------|
| IBERIA, L.A.E. | 25,613 | 24,681 | 932 | 3.8 |
| BINTER CANARIAS | - | 1,034 | (1,034) | N/A |
| IBERIA GROUP | 25,613 | 25,715 | (102) | (0.4) |

PASSENGERS BY SECTOR

THOUSANDS OF PASSENGERS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------|---------------|---------------|-----------------|--------------|
| DOMESTIC | 14,581 | 14,908 | (327) | (2.2) |
| MEDIUM-HAUL | 7,756 | 7,664 | 92 | 1.2 |
| LONG-HAUL | 3,276 | 3,143 | 133 | 4.2 |
| IBERIA GROUP | 25,613 | 25,715 | (102) | (0.4) |



The Iberia Group's traffic, measured in revenue passenger kilometers (RPKs), rose by 3.6% in 2003, as compared with the 0.9% increase in supply. RPKs increased by 1.3% on medium-haul flights and by 5.4% on long-haul flights, giving an average increase of 4.2% for international traffic taken as a whole. In 2003 international traffic accounted for 76.9% of the Group's total RPKs and domestic traffic for 23.1%.

The following two tables show the breakdown of the Iberia Group's RPKs by company and by sector:

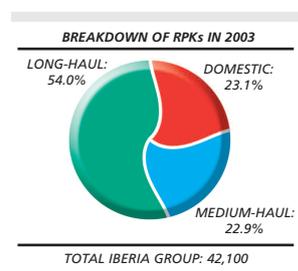
TRAFFIC BY COMPANY MILLIONS OF RPKs

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------|---------------|---------------|-----------------|-------------|
| IBERIA, L.A.E. | 42,100 | 40,470 | 1,630 | 4.0 |
| BINTER CANARIAS | - | 177 | (177) | N/A |
| IBERIA GROUP | 42,100 | 40,647 | 1,453 | 3.6 |

TRAFFIC BY SECTOR MILLIONS OF RPKs

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------|---------------|---------------|-----------------|-------------|
| DOMESTIC | 9,718 | 9,557 | 161 | 1.7 |
| MEDIUM-HAUL | 9,655 | 9,531 | 124 | 1.3 |
| LONG-HAUL | 22,727 | 21,559 | 1,168 | 5.4 |
| IBERIA GROUP | 42,100 | 40,647 | 1,453 | 3.6 |

The Iberia Group's passenger load factor of 75.0% in 2003 was 1.9 percentage points higher than in 2002. The load factor in Iberia, L.A.E.'s network also rose by 1.9%, where the load factor improved in all markets, although the greatest increase (3.0%) took place on long-haul routes.



LOAD FACTOR BY COMPANY %

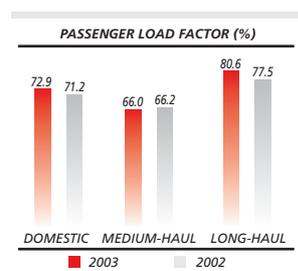
| | 2003 | 2002 | VARIATION 03/02 |
|---------------------|-------------|-------------|-----------------|
| IBERIA, L.A.E. | 75.0 | 73.0 | 1.9 |
| BINTER CANARIAS | - | 77.8 | N/A |
| IBERIA GROUP | 75.0 | 73.1 | 1.9 |

The detail, by sector, of the load factor in 2003 and 2002 is as follows:

LOAD FACTOR BY SECTOR %

| | 2003 | 2002 | VARIATION 03/02 (*) |
|---------------------|-------------|-------------|---------------------|
| DOMESTIC | 72.9 | 71.2 | 1.8 |
| MEDIUM-HAUL | 66.0 | 66.2 | (0.1) |
| LONG-HAUL | 80.6 | 77.5 | 3.0 |
| IBERIA GROUP | 75.0 | 73.1 | 1.9 |

(*) The differences in terms of percentages appear not to add up as a result of the rounding-off effect.



2.1.2. TRAFFIC REVENUES

Iberia L.A.E.'s yield (average revenue per RPK) was 7.3% lower in 2003 than in 2002, due in part to the appreciation of the euro. The Iberia Group's yield fell by a little more (-8,3%), since Binter Canarias had a higher yield because its average haul was shorter. The following two tables show the variations in the Iberia Group's yield, by company and sector:

| YIELD BY COMPANY | | | | | € CENTS |
|---------------------|-------------|-------------|-----------------|--------------|---------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| IBERIA, L.A.E. | 7.97 | 8.60 | (0.63) | (7.3) | |
| BINTER CANARIAS | - | 28.28 | - | N/A | |
| IBERIA GROUP | 7.97 | 8.69 | (0.72) | (8.3) | |

| YIELD BY SECTOR | | | | | € CENTS |
|---------------------|-------------|-------------|-----------------|--------------|---------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| DOMESTIC | 13.12 | 13.89 | (0.77) | (5.5) | |
| MEDIUM-HAUL | 10.91 | 11.82 | (0.91) | (7.7) | |
| LONG-HAUL | 4.52 | 5.00 | (0.48) | (9.6) | |
| IBERIA GROUP | 7.97 | 8.69 | (0.72) | (8.3) | |

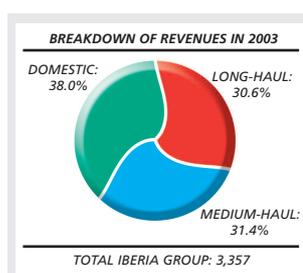
In 2003 the average revenue per ASK of Iberia, L.A.E.'s network taken as a whole fell by 4.8% with respect to 2002. The improved load factor cushioned the fall in the yield.

The following two tables show the variations in the average revenues per ASK, by company and market:

| AVERAGE REVENUES PER ASK BY COMPANY | | | | | € CENTS |
|-------------------------------------|-------------|-------------|-----------------|--------------|---------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| IBERIA, L.A.E. | 5.98 | 6.28 | (0.30) | (4.8) | |
| BINTER CANARIAS | - | 21.99 | - | N/A | |
| IBERIA GROUP | 5.98 | 6.35 | (0.37) | (5.8) | |

| AVERAGE REVENUES PER ASK BY SECTOR | | | | | € CENTS |
|------------------------------------|-------------|-------------|-----------------|--------------|---------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| DOMESTIC | 9.57 | 9.89 | (0.32) | (3.2) | |
| MEDIUM-HAUL | 7.20 | 7.82 | (0.62) | (7.9) | |
| LONG-HAUL | 3.65 | 3.88 | (0.23) | (5.9) | |
| IBERIA GROUP | 5.98 | 6.35 | (0.37) | (5.8) | |

The Iberia Group's passenger revenues amounted to almost €3,357 million in 2003, the breakdown by market being as follows: 38% on domestic flights; and around 31% on both medium-haul and long-haul international routes.



Revenues fell by 5.0% compared to 2002, one-third of the decrease being due to the sale of Binter Canarias. The detail of the passenger revenues by company and market is as follows:

| PASSENGER REVENUES BY COMPANY | | | | MILLIONS OF EUROS |
|--------------------------------------|----------------|----------------|-----------------|-------------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| IBERIA, L.A.E. | 3,356.8 | 3,481.4 | (124.6) | (3.6) |
| BINTER CANARIAS | - | 50.3 | (50.3) | N/A |
| IBERIA GROUP | 3,356.8 | 3,531.7 | (174.9) | (5.0) |

| PASSENGER REVENUES BY SECTOR | | | | MILLIONS OF EUROS |
|-------------------------------------|----------------|----------------|-----------------|-------------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| DOMESTIC | 1,275.3 | 1,327.6 | (52.3) | (3.9) |
| MEDIUM-HAUL | 1,053.4 | 1,126.5 | (73.1) | (6.5) |
| LONG-HAUL | 1,028.1 | 1,077.6 | (49.5) | (4.6) |
| IBERIA GROUP | 3,356.8 | 3,531.7 | (174.9) | (5.0) |

2.2. SAVIA

Sistemas Automatizados Agencias de Viaje, S.A. (SAVIA) is the market leader in the distribution of tourism bookings in Spain. It engages mainly in the marketing and local adaptation of the Amadeus System, the development and distribution of local products and services and the provision of assistance to travel agencies in connection with technological infrastructure, training, consulting and customer service.

In 2003 SAVIA completed the migration of its communications network that it had commenced in 2002 and, almost all travel agencies now have ADSL technology, thereby improving the quality and speed of communications. Also, SAVIA continued to replace computers and to install ticket printers using ATB technology.

SAVIA continued to increase its presence in the Spanish market in 2003. 615 new agencies were connected to the system, as a result of which the total number connected increased by 8.9% to stand at 7,493 in December 2003; the number of terminals installed at Spanish travel agencies was 21,749 at year-end.

Also, SAVIA has a presence in the Portuguese market with 131 agencies connected at the end of 2003.

The bookings made over the system increased by 11% in 2003 to almost 31.2 million. Approximately 97.5% of these bookings were related to airline tickets, and the remainder to hotel and car hire bookings.

The following tables show the variations in SAVIA's main production and financial aggregates:

▶▶ SAVIA, PRODUCTION

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--------------------------------|--------|--------|-----------------|-------------|
| THOUSANDS OF BOOKINGS | 31,177 | 28,096 | 3,081 | 11.0 |
| TOTAL NUMBER OF TERMINALS | 22,227 | 21,273 | 954 | 4.5 |
| TOTAL NUMBER OF AGENCIES | 7,624 | 7,023 | 601 | 8.6 |
| EQUIVALENT FULL-TIME EMPLOYEES | 119 | 113 | 6 | 5.3 |

▶▶ SAVIA, EARNINGS

| | MILLIONS OF EUROS | | | |
|-----------------------------|-------------------|-------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| OPERATING INCOME | 9.2 | 9.7 | (0.5) | (5.1) |
| OPERATING REVENUES | 58.0 | 58.9 | (0.9) | (1.5) |
| AMADEUS BOOKINGS | 42.3 | 39.1 | 3.2 | 8.2 |
| OTHER REVENUES | 15.7 | 19.8 | (4.1) | (20.7) |
| OPERATING EXPENSES | 48.8 | 49.2 | (0.4) | (0.8) |
| FEES | 12.5 | 12.0 | 0.5 | 4.2 |
| COMMUNICATIONS | 8.1 | 8.6 | (0.5) | (5.8) |
| PERSONNEL EXPENSES | 5.1 | 4.6 | 0.5 | 10.9 |
| OTHER OPERATING EXPENSES | 23.1 | 24.0 | (0.9) | (3.7) |
| FINANCIAL INCOME | 0.1 | 0.1 | 0.0 | 0.0 |
| EXTRAORDINARY INCOME (LOSS) | (1.4) | 0.8 | (2.2) | N/M |
| INCOME BEFORE TAXES | 7.9 | 10.6 | (2.7) | (25.5) |
| TAXES | (2.8) | (3.7) | 0.9 | (24.3) |
| NET INCOME AFTER TAXES | 5.1 | 6.9 | (1.8) | (26.1) |

N/M: not material. Shown where the variation is greater than +/-300%.

▶▶ SAVIA, BALANCE SHEET

| | MILLIONS OF EUROS | | | |
|---|-------------------|-------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| FIXED ASSETS, NET | 8.1 | 4.4 | 3.7 | 84.1 |
| DEFERRED CHARGES | 0.1 | 0.1 | 0.0 | 0.0 |
| CURRENT ASSETS | 21.3 | 20.6 | 0.7 | 3.4 |
| TOTAL ASSETS | 29.5 | 25.1 | 4.4 | 17.5 |
| EQUITY | 16.0 | 17.8 | (1.8) | (10.1) |
| LONG-TERM PROVISIONS FOR CONTINGENCIES AND EXPENSES | 1.7 | 0.0 | 1.7 | - |
| LONG-TERM DEBT | 4.2 | 0.0 | 4.2 | - |
| CURRENT LIABILITIES | 7.6 | 7.3 | 0.3 | 4.1 |
| TOTAL EQUITY AND LIABILITIES | 29.5 | 25.1 | 4.4 | 17.5 |

2.3. IBER-SWISS CATERING

At the end of 2003 Iberia, L.A.E. entered into a preliminary agreement for the sale of its 70% holding in Iber-Swiss Catering, S.A. ("Iber-Swiss") to the catering services company Gate Gourmet International, which owned the remaining 30% of the shares. As of the date of this report this purchase and sale transaction, which forms part of a new in-flight service model, had not yet been approved by the Spanish antitrust authorities. Accordingly, the agreement entered into also provides for the signing of an agreement whereby Gate Gourmet International will provide Iberia, L.A.E. with general catering services throughout the world for seven years, and for cooperation in various areas relating to in-flight catering and, in particular, in the new in-flight pay service that Iberia, L.A.E. has introduced on certain short- and medium-haul flights since March 2004.

On January 20, 2004, the agreement was reached when the senior executives of the two companies signed the related contracts.

Gate Gourmet International, one of the leading catering services companies in the world, has been responsible for managing Iber-Swiss since 1986 and, therefore, the sale of the shares owned by Iberia, L.A.E. constitutes a continuation of the catering company's management model.

In 2003 Iber-Swiss continued to provide food and catering services to Iberia, L.A.E. and other airlines. Despite the adverse economic situation (the war in Iraq and the outbreak of the SARS virus had a direct effect on the air transport industry), Iber-Swiss reported relatively good results in 2003.

The company's volume of business in 2003 increased by 12.6% with respect to 2002 in terms of the number of trays and by 2.1% in terms of the number of flights served. 2003 saw a gradual increase in the number of flights with the inclusion of meals on return legs of the European flights of the main customer, Iberia, L.A.E., which gave rise to an increase in the profits of the Iberia Group.

Iber-Swiss gained new airline customers in 2003. From the beginning of the year, at the Madrid and Barcelona production centers, Iber-Swiss started to provide catering services to Delta Air Lines on its flights to New York and Atlanta. In April the Dutch airline KLM and the Spanish airline Swiftair became customers of Iber-Swiss. In Barcelona services also started to be provided to Cubana de Aviación and Air Plus Comet.

In addition, the company decided to penetrate hitherto unserved new markets. Thus it entered into an agreement for the supply of products for the Spanish chain Delinas, which sells high-quality fast food in Madrid. Also, at the Barcelona center food is produced for Sodexo Pass, and in October an agreement was entered into with the railroad company Wagons Lits for ALTARIA, which operates seven trains each day between Barcelona and Madrid.

The aggregate headcount at the Madrid, Málaga and Barcelona work centers totaled 1,454 employees in 2003, up 1.1% on 2002. Productivity, measured in terms of the number of trays per employee, increased by 11.4%.

Operating revenues amounted to €72.2 million in 2003, up 8.1% on 2002. The operating income of €4.0 million reported in 2003 was €0.8 million lower than in 2002, and the income after taxes of €2.2 million represented a slight increase with respect to the previous year.

Iber-Swiss successfully passed the audits for the renewal of the ISO 9001:2000 certificate for all its laboratory processes granted by AENOR. It also passed the audit for the renewal of its environmental certificate under the ISO 14.000 standard.

In 2003 Iber-Swiss continued to work towards achieving a GSE 3000 certificate for its Madrid work center, as part of the "Global Service Excellence" program implemented by Gate Gourmet International. In 2003, the Málaga work center received a GSE 1000 certificate and the Barcelona work center received a GSE 2000 certificate, which the Madrid work center had already achieved in 2002.

In January 2003 Iber-Swiss posted a website on the Internet as a new communication channel targeted at its customers and anyone who might be interested in knowing more about the company.

The detail of the variations in the main production aggregates of Iber-Swiss is as follows:

▶▶ IBER-SWISS CATERING, PRODUCTION

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--------------------------------------|---------|---------|-----------------|-------------|
| PRODUCTION OF FOOD-TRAYS (THOUSANDS) | 15,317 | 13,602 | 1,715 | 12.6 |
| PLANES SERVED (UNITS) | 133,302 | 130,588 | 2,714 | 2.1 |
| EQUIVALENT FULL-TIME EMPLOYEES | 1,454 | 1,438 | 16 | 1.1 |
| FOOD-TRAYS PER EMPLOYEE | 10,534 | 9,458 | 1,076 | 11.4 |

The variation in the main aggregates in the management statement of income and balance sheet of Iber-Swiss were as follows:

▶▶ IBER-SWISS CATERING, EARNINGS

MILLIONS OF EUROS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--------------------------|-------|-------|-----------------|-------------|
| OPERATING INCOME | 4.0 | 4.8 | (0.8) | (16.7) |
| OPERATING REVENUES | 72.2 | 66.8 | 5.4 | 8.1 |
| CATERING SALES | 44.1 | 39.3 | 4.8 | 12.2 |
| OTHER HANDLING SERVICES | 21.8 | 21.6 | 0.2 | 0.9 |
| OTHER REVENUES | 6.3 | 5.9 | 0.4 | 6.8 |
| OPERATING EXPENSES | 68.2 | 62.0 | 6.2 | 10.0 |
| MATERIALS USED | 21.2 | 18.6 | 2.6 | 14.0 |
| PERSONNEL EXPENSES | 36.7 | 34.1 | 2.6 | 7.6 |
| OTHER OPERATING EXPENSES | 10.3 | 9.3 | 1.0 | 10.8 |
| FINANCIAL LOSS | (0.4) | (0.4) | 0.0 | 0.0 |
| EXTRAORDINARY LOSS | (0.2) | (1.2) | 1.0 | 83.3 |
| INCOME BEFORE TAXES | 3.4 | 3.2 | 0.2 | 6.3 |
| TAXES | (1.2) | (1.1) | (0.1) | 9.1 |
| NET INCOME AFTER TAXES | 2.2 | 2.1 | 0.1 | 4.8 |

IBER-SWISS CATERING, BALANCE SHEET

MILLIONS OF EUROS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--|-------------|-------------|-----------------|---------------|
| FIXED ASSETS, NET | 14.8 | 17.5 | (2.7) | (15.4) |
| DEFERRED CHARGES | 0.1 | 0.5 | (0.4) | (80.0) |
| CURRENT ASSETS | 9.6 | 10.7 | (1.1) | (10.3) |
| TOTAL ASSETS | 24.5 | 28.7 | (4.2) | (14.6) |
| EQUITY | 13.4 | 12.3 | 1.1 | 8.9 |
| LONG-TERM PROVISIONS FOR CONTINGENCIES AND EXPENSES | 0.6 | 1.4 | (0.8) | (57.1) |
| LONG-TERM DEBT | 0.9 | 3.2 | (2.3) | (71.9) |
| CURRENT LIABILITIES | 9.6 | 11.8 | (2.2) | (18.6) |
| TOTAL EQUITY AND LIABILITIES | 24.5 | 28.7 | (4.2) | (14.6) |

2.4. CACESA

In 2003 Compañía Auxiliar al Cargo Express, S.A. (CACESA) obtained a slightly higher consolidated income than in 2002, and its operating income amounted to approximately €1.2 million. Its operating revenues increased by 12.2% to €42.4 million in 2003. Operating expenses amounted to €41.2 million in 2003, up 12.0% on the figure for 2002. Both increases were due mainly to the increase in the company's production.

In June 2002 CACESA incorporated Auxiliar Logística Aeroportuaria, S.A. (ALAE) and transferred certain of its activities to this subsidiary. In order to make the figures for the two years comparable, the figures included in this management report are the consolidated figures of CACESA and ALAE, although for the purposes of preparing the Iberia Group's consolidated financial statements the figures of ALAE were excluded.

Total sales of the Ibexpress product amounted to €17.0 million in 2003, up 1.2% on 2002. This increase was due mainly to the significant increase in international traffic, above all in relation to exports, following the attraction of important accounts in 2002. The growing reliability of the U.S. network, together with improvements in processes and systems made it possible to retain these customers in 2003 and to significantly increase the customer roster for traffic of this nature. The cargo line to and from the Canary Islands and inter-Canary Islands traffic also performed positively in 2003, and there were slight decreases in non-Canary Islands airport-to-airport, door-to-door and mixed product movements, as a result of the economic crisis. However, there was a slight upturn in the latter part of the year.

Transit product sales totaled €19.6 million in 2003, up 14% on 2002, due to the significant increase (47%) in imports with the introduction of new shipments of perishable goods from New York and Buenos Aires. Although exports were in line with 2002, they did not recover the levels achieved in prior years. Canary Islands product shipments again performed well in 2003, although domestic traffic, as in the case of the Ibexpress product, fell back during the year.

The revenues generated by CACESA's other services, such as customs and auxiliary logistics services, also increased significantly with respect to the previous year, due in part to the sound performance of Transit product imports.

In 2003 CACESA's new IT platform was configured and installed. This platform will support the company's new management application, E-First, development of which has been completed and which will be implemented in the first half of 2004.

Having obtained a UNE-EN-ISO 9001:2000 quality certificate for its Madrid and Barcelona work centers in 2002, CACESA extended this certificate to its other work centers in January 2003. Work continued in 2003 on the obtainment of this certificate for the centers managed under concession arrangements, and the related AENOR audits are scheduled for March 2004.

The variations in 2003 in the main aggregates of CACESA, including ALAER, were as follows:

▶▶ CACESA, PRODUCTION

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|--|------|------|-----------------|-------------|
| OPERATING REVENUES (MILLIONS OF €) | 42.4 | 37.8 | 4.6 | 12.2 |
| IBEXPRESS REVENUES (MILLIONS OF €) | 17.0 | 15.8 | 1.2 | 7.6 |
| IBERTRAS REVENUES (MILLIONS OF €) | 19.6 | 17.1 | 2.5 | 14.6 |
| REVENUES FROM OTHER SERVICES (MILLIONS OF €) | 5.8 | 4.9 | 0.9 | 18.4 |
| EQUIVALENT FULL-TIME EMPLOYEES | 188 | 159 | 29 | 18.2 |

▶▶ CACESA, EARNINGS

| | MILLIONS OF EUROS | | | |
|-----------------------------|-------------------|-------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| OPERATING INCOME | 1.2 | 1.0 | 0.2 | 20.0 |
| OPERATING REVENUES | 42.4 | 37.8 | 4.6 | 12.2 |
| CARGO REVENUES | 36.6 | 33.0 | 3.6 | 10.9 |
| CARGO HANDLING AND SERVICES | 5.8 | 4.8 | 1.0 | 20.8 |
| OPERATING EXPENSES | 41.2 | 36.8 | 4.4 | 12.0 |
| SALES EXPENSES | 32.3 | 28.8 | 3.5 | 12.2 |
| PERSONNEL EXPENSES | 5.3 | 4.6 | 0.7 | 15.2 |
| OTHER OPERATING EXPENSES | 3.6 | 3.4 | 0.2 | 5.9 |
| FINANCIAL INCOME | 0.0 | 0.0 | 0.0 | - |
| EXTRAORDINARY INCOME | (0.0) | (0.0) | 0.0 | - |
| INCOME BEFORE TAXES | 1.2 | 1.0 | 0.2 | 20.0 |
| TAXES | (0.4) | (0.3) | (0.1) | 33.3 |
| NET INCOME AFTER TAXES | 0.8 | 0.7 | 0.1 | 14.3 |

The financial and extraordinary revenues are shown as zero due to the rounding-off effect.

▶▶ CACESA, BALANCE SHEET

| | MILLIONS OF EUROS | | | |
|---|-------------------|-------------|-----------------|-------------|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
| FIXED ASSETS, NET | 1.5 | 1.5 | 0.0 | 0.0 |
| ACCOUNTS RECEIVABLE, NET | 7.6 | 9.1 | (1.5) | (16.5) |
| SHORT-TERM INVESTMENTS AND CASH | 5.0 | 2.6 | 2.4 | N/M |
| TOTAL ASSETS | 14.1 | 13.2 | 0.9 | 6.8 |
| EQUITY | 3.4 | 2.9 | 0.5 | 17.2 |
| LONG-TERM PROVISIONS FOR CONTINGENCIES AND EXPENSES | 0.0 | 0.1 | (0.1) | (100.0) |
| TRADE ACCOUNTS PAYABLE | 2.3 | 3.0 | (0.7) | (23.3) |
| OTHER SHORT-TERM PAYABLES | 8.4 | 7.2 | 1.2 | 16.7 |
| TOTAL EQUITY AND LIABILITIES | 14.1 | 13.2 | 0.9 | 6.8 |

2.5. VIVA TOURS

In December 2003 Iberia, L.A.E. entered into a contract for the sale of its 49% holding in Touroperador Viva Tours, S.A. (Viva Tours) and the "Viva Tours" brand name to Iberojet, one of the leading wholesale agents in the Spanish tourism industry. This transaction was approved by the Spanish antitrust authorities in February 2004.

Viva Tours was incorporated in November 1998 and started to operate in the summer season of 1999. Its shareholders, other than Iberia, L.A.E., included some of the most important companies in the tourism industry in Spain, namely Iberostar; Hoteles y Apartamentos, S.A.; Sol Meliá, S.A.; and Air Nostrum.

2.6. IBERIA CARDS

Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A. ("Iberia Cards") is a credit finance establishment formed by Iberia, L.A.E., which owns 40% of the capital stock, and the financial institutions Caja Madrid, BBVA and the Banco Popular Group in April 2002.

In 2003 the activities performed by Iberia Cards focused on the attraction of new Visa Iberia card customers and on consolidating its launch in 2002 from various standpoints: completing its product range, introducing new services, establishing internal procedures and preparing management reports.

More than 290,000 cards had been issued at 2003 year-end. Also, this volume of cards was achieved while at the same time maintaining customer quality, thereby consolidating Iberia Cards' position among the leading card issuers in Spain in terms of the average charge per card and of absolute charge per company card. The benefits associated with the cards include most notably the inclusion of the Iberia Plus loyalty-building program.

In regards to completion of the product range, 2003 saw the commercial launch of the Shuttle Card ("Tarjeta Puente Aéreo (TPA)", the Company Card ("Tarjeta de Empresa") and the Corporate Card ("Tarjeta Corporate"). These cards make it possible for Iberia Cards to cater for all potential customer market segments with a differentiated and competitive range of products. The TPA Card constitutes a landmark for means of payment in Spain since it incorporates a chip that provides huge advantages when it comes to purchasing tickets and obtaining boarding passes for Iberia, L.A.E.'s Shuttle flights between Madrid and Barcelona.

In 2003 information on, inter alia, tickets, routes, passenger particulars and flight numbers was included in the information provided in the company card statements, making the Visa Iberia Business card a much more effective travel expense management control tool.

Iberia Cards ended 2003 with pre-tax income of over €100,000, thereby achieving break-even point one year before initially scheduled. The risk ratios were also better than envisaged in the budget for the year.

On April 23, 2003, capital was increased through the emission of 8,000 new shares of the same par value and carrying the same rights as the existing shares, which were subscribed and paid in full by the shareholders.

Set forth below are the main aggregates in the 2003 statement of income and balance sheet of Iberia Cards:

| IBERIA CARDS, EARNINGS | | MILLIONS OF EUROS |
|--|--|-------------------|
| | | 2003 |
| REVENUES | | 23.64 |
| INTEREST AND SIMILAR REVENUES | | 0.15 |
| FEES RECEIVED | | 23.29 |
| RECOVERIES | | 0.20 |
| EXPENSES | | 23.53 |
| INTEREST AND SIMILAR EXPENSES | | 1.19 |
| BROKERAGE AND SUNDRY FEES | | 10.35 |
| OPERATING EXPENSES | | 11.01 |
| FIXED ASSET DEPRECIATION, AMORTIZATION AND WRITE-DOWNS | | 0.05 |
| SUNDRY LOSSES AND BAD DEBTS | | 0.93 |
| INCOME BEFORE TAXES | | 0.11 |
| CORPORATE INCOME TAX | | (0.04) |
| INCOME AFTER TAXES | | 0.07 |

A comparison with 2002 is not meaningful because Iberia Cards commenced commercial activities in the last quarter of 2002.

| IBERIA CARDS, BALANCE SHEET | | MILLIONS OF EUROS |
|-------------------------------------|--|-------------------|
| | | 2003 |
| CASH ON HAND AND AT BANKS | | 1.71 |
| LOANS AND CREDITS | | 5.89 |
| INVESTMENT SECURITIES | | 0.12 |
| FIXED ASSETS, NET | | 0.18 |
| SUNDRY ACCOUNTS RECEIVABLE | | 0.92 |
| ACCRUAL ACCOUNTS | | 4.77 |
| ACCUMULATED LOSSES | | 1.76 |
| TOTAL ASSETS | | 15.35 |
| PAYABLE TO BANKS | | 0.02 |
| SUNDRY ACCOUNTS PAYABLE | | 0.52 |
| ACCRUAL ACCOUNTS | | 4.36 |
| SPECIAL FUNDS | | 0.29 |
| EQUITY | | 10.09 |
| INCOME FOR THE YEAR | | 0.07 |
| TOTAL LIABILITIES AND EQUITY | | 15.35 |

3 Resources

3.1. FLEET

As of December 31, 2003, the Iberia Group had 149 aircraft in service, of which 27 were operated on long-haul routes and 122 operated short- and medium-haul routes. The detail, by type of aircraft and operating arrangement, of the aircraft operated by the Iberia Group is as follows:

▶▶ **FLEET**

| AIRCRAFT TYPE | OWNED | AIRCRAFT UNDER FINANCIAL LEASE | AIRCRAFT UNDER OPERATING LEASE | TOTAL OPERATED |
|---------------|-----------|--------------------------------|--------------------------------|----------------|
| B-747 | 4 | - | 2 | 6 |
| B-757 | 1 | - | 16 | 17 |
| A-319 | - | - | 4 | 4 |
| A-320 | 10 | 10 | 36 | 56 |
| A-321 | - | 2 | 5 | 7 |
| A-340 | - | - | 18 | 18 |
| A-340/600 | - | - | 3 | 3 |
| MD-87 | 19 | - | 5 | 24 |
| MD-88 | 13 | - | 1 | 14 |
| TOTAL | 47 | 12 | 90 | 149 |

As of December 31, 2002, there were 146 available passenger aircraft. The following list shows the additions and retirements in 2003, explaining this net increase of 3 aircraft in service:

Additions

- 1 A-320 aircraft under operating lease
- 2 A-321 aircraft under operating lease
- 3 A-340/600 aircraft under operating lease
- 1 MD-88 aircraft under operating lease

Retirements

- 2 B-747 aircraft owned outright
- 2 B-757 aircraft under operating lease

Also, in 2003 the Group acquired outright one B-757 aircraft that had been operated under a financial lease.

At the end of 2003 the Iberia Group had 56 A-320 150-seat aircraft, following the addition in March of one new plane. Also, the short- and medium-haul Airbus family fleet consisted of four A-319 and seven A-321 planes. In March and October 2003 the Group received two new A-321 aircraft, which have 186 seats and are used for high-density domestic and European routes.

In March one MD-88 was also added to the Group's short- and medium-haul fleet and, accordingly, as of 2003 year-end there were 38 MD-87/88 aircraft.

On January 30, 2003, the Board of Directors of Iberia, L.A.E. authorized the purchase of new A-340/600 aircraft to replace the B-747 aircraft. The A-340/600 aircraft, which have four engines and a range of 13,900 km, is the longest and most modern A-340-type plane, since it has 350 seats, compared with the 249 on the A-340/300 aircraft, and is equipped with state-of-the-art communications and entertainment systems for the passengers. The A-340/600 aircraft consume less fuel, are more efficient, have larger holds and are quieter and more comfortable than the B-747 aircraft.

The first Airbus A-340/600 bought by the Group arrived in June 2003, followed by a further two in August and October 2003. These three aircraft, together with 18 A-340/300 and 6 B-747 (after the retirement of two aircraft during the year), composed the Group's long-haul fleet as of December 31, 2003.

The Company has entered into agreements with International Lease Finance Corporation (ILFC) and Airbus for the addition of a further seven new A-340/600 aircraft in 2004 and 2005 and it holds purchase options on another five aircraft of the same type. When all the B-747 aircraft have been retired, a process that commenced in 2003, the Group will be operating only one type of aircraft on long-haul routes.

The average usage of the Iberia Group's aircraft in terms of block hours per aircraft per day was slightly higher in 2003 than in 2002. However, excluding the aircraft of Binter Canarias from the 2002 figure, the average usage of the aircraft was 8.78 block hours per aircraft per day in both years.

| | BLOCK HOURS/AIRCRAFT/DAY | |
|---|--------------------------|-------------|
| | 2003 | 2002 |
| AVERAGE SHORT- AND MEDIUM-HAUL AIRCRAFT USAGE | 7.90 | 7.83 |
| AVERAGE LONG-HAUL AIRCRAFT USAGE | 12.85 | 12.93 |
| TOTAL AVERAGE AIRCRAFT USAGE | 8.78 | 8.68 |

3.2. PERSONNEL

3.2.1. HEADCOUNT

The table below shows the Iberia Group's average headcounts in 2003 and 2002. In order to make the figures comparable, the employees of Binter Canarias, which ceased to form part of the Group in July 2002, were not included.

| | GROUND | | FLIGHT | | TOTAL | |
|-------------------------|---------------|---------------|--------------|--------------|---------------|---------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| IBERIA, L.A.E. | 18,063 | 17,675 | 6,378 | 6,369 | 24,441 | 24,044 |
| CACESA | 188 | 159 | - | - | 188 | 159 |
| IBER-SWISS CATERING | 1,454 | 1,438 | - | - | 1,454 | 1,438 |
| SAVIA | 119 | 113 | - | - | 119 | 113 |
| IBERIA GROUP | 19,824 | 19,385 | 6,378 | 6,369 | 26,202 | 25,754 |
| VARIATION 2003/2002 (%) | 2.3% | | 0.1% | | 1.7% | |

In 2003 the Group's average equivalent full-time employees increased by a net number of 448 employees (397 at the Parent Company and 51 at the subsidiaries), representing an increase of 1.7% with respect to 2002. However, 623 ground employees, flight technicians and cabin crew members of Iberia, L.A.E. availed themselves of the labor force reduction plan in 2003; and a further 149 left the Company as a result of the restructuring of the organization abroad, which led to a reduction of the headcount in most of the areas of the Company.

The introduction of second pilots sufficiently in advance to cater for the projected increase in the volume of business gave rise to a 2.0% increase in the headcount relating to flight technicians. However, there was a 0.7% drop in the number of cabin crew members. The average ground staff headcount increased by 2.3%, mainly as a result of the 7.8% increase in the number of Iberia Handling employees due to the significant rise in the number of planes handled for third parties and to the provision of new services (mainly security). Disregarding the handling employees, the number of ground employees of the Iberia Group was 1.6% lower in 2003 than in 2002.

3.2.2. PRODUCTIVITY

Following the sale of Binter Canarias in July 2002, Iberia, L.A.E. is the only Group company that engages in air transport activities. Therefore, the variations in productivity (in terms of block hours per crew member and of ASKs per employee) are only meaningful in the case of the Group's Parent Company. The variations in 2003 in the flight and ground employees' productivity were as follows.

▶▶ PRODUCTIVITY OF IBERIA, L.A.E. EMPLOYEES

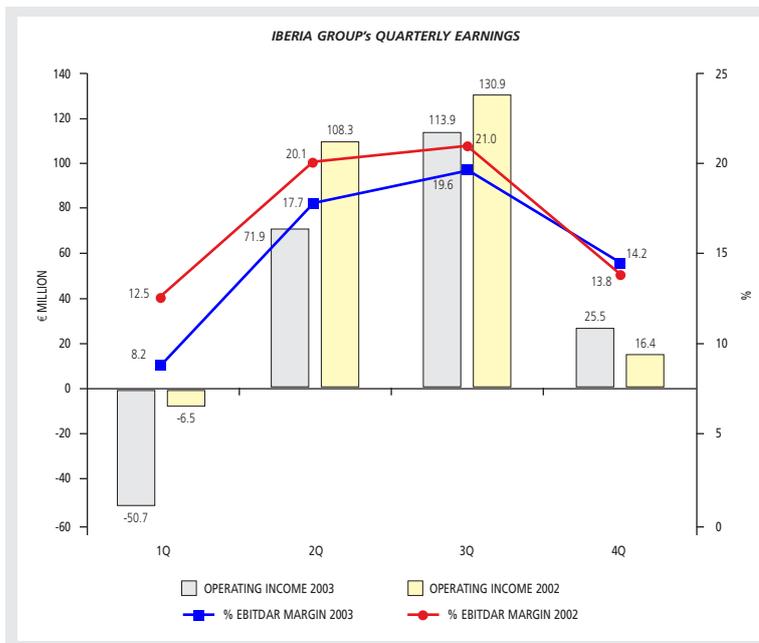
| | 2003 | 2002 | % VARIATION |
|---|-------|-------|-------------|
| TOTAL LABOR FORCE (THOUSANDS OF ASKS PER EMPLOYEE) | 2,297 | 2,304 | (0.3) |
| GROUND PERSONNEL (THOUSANDS OF ASKS PER EMPLOYEE) | 3,108 | 3,135 | (0.9) |
| GROUND STAFF EXCLUDING HANDLING EMPLOYEES (THOUSANDS OF ASKS PER EMPLOYEE) | 5,885 | 5,671 | 3.8 |
| TECHNICAL CREW (BH PER CREW MEMBER) | 250.1 | 250.6 | (0.2) |
| CABIN CREW (BH PER CREW MEMBER) | 110.1 | 106.9 | 3.0 |

4 Financial Performance

4.1. OPERATING INCOME

The Iberia Group's operating income for 2003 amounted to €160.7 million. Although this income was €88.4 million lower than the significant earnings achieved in 2002, it should be considered that it was obtained against a backdrop of an exceptional series of difficulties that hit the air transport industry particularly hard in 2003. The lackluster nature of the main world economies, the uncertainties existing in the lead-up to the war, the war in Iraq and the effect of the SARS virus put back the long-awaited upturn in world air traffic, which did not occur until the summer, although significant growth was observed in both passenger and cargo traffic in the last quarter. The significant increase in fuel prices and navigation charges, together with the growing travel price sensitivity of customers, also had an adverse impact on airlines' earnings.

The EBITDAR (operating income before depreciation, amortization and aircraft lease expenses) generated by the Group amounted to €700.7 million in 2003, representing a 15.2% margin on revenues, as compared with the margin of 17.1% achieved in 2002.



However, the Company's earnings, compared with the quarterly operating results figures of the previous year, followed an upward trend in 2003. The negative differences gradually decreased in the first three quarters of the year to the extent that there was a positive difference in the last quarter, in which the Iberia Group obtained operating income of €25.5 million, up €9.1 million on that of the fourth quarter of 2002.

The rise in the value of the euro against the U.S. dollar (by around 16% with respect to the average for 2002) made a particularly significant contribution to the drop in both revenues and operating costs in 2003 and had a net positive effect on the Group's earnings.

The detail of the Iberia Group's operating income statement for management accounting purposes, which differs from the statement of income in the Annual Report because the revenue and expense items are aggregated using management accounting criteria, is as follows:

IBERIA GROUP - OPERATING INCOME

MILLIONS OF EUROS

| | 2003 | 2002 | VARIATION 03/02 | % VARIATION |
|---------------------------------------|----------------|----------------|-----------------|---------------|
| OPERATING REVENUES | | | | |
| PASSENGER REVENUES (a) | 3,587.4 | 3,743.3 | (155.9) | (4.2) |
| CARGO REVENUES | 254.6 | 256.7 | (2.1) | (0.8) |
| HANDLING REVENUES | 272.8 | 234.8 | 38.0 | 16.2 |
| MAINTENANCE REVENUES | 104.0 | 91.3 | 12.7 | 13.9 |
| SALES COMMISSIONS | 120.9 | 108.5 | 12.4 | 11.4 |
| CATERING SALES | 19.1 | 16.0 | 3.1 | 19.4 |
| OTHER OPERATING REVENUES (a) | 260.5 | 248.9 | 11.6 | 4.7 |
| | 4,619.3 | 4,699.5 | (80.2) | (1.7) |
| OPERATING EXPENSES | | | | |
| PERSONNEL EXPENSES | 1,402.7 | 1,353.7 | 49.0 | 3.6 |
| FUEL | 556.8 | 553.2 | 3.6 | 0.7 |
| COMMISSIONS | 437.8 | 464.3 | (26.5) | (5.7) |
| AIRCRAFT LEASE EXPENSES | 373.7 | 395.8 | (22.1) | (5.6) |
| TRAFFIC SERVICES | 362.7 | 362.7 | 0.0 | 0.0 |
| AIRCRAFT MAINTENANCE | 235.5 | 239.6 | (4.1) | (1.7) |
| NAVIGATION CHARGES | 257.6 | 226.6 | 31.0 | 13.7 |
| DEPRECIATION AND AMORTIZATION EXPENSE | 170.8 | 164.7 | 6.1 | 3.7 |
| BOOKING SYSTEMS | 128.2 | 126.3 | 1.9 | 1.5 |
| IN-FLIGHT SERVICES (b) | 74.2 | 87.2 | (13.0) | (14.9) |
| INSURANCE | 51.1 | 76.0 | (24.9) | (32.8) |
| OTHER OPERATING EXPENSES (b) | 407.5 | 400.3 | 7.2 | 1.8 |
| | 4,458.6 | 4,450.4 | 8.2 | 0.2 |
| OPERATING INCOME | 160.7 | 249.1 | (88.4) | (35.5) |

(a) In 2003 the balance of the "Security Charge Revenues" was included under the "Passenger Revenues" caption; based on the same criterion, the amount relating to 2002 (€14.8 million) was transferred from "Other Operating Revenues" to "Passenger Revenues".

(b) Also, the catering expenses were included in the "In-Flight Services" account in 2003. In order to make the figures uniform, the amount relating to 2002 (€22.7 million), which had previously been included under the "Other Operating Expenses" caption, was transferred to "In-Flight Services".

The detail, by company, of the Iberia Group's operating income in 2003 and 2002 is as follows:

OPERATING INCOME BY COMPANY

MILLIONS OF EUROS

| | 2003 | 2002 |
|-------------------------|--------------|--------------|
| IBERIA, L.A.E. | 139.2 | 228.7 |
| SAVIA | 9.2 | 9.7 |
| IBER-SWISS | 4.0 | 4.8 |
| CACESA | 1.2 | 1.0 |
| IBERIA GROUP (*) | 160.7 | 249.1 |

(*) The total figures for the Iberia Group include the related consolidation adjustments.

4.1.1. OPERATING REVENUES

The Iberia Group's operating revenues of €4,619.3 million in 2003 were 1.7% lower than in 2002. Passenger revenues, which accounted for 77.7% of the Group's total operating revenues, fell by 4.2% with respect to the previous year. The sound performance of the other operating revenues, which totaled €1,032.0 million in 2003 (up 7.9% on 2002), partially offset the decrease in passenger revenues.

PASSENGER REVENUES

Passenger revenues amounted to €3,587.4 million in 2003. The difference between this figure and that shown in the "Main Aggregates" and "Traffic Revenues" (section 2.1.2.) tables is due to the fact that the latter relates directly to the actual production for each year, excluding the revenues derived from the unused ticket recovery process and other minor accounting adjustments and revaluations, which are included in the figure in the operating income statement.

Passenger revenues dropped by €155.9 million in 2003, due largely to the 7.3% decrease in the average yield of Iberia, L.A.E., as a result of the appreciation of the euro against other currencies, mainly against the U.S. dollar, which accounted for more than one-third of this decrease; and to the decrease in the average fare due to the delay in the recovery of demand and the increase in competition. The increase in the volume of traffic, thanks to the rise in the load factor, cushioned the impact of the drop in the yield. Therefore, the passenger revenues generated by Iberia, L.A.E. fell by €124.6 million in 2003.

The other passenger revenues (i.e. those not associated with the traffic in the period) totaled €230.6 million in 2003, down by approximately €31.3 million from 2002, in line with the lower volume of sales and as a result of the new methods used to set fares on certain routes.

CARGO REVENUES

The Group's cargo revenues amounted to €254.6 million in 2003, down €2.1 million (0.8%) on 2002. The reduction was due mainly to the depreciation of the U.S. dollar against the euro, since approximately 25% of cargo revenues are earned in U.S. dollars.

HANDLING REVENUES

Airport handling revenues were 16.2% higher in 2003 than in 2002 and amounted to €272.8 million, mainly as a result of the increase in the handling services provided to other airlines and of the performance of new security-related work, which increased the unit price of the services provided.

MAINTENANCE REVENUES

Revenues from technical assistance services provided to third parties increased by €12.7 million (13.9%) to €104.0 million in 2003. The salient features of the year were the increase in the work performed for the Ministry of Defense and the recovery of the production for third parties by the company's Engine Workshop.

SALES COMMISSIONS

Sales commissions amounted to €120.9 million in 2003, up 11.4% on 2002, due mainly to the increase in passenger ticket commissions as a result of the code-sharing and franchise agreements entered into by the Group with third-party airlines.

OTHER OPERATING REVENUES

The "Catering Sales" and "Other Operating Revenues" totaled €279.6 million in 2003, representing an increase of 5.5% with respect to the previous year. These revenues included most notably in 2003: revenues from billings for the use of the various booking systems, which amounted to €79.8 million; revenues from handling and cargo services, which totaled €38.4 million (up €17.3 million on 2002); other traffic revenues (derived mostly from commercial agreements with other airlines, most of which belong to the oneworld alliance), amounting to €34.1 million in 2003; revenues from the release of provisions for major repairs, which amounted to €21.9 million; and revenues from work performed by the Company on its fixed assets, which totaled €12.0 million.

"Other Operating Revenues" include "Adjustment of Traffic Revenues Not Allocable to Passenger Routes" and "Other Traffic Revenues", which are included under "Passenger Revenues" in the notes to consolidated financial statements. The aggregate balances of these accounts were €28.1 million in 2003 and €32.7 million in 2002 (excluding revenues from security and safety charges).

Also, the "Other Operating Revenues" caption includes the balance of the "Adjustment of Traffic Revenues Not Allocable to Cargo Routes" account, which in the notes to consolidated financial statements is included under "Cargo Revenues" and totaled €0.3 million in 2003 and €-3.3 million in 2002.

4.1.2. OPERATING EXPENSES

Operating expenses amounted to €4,458.6 million in 2003, only 0.2% up on 2002. The Iberia Group continued to implement cost-cutting measures which, together with the depreciation of the U.S. dollar and the fall in interest rates, offset the increase in operating costs and in the funds required to cater for the increased flight and handling activities. The reductions in commercial expenses, aircraft leases and insurance expenses were noteworthy. These were offset by the increases in fuel prices and navigation charges. Therefore, in 2003 unit operating costs were 1.1% lower than in 2002.

PERSONNEL EXPENSES

Personnel expenses amounted to €1,402.7 million in 2003, up €49 million (3.6%) on 2002. Of this amount, €1,064.2 million related to wages, salaries and similar items and the remaining €338.6 million to social security costs, contributions to employee pension funds and other employee welfare expenses.

The main factors behind this increase in personnel expenses were: a 1.7% increase in the average headcount, the effect of promotions, which is estimated at approximately 1.5%; and the adoption of measures agreed on in the collective labor agreements, i.e. an increase in salaries of 2.6% (equal to the actual increase in the CPI in 2003), additional payments relating to the earnings targets met in 2002 and 2003 (1.6%), and the "Profit-Sharing Due to the Improvement in Earnings in 2003" (1.7%). These increases were partially offset by the application of the labor force reduction plan at Iberia, L.A.E., which gave rise to a decrease of around 5% in personnel expenses, since it led to a significant reduction in the average salary per employee.

FUEL

The fuel expense of €556.8 million in 2003 was 0.7% higher than in 2002, which reflects the equal strengths of the various factors that influence variations in fuel prices. Not taking into account the increase in activity, fuel costs actually fell slightly. The unit cost per ASK was €0.99 in 2003, a drop of 0.7% with respect to 2002.

As a result of historically low fuel stocks, the instability in Venezuela and, above all, the pre-war tensions, the international market price of a barrel of Brent crude increased sharply in early 2003 to stand at over US\$ 34. After the Iraq war, the U.S. dollar price of a barrel of crude oil was highly volatile and remained at high levels until the end of the year. Through active risk management policies, Iberia managed to limit the increase in the average annual price to around 15% with respect to the already high price registered in 2002. This price increase led to a rise in the annual expense of over €81 million, which was offset in full by the depreciation of the U.S. dollar against the euro.

COMMERCIAL EXPENSES

Commercial expenses (commissions, overcommissions and advertising) amounted to €437.8 million in 2003. These expenses were among the items that made the greatest contribution to the decrease in costs, since they fell by €26.5 million (5.7%) with respect to 2002. The unit commercial expense of €0.78/ASK represented a decrease of 6.9% from 2002.

Almost 90% of the total commercial expenses in 2003 was due to commissions, sales bonuses and other development and promotion expenses. The aggregate cost of these items was €38.1 million (8.8%) lower in 2003 than in 2002. This drop was due to the 4.0% decrease in passenger and cargo revenues and, more importantly, to the savings achieved as a result of the various commercial measures adopted, namely, the application throughout 2003 of the agreement relating to the remuneration of Spanish travel agencies, which came into force in June 2002; the reduction in commercial costs abroad, with specific actions in each country; the extension of the system of fares net of commissions; and the increased use of direct selling systems, such as Iberia.com and Serviberia.

Advertising and promotion expenses increased by €11.7 million with respect to 2002, due mainly to the launch of the advertising campaign aimed at publicizing the new Iberia, L.A.E. service model.

The Iberia Group's net commercial costs (commercial expenses net of commercial revenues) fell by 10.9% in 2003. Net commercial costs as a percentage of traffic revenues continued to improve and stood at 8.2% in 2003, down 0.6 percentage points from 2002.

AIRCRAFT LEASE EXPENSES

Aircraft lease expenses amounted to €373.7 million in 2003, down 5.6% from 2002. Most of this amount (€353.2 million) is due to the lease of passenger aircraft, the cost of which decreased by 5.5%, due to the appreciation of the euro and, above all, to the fall in interest rates, the positive effect of which exceeded the increase in the expense arising from the additions of new aircraft under operating lease arrangements.

The expenses relating to cargo aircraft lease contracts totaled €16.0 million in 2003, down €7.3 million from the previous year, and the cost of leasing cargo holds fell by €5.4 million to €4.6 million for 2003 as a whole. The expense incurred in leasing cargo capacity is recorded under the "Other Rent" caption in the notes to consolidated financial statements.

TRAFFIC SERVICE COSTS

Traffic services costs totaled €362.7 million in 2003, practically the same as in 2002.

The cost of the items included under this caption is related to the variation in the air transport activity of Iberia, L.A.E., which increased by 1.3% in terms of ASKs and by 2.9% in terms of the number of take-offs. The cost incurred in relation to landing charges, which increased by 2% in Spain, rose by 3.9% with respect to 2002 to stand at €117.5 million in 2003. The 4.3% increase in aircraft dispatching costs to €85.6 million in 2003 was due in part to the impact of the sharp increases in AENA's H1 and H2 rates.

However, expenses derived from incidents such as lost luggage, interrupted journeys and lost connections decreased in 2003 by €7.7 million (almost 40% with respect to 2002), thanks to improved service quality. Also, flight personnel accommodation costs fell by 5.7% as a result of the negotiation of new contracts and of the ongoing improvement of crew scheduling.

AIRCRAFT MAINTENANCE

Aircraft maintenance expenses, which include the cost of aircraft spare parts, maintenance outsourcing costs and the provision recorded for major repairs, amounted to €235.5 million in 2003, a decrease of 1.7% with respect to 2002.

The spare parts used amounted to €130.8 million in 2003, down 8.5% as a result of the depreciation of the U.S. dollar and the greater uniformity of the aircraft. The outside upkeep and repair services of €67.8 million in 2003 were 16.1% higher than in 2002, due mainly to the increase in the volume of work performed for third parties and to the total outsourcing of work on the A-340/600 aircraft engines. The provisions recorded for major aircraft repairs amounted to €36.9 million in 2003, a decrease of 3.6% with respect to the previous year.

Discounting the revenues from technical assistance from the aggregate amount of the annual maintenance expenses, the net maintenance expense amounted to €131.5 million in 2003, down 11.3% from the figure for 2002, in line with the targets established within the Master Plan for 2003.

The balance of the aircraft spare parts used in 2003 included in the management statement of income is €5.1 million lower than the expense included in the statutory consolidated financial statements as a result of the use of allowances for obsolescence.

NAVIGATION CHARGES

There was an increase in air traffic control expenses (such as in-flight navigation assistance and airport approach expenses) of €31.0 million (13.7%) in 2003 with respect to 2002.



Navigation charges increased by €25.5 million (14.1%) in 2003, due mainly to the significant increases in the prices charged by Eurocontrol. This agency, which operates in 30 countries, increased its reference unit prices for the Spain-Continental and Spain-Canary Islands flight regions by around 17% in January 2003, which must be added to the increase of approximately 25.5% in April 2002. The price hikes in the other European flight regions were lower.

In 2003 approach charges rose by €5.5 million (12%) with respect to 2002, and the increase in these charges at Spanish airports was 4%.

DEPRECIATION AND AMORTIZATION EXPENSE

The depreciation and amortization expense for 2003 amounted to €170.8 million, up €6.1 million on the previous year. The highest increases were related to aircraft, engines and computer hardware and software.

BOOKING SYSTEM COSTS

In contrast with the increase of 3.8% in bookings and the rise of around 2.9% in the prices for the various computer reservation systems (CRSs), the annual booking system expense increased by only €1.9 million (1.5%) with respect to 2002. This was made possible by the improvement in the expense audit, control and management procedures and tools, by the increase in the market share of bookings of Amadeus over Galileo and Sabre and by the depreciation of the U.S. dollar against the euro. Therefore, in 2003 the average cost per booking billed fell by 2.3% with respect to 2002.

IN-FLIGHT SERVICES

The Group's in-flight service expense amounted to €74.2 million in 2003, which represented a decrease of €13 million (14.9%) with respect to 2002. The decrease was 18% in terms of the average cost per passenger.

This significant drop was achieved thanks to the introduction of various initiatives, focused mainly on simplifying the service provided in tourist class on short- and medium-haul routes.

INSURANCE AND OTHER OPERATING EXPENSES

Following the terrorist attacks of September 11, 2001, aircraft and passenger insurance costs soared. In 2003 the aviation market revised its charges downward, helped by a moderate level of claims. In this context, the Iberia Group's insurance expense for 2003 was 32.8% lower than in 2002, and was also favored by the depreciation of the U.S. dollar. The Group's insurance expense amounted to €51.1 million in 2003.

The aggregate balance of the "Other Operating Expenses" caption increased by €7.2 million (1.8%) in 2003. This caption includes numerous items of a very diverse nature, including rent, utilities, repair and upkeep services, communications, security and surveillance services, computer software, severance costs, travel expenses and ancillary services.

4.2. FINANCIAL AND EXTRAORDINARY RESULTS

The Iberia Group reported an income before taxes of €201.7 million in 2003, €7.6 million more than the income obtained in 2002. This increase was due to the advances made in connection with financial earnings, to the increase in the balance of the "Share in the Income of Companies Accounted for by the Equity Method" caption and to the improvement in extraordinary earnings, as shown in the following table:

| FINANCIAL AND EXTRAORDINARY RESULTS | | MILLIONS OF EUROS | | | |
|---|--------------|-------------------|-----------------|---------------|--|
| | 2003 | 2002 | VARIATION 03/02 | % VARIATION | |
| OPERATING INCOME | 160.7 | 249.1 | (88.4) | (35.5) | |
| FINANCIAL REVENUES | 52.9 | 51.2 | 1.7 | 3.3 | |
| FINANCIAL EXPENSES | 50.6 | 39.3 | 11.3 | 28.8 | |
| EXCHANGE LOSSES | (6.7) | (33.4) | 26.7 | 79.9 | |
| FINANCIAL LOSS | (4.4) | (21.5) | 17.1 | 79.5 | |
| SHARE IN THE INCOME OF COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | 33.9 | 19.7 | 14.2 | 72.1 | |
| AMORTIZATION OF GOODWILL | (6.6) | (6.6) | 0.0 | 0.0 | |
| INCOME FROM ORDINARY ACTIVITIES | 183.6 | 240.7 | (57.1) | (23.7) | |
| EXTRAORDINARY REVENUES | 102.6 | 73.0 | 29.6 | 40.5 | |
| EXTRAORDINARY EXPENSES | 84.5 | 119.6 | (35.1) | (29.3) | |
| EXTRAORDINARY INCOME (LOSS) | 18.1 | (46.6) | 64.7 | 138.8 | |
| NET INCOME (LOSS) BEFORE TAXES | 201.7 | 194.1 | 7.6 | 3.9 | |
| TAXES | (55.8) | (34.3) | (21.5) | 62.7 | |
| CONSOLIDATED INCOME | 145.9 | 159.8 | (13.9) | (8.7) | |
| INCOME ATTRIBUTABLE TO MINORITY INTERESTS | 2.3 | 2.7 | (0.4) | (14.8) | |
| INCOME OF THE PARENT COMPANY | 143.6 | 157.1 | (13.5) | (8.6) | |

The financial loss decreased by €17.1 million from €21.5 million in 2002 to €4.4 million in 2003, due to the decrease in the net exchange losses from €33.4 million in 2002 to €6.7 million in 2003. The devaluation of the Argentine peso and the situation in Argentina (the so-called "corralito" effect) had a negative impact of approximately €16 million on the results at 2002 year-end. The exchange rate hedging policies helped to minimize these losses in both years.

Financial revenues amounted to €52.9 million in 2003, up €1.7 million on 2002. The revenues included a gross capital gain of €11.5 million obtained on the sale of the Mundicolor brand name and the shareholding in the tour operator Tiempo Libre. This gain offset the decrease in the other financial revenues with respect to 2002 triggered mainly by the fall in interest rates.

In 2003 financial expenses increased by €11.3 million with respect to the previous year and amounted to €50.6 million. This amount includes €16.2 million relating to the increase in the investment valuation allowance, due mainly to the provisions recorded to cover the full amount of Iberia, L.A.E.'s holdings in Opodo and Cordiem. The financial expenses incurred on the debt in the Group's consolidated balance sheet amounted to €17.2 million, which represented a decrease of €4.7 million with respect to 2002, largely as a result of lower interest rates. The provision for interest on the pension funds also decreased.

The associated companies accounted for by the equity method in both 2003 and 2002 were: Amadeus Group; Touroperador Viva Tours, S.A.; Multiservicios Aeroportuarios, S.A. (MASA); Iber-América Aerospace, LLC; Empresa Logística de Carga Aérea (ELCA); Empresa Hispano Cubana de Mantenimiento de Aeronaves, Ibeca, S.A.; Handling Guinea Ecuatorial, S.A.; and Iberia Cards. The share in the income of these companies was €33.9 million in 2003, up €14.2 million on 2002, due mainly to the increase in the income of Amadeus.

The extraordinary income of €18.1 million reported in 2003 is clearly in contrast with the extraordinary loss of €46.6 million incurred in 2002, the year in which provisions were recorded in relation with the Company's fleet renewal process, which gave rise to an additional expense of €60 million.

In 2003 extraordinary revenues included the following items: the release of various unused provisions (insurance, bad debts, aircraft, etc.); gains on fixed asset sales, which include the disposal of the inactive aircraft (DC-9, B-727, DC-10 and A-300 engines), which in the consolidated financial statements amounted to €28.7 million, and on the sale of two premises in Barcelona and Rome, which gave rise to revenues of €9.3 million; and the gains on the transactions involving shares of treasury stock, which totaled €8.3 million. The extraordinary expenses included most notably the depreciation and amortization and other expenses associated with the fleet renewal plan and other fixed asset retirements; and provision of €25.0 million aimed mainly at topping up the provisions for the labor force reduction plan and its renewal and extension thereof in 2003.

The Iberia Group achieved net income after taxes of €143.6 million in 2003.

4.3. INVESTMENTS

The Iberia Group's investments in 2003, net of divestments, totaled €216 million.

In order to adapt the accounts to International Accounting Standards, in 2003 the advances relating to the new Airbus aircraft and engines were transferred from "Construction in Progress" to "Long-Term Investments". This change of accounting method had a significant effect on the resulting partial balances at year-end. Thus, the net investment in tangible fixed assets and intangible assets had a negative balance of around €89 million; whereas the net additions to long-term investments had a positive balance of €304 million.

In 2003 the main additions to tangible fixed assets and intangible assets related to purchases of aircraft spare parts (amounting to over €117 million); additions of two A-321 and one A-320 aircraft, which were subsequently sold and leased back; changes made to the MD-87/88, B-747, B-757, A-320, A-321 and A-340 aircraft; purchases of parts (BFEs) for the Airbus aircraft; and purchases of computer hardware and software. The tangible fixed asset and intangible asset divestments included most notably the transfer of the advances on aircraft (which amounted to €155.3 million at 2002 year-end); the aforementioned sale and leaseback transactions; aircraft spare part and component retirements; and retirements due to the sale, scrapping and donation of 17 DC-9, 6 DC-10, 4 B-727 and 1 B-747 and the engines of inactive airplanes.

The most significant increase in long-term investments was related to the long-term deposits and guarantees given, the balance of which as of 2003 year-end included €307.4 million relating to the advances paid under the terms and conditions agreed on in the aircraft acquisition agreements. This balance also includes €27.5 million relating to a restricted deposit paid in connection with the Iberia, L.A.E. stock option plan for executives, directors and other management personnel, instrumented through the issue of debentures convertible into Company shares.

4.4. BALANCE SHEET

As of December 31, 2003, the Iberia Group's shareholders' equity amounted to €1,423.8 million, an increase of 8.7% with respect to 2002 year-end. The aggregate balance of the reserves was more than €121 million higher than in 2002. Moreover, capital was increased at Iberia, L.A.E. in the last quarter of 2003 in order to cater for the first exercise date under the stock option plan for Company employees. Therefore, the number of listed shares was increased by 6,054,859 and capital increased by €4.7 million.

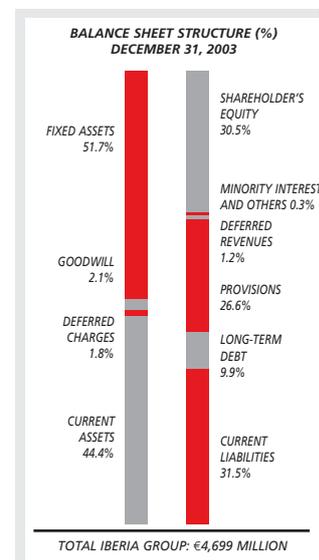
In 2003 Iberia, L.A.E. paid a dividend of €0.04 gross per share out of 2002 income, thereby paying a total amount of €35,6 million to its shareholders.

The balance of the long-term "Provisions for Contingencies and Expenses" caption at 2003 year-end amounted to €1,250 million, down 0.9% from December 31, 2002.

The total interest-bearing debt amounted to €516.4 million at 2003 year-end. Not taken into account the amount relating to the interest on outstanding financial lease payments (€78.8 million), the interest-bearing debt decreased by €64.3 million in 2003 to stand at €437.6 million at year-end.

The balance of the short-term investments and cash at the end of 2003 exceeded €1,376 million, up €159.5 million with respect to 2002 year-end, due mainly to the increase in cash flow generated by the Company's operations. As a result, the negative net debt in the consolidated balance sheet as of December 31, 2003, amounted to €938.5 million, i.e., cash and cash equivalents once again exceeded interest-bearing debt (excluding the interest on lease payments payable).

The Group's net fixed and other noncurrent assets amounted to €2,429.2 million as of December 31, 2003. In order to adapt the accounts to International Accounting Standards, in 2003 the advances on aircraft were transferred from tangible fixed assets (where they had been recorded through 2002) to "Long-Term Investments - Long-Term Deposits and Guarantees Given". The deposits paid for aircraft acquisitions amounted to €307.4 million as of December 31, 2003.



4.5. CASH FLOW STATEMENT

Next is the consolidated cash flow statement for 2003:

| CONSOLIDATED CASH FLOW STATEMENT | | MILLIONS OF EUROS |
|---|--|-------------------|
| | | 2003 |
| INCOME ATTRIBUTABLE TO THE PARENT COMPANY | | 143.6 |
| DEPRECIATION AND AMORTIZATION EXPENSE | | 170.8 |
| PROVISIONS | | 13.3 |
| AMORTIZATION OF GOODWILL | | 6.6 |
| INCOME ATTRIBUTED TO MINORITY INTERESTS | | 2.3 |
| SHARE IN THE INCOME OF COMPANIES ACCOUNTED FOR BY THE EQUITY METHOD | | (33.9) |
| OTHER NONMONETARY ADJUSTMENTS | | 23.2 |
| WORKING CAPITAL | | 14.9 |
| CASH FLOW FROM ORDINARY ACTIVITIES | | 340.8 |
| NET INVESTMENT IN TANGIBLE FIXED ASSETS AND INTANGIBLE ASSETS | | 107.1 |
| NET INVESTMENT IN LONG-TERM INVESTMENTS | | (240.2) |
| CASH FLOW FROM INVESTMENT ACTIVITIES | | (133.1) |
| DIVIDENDS PAID | | (38.3) |
| CAPITAL INCREASE | | 5.4 |
| VARIATIONS IN FINANCIAL DEBT | | (15.3) |
| CASH FLOW FROM FINANCING ACTIVITIES | | (48.2) |
| NET CASH FLOW | | 159.5 |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD | | 1,216.6 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD | | 1,376.1 |

4.6. OUTLOOK

Passenger and cargo air traffic experienced a clear recovery in practically all markets since autumn of 2003. IATA's latest projections for 2004 predict growth of 7.5% in world international air traffic.

Expectations also point towards an across-the-board improvement in the world economies. Analysts expect Spain's GDP to grow by 2.9% in 2004; that of the euro-zone countries by 1.7% and that of Latin America to increase by over 4% in 2003. If these predictions are met and there are no exceptional events, traffic in these areas should be in line with the good performance seen in recent months, with particularly significant growth on South Atlantic routes.

Iberia, L.A.E. predicts an increase in its production of around 8% of 2004, in order to meet the foreseeable increase in demand. Most of this growth will be caused by the increase in capacity in the latter part of 2003. The increase in capacity that has taken place will be greater on international routes (above 10%) than on domestic routes (estimated at around 3%). Based on the good market prospects, the Company expects to maintain the high load factors that it achieved in 2003.

In addition, the implementation of Iberia, L.A.E.'s fleet renewal plan will enable it to grow with flexibility and will provide it with the resources required to take advantage of the significant increase in the capacity of Madrid and Barcelona airports. Per AENA projections, the two new runways at Madrid-Barajas airport will be operational from the summer of 2004 onwards.

Based on the strategies established in the 2003/05 Master Plan, the Iberia Group will continue to adopt measures that will enable it to reduce costs and adapt to demand preferences, with a view to strengthening its position vis-à-vis with the growing competition from low-cost operators. As a result of this competition, prices will foreseeably continue to drop in 2004, above all in Europe, albeit to a lesser extent than in 2003.

The collective labor agreements for Iberia, L.A.E. employees expire at the end of 2004 and negotiations will be held during the year to renew them.

