2006 Annual Report

IBERIA

Dear shareholders,

Once again I take this opportunity to reflect on some of the most significant events during 2006 and to inform you on some of the priorities we have for 2007 and future years.

Of all that has happened in our company during the year, the feature that will no doubt go down in the history of the company, because of the leap in quality and capacity it gives us, is the extension of the Madrid-Barajas airport, with a new terminal, T4, and two new runways, enabling us to look towards the future with the confidence that our plans for growth and enhancement of the service will not be frustrated through lack of capacity, as earlier.

2006 was also our first year under the current three-year Director Plan and we have already started to reap the benefits, especially in aspects such as streamlining of the network and improved revenues and quality.

As you are no doubt aware, IBERIA has been adapting its network to the new reality for several years now, giving greater weight to long-haul flights and connections. In 2006 we made further progress along these lines and the results could not be more encouraging, as you will see in the examples I am going to give on load factor, market share and revenues.

The overall load factor of our flights has reached an all-time high, both the general average, at 79.8%, and on the long-haul network, at 85.6%.

On the Europe-Latin America routes, our great strategic commitment, we have achieved a market share of 19%, a year-on-year growth of 1.4 percentage points, strengthening our leadership on that market. In business traffic, this increase was even greater, 2.9 percentage points, thanks to the impact and excellent appreciation by customers of our new Business Plus class.

Particularly with these levels of general load factor and business classes, we have improved our unit revenues, following several years of shrinking revenues. This increase was, once again, especially significant on long-haul flights, with a 16.6% growth in unit revenue per ASK.

Some of the results relating to the generation of revenues and quality were also outstanding. In both cases, the star was the Business Plus class on our long haul aircraft, which has achieved an excellent acceptance among our customers. The number of passengers travelling in this class increased by a very significant 25%. The load factor improved by 10 percentage points, outshining even the objectives we had set for 2008, and revenues increased by 36%.

Apart from the actions taken in respect of the long haul sector, during 2006 we embarked on a 30 million euro investment in our short and medium haul fleet to change all the interiors and incorporate new seats, the most advanced on the market, with which we make the most of the space available while at the same time offering our customers more comfort.

Apart from optimisation of the network and improvement of revenues and quality, the Director Plan 2006-2008 stresses the inevitable need to cut costs and increase productivity of our resources. Major progress has been made in this area, although there is still work to be done, which we will continue in 2007 and 2008.

Some of the most positive achievements were more than the 11% growth in operating revenues per employee and the improved productivity of the ground staff, thanks to the measures established in their collective agreement, which have led to a 5.5% increase in ASK per employee.

On the negative side, it was not possible to reach agreements with the representatives of the flight crew to increase their productivity. Nevertheless, 2007 commenced with the signing of the collective agreement for flight attendants, an agreement that is certainly necessary for the company, but will be especially beneficial also for the employees.

Furthermore, as we have done in recent years, we will continue managing the company, taking up all the opportunities available on the market. One example of this is the use of wet leases (leasing of aircraft + crew), which will be used entirely for long-haul routes in 2007, to take advantage of the current strength of that market and strengthen our leadership even more.

In 2006 we proceeded with our fleet renewal and homogenisation plans. In the long haul, for example, we have been operating since July with a single model of aircraft, the Airbus A340, in its versions 300 and 600, with an average age of 5.2 years, one of the lowest in the world. In the short and medium haul, we withdrew 13 aircraft last year and incorporated 8 new A320s. In doing so we have improved our efficiency and lowered our operating, maintenance and fuel expenses. We have also reduced our CO_2 emissions, while increasing productivity and the quality of service to our clients.

In an effort to cut costs, we have implemented more efficient purchasing formulas, such as using electronic auctions; we have also continued our distribution cost-cutting policy and started to outsource certain tasks, through which we are able to reduce costs while maintaining, or even improving, the quality and efficiency of our service.

What we have not been able to avoid, despite hedging, was a new fuel price hike, smashing all previous records. We paid 312 million euro more for fuel than in 2005, equivalent to a 36% year-on-year growth.

In this review of the most significant aspects of the year, I should not overlook the other two major businesses integrated in IBERIA, together with air carriage of passengers and cargo. I am talking about Maintenance and Handling. 2006 was an important year for both these businesses, in many aspects.

The Maintenance business recorded an excellent performance, with a third party revenue of 230 million euro, up 36% year on year and double the amount budgeted, thanks to a successful commercial policy through which we have attracted new clients. If we continue in this line, and I trust we will, we will meet the targets set in the Director Plan a year ahead of schedule.

2006 was a bitter-sweet year for the Airports division. The tenders for ramp handling licences for all Spanish airports were awarded this year, in which we had submitted bids for renewal. The outcome was positive in all except for five, although in three of these we now participate in the joint ventures awarded some of the licences to continue providing these services. In view of this situation and the entry of new rivals at most airports, we are faced with huge challenges to continue being the best alternative on the market.

Despite the enormous competition, in spite of the record prices of oil, once again, and although we are still at the beginning of our Director Plan, the results for the year were satisfactory. I draw your attention to the figures that really reflect the progress of the business, such as the Ebitdar or operating profit, since the final results are distorted this year by extraordinary events, such as the impact of the new international accounting standards (IAS39), changes in corporation tax, or the necessary comparison with 2005, when we sold our stake in Amadeus with significant capital gains.

In 2006, we have posted an operating profit of 122 million euro, up 4.6% on last year. Eliminating the effect of IAS39 in both years (positive in 2005 and negative in 2006), the operating profit would have grown 67.6% year on year. The Ebitdar rose 12.9% to 790.5 million euro. And at the same time we continue to improve the Group's financial soundness.

In 2007 we will continue with our Director Plan and the strategic objectives contemplated in its four areas: revenues and quality, expenses, productivity and network. Once again, the greatest growth will be in the long haul, with new routes to Boston and Washington and increased frequencies in Central America, Chicago, Miami and Brazil, among others. In the short and medium haul, with a view to serving new markets and strengthening the network, we are opening up new routes to Algiers, Bucharest and Saint Petersburg, while increasing our capacity to many other destinations, such as Moscow, Dublin, Casablanca, Rome, Munich, Istanbul, Bilbao, Malaga or Seville. We will also give careful consideration to all the alternatives arising on the market.

Another of our priorities will be the handling of industrial relations, to reach productivity agreements where this has not yet been possible and implement the measures agreed with the ground staff and flight attendants.

In the Handling area, we will have to manage the new situation at airports in Spain, with new rivals, but with confidence in our vast experience in this business.

In Maintenance we have a clear growth objective. We are the benchmark in southern Europe, we have specialised in value added products that practically no other operator is capable of developing and we are already working on the preliminaries for building another hangar in Barcelona.

As you know, I like to end this statement each year with a mention of our commitment to society in all its aspects: transparency for you, our shareholders, honest and responsible actions for the environment, employers, suppliers and the entire society in which we operate.

We have received recognition that this commitment is real and not just a good intention, being selected for inclusion in the Dow Jones World Sustainability Index, which acknowledges the best practices in this area. Only three airlines in the world have obtained this recognition, one of which is IBERIA. In the careful analysis to which our company has been submitted, it obtained the highest grades in risk and crisis management, environmental report, average age of the fleet, supplier procedures, actions in respect of the climate change and quality of air.

In these times of profound changes, I am pleased to inform our shareholders that the company in which you have invested your money has taken specific, proactive measures to favour its soundness and future.

Fernando Conte
Chairman of IBERIA

Financial Statements & Management Report

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Iberia, Líneas Aéreas de España, S.A.

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Iberia, Líneas Aéreas de España, S.A.

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Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain and 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.

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 at December 31, 2006 and the related income statement and notes to the 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 evidence supporting the financial statements and evaluation of their presentation, of the accounting policies applied and of the estimates made.

For comparison purposes the Company's directors present, in addition to the 2006 figures for each item in the balance sheet, income statement and statement of changes in financial position, the figures for 2005. Our opinion refers only to the 2006 financial statements. On March 29, 2006, we issued our auditors' report on the 2005 financial statements, in which we expressed an unqualified opinion.

Since the Company is the head of a Group and meets certain requirements, it is obliged under current legislation to prepare separate consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, on which we issued our auditors' report on this same date, in which we expressed an unqualified opinion. The effect of consolidation in accordance with International Financial Reporting Standards as adopted by the European Union, with respect to the accompanying individual financial statements, is detailed in Note 4-c to the accompanying financial statements.

In our opinion, the accompanying financial statements for 2006 present fairly, in all material respects, the net worth and financial position of Iberia, Líneas Aéreas de España, S.A. at December 31, 2006 and the results of its operations and 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 directors' report for 2006 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 directors' report is consistent with that contained in the financial statements for 2006. Our work as auditors was confined to checking the directors' report with the aforementioned scope, and did not include a review of any information other than that drawn from the Company's accounting records.

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

Luis de la Mora
March 29, 2007

Financial Statements

Iberia, Líneas Aéreas de España, S.A.

Iberia, Líneas Aéreas de España, S.A.

Balance sheets at December 31, 2006 and 2005

Thousands of euros

ASSETS	Dec 31, 2006	Dec 31, 2005
NON-CURRENT ASSETS:		
Start-up costs	292	296
Intangible assets (Note 5)	492,156	519,847
Property, plant and equipment (Note 6)	927,158	1,019,391
Aircraft:		
Cost	1,822,251	1,850,387
Accumulated depreciation and allowances	(1,244,243)	(1,206,925)
	578,008	643,462
Other property, plant and equipment		
Cost	1,009,996	1,070,458
Accumulated depreciation and allowances	(660,846)	(694,529)
	349,150	375,929
Long-term investments (Note 7)	619,547	716,075
Investments in Group companies and associates	120,971	105,288
Loans to Group companies and associates	25,623	25,623
Long-term investment securities	98,559	129,369
Other loans	276,421	303,839
Long-term guarantees and deposits	306,333	367,406
Allowances	(208,360)	(215,450)
Long-term receivables from public authorities (Note 18)	276,220	325,680
Total non-current assets	2,315,373	2,581,289
DEFERRED CHARGES (Note 5)	85,230	113,273
CURRENT ASSETS:		
Treasury shares (Note 8)	12,694	23,696
Inventories (Note 9)	187,594	114,660
Receivable from Group companies (Note 17)	29,746	21,276
Accounts receivable (Note 10)	621,719	661,571
Short-term investments (Note 11)	2,403,941	1,923,849
Cash in hand and at banks	7,982	15,868
Accrual accounts	11,964	23,526
Total current assets	3,275,640	2,784,446
TOTAL ASSETS	5,676,243	5,479,008

The accompanying Notes 1 to 24 form an integral part of the balance sheet at December 31, 2006.

Thousands of euros

SHAREHOLDERS' EQUITY AND LIABILITIES	Dec 31, 2006	Dec 31, 2005
SHAREHOLDERS' EQUITY (Note 12):		
Share capital	739,492	735,666
Share premium	115,405	111,285
Revaluation reserve	38	38
Legal reserve	147,133	104,757
Voluntary reserves	581,762	396,335
Reserve for treasury shares (Note 8)	12,694	23,696
Merger reserve	165	165
Differences on translation of capital to euros	1,201	1,201
Profit for the year	85,203	512,997
Interim dividend on account	–	(281,026)
Total shareholders' equity	1,683,093	1,605,114
DEFERRED INCOME	59,082	28,042
PROVISIONS FOR CONTINGENCIES AND CHARGES (Note 13):		
Provisions for obligations to employees	618,331	573,221
Provision for major repairs	62,194	60,985
Provision for liabilities	707,862	776,050
Total provisions for contingencies and charges	1,388,387	1,410,256
NON-CURRENT LIABILITIES:		
Convertible debenture issue (Note 15)	–	9,153
Bank borrowings and other financial liabilities (Note 14)	544,930	782,707
Other long-term payables	4,393	4,998
Total non-current liabilities	549,323	796,858
CURRENT LIABILITIES:		
Convertible debenture issue (Note 15)	10,362	9,153
Bank borrowings and other financial liabilities (Note 14)	241,610	127,583
Payable to Group companies and associates (Note 17)	29,492	15,702
Trade payables	1,340,308	1,173,929
Customer advances (Note 4-g)	435,535	359,723
Accounts payable for purchases and services	904,773	814,206
Remuneration payable	158,561	165,038
Other non-trade payables	215,031	146,386
Payable to public authorities (Note 18)	167,645	107,978
Other payables	47,386	38,408
Accrual accounts	994	947
Total current liabilities	1,996,358	1,638,738
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	5,676,243	5,479,008

Iberia, Líneas Aéreas de España, S.A.

Income statements for the years ended December 31, 2006 and 2005

Thousands of euros

DEBIT	2006	2005
EXPENSES:		
Procurements (Note 19)	1,374,704	1,060,396
Staff costs (Note 19)	1,388,879	1,434,163
Depreciation and amortisation charges (Notes 5 and 6)	224,374	184,409
Change in operating allowances	4,409	2,084
Other operating expenses (Note 19)	2,225,952	2,142,168
	5,218,318	4,823,220
Profit from operations	**141,132**	**80,633**
Finance and similar costs (Notes 13 and 14)	60,995	46,252
Change in investment valuation allowances	(6,557)	(51)
Foreign exchange losses	79,138	88,324
	133,576	134,525
Financial profit	**33,009**	**10,618**
Profit from ordinary activities	**174,141**	**91,251**
Change in allowances for non-current assets	(688)	1,327
Losses on intangible and property, plant and equipment, and investments in Group companies and associates (Note 6)	4,604	17,008
Extraordinary expenses (Note 19)	66,221	410,223
Prior years' expenses and losses	242	686
	70,379	429,244
Extraordinary profit	**10,974**	**422,956**
Profit before tax	**185,115**	**514,207**
Income tax (Note 18)	59,484	1,210
Negative adjustments to income tax (Note 18)	40,428	–
Profit for the year	**85,203**	**512,997**

The accompanying Notes 1 to 24 form an integral part of the income statement for 2006.

Thousands of euros

CREDIT	2006	2005
INCOME:		
Revenue (Note 19)	5,159,846	4,729,950
Other operating income (Note 19)	199,604	173,903
	5,359,450	4,903,853
Income from equity investments (Note 7)	11,707	751
Other interest and similar income (Notes 7 and 11)	76,811	56,196
Exchange gains	78,067	88,196
	166,585	145,143
Gains on disposals of intangible assets, property, plant and equipment and control portfolio	853	827,384
Gains on transactions involving treasury shares (Note 8)	4,098	4,056
Extraordinary income (Note 19)	55,098	15,013
Prior years' income and profits (Note 19)	21,304	5,747
	81,353	852,200

Notes to the 2006 Financial Statements

1. Company Description

Iberia, Líneas Aéreas de España, S.A. engages mainly in the air transport of passengers and cargo. Additionally, the Company also conducts other supplementary activities, including most notably passenger and aircraft handling at airports and aircraft maintenance.

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 Alliance, one of the largest airline groups in the world, which facilitates the globalization of its air transport business.

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 2006 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 and financial position at 31 December 2006, and the results of operations and funds obtained and applied in the year then ended. 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 change.

3. Distribution of income

The proposed distribution of 2006 income that the Company's Board of Directors will submit for approval by the Shareholders' Meeting consists of the distribution of EUR 0.035 per share as dividends, with an appropriation of EUR 765 thousand to the legal reserve and the remainder to voluntary reserves.

4. Valuation standards

The main valuation methods applied by the Company in preparing the 2006 financial statements, 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 "Deferred Charges" 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.

Until 2003, the acquisition cost and related accumulated amortization of aircraft purchased and acquired under financial lease contracts during that year and the four preceding years were adjusted each year pursuant to a Ministerial Order dated 18 December 2001 by the net amount of the exchange differences arising on the adjustment to official year-end exchange rates of the principal of specific foreign currency funding arranged.

In the last three years, these valuation differences have been charged to the income statement, as the impact thereof was not material.

The cost of aircraft acquired under financial lease contracts reflected in the accompanying balance sheet at 31 December 2006 has been reduced by EUR 6,597 thousand due to the effect of the capitalization of accumulated valuation differences.

Computer software is recorded at acquisition or production cost and is amortized on a straight-line basis as from the moment it becomes operational over an estimated useful life of five years.

Industrial 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 legislation, including Royal Decree-Law 7/1996, of 7 June.

At 31 December 2006, the acquisition cost of aircraft owned by the Company included cumulative exchange differences totalling approximately EUR 75,166 thousand (see Note 4-a).

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
Aircraft:	
Fuselage and engines[(a)]	18 – 22
Components	4 – 7
Buildings and other structures	20 – 50
Machinery, fixtures and tools	10 – 15
Land transport equipment	7 – 10
Furniture	10
Computer hardware	4 – 7
Rotatable parts	18
Repairable fuselage parts	8 – 10
Flight simulators	12 – 14

[(a)] Except for the aircraft acquired from Aviación y Comercio, S.A. which, because they are second-hand, are being depreciated over 12 years (MD-88) and 10 years (MD-87).

In the case of own and leased aircraft, except in the case of the MD aircraft, the Company separates the cost of components scheduled for replacement in the next major repairs that take place every four to seven years.

Assets subject to an 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 repairable fuselage parts is 10% of acquisition cost. The Company depreciates in full the acquisition cost of other items of property, plant and equipment.

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 capitalised to the acquisition cost of the aircraft.

In general, engine, fuselage and other aircraft component repair and maintenance costs are charged to the income statement for the year in which they are incurred. However, based on the terms of the aircraft operating lease agreements, the Company recognises an allowance based on

the individual estimated cost for each leased aircraft of the total cost to be incurred in major repairs and allocates this cost on a straight-line basis during the period between two consecutive major repairs (see Note 13).

c) Long and short term investments

Investments in Group and 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 acquisition and still existing at the date of the subsequent valuation.

The underlying book value of shares denominated in currencies other than the euro is calculated by converting the net worth of the investee to euros at the official year-end rate of exchange.

Provision is made to recognize unrealized losses on investments where cost is higher than market value.

Nevertheless, the acquisition cost of equity investments in Iberbús companies (see Note 7) is not adjusted to market value because the other partner in these enterprises, Airbus, has guaranteed that Iberia, Líneas Aéreas de España, S.A. will recover the investment made in full, pursuant to the agreements made.

Likewise, the investment in the share capital of Clickair, S.A. is reflected at cost of acquisition in accordance with the terms of the shareholders agreement entered into by the shareholders of the investee.

The effect of applying consolidation criteria in accordance with the International Financial Reporting Standards adopted by the European Union to the investees in which the Company holds a majority or exercises significant influence in comparison to the figures disclosed in these annual financial statements would result in increases in assets and reserves of EUR 75,007 thousand and EUR 82,802 thousand, respectively, and a decrease of EUR 28,478 thousand in results.

Loans to Group companies and associates 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 provisions 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, which are recorded at the amounts effectively disbursed. The interest on these transactions is recorded as revenue when earned, and unmatured interest at year end is reflected as an addition to the balance of "Short-Term Investments" in the balance sheet.

d) Treasury shares

Treasury shares are 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. Where the net book value of the shares is lower than cost of acquisition, the Company makes the appropriate provisions, which are charged against voluntary reserves.

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 31 December 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 "Exchange Losses" in the income statement, whereas exchange gains are deferred through the date on which the related accounts receivable or payable fall due, and are recorded under "Deferred Income" 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 "Exchange Gains" or "Exchange Losses", as appropriate, in the income statement.

f) Inventories

Inventories are recognised at the lower of weighted average acquisition cost and market value.

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

In 2006 the Company reclassified the repairable spare parts for engines from "Property, Plant and Equipment – Spare Parts for Property, Plant and Equipment" to "Inventories" since the rotation of the spare parts used to repair engines is now less than one year.

g) Income and expenses

Income 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 traffic documents for cargo and other services are initially credited to "Customer Advances" in the balance sheet. The balance of this heading reflects the estimated liability for tickets and traffic documents sold prior to 31 December 2006 but not yet used as of that date. The revenue relating to these items is recognized when the transport or service is performed.

The Company has implemented the "Iberia Plus" card as an ongoing customer loyalty tool. 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 programme. The points obtained can be exchanged for free tickets or other services offered by the companies included in the programme. "Accounts Payable for Purchases and Services" in the accompanying balance sheet at 31 December 2006 includes a provision of EUR 91,809 thousand in this connection, based on the estimated redemption value of the unused points accumulated as of that date.

In general, the policy applied by the Company to the treatment of incentives, bonuses or discounts received in cash or in kind on the acquisition of aircraft previously flown under operating leases is to defer the resulting revenues, which are recognized in the income statement over the term of the lease agreement or in line with the consumption of the incentivised items.

h) Obligations to employees

Under the collective labour agreements in force, on reaching the age of 60 flight crew cease to discharge their duties and are placed on the reserve, although their employment relationship remains in place until their statutory retirement age. The Company recognises the costs of staff placed on special reserve throughout the active working life of each employee based on the related actuarial studies.

The collective labour agreements in force also provide that flight crew who meet certain conditions may take early retirement. The Company is required to pay certain amounts of remuneration to these employees until they reach the statutory retirement age. The Company recognises, with a charge to the income statement in the year in which this circumstance arises, the provision required, calculated on the basis of actuarial studies, to meet the future payment obligations to the employees concerned. 153 employees are currently on special leave and 384 on special reserve.

"Provisions for Contingencies and Charges – Provisions for Obligations to Employees" includes the liabilities incurred in this connection (see Note 13).

The aforementioned liabilities 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%, among other assumptions.

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 or permanent disability).

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

The Company's contributions of EUR 23,066 thousand in 2006 were recognised under "Staff Costs" in the accompanying income statement for 2006.

j) Provision for third-party liability

The Company records under "Provision for Liabilities" in the balance sheet the estimated amount required for probable or certain liabilities arising from legal proceedings and litigation in progress, or from outstanding indemnity payments or obligations of undetermined amount, as well as collateral and similar guarantees provided by the Company. These provisions are recorded when the liability arises or becomes known. This heading also includes provisions for the estimated cost, 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 workforce reduction plan authorised by the Ministry of Employment and Social Affairs on 26 December 2001, and implemented since 2002. This workforce reduction plan, which initially concluded on 31 December 2002, was extended with the prior authorisation of the Ministry of Employment and Social Affairs to 31 December 2004, and subsequently to 31 December 2007, as authorised on 16 December 2004, for ground personnel, cabin crew, and flight engineers up to the limit of the structural target headcount for each group of employees.

k) Income tax

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

Since 1 January 2002 the Company and certain subsidiaries file consolidated tax returns under the tax system provided for by Chapter VII of Title VII of the Consolidated Corporate Income Tax Law.

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. Exchange rate hedging operations related with asset and liability positions are restated at 31 December each year on the basis of the gains or losses arising, which are recognized in "Foreign Exchange Gains" or "Foreign Exchange Losses" in the income statement.
2. For the other exchange and interest rate transactions and aviation fuel purchases, the price differences are recorded in the income statement when transactions involving futures or similar instruments are cancelled or finally settled.

m) Activities with an environmental impact

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 measured at acquisition cost and are capitalised as an addition to non-current 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.

At its meeting of 21 January 2005, the Spanish Council of Ministers resolved to assign greenhouse gas emission rights to the Company free of charge (15,583, 15,583 and 23,374 rights for 2005, 2006 and 2007, respectively). The tonnage of greenhouse gases emitted by the Company in 2006 was lower than the rights assigned.

5. Intangible assets

Changes in intangible asset accounts and in the related accumulated amortisation in 2006 were as follows:

Thousands of Euros

	31/12/05	Additions and Provisions	Disposals	Transfers	31/12/06
Cost:					
Rights over assets contracted through lease financing	587,516	3,712	(3,511)	(10,722)	576,995
Computer software	122,307	21,082	(1,146)	(574)	141,669
Industrial property	551	–	–	–	551
Assignment rights and other intangibles	394	103	–	–	497
	710,768	24,897	(4,657)	(11,296)	719,712
Accumulated amortisation:					
Rights over assets contracted through lease financing	(110,005)	(28,840)	438	6,630	(131,777)
Computer software	(75,421)	(19,027)	1,146	–	(93,302)
Industrial property	(247)	(55)	–	–	(302)
Assignment rights and other intangibles	(394)	–	–	–	(394)
	(186,067)	(47,922)	1,584	6,630	(225,775)
Allowances	(4,854)	–	3,073	–	(1,781)
Net value	519,847	(23,025)	–	(4,666)	492,156

The cost of the Company's fully amortised intangible assets at 31 December 2006 amounted to EUR 50,285 thousand, the detail being as follows:

Thousands of euros

Computer software	49,891
Assignment rights	394
Total	**50,285**

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

The general terms of the lease financing contracts (relating mainly to aircraft) in force at 31 December 2006, some of which provide for floating interest and lease payments denominated in foreign currencies, are as follows:

Thousands of euros

Cost of the leased fixed assets	576,995
Lease instalments paid:	
In prior years	209,204
In 2006	47,968
Outstanding instalments at December 31 (Note 14)[(a)]	209,124
Amount of purchase options (Note 14)	302,411

[(a)] These amounts included EUR 79,036 thousand of unaccrued interest with a balancing entry included under "Deferred Expenses" in the accompanying balance sheet at 31 December 2006.

The due dates for the financial lease contract payments outstanding at 31 December 2006 are as follows:

Thousands of euros

Lease instalments maturing in	
2007	171,854
2008	48,444
2009	54,247
2010	23,148
2011 and thereafter	213,842
	511,535

6. Property, plant and equipment

Changes in property, plant and equipment accounts and in the related accumulated depreciation and provisions in 2006 were as follows:

Thousands of euros

Cost	**31/12/05**	**Additions**	**Derecognitions**	**Transfers**	**31/12/06**
Aircraft	1,850,387	56,715	(97,270)	12,419	1,822,251
Other property, plant and equipment:					
Land	2,518	–	–	–	2,518
Buildings and other structures	156,377	–	(4,660)	–	151,717
Machinery, fixtures and tools	429,788	31,887	(18,582)	12,657	455,750
Land transport equipment	32,422	6,644	(390)	567	39,243
Furniture	18,651	3,679	(2,513)	(30)	19,787
Computer hardware	108,711	11,027	(3,989)	2,719	118,468
Spare parts	279,315	14,081	(5,628)	(86,867)[(a)]	200,901
Flight simulators	11,101	–	(8,402)	–	2,699
Construction in progress	31,575	22,196	(19,180)	(15,678)	18,913
	1,070,458	89,514	(63,344)	(86,632)	1,009,996

Thousands of euros

	31/12/05	Allowances	Derecognitions	Transfers	31/12/06
Depreciation and provisions:					
Aircraft	1,013,257	122,673	(67,402)	–	1,068,528
Other property, plant and equipment:					
Buildings and other structures	113,702	3,589	(3,741)	–	113,550
Machinery, fixtures and tools	312,481	22,436	(16,982)	4,716	322,651
Land transport equipment	21,478	3,325	(361)	283	24,725
Furniture	13,514	1,459	(2,312)	–	12,661
Computer hardware	75,828	13,286	(3,951)	1,631	86,794
Spare parts	144,554	9,384	(56,849)[a]	–	97,089
Flight simulators	8,962	206	(8,402)	–	766
	690,519	**53,685**	**(92,598)**	**6,630**	**658,236**
Provisions:					
Aircraft fleet					
Provision for major repairs	15,992	–	(7,068)	–	8,924
Other aircraft provisions	177,676	–	(10,885)	–	166,791
Other property, plant and equipment	4,010	–	(1,400)	–	2,610

[a] Relating to repairable engine spare parts transferred from "Inventories" since they are rotated in periods of less than one year (see Note 4-f).

Aircraft

Main period changes

The main period additions are summarised as follows:

Thousands of euros

Aircraft	14,464
Engines	8,854
Refurbishments	33,397
	56,715

The main derecognitions during the year were as follows:

Thousands of euros

	Cost	Accumulated Depreciation	Provisions
MD-87	16,441	(13,375)	(3,066)
B-757	34,678	(19,641)	(4,692)
Other derecognitions	46,151	(34,386)	(10,195)
	97,270	**(67,402)**	**(17,953)**

The Company derecognised one MD-87 aircraft with a net carrying amount of zero, and sold one B-757 aircraft for its net carrying amount (EUR 10,345 thousand).

"Other Derecognitions" in the foregoing table also includes sales of engines and derecognitions of refurbishments made to aircraft on operating lease which were withdrawn from service in 2006.

Other aircraft provisions

In order to recognize possible losses arising from the retirements of aircraft planned for the near future, the Company has recorded the related provisions for decline in value to adjust the net book value of these aircraft to their estimated realizable value. Changes in 2006 were as follows:

Thousands of euros

	Balance at 31/12/05	Applications	Balance at 31/12/06
Aircraft (fuselage and engines):			
B-747	71,306	(1,525)	69,781
B-757	8,000	(4,692)	3,308
MD	94,493	(3,066)	91,427
Other non-operating aircraft	3,877	(1,602)	2,275
	177,676	**(10,885)**	**166,791**

MD aircraft are recognized at their estimated realisable value, taking into account that these aircraft will be disposed of between 2007 and 2009.

Commitments and other guarantees on aircraft

The Company is using three aircraft under finance lease contracts and seven aircraft under operating leases the payments under which are securing, together with the aircraft, the repayment of a bond issue launched by the lessor in the European market in 2000. EUR 192,016 thousand of the bonds have not yet been repaid.

In addition, the Parent is guaranteeing the use of twenty aircraft under operating or finance lease for periods of between 9 and 14 years vis-à-vis the subscribers of a bond issue with outstanding amounts of USD 128,713 thousand and EUR 120,300 thousand.

The Company is currently implementing a fleet renewal plan instrumented through various agreements entered into with Airbus for A-320-type and A-340-type aircraft. The aircraft not yet delivered at 31December 2006 and the year in which they are scheduled to be added to the fleet pursuant to the agreements entered into are as follows:

Type of Aircraft	2007	2008	Total
A-319	8	5	13
A-320	6	4	10
A-321	1	–	1
	15	**9**	**24**

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered at 31 December 2006 amounted to approximately EUR 909 million.

The Company also has options on 2 A-340-600 aircraft and 49 A-320-type aircraft.

Aircraft in service

Following is a summary of the Company's aircraft in service at 31 December 2006:

Type of Aircraft	Owned	Under Finance Lease	Under operating Lease	Under *wet lease*[d]	Total
B-747	–[a]	–	–	–	–
B-757	–	–	–	7	7
A-319	–	–	11	–	11
A-320	10	10[b]	33[c]	–	53
A-321	–	4	14	–	18
A-340-300	5	–	11	2	18
A-340-600	–	–	13	–	13
MD-87	18	–	–	–	18
MD-88	12	–	–	–	12
	45	**14**	**82**	**9**	**150**

[a] Excluding five aircraft grounded at 31 December 2006 because they were to be sold or scrapped. The net carrying amount of these aircraft, after deducting the related impairment losses, is zero.
[b] Excluding two aircraft leased to Compañía Mexicana de Aviación.
[c] Excluding one aircraft leased to Compañía Mexicana de Aviación and two aircraft which are being reconfigured prior to return.
[d] Lease type which includes the aircraft, crew, maintenance and insurance.

Aircraft operated under operating lease and wet lease contracts

EIn 2006, four A-319 aircraft, three A-340-600 aircraft, two A-320 aircraft and two A-321 aircraft were leased under an operating lease arrangement. Also, six A-320 aircraft and two B-757 aircraft the operating lease contracts for which expired in 2006 were returned under early return agreements. The leases of five B-757 aircraft operated under operating lease in 2005 were transformed into wet leases.

The expiry dates of the operating lease contracts entered into by the Parent are summarised as follows:

Aircraft	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Nr of Aircraft
A-319	–	2	2	–	–	4	–	–	–	–	–	–	3	11
A-320	10	2	1	1	1	1	5	2	1	–	–	–	9	33
A-321	–	–	–	–	–	–	1	–	2	2	2	1	6	14
A-340-300	–	1	2	3	1	3	–	1	–	–	–	–	–	11
A-340-600	–	–	–	–	–	–	–	–	3	2	3	4	1	13
Total	**10**	**5**	**5**	**4**	**2**	**8**	**6**	**3**	**6**	**4**	**5**	**5**	**19**	**82**

The foregoing table includes eleven A-320 aircraft and four A-319 aircraft that are being leased from International Lease Finance Corporation. As a result of the execution of this contract, the Parent has deposited completion bonds totalling EUR 10,118 thousand and this amount is recognised under "Long-Term Guarantees and Deposits" in the accompanying balance sheet at 31 December 2006 (see Note 7).

Certain of the operating lease contracts include a purchase option on the aircraft that can be exercised during the lease term, and the possibility of extending the lease for periods ranging from one to nine years.

In 2006 the Company entered into wet lease contracts on seven B-757 aircraft and two A-340-300 aircraft that were used under operating leases in 2005.

The wet lease contracts on two B-747 aircraft and one B-757 aircraft (which is owned by the Company) expired in 2006.

The lease payments accrued in 2006 on aircraft operating lease contracts amounted to EUR 406,458 thousand and are included under "Other Operating Expenses" in the income statement (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:

Millions of euros

Year	
2007	373
2008	335
2009	311
2010	275
2011 and subsequent years	1.363
	2,657(*)

(*) Equivalent to USD 3,499 million at the year-end exchange rate. The exchange rate risk on these lease payments is partially hedged with derivatives (see Note 16).

At the date of preparation of these consolidated financial statements the Company's directors did not intend to exercise the purchase options on the aircraft that were being operated under operating lease contracts at 31 December 2006, or to extend contracts that would give rise to using aircraft for periods exceeding 16 years.

Other property, plant and equipment

The additions to "Machinery, Fixtures and Tools" relate mainly to acquisitions of airport equipment.

Changes in the account "Fixed Assets in Course of Construction" in the above detail include retirements totalling EUR 19,180 thousand in respect of refurbishment work on the interiors of aircraft utilized under operating leases. These amounts have been recovered from the lessor.

The carrying amount of the buildings and facilities constructed on land owned by the State, mostly at Spanish airports, amounted to EUR 26,297 thousand at 31 December 2006. The Company's directors do not expect any material losses to arise as a result of the reversion process since the Company's maintenance programmes ensure that the items are always in good operating condition.

Revaluation reserve Royal Decree-Law 7/1996, of 7 June

On 31 December 1996, the Group revalued its property, plant and equipment pursuant to Royal Decree-Law 7/1996, of 7 June, and paid the single 3% tax. The net book value of the revalued assets at 31 December 2006 is EUR 11,968 thousand, and the effects on depreciation total EUR 430 thousand and EUR 417 thousand in 2006 and 2007, respectively.

The revaluation surplus, net of the single 3% tax, was credited to "Revaluation Reserve", with a charge to the appropriate revalued asset accounts, without altering the recognised accumulated depreciation. On 22 January 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 items

The cost of the Company's fully depreciated property, plant and equipment amounted to EUR 345,874 thousand at 31 December 2006, the detail being as follows:

Thousands of euros

Buildings	57,927
Machinery, fixtures and tools	189,018
Furniture and fixtures	6,880
Computer hardware	54,191
Flight simulators	146
Transport equipment and other items of	12,777
Aircraft	24,935
Total	**345,874**

Insurance coverage

The Company has taken out insurance policies for its property, plant and equipment and intangible assets which sufficiently covered their carrying amount at 31 December 2006. Also, the Company has taken out insurance policies for the aircraft leased from third parties, in accordance with the conditions established in the related lease contracts.

7. Long-term investments

Investments in Group companies and associates

The changes in 2006 in the balance of "Investments in Group Companies and Associates" and in the related allowance were as follows:

Thousands of euros

Group Companies and Associates	Cost	Allowance
Balance at 31/12/05	105,288	(92,120)
Additions or provisions	15,683	(786)
Disposals or recoveries	–	74
Balance at 31/12/06	**120,971**	**(92,832)**

Additions in 2006 relate basically to the acquisition of a 20% interest in the share capital of Clickair, S.A.

This investment represented the acquisition of 37,920 ordinary shares of EUR 10 par value each, issued with a total share premium of EUR 379 thousand. Also, Iberia, Líneas Aéreas de España, S.A. has subscribed and paid 9,480 preferred shares with the same par value and a share premium of EUR 1,510 each.

The preferred shares earn a fixed cumulative dividend of 6% of their nominal amount plus the related share premium and also entitle holders to collect a variable dividend if the company records a profit, the amount of which is calculated as the lower of 6% of the total investment in preferred shares and 50% of the investee's profit for the year after offsetting accumulated losses and transfers to the legal and bylaw reserves. The preferred shares entitle holders to collect 76% of the ordinary dividend.

In accordance with the shareholders' agreement, Iberia, Líneas Aéreas de España, S.A. will hold up to 80% of the net worth of Clickair, S.A. to the limit of the amount actually invested as from the commencement of the company's operations. In light of the above, it is not likely that the market valuation of Clickair, S.A. will have a significant impact on net worth.

Details of the main Group companies and associates at 31 December 2006 are as follows:

Thousands of euros

Company Name Address Corporate Purpose	Direct or Indirect Ownership	Cost	Provision	Capital	Reserves	Income/ Loss Total	Income/ Loss Extraord.	Dividends received
Compañía Auxiliar al Cargo Exprés, S.A.:	75.00	670	–	192	3,401	928	(167)	325
Centro de Carga Aérea Parcela 2 p.5 nave 6, Madrid. Cargo transport								
Cargosur, S.A.:[a]	100.00	8,685	(3,492)	6,058	(938)	73	37	–
Velázquez, 130; Madrid Air transport of cargo								
Iber-America Aerospace, LLC:	49.00	577	(70)	1,178	(311)	169	–	87
Miami, Florida Purchase and sale of aircraft parts and engines								
Serpista, S.A.:	39.00	456	–	1,170	2,317	849	–	–
Velázquez, 130, Madrid Maintenance of airport equipment								
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.:	43.50	4,484	–	6,000	6,032	2,955	332	–
(IBERIA-CARDS). Velázquez, 94, Madrid Issuance and management of payment instruments								

[a] The related financial information refers to Cargosur, S.A.'s individual financial statements, since this company, which at 31 December 2006 had holdings in Campos Velázquez, S.A. and Viva, Vuelos Internacionales de Vacaciones, S.A., is exempt from the obligation to present consolidated financial statements because the three companies are consolidated in the Iberia Group.

The balance of "Investments in Group Companies and Associates" includes the cost of the shareholding in Venezolana Internacional de Aviación, S.A. (EUR 88,446 thousand), which has been fully provided for, as have the loans granted to this investee (EUR 25,623 thousand) included in "Loans to Group Companies and Associates", because this company is currently in the process of liquidation.

Long term securities portfolio

Changes in this heading of the accompanying balance sheet at 31 December 2006, and in the related provisions, are as follows:

Thousands of euros

	% of ownership at 31/12/06	Balance at 31/12/05	Additions	Retire-ments	Transfers	Balance at 31/12/06
Fixed income securities:						
Iberbond PLC 1999		30,810	–	–	(30,810)	–
Government debt		244	–	–	–	244
Equity securities:						
Interinvest, S.A.	0.1438	30,244	–	–	–	30,244
Iberbus companies	[a]	24,930	–	–	–	24,930
Opodo, Ltd.	2.38	19,246	–	–	.–	19,246
Servicios de Instrucción de Vuelo, S.L.	19.90	8,853	–	–	–	8,853
Wam Acquisition, S.A.	11.68	8,638	–	–	–	8,638
Other	–	6,404	–	–	–	6,404
Total coste		129,369	–	–	(30,810)	98,559
Provisiones		(54,284)	(37)	81	–	(54,240)

[a] Percentage ownership in these companies ranges from 40% to 45.45%.

Fixed income securities

The bonds issued by Iberbond PLC 1999 and subscribed by the Company partially finance the acquisition by third parties of six A-320 aircraft operated under lease financing arrangements by Iberia, Líneas Aéreas de España, S.A. The bonds bear interest at an annual rate of 5.90%, which is settled on a six-monthly basis. The principal is repaid at an annual 3% through final maturity on 1 March 2007. The remaining 76% falls due in September 2007. In accordance with the terms described, the Company has reclassified the balance falling due in the short term to "Short-Term Investments" (see Note 11).

Equity securities

The interest owned by the Company in the share capital of Interinvest, S.A. (the majority shareholder of Aerolíneas Argentinas, S.A.) has been fully provided for.

Information relating to the Iberbus companies, which own certain A-340-300 aircraft operated by the Company at 31 December 2006, drawn from their respective provisional financial statements, is as follows:

Thousands of euros

Group Companies and Associates	Address	Direct Ownership	Cost	Capital	Reserves	Ordinary Profit/ Loss
Iberbus Concha, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,029	5,206	(4,545)	356
Iberbus Rosalía, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,056	5,166	(3,860)	211
Iberbus Chacel, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,283	5,723	(5,303)	414
Iberbus Arenal, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,362	5,854	(10,436)	(368)
Iberbus Teresa, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,504	5,293	(2,280)	666
Iberbus Emilia, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,497	5,317	(2,405)	688
Iberbus Agustina, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,587	5,319	(3,556)	762
Iberbus Beatriz, Ltd.	George's Dock House, IFSC; Dublin	40.00	2,556	5,336	(3,420)	765
Iberbus Juana Inés, Ltd.	George's Dock House, IFSC; Dublin	45.45	1,896	3,182	(5,444)	(95)
Iberbus María de Molina, Ltd	George's Dock House, IFSC; Dublin	45.45	1,983	3,346	(5,950)	(63)
Iberbus María Pita, Ltd	George's Dock House, IFSC; Dublin	45.45	2,177	3,523	(5,865)	(77)
			24,930			

The majority shareholder of these companies, Airbus, has guaranteed 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.

The investment in Wam Acquisition, S.A. was acquired as partial consideration for the sale of Amadeus, S.A. and is instrumented in ordinary shares and preferred shares. The latter entitle holders to collect a fixed cumulative dividend of 13.75% of their nominal amount. "Finance Income" in the accompanying income statement for 2006 includes EUR 10,987 thousand in this connection. These shares are convertible into ordinary shares in the event the investee is floated.

Other loans

The detail of the changes in this balance sheet heading is as follows:

Thousands of euros

	Balance at 31/12/05	Additions	Exchange Differences	Disposals	Transfers	Balance at 31/12/06
Loans to Iberbús companies	167,879	–	(17,502)	–	–	150,377
Loans to Aerolíneas Argentinas, S.A.	35,665	–	–	–	–	35,665
Loans to Wam Acquisition, S.A.	40,388	5,660	–	–	–	46,048
Loans to Iberlease 2004 Ltd.	45,365	–	(4,729)	–	–	40,636
Other loans	14,542	79	–	(9,094)	(1,832)	3,695
Total cost	**303,839**	**5,739**	**(22,231)**	**(9,094)**	**(1,832)**	**276,421**
Provision	**(43,423)**	–	–	**7,758**	–	**(35,665)**

The Company has granted a loan to each of its Iberbus investees. The principal ranges, depending on the company in question, from USD 11,049 thousand to USD 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%. The loans are repayable in a one-off lump sum upon maturity, which, depending on the company concerned, will take place in the period from 2008 to 2012.

The outstanding amounts in this connection, by maturity, are as follows:

Thousands of euros

Maturing in	
2008	62,920
2009	15,240
2010	30,544
2011	8,390
2012	33,283
Total	**150,377**

The balance of EUR 35,665 thousand with Aerolíneas Argentinas, S.A. relates to the subrogation to a loan of USD 43 million granted by Banesto, S.A. guaranteed by a mortgage on two B-747 aircraft, the repayment of which was guaranteed by the Company. In addition, the Company provided guarantees totalling USD 6 million to Aerolíneas Argentinas, S.A. The exposures with this company have been provided for in their entirety.

"Loans to Wam Acquisition, S.A." relates to a subordinated loan granted to that investee, which is repayable in a single instalment maturing in 2020, except in certain circumstances. The interest rate agreed is 13.75% per annum. Accrued interest accumulates as principal and is payable upon the maturity of the principal.

Iberlease 2004 Ltd., the lessor of four aircraft acquired by the Company under lease financing arrangements, has been granted four loans by Iberia, Líneas Aéreas de España, S.A. with the same terms as established in the respective lease agreements, which are repayable in a single instalment in 2014. The principal on these loans totals USD 53,518 thousand with annual interest of between 6% and 6.5% payable on a quarterly basis.

Long-term deposits and guarantees

Changes in the items comprising this balance sheet heading in 2006 were as follows:

Thousands of euros

Description	Balance at 31-12-05	Additions	Retirements	Transfers	Exchange Differences	Balance at 31-12-06
Deposits for acquisition of aircraft	351,660	160,507	(191,060)	(1,358)	(30,751)	288,998
Deposit for convertible bonds (Note 15)	9,153	–	–	(9,153)	–	–
Valuation of hedging transactions	(19,321)	2,714	(5,376)	–	15,086	(6,897)
Deposits and guarantees for operation of aircraft under dry and wet lease arrangements (Note 6)	10,669	1,615	(510)	–	(1,161)	10,613
Deposits and guarantees for operation of aircraft leased from ILFC (Note 6)	11,295	–	–	–	(1,177)	10,118
Other	3,950	361	(612)	–	(198)	3,501
	367,406	**165,197**	**(197,558)**	**(10,511)**	**(18,201)**	**306,333**

The amounts included in "Deposits for Acquisition of Aircraft" relate to the reimbursable advances paid for the acquisition of aircraft and engines, the detail being as follows:

Thousands of euros

	Firm purchases	Options
A-319	135,069	
A-320	112,319	3,721[(a)]
A-321	16,158	
A-340	–	1,519
Engines	20,212	–
	283,758	**5,240**

[(a)] Deposits paid for all the A-320-type aircraft.

Based on scheduled aircraft deliveries, the Group considers that deposits amounting to EUR 204 million will be taken to income in 2007.

8. Treasury shares

The changes in "Treasury Shares" in the accompanying balance sheet at 31 December 2006 were as follows:

Thousands of euros

Balance at 31 December 2005	23,696
Additions	8,981
Disposals	(23,431)
Change in reserve for treasury shares (Note 12)	3,448
Balance at 31 December 2006	**12,694**

The 6,702,368 treasury shares held by the Company at 31 December 2006 represent 0.71% of its share capital, with an overall par value of EUR 5,228 thousand and an average acquisition cost of EUR 2.0772 per share. A debit of EUR 3,448 thousand was made to voluntary reserves in 2006 as a result of the change in the provision for treasury shares in 2006. The balance of EUR 12,694 thousand on the "Reserve for Treasury Shares" account at 31 December 2006 covers the net book value of the shares in full.

The sale of treasury shares in 2006, the only item included in "Disposals" in the above table, gave rise to gains totalling EUR 4,098 thousand, which were recognised under "Gains on Transactions with Treasury Shares" in the income statement.

9. Inventories

The detail of this heading at 31 December 2006 is as follows:

	Thousand of euros
Engine parts[(a)]	111,847
Aircraft parts	63,025
Fuel	37,707
Other	19,077
Provisions	(44,062)
Total	**187,594**

[(a)] See Note 4-f and Note 6.

10. Accounts receivable

A breakdown of "Accounts Receivable" in the accompanying balance sheet at 31 December 2006 is as follows:

	Thousands of euros
Receivable from passenger and cargo agencies	204,955
Other trade receivables for sales and services	185,020
Taxes receivable (Note 18)	52,113
Receivable from public authorities	38,936
Sundry accounts receivable	51,683
Receivable from airlines	52,997
Receivable from customers at sales offices	19,724
Credit card receivables	19,870
Doubtful debts	22,588
Provisions	(26,167)
	621,719

11. Short-term investments

The detail of this heading in the accompanying balance sheet at 31 December 2006 is as follows:

	Thousands of euros
Short-term financial assets	2,310,675
Unmatured interest receivable	25,373
Restricted deposits for convertible debentures (Note 15)	10,362
Iberbond bonds (Note 7)	30,810
Other short-term deposits and guarantees	11,887
Accrued dividends receivable (Note 7)	10,987
Other short-term investments	3,847
	2,403,941

The average return obtained in 2006 on amounts placed in short term financial assets, basically comprising deposits, eurodeposits and promissory notes was 2.92%.

12. Equity

The changes in the Company's equity accounts in 2006 were as follows:

Thousands of euros

Item	Capital Stock	Share Premium	Legal Reserve	Voluntary Reserves	Reserve for Treasury Shares	Other Reserves	Profit for the year	Interim Dividend	Dividends
Balance at 31 December 2005	735,666	111,285	104,757	396,335	23,696	1,404	512,997	(281,026)	–
Distribution of 2005 profit	–	–	42,376	170,977	–	–	(512,997)	281,026	18,618
Capital increase	3,826	4,120	–	–	–	–	–	–	–
Treasury stock	–	–	–	14,450	(11,002)	–	–	–	–
2006 Profit	–	–	–	–	–	–	85,203	–	–
Balance at 31 December 2006	**739,492**	**115,405**	**147,133**	**581,762**	**12,694**	**1,404**	**85,203**	**–**	**–**

In any evaluation of the Company's net worth at 31 December 2006, the value of its treasury shares should be deducted from the equity balance shown in the accompanying balance sheet.

Share capital

In 2006 the Company increased capital by EUR 3,826 thousand by issuing 4,904,693 ordinary shares of EUR 0.78 par value each, with a share premium of EUR 0.84 per share. This capital increase was performed to cater for the conversion into shares of the same number of convertible debentures issued to cover the share option plan approved by the shareholders at the Annual General Meeting in 2002 and aimed at certain executive directors, executives and other employees.

At 31 December 2006, 6,396,236 share options had been subscribed but not yet exercised. These options may be exchanged for shares at a price of EUR 1.62 per share on the following dates: 10 March 2007, 10 September 2007 and 25 April 2008.

At 31 December 2006, the Company's share capital consisted of 948,066,632 fully subscribed and paid shares of EUR 0.78 par value each, traded by the book-entry system.

At 31 December 2006, the Company's shareholders were as follows:

	Number of Shares	Percentage
British Airways	94,309,090	9.95
Caja de Ahorros y Monte de Piedad de Madrid	91,290,716	9.63
Banco Bilbao Vizcaya Argentaria, S.A.	69,492,448	7.33
Compañía de Distribución Integral Logista, S.A.	61,164,780	6.45
Sociedad Estatal de Participaciones Industriales	49,212,526	5.19
El Corte Inglés, S.A.	27,387,215	2.89
Other, including employees	555,209,857	58.56
Total	**948,066,632**	**100.00**

Share premium

The Consolidated Spanish Companies Law expressly permits the use of the share premium balance to increase capital and does not establish any specific restrictions as to its use.

Legal reserve

Under the Consolidated Spanish Companies Law, 10% of net profit for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of the share capital.

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

13. Provisions for contingencies and charges

The changes in this heading of the accompanying balance sheet in 2006 were as follows:

Thousands of euros

	Balance at 31/12/05	Additions or Allowances	Applications	Other Changes	Balance at 31/12/06
Provision for obligations to employees (Note 4-h)	573,221	65,648	(20,538)	-	618,331
Provision for major repairs (Note 4-b)	60,985	21,570	(20,361)	–	62,194
Provision for third-party liability (Note 4-j)	776,050	37,008	(104,646)	(550)	707,862
	1,410,256	**124,226**	**(145,545)**	**(550)**	**1,388,387**

The additions to "Provisions for Obligations to Employees" include the period provision for the normal cost and for the amounts relating to the interest income from the provision already recognised, which is recognised under "Staff Costs" (EUR 45,584 thousand) and under "Finance and Similar Costs" (EUR 20,064 thousand) in the consolidated income statement for 2006.

At 31 December 2006 the balance of the "Provision for Third-Party Liability" includes EUR 539,767 thousand covering the liabilities associated with the collective redundancy procedure (see Note 4-j). Of this amount, EUR 348,889 thousand represent the estimated amount per the actuarial studies performed by independent actuaries of future payments to meet the obligations with employees who have taken early retirement under the conditions envisaged in the workforce rejuvenation plan implemented in 2000 (341 employees at 31 December 2006) and the collective redundancy procedure approved in 2001 and extended until 2007 (3,307 employees at 31 December 2006). In addition, the Company recognised a provision of EUR 190,878 thousand for the estimated cost of the group of employees who are expected to avail themselves of these measures. In 2006, 1,034 employees availed themselves of the collective redundancy procedure and the provision in this connection amounted to EUR 25,800 thousand (see Note 19-h).

The other provisions for third-party liability in 2006, which were also recorded with a charge to "Extraordinary Expenses" in the accompanying income statement (see Note 19-h), relate to the estimated amount required to cover probable sundry third-party liabilities.

The main applications relate to payments associated with the employee reduction plans described above.

14. Bank borrowings and other financial liabilities

A breakdown, by maturity, of amounts payable to credit institutions at 31 December 2006, which related to loans, credit facilities and financial lease transactions (see Note 5), is as follows:

Thousands of euros

		Due in					
Borrowings	**Currency**	**2007**	**2008**	**2009**	**2010**	**2011**	**Subsequent Years**
In euros:							
Principal		190,295	32,936	41,966	8,391	8,824	69,705
Interest		15,229	6,683	4,642	3,423	3,128	5,193
In foreign currencies:							
Principal	US dollars	29,919	130,815	17,576	62,663	8,582	99,812
Interest	US dollars	6,167	5,789	5,389	4,966	4,520	19,927
		241,610	**176,223**	**69,573**	**79,443**	**25,054**	**194,637**

At 31 December 2006 the Company has arranged credit facilities with a limit of EUR 267 million, of which EUR 224 million are available for drawing.

The weighted annual average interest rate on the aforementioned loans in 2006 was 4.50% for euro loans and 5.49% for foreign currency loans. The majority of these interest rates were tied to EURIBOR or LIBOR, respectively.

15. Convertible debenture issue

The Company issued debentures in 2003 convertible into shares in the proportion of one to one with a par value of EUR 1.62 each. This issue is earmarked to cover the Share Option Plan described in Note 12. Interest is tied to three-month Euribor, while outstanding maturities coincide with the exercise dates for the stock option plan and repayment is guaranteed by way of a restricted deposit (see Note 11).

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, the Company has a medium-term plan to manage these risks based on the guidelines and time horizon established in the Master Plan.

Exchange rate risk

Hedging of balance sheet positions at 31 December 2006

Underlying	**Currency**	**Amount (Millions of Currency)**	**Type of Hedge**	**Nominal Amount (Millions of Currency)**
Loans to Iberbús companies	USD	198	Cross currency swaps	147
Advances on aircraft and engines	USD	381	Cross currency swaps	(65)
Guarantees	USD	31	Fx forward	121
A-320 equities	USD	53		
4 A-320/321 debt	USD	(182)		
5 A-340 debt	USD	(278)		
Total		203		203

Cash flow hedges at 31 December 2006

Underlying	Currency	Amount (Millions of Currency)	Type of Hedge	Forecast Cash Flows (Millions of Currency) 2007	2008	2009	2010	2011
Foreign currency expenses	USD	(1,317)	Cross Currency Swaps	240	231	230	128	60
			Opciones:					
			USD four ways	511	430	–	–	–
			USD cylinders	40				
			Fx Forwards	329	47	–	–	–
Foreign currency income	GBP	91	Fx Forwards	28	–	–	–	–
	CHF	124	Fx Forwards	7	–	–	–	–
New aircraft	USD	(147)	Opciones:					
			USD four ways	92	–	–	–	–
			USD cylinders	9				
			Fx Forwards	38	–	–	–	–

Fx forwards for USD purchases have been contracted at an average exchange rate of 1.2692 USD/EUR, those for GBP sales at an average rate of 0.6782 GBP/EUR, and those for CHF sales at an average rate of 1.5977 CHF/EUR.

The average prices of flexible options structures (four ways) in respect of foreign currency expenses are as follows: USD Puts sold 1.2855 USD/EUR, USD Puts purchased 1.5988 USD/EUR, USD Calls sold 1.1464 USD/EUR and USD Calls purchased 1.2302 USD/EUR. Meanwhile, the average prices of flexible options structures (cylinders) were as follows: USD Call purchased 1.2737, and USD Put sold 1.3355.

The average prices of flexible options structures (four ways) in respect of fleet acquisitions are as follows: USD Call purchased 1.2333 USD/EUR and USD Call sold 1.1512 USD/EUR, USD Put purchased 1.60 USD/EUR and USD Put sold 1.2924 USD/EUR. The prices of flexible options structures (cylinders) were as follows: USD Call purchased 1.25, and USD Put sold 1.2903.

At 31 December 2006 the market value of exchange rate derivatives is negative and totals EUR 36.8 million.

Interest rate risk

Hedging of balance sheet positions at 31 December 2006

Amount (Thousands of Currency) Instrument	IBERIA	IBERIA	Nom. Amount 31/12/06(*)	Nom. Amount 31/12/07(*)	Nom. Amount 31/12/08(*)
Cross Currency Swaps					
From floating to floating	Receives EUR	Pays USD	146,774	122,922	40,056

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

Amount (Thousands of Currency) Instrument	Currency	Nominal Amount 31/12/06
Interest Rate Swaps		
From fixed to floating(1)	EUR	49,141

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

Hedging of balance sheet positions at 31 December 2006

Amount (Thousands of Currency)(*) Instrument	IBERIA	IBERIA	Nom. Am. at 31/12/06	Nom. Am. at 31/12/07	Nom. Am. at 31/12/08	Nom. Am. at 31/12/09	Nom. Am. at 31/12/10
Cross Currency Swaps:							
Floating to fixed	Receives USD	Pays EUR	470,809	261,820	201,244	-	-
Floating to floating	Receives USD	Pays EUR	883,710	762,005	608,799	412,013	190,476
Floating to floating	Receives EUR	Pays USD	824,084	698,676	538,240	386,173	76,723
Fixed to fixed	Receives USD	Pays EUR	723,122	543,031	470,096	290,317	123,013

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

Amount (Thousands of Currency) Instrument	Currency	Nominal Amount at 31/12/06	Nominal Amount at 31/12/07
Interest Rate Swaps			
Floating to fixed (1)	USD	137,981	

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

The average fixed interest rates of the interest rate hedges are: EUR 4.15%, USD 3.74%.

At 31 December 2006 the market value of interest rate derivatives (IRS and CCS) is negative and totals EUR 44.8 million.

Iberia Líneas Aéreas de España, S.A. has arranged interest rate swap transactions as part of the Japanese Operating Lease (JOL) internal structures for a notional amount of USD 678 million at 31 December 2006.

Fuel risk

Underlying	Commodity	Amount (Tm)	Hedge	Nominal (Tm)
Consumption of aviation fuel	JET Kero CIF-NWE	Approx. 2 million	Combination of options	935,000

To date Iberia, Líneas Aéreas de España, S.A. has directly hedged the price of kerosene using swaps and options structures.

The outstanding hedges at 31 December 2006 enable the Company to partially hedge the price of fuel at a price of USD 61.5/bbl for 50% of the volume of kerosene consumption projected for all of 2007.

The market value of these derivatives is EUR 6.7 million at 31 December 2006.

17. Balances and transactions with Group companies and associates

The breakdown of balances receivable from and payable to Iberia Group companies and associates at 31 December 2006, as well as the main transactions carried out with these undertakings during the year, was as follows:

Thousands of euros

Company	Short-Term Receivables	Short-Term Payables	Services rendered	Financial revenues and Dividends	Services received	Financial Expenses
Vuelos Internacionales de Vacaciones, S.A.	–	3,445	–	–	–	92
Compañía Auxiliar al Cargo Exprés, S.A.	5,102	108	21,311	325	1,764	–
Iberia Tecnología, S.A.	–	1,082	–	–	–	–
Iberia México	244	1,863	–	–	–	–
Cargosur, S.A.	–	2,672	–	–	–	76
Binter Finance, B.V.	12,179	–	–	–	280	–
Venezolana Internacional de Aviación, S.A.[a]	–	2,473	–	–	–	–
Iberamérica Aerospace LLC	2,847	25	564	87	715	–
Multiservicios Aeroportuarios, S.A.	36	5,629	538	303	38,814	–
Handling Guinea Ecuatorial, S.A.	68	73	226	–	479	–
Auxiliar Logística Aeroportuaria, S.A.	126	505	168	–	6,599	–
Clickair, S.A.	9,144	9,800	7,141	–	–	–
Serpista, S.A	–	979	3	–	7,442	–
Internacional Supply Management, S.L.	–	405	–	–	2,192	–
Other	–	433	150	–	531	13
	29,746	**29,492**	**30,101**	**715**	**58,816**	**181**

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

The main transactions carried out with Group companies and associates relate to billings issued to Compañía Auxiliar al Cargo Exprés, S.A. in respect of cargo transport, and invoices received from Multiservicios Aeroportuarios, S.A. for cleaning of aircraft.

Also, Iberia, Líneas Aéreas de España, S.A. sells tickets on behalf of Clickair, S.A. and carries out handling and aircraft maintenance services for that company.

18. Tax matters

"Accounts Receivable" and "Other Non-Trade Payables" in the accompanying balance sheet at 31 December 2006 include accounts receivable from and payable to public authorities. The detail is as follows:

Thousands of euros

Balances receivable (Note 10):	
Deferred tax asset	46,800
Foreign tax receivables	4,075
VAT	818
Withholdings and pre-payments	420
	52,113
Balances payable:	
Personal income tax withholdings	30,433
Take-off and security charges at airports	30,486
Foreign tax payables	48,278
Social security taxes	42,014
Income tax	15,243
Other tax payables	1,191
	167,645

Income tax is calculated on the basis of accounting profit, which does not necessarily coincide with taxable profit.

Since 1 January 2002 the Company files consolidated tax returns under the tax system provided for by Chapter VII of Title VII of the Consolidated Corporate Income Tax Law (Legislative Royal Decree 4/2004, of 5 March) as part of Tax Group 148/02 of which it is the Parent.

The reconciliation of accounting profit for 2006 to the taxable profit for income tax purposes is as follows:

Thousands of euros

	Increase	Decrease	Amount
Accounting profit for the year per books (before tax)			185,115
Permanent differences	2,407	(127)	2,280
Timing differences:			
Arising in the year	171,116[(a)]	–	171,116
Arising in prior years	1,426	(149,355)[(b)]	(147,929)
Taxable profit			**210,582**

[(a)] This amount relates mainly to provisions made for obligations to employees, as well as deferred income received on credit memorandum during the year and other deferred incentives.

[(b)] This amount relates basically to amounts used in the application of provisions recorded in prior years for obligations to employees, as well as provisions for other contingencies and expenses, and revenues on credit memorandums received in prior years and allocated to the income statement in 2006.

The balance of the "Income Tax" in the accompanying 2006 income statement is as follows:

Thousands of euros

	Expense (Income)
Application of the tax rate of 35% to accounting profit adjusted for permanent differences	65,588
Add/(Less)-	
Tax credits	(13,959)
Adjustment of previous year's income tax	(5,702)
Other	13,557
Income tax	**59,484**

"Other" basically reflects the regularisation of deferred tax assets with an estimated recovery period of over ten years in accordance with Spanish accounting rules.

Law 35/2006, of 28 November, on Personal Income Tax and partially amending the Spanish Corporation Tax, Non-Resident Income Tax and Wealth Tax Laws provides, inter alia, for the reduction over two years of the standard Spanish corporation tax rate from 35% at 31 December 2006 to 32.5% in 2007 and 30% in subsequent years.

As a result of the above, in 2006 the Company recalculated its tax assets and liabilities taking into account that they will foreseeably be reversed. Consequently, an adjustment of EUR 40,428 thousand was recognised under "Negative Adjustments to Income Tax" in the accompanying income statement for 2006.

Deferred tax assets and liabilities are recognised in the balance sheet under "Accounts Receivable", "Long-Term Receivables" and "Other Long Term Payables" on the basis of their recovery date, the detail being as follows:

Thousands of euros

	Accounts Receivable			Other Long-Term Payables
	Short-Term	Long-Term	Total	
Timing differences arising in the year	–	46,334	46,334	–
Unallocated timing differences arising in prior years	46,800	229,886	276,686	1,915
Total	**46,800**	**276,220**(*)	**323,020**	**1,915**

(*) Relating mainly to deferred tax assets arising from provisions for obligations to employees and other provisions.

The deferred tax assets at 31 December 2006 are expected to be recovered as follows:

Thousands of euros

Year of Recovery	
2008	40,000
2009	40,000
2010 and subsequent years	196,220
	276,220

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

Current Spanish corporation tax regulations provide certain tax incentives to encourage investments and contributions to employees' mutual funds. The Company has obtained certain tax benefits in respect of the aforementioned items and expects to apply deductions totalling EUR 7,400 thousand in the income tax return for 2006. The Company also intends to apply domestic and international double taxation relief totalling EUR 6,472 thousand in the 2006 income tax return. Finally, the Company has reinvested EUR 569 thousand of the amount obtained on the sale of assets, giving rise to tax assets EUR 87 thousand. The amounts reinvested in the recent years and the related tax credits are as follows:

Thousands of euros

Year	Reinvestment	Tax Credits
2002	72,794	4,423
2003	31,516	4,822
2004	124,869	16,980
2005	824,576	128,710
2006	569	87

As a result of successive tax audits, the tax authorities issued certain assessments for 1993 to 1997 (relating mainly to personal income tax withholdings), which were signed on a contested basis and appealed against by the Company.

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).

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

In connection with the years open to possible tax audit, in general 2002 to 2006 for income tax and 2003 to 2006 for the other taxes applicable to the Company, the directors of Iberia, Líneas Aéreas de España, S.A. do not expect that additional liabilities will arise apart from those already recorded that could have a material impact on these annual financial statements.

Pursuant to Article 93 of the Consolidated Corporate Income Tax Law (Legislative Royal Decree 4/2004, of 5 March), 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. Also, a contribution in kind was made to Servicios de Instrucción de Vuelo, S.L. in 2004, in respect of which the Company has waived part of the applicable tax benefits, in accordance with Article 84 of the Consolidated Corporate Income Tax Law. The information concerning this transaction was disclosed in Note 18 to the 2004 financial statements.

19. Income and expenses

a) Revenue

The breakdown, by activity, of the Company's revenue in 2006 is as follows:

Thousands of euros

By Activity	
Passenger ticket revenue[a]	4,222,904
Cargo revenue	296,563
Handling (aircraft dispatching and airport services)	331,154
Technical assistance to airlines	219,038
Other income	90,187
	5,159,846

[a] Including other income (recovery of unused tickets, commercial agreements, etc.) amounting to EUR 259,904 thousand in 2006.

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

Millions of euros

Network	
Domestic	1,206
Medium-haul	1,170
Long-haul	1,587
	3,963

b) Other operating income

The detail of "Other Operating Income" in the accompanying 2006 income statement is as follows:

Thousands of euros

Item	
Commissions	80,149
Royalties	8,943
Rental income	22,142
Sundry income	88,370
	199,604

The income from commissions relates basically to the commissions on the sale of tickets for other airlines and the commissions arising from the franchise agreement with Air Nostrum.

c) Extraordinary profit and prior years' income and profit

The breakdown of "Extraordinary Profit" in the accompanying income statement for 2006 is as follows:

	Thousands of euros
Recovery of provisions for spare parts	53,279
Other extraordinary income	1,819
	55,098

As indicated in Note 4-f, due among other reasons to the substantial improvement in the computer and warehouse management systems, in 2006 there was a highly significant increase in the turnover of repairable engine parts and, accordingly, the value of these spare parts, which until 2005 were classified as property, plant and equipment and depreciated annually as slow-moving goods, were reclassified to "Inventories" and the allowance for depreciation required at 31 December 2006 was recalculated, giving rise to net income of EUR 26,864 thousand in the consolidated income statement (see Note 19-h).

"Prior Years' Income and Profits" includes a gain of EUR 14,783 thousand resulting from the final settlement on the 1997 sale of the investment in Musini, the former SEPI insurer, in which Iberia, Líneas Aéreas de España, S.A. owned shares.

d) Procurements

The detail of "Procurements" in the accompanying 2006 income statement is as follows:

	Thousands of euros
Aircraft fuel	1,173,812
Aircraft spare parts	157,952
Catering materials	24,069
Other purchases	18,871
	1,374,704

The aircraft fuel expense in 2006 totalled EUR 1,179,332 thousand. However, the related hedging derivatives transactions (price and exchange rate hedges) reduced this expense by EUR 5,520 thousand.

e) Headcount and staff costs

The detail of "Staff Costs" in the accompanying 2006 income statement is as follows:

	Thousands of euros
Wages, salaries and similar	1,044,729
Social security charges	244,154
Other employee welfare expenses	99,996
	1,388,879

The average number of employees, by professional category, in 2006 was as follows:

	Number of Employees
Ground personnel:	
Senior managers and other line personnel	1,185
Clerical staff	6,276
Other	10,089
	17,550
Flight personnel:	
Pilots	1,826
Cabin crew	4,337
	6,163
	23,713

g) Other operating expenses

The detail of "Other Operating Expenses" in the accompanying 2006 income statement is as follows:

	Thousands of euros
Commercial expenses	247,729
Aircraft lease payments: (Note 6):	
Dry lease[a]	351,864
Wet lease[a]	51,245
Cargo	12,597
Other	8,839
Air traffic services	388,034
Stopover expenses	41,899
Incident expenses	24,373
Navigation charges	285,758
Aircraft maintenance[b]	179,806
General maintenance	41,315
Booking system expenses	147,767
In-flight services	67,957
Other rent	75,512
Indemnities for passengers, luggage and cargo	51,638
Other[c]	249,619
	2,225,952

[a] Aircraft lease payments amounted to EUR 406,458 thousand in 2006. The related interest rate and foreign exchange hedging transactions reduced these expenses by EUR 3,349 thousand.
[b] IIncluding the expenses for subcontracted maintenance work and the provision for major repairs of aircraft operated under operating leases.
[c] The fees for financial audit services provided to Iberia, Líneas Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related to the auditor during 2006 amounted to EUR 501 thousand.
Also, the fees for other professional services provided to Iberia, Líneas Aéreas de España, S.A., and Group companies by the main auditors and by other entities related thereto amounted to EUR 145 thousand in 2006.

h) Extraordinary expenses

The detail of "Extraordinary Expenses" in the accompanying 2006 income statement is as follows:

	Thousands of euros
Provisions for extension of the workforce reduction plan (Note 13)	25,800
Provision for engine parts (Note 19-c)	26,415
Other allowances	10,861
Other extraordinary expenses	3,145
	66,221

20. Directors' remuneration and other benefits

The detail of the remuneration earned by the members of the Board of Directors in 2006 in their capacity as directors of the Company is as follows:

Thousands of euros

Directors' Remuneration	
Fixed remuneration	628
Attendance fees	578
Compensation in kind	85
Total remuneration	1,291

In 2006 Iberia Líneas Aéreas de España, S.A. incurred expenses related to the performance of non-executive directors' functions amounting to EUR 9 thousand.

In addition, certain directors occupy executive positions in the Company for which they received the following remuneration in 2006:

Thousands of euros

Fixed remuneration	838
Variable remuneration	755
Compensation in kind	21
Options	350
	1,964

The Company incurred expenses amounting to EUR 1,849 thousand associated with the termination of an executive director in connection with a non-competition covenant, variable remuneration and the surrender of an insurance policy.

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 EUR 571 thousand.

In 2006 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 investments in companies engaging in similar activities and of the performance, by the directors, as independent professionals or as employees, of similar activities

Pursuant to Article 127 ter.4 of the Spanish Companies Law, introduced by Law 26/2003, of 17 July, which amends Securities Market Law 24/1988, of 28 July, and the Consolidated Spanish Companies Law, in order to reinforce the transparency of listed corporations, following is a detail of the activities carried on in 2006, as independent professionals or as employees, by the various members of the Board of Directors that are identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A.:

Name	Line of Business	Type of Arrangement	Company	Position/Function
Roger Maynard	Air transport	Employee	British Airways	Director of Alliances and Investments
	Air transport	Employee	British Airways Citiexpress	Chairman
Lord Garel-Jones	Handling	Employee	Acciona	Independent director

Fernando Conte is also a member of the Board and Chairman of the Audit Committee of IATA.

Also, pursuant to the aforementioned Law, it is hereby stated that no member of the Board of Directors owns any equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A.

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.

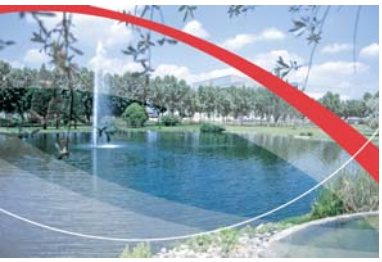
22. Information on the environment

Within the framework of its environmental policy, Iberia, Líneas Aéreas de España, S.A. continued to undertake various activities and projects in 2006 in order to guarantee the proper management of the main environmental impacts of the air transport business as a whole.

In 2006 the Company incurred environmental expenses of EUR 3,926 thousand, the detail being as follows:

	Thousands of euros
Environmental repair and maintenance	1,676
Environmental technical services	919
Staff costs relating to environmental management	1,009
Environmental taxes and other	338
Total	**3,942**

At 31 December 2006, the acquisition cost and accumulated depreciation of the environmental assets, which include, inter alia, water-treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, amounted to EUR 60,285 thousand and EUR 29,633 thousand, respectively.



With respect to its aircraft, the Company has a renewal policy in which the environment (minimising the impact of noise and air emissions) is an important factor to be borne in mind. Accordingly, the Company is continuing to add new aircraft models that reduce fuel consumption by approximately 20% compared to earlier generation aircraft. In 2006 three A-340-600 were added for long-haul routes and two B-747 were retired. Eight aircraft of the A-320 family were also acquired and three B-757, six A-320 and one MD aircraft were retired.

As far as ground operations are concerned, the ISO 14001: 2004 Environmental Management System certification was renewed for the aircraft maintenance activity in the Madrid facilities and for the handling business at 39 Spanish airports.

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. 2006 and 2005 statements of changes in financial position

Following are the Company's statements of changes in financial position for 2006 and 2005:

Thousands of euros

Applications	2006	2005
Start-up costs	91	93
Non-current asset additions		
Intangible assets	21,107	24,197
Property, plant and equipment	126,571	285,176
Long-term investments in Group companies and associates	15,683	446
Other financial investments	162,915	350,474
Deferred charges	5,366	8,906
Dividends	18,619	327,282
Repayment or transfer to short term of non-current liabilities		
Loans	202,886	45,747
Other debts	–	59
Provision for major repairs	4,474	7,849
Provision for pensions	8,515	–
Provisions for obligations to employees	12,022	22,002
Provision for liabilities	104,646	160,136
Long-term deferred tax asset	848	–
Total applications	**683,743**	**1,232,367**
Excess of sources over applications (increase in working capital)	**130,126**	**409,480**

Sources	2006	2005
Funds generated from operations	449,122	298,983
Capital increase	7,946	9,225
Non-current liabilities		
Other companies	3,890	5,219
Disposal of property, plant and equipment and intangible assets	64,378	332,256
Disposal of long-term investments	–	830,122
Early amortisation or transfer to short-term of long-term investments	236,973	155,295
Deferred income	51,560	10,667
Long-term deferred tax liability	–	80
Total sources	**813,869**	**1,641,847**
Excess of applications over sources (decrease in working capital)	**–**	**–**

Thousands of euros

Change in working capital	2006		2005	
	Increase	Decrease	Increase	Decrease
Treasury shares	–	14,450	–	3,589
Inventories	72,934	–	27,722	–
Accounts receivable	–	31,382	97,481	–
Current liabilities	–	357,620	–	129,809
Short-term investments	480,092	–	414,200	–
Cash in hand and at banks	–	7,886	867	–
Asset accrual accounts	–	11,562	2,608	–
Total	**553,026**	**422,900**	**542,878**	**133,398**

The reconciliation of the accounting profit to the funds obtained from operations is as follows:

Thousands of euros

	2006	2005
Accounting profit	85,203	512,997
Add/(Less)-		
Depreciation and amortisation charge and fixed asset allowances	217,286	289,139
Period provisions for contingencies and charges	124,226	391,591
Deferred interest expenses and deferred charges	32,135	21,238
Tax asset recoverable at long term	9,033	(45,930)
Negative adjustment of income tax	40,428	-
Net exchange differences on long-term items	3,172	(11,550)
Work on non-current assets	3,751	(16,881)
Deferred interest income	(20,623)	(6,248)
Net gains on fixed asset disposals	(16,439)	(810,376)
Interest on financial assets	(23,344)	(2,627)
Recovery of excess provisions and depreciation and amortisation	(5,706)	(22,370)
	449,122	**298,983**

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
Iberia, Líneas Aéreas de España, S.A.

Key data

IBERIA	2006	2005	% Change
Result (millions of €)			
Operating revenue	5,359.4	4,903.9	9.3
EBITDAR	790.1	700.3	12.8
Operating profit	141.1	80.6	75.0
Profit before tax	185.1	514.2	(64.0)
Profit for the year	85.2	513.0	(83.4)
Net profit before adjustments for taxes	125.6	513.0	(75.5)
Basic earnings per share (€ cents)[1]	9.1	55.4	(83.5)
Dividends per share (€ cents)	3.5	32.2	(89.1)
Passenger traffic: production and revenue			
ASK (millions)	65,802	63,628	3.4
RPK (millions)	52,493	49,060	7.0
Passenger load factor (%)	79.8	77.1	2.7 p.
Passenger revenue (millions of Euros)	3,963.2	3,610.0	9.8
Passenger revenue per RPK (€ cents)	7.55	7.36	2.6
Passenger revenue per ASK (€ cents)	6.02	5.67	6.2
Financial aggregates and ratios			
FShareholders' equity (millions of Euros)	1,683.1	1,605.1	4.9
Net debt per balance sheet (millions of Euros)[2]	(1,700.1)	(1,119.3)	51.9
Adjusted net debt (millions of Euros)[3]	1,368.7	1,762.2	(22.3)
Operating profit margin (%)	2.6	1.6	1.0 p.
Net profit margin for the year (%)	1.6	10.5	(8.9 p.)
Operating revenue per ASK (€ cents)	8.14	7.71	5.7
Operating cost per ASK (€ cents)	7.93	7.58	4.6
Operating cost per ASK excluding fuel (€ cents)	6.15	6.22	(1.2)
Resources			
Average no. of full-time equivalent employees	23,713	24,160	(1.8)
Operating revenue per employee (thousands of Euros)[4]	226.0	203.0	11.4
Productivity (thousands of ASK per employee)[4]	2,775	2,634	5.4
Aircraft in service at December 31	150	154	(2.6)
Usage of the fleet (B.H. per aircraft per day)	9.1	9.1	(0.6)

IBERIA GROUP	2006	2005	% Change
Result (millions of €)			
Operating revenue	5,387.8	4,929.1	9.3
EBITDAR	790.5	699.9	12.9
Operating Profit	122.0	116.6	4.6
Operating Profit (excluding IAS 39)	150.3	89.6	67.6
Profit before tax	165.2	393.5	(58.0)
Consolidated profit for the year	57.0	396.0	(85.6)
Consolidated profit before adjustments for taxes	116.1	396.0	(70.7)
Financial aggregates and ratios			
Equity (millions of Euros)	1,738.6	1,738.2	0.0
Adjusted net debt (millions of Euros)[3]	1,346.6	1,739.1	(22.6)
EBITDAR margin (%)	14.7	14.2	0.5 p.
Operating profit margin (%)	2.3	2.4	(0.1 p.)
Consolidated profit margin (%)	1.1	8.0	(7.0 p.)

[1] Weighted average number of shares outstanding (in thousands): 932,049 in 2006; 925,434 in 2005.
[2] Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding interest on financial lease contracts).
[3] Net debt per balance sheet + Capitalised aircraft leases (in 2005 this excludes leases on five A340 aircraft included in the balance sheet in December) – (Iberbond Bonds + Capitalised interest on Iberbus loans).
[4] Productivity of IBERIA's entire workforce.

1. Highlights

The air transport industry taken as a whole saw passenger traffic on regular international flights –measured in revenue passenger kilometers (RPK)– grow by 5.9% in 2006, according to data published by the International Air Transport Association (IATA). This increase was in line with the industry's average historical growth rate, although it represented a slowdown with respect to the increase in 2005 (7.6%). Worldwide, the 4.6% increase in capacity was somewhat more modest in 2006, although the load factor increased by 0.9 percentage points compared to 2005.

As in 2005, Middle Eastern airlines continued to represent the region that saw the highest levels of traffic growth, 15.4%, while Latin American airlines achieved growth of 11.5% (excluding Varig, which is immersed in a rigorous restructuring plan). North American airlines were the companies that achieved the highest load factors, with an annual average of 80.2% in 2006.

The increase in international traffic carried by European network airlines was 5.5% as compared with 2005, according to data from the Association of European Airlines (AEA). Total AEA traffic, including domestic flights, saw a 5.2% increase in RPK, while growth in availability of seat-kilometers (ASK) was more modest at 4.4% for the year taken as a whole. As a result, the load factor improved by 0.6 percentage points with respect to 2005.

In 2006 the price of fuel once again exceeded the all-time-highs it had achieved in 2005. Prices in August approached USD 80 a barrel and then went on to fall, leaving the prices of Brent crude at around USD 60 a barrel at year-end. In spite of this adjustment, the average annual price of crude oil increased by close to 20% with respect to the average price in 2005.

In 2006, the net results of the air transport industry improved with respect to the 2005, despite the increase in the price of fuel, and according to the latest estimates published by IATA losses will have fallen by USD 500 million as compared with the USD 3,200 million in 2005. These improved results were favoured by economic growth, which led to increased revenue, together with the cost containment plans implemented by the airlines and by the moderate growth in capacity. The most pronounced improvement in results was seen in the US, where the majority of airlines returned to profit after five years of major losses.

In this scenario, the Iberia Group addressed the first year of implementation of the 2006/08 Master Plan, achieving most of the objectives established for 2006 and improving on operating profit for 2005.

Thus, complying with one the Plan's strategic lines, the Company commenced to undertake a far-reaching restructuring and review of its flight programme, promoting growth in services in the long-haul sector. To execute this strategy, the Iberia Group has a new location in the T4 Terminal at Madrid-Barajas airport, which came into service in February 2006 and offers optimal conditions for the Company to continue to strengthen its hub and improve service quality.

In 2006, the RPK of Iberia, Líneas Aéreas de España, S.A. ("IBERIA") increased by 7.0% as compared with 2005, compared to an increase in supply of 3.4%, and the passenger load factor improved 2.7 percentage points, reaching 79.8%, which was –for the second successive year– an all-time-high in the Company's load factor, which is one of the highest among the European network airlines.

IBERIA focused the growth of its air transport business on its long-haul flights, in particular the routes to Central and South America, and received an excellent response in terms of demand, which enabled it to consolidated its position of leadership in the Europe– Latin America market with market share increasing to 19% in 2006 and widening the advantage it has over its main competitors. Adjustments were also made in the medium-haul and domestic sectors in order to ensure suitable levels of return.

Despite the 6.5% growth in the average haul in 2006, passenger revenue per RPK increased by 2.6% with respect to 2005, after three years of decreases. Unit passenger revenues per ASK improved in all the sectors with respect to 2005, increasing by 6.2% in the network as a whole,

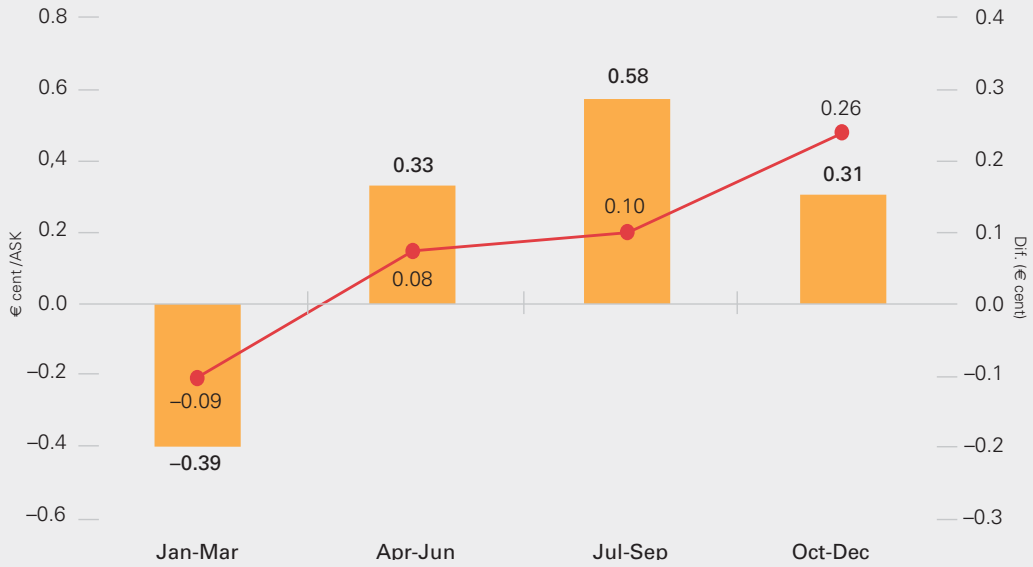
due mainly to the marked 16.6% increase in the unit revenue witnessed in the long-haul sector, which was, in part, driven by the significant improvement in the class mix, increasing 25% with respect to 2005 in the number of passengers flying Business Plus, the new business class that the Company consolidated in 2006 with an exceptional response from passengers who value it is one of the best products to fly to America offered by the European airlines.

Passenger revenue from flights in 2006 increased by 9.8% with respect to 2005. Other operating revenue also increased with respect to 2005, most notably the major increase in revenue from aircraft maintenance services (40.7% as compared with 2005), which is a business area that is surpassing the demanding objectives set out in the 2006/08 Master Plan and carries on its business activity in a services market that has high growth potential, in which IBERIA is becoming one of the leading suppliers in Europe. IBERIA's aggregate operating revenue amounted to EUR 5,359.4 million, up 9.3% on 2005.

The Company's operating expenses increased by 8.2% compared to 2005, due mainly to the 36% increase of EUR 310.7 million in the fuel expense, driven by the aforementioned increase in kerosene prices. These increases were partly offset by the implementation of a range of cost cutting measures established in the 2006/08 Master Plan. Therefore, in 2006, IBERIA's unit operating cost per ASK increased by 4.6% with respect to 2005. Excluding the fuel expense, IBERIA's unit operating cost decreased by 1.2% with respect to 2005. Notable among the cost reductions was the 3.2% decrease in staff costs, based on improved productivity and the containment of salary increases.

The favourable effect of the measures contained within the 2006/08 Master Plan implemented throughout 2006, together with the gradual narrowing of the year-on-year fuel price differential, meant that the change in the unit operating margin per ASK was extremely positive throughout the year, as illustrated in the following graph.

Quarterly changes in IBERIA's unit operating margin in 2006

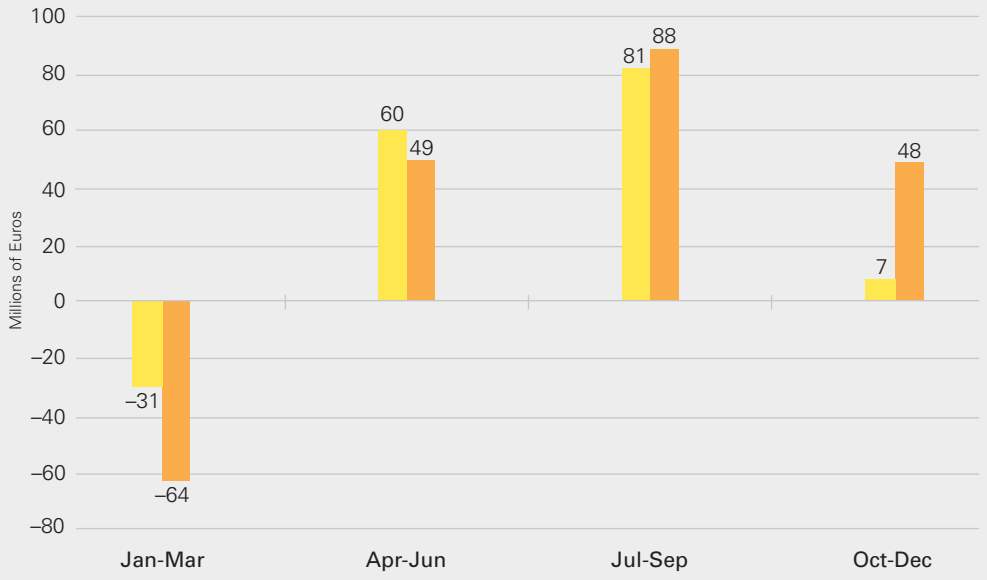


IBERIA's operating profit amounted to EUR 141.1 million in 2006, up 75.0% on 2005. The individual Company's profit before tax, in accordance with the Spanish National Chart of Accounts and other accounting regulations, was EUR 185.1 million in 2006, with a positive contribution from finance income of EUR 33 million and extraordinary items of EUR 11 million.

In the Iberia Group financial statements, consolidated in accordance with International Financial Reporting Standards (IFRSs), operating profit, which does not include the non-recurring income and expenses, amounted to EUR 122 million in 2006, up 4.6% on 2005. The application of IAS 39 in the

measurement of hedges had a contrary effect in the two years (negative in 2006 and positive in 2005), with an impact of EUR 55.3 million on comparing 2006 costs with those of 2005. Excluding the effects of applying IAS 39 in the two years (thus comparing the Company's operating performance on a uniform basis) the consolidated operating profit in 2006 surpassed the figure for 2005 by 67.6%.

Quarterly changes in the Iberia Group's profit from operations



In accordance with applicable regulations, the decrease in the standard Spanish Corporation Tax rate from 2007 onwards entails a proportionate reduction in the value of the Company's tax credits recognised in its balance sheet at year-end, with an impact of EUR 59.1 million on the net consolidated profit for 2006 which amounted to EUR 57 million. The net consolidated profit obtained by the Company from its ordinary activity, excluding this exceptional tax adjustment, was EUR 116.1 million in 2006. Consolidated profit had amounted to EUR 396 million in 2005, when the capital gain on the sale of the ownership interests in Amadeus Global Travel Distribution, S.A. (Amadeus) and in SAVIA was recognised.

2006 was not free from tense labour relations, mainly involving the flight crews. The IBERIA section of the Spanish Airline Pilots Union (SEPLA) called seven consecutive days of strikes between 10 and 16 July 2006, as a result of its opposition to the involvement of IBERIA, together with four other partners, in the launch of Clickair, a new generation airline that began operating in October; finally, stoppages occurred only on 10, 11 and 12, despite which the Company was forced to cancel 1,032 flights between Monday 10 and Sunday 16, with an estimated impact of around EUR 15 million. Also in summer, the Cabin Crew's union called a strike, although with less disruption of Company activity.

On 25 July the award was made public of the new concessions for third-party ramp handling services throughout the entire state airport network, in accordance with the resolution adopted by the Board of Directors of AENA (the Spanish public airports and aviation entity), thereby completing the public calls for tenders that have further deregulated the industry. IBERIA is the operator that obtained most licences, a total of 21, maintaining its presence at 36 airports (plus the heliport at Ceuta). The new licences will have a term of seven years.

The aforementioned competition of the calls for tender meant the loss of the licence held by IBERIA at the El Prat airport. In protest at this decision, on 28 July the Barcelona handling employees went on an illegal strike that forced the cancellation of 300 IBERIA flights, affecting some 30,000 passengers and causing losses to the Company of more than EUR 6 million.

Product and Quality

Pursuant to the strategy established in the 2006/08 Master Plan of improving quality, the Company continued to promote the products that provide the greatest added value to the passenger and to the Company, offering differentiated services that have been well valued by our passengers. Noteworthy among the projects implemented, in terms of the investment made and the significant effect on revenue, was the aforementioned launch of the new long-haul business class named Business Plus, which IBERIA began to market in mid- 2005.

The Business Plus Class features ergonomic seats with ample legroom which can be reclined to form a bed. It also offers passengers the most advanced communications systems (telephone, SMS and e-mail) and in-flight entertainment (interactive games and audio and video channels on request). All the aeroplanes in the long-haul fleet have been operating since July 2006 with this new class.

In parallel, the Company also changed its in-flight catering items and redesigned in-flight service, renewing the menus and wines, whose high quality has been recognised by various international awards.

The passengers have valued the Business Plus Class highly. From January 2006 the number of tickets and the volume of billings in this service class had monthly increases with respect to 2005. Over the twelve months taken as a whole, the passenger revenue obtained in the Business Plus class increased by 36% in relation to 2005 while the number of seats offered to the market increased by only 2.5%.

In 2006 IBERIA initiated a programme to reconfigure the passenger cabins of the entire Airbus fleet (A319, A320 and A321 models) with which it operates its domestic and European connections. This renovation of the interiors of the aircraft includes the fitting of latest-generation seats, upholstered in prime-quality materials, with a structural design that affords maximum comfort and room, especially at knee height.

In addition, with the aim of also improving service to Business Class passengers on medium-haul flights, IBERIA ceased to market the central seats of the rows in its business class.

Iberia Plus, the Company's loyalty programme, represents one of the Iberia Group's strengths and it is one of the greatest attractions for our passengers. The number of Iberia Plus card holders has had an average annual increase of 22% over the last four years, achieving close to three million card holders at year-end 2006.

Innovation and Technology

The Iberia Group focused its interest on using new technologies to simplify all its processes, facilitate passenger accessibility and reduce expenses.

Throughout 2006, IBERIA continued to improve the functionality of its website and to introduce new products for its passengers, such as, inter alia, the issuing of automatic invoices ("online") or the minimum price guarantee. It also continued to expand internationally, launching new specific versions in 13 countries, mainly in Central America and Africa, and entered into new agreements with various partners to offer online purchases to its passengers. The number of air transport tickets sold by the Company through Iberia.com in 2006 increased by 41.6% with respect to 2005, and the volume of flight sales increased by 56% to exceed EUR 447.1 million.

For several years now, IBERIA has promoted the use of the e-ticket (its flight coupons are an electronic registration in the database), to replace the traditional paper ticket. This new type of ticket provides the passenger with greater convenience and security and at the same time reduces airline costs.

At year-end 2006 the e-ticket was valid for all destinations (except Naples and Pisa) on the Iberia Group network and it had become the format used by the great majority of its passengers. In 2006, e-tickets represented 90% of all tickets issued, establishing IBERIA as the clear leader in this area among the European network carriers; in the case of tickets issued by travel agencies, the increase was 81.3%. It should also be mentioned that the growth in the use of the e-ticket on the Madrid-Barcelona Shuttle flights, subsequent to its introduction mid-2005, exceeded 87% in the

last quarter of 2006. Also, IBERIA continued to extend the use of interline e-ticketing for the flights that combine IBERIA flights with those of other airlines.

The Iberia Group also offers its passengers auto check-in through Iberia.com (auto check-in online) or by using the self-service automated kiosks at the airports. Auto check-in, by either means, enables passengers to obtain their boarding card directly and select their seat in a trouble-free way, without the need to go to the check-in desks, with the related time savings and greater degree of convenience. The auto check-in service can be used by all the passengers who are travelling to any destination where no passport or immigration documents or security procedures are required.

Auto check-in online has been well received since May 2005, when IBERIA afforded its passengers the possibility of auto checking-in online from their own home or office, whether or not they take baggage, up to two hours prior to the departure of the flight, travelling with an e-ticket or a paper ticket. The percentage of users of this service has grown solidly and in the last quarter of 2006 stood at 9.8% of the total of passengers on domestic and Schengen destination flights. A daily average of 9,500 boarding cards issued through the website was achieved.

In 2006 the Company continued to increase the number of self-service automated kiosks installed at the airports, extending the service to new Spanish and European destinations. Accordingly, during 2006 IBERIA introduced this facility at Amsterdam, Athens, Brussels, Copenhagen, London, Munich, Rome and Venice airports, which joined Frankfurt and Paris, where the Company was already offering the service. In Spain, by the end of December, a total of 137 kiosks had been installed at 19 stopovers, including 20 specific kiosks for the Madrid-Barcelona Shuttle at Madrid and Barcelona. In April the Company extended the use of these 20 kiosks, until that time limited to Iberia Plus programme members, to all the passengers on the Madrid-Barcelona Shuttle that used the e-ticket (close to 90%). In 2006 the number of passengers using the self-service automated kiosks increased by 22% with respect to 2005, of particular note being the growth witnessed in the use of Madrid-Barcelona Shuttle kiosks, which increased two-fold.

Auto check-in taken as a whole (using conventional machines, Madrid-Barcelona Shuttle kiosks and online) performed extremely satisfactorily, with the greatest growth being seen in auto check-in online. The total number of passengers using auto check-in in the last quarter of 2006 represented 19.1% of all the passengers on domestic and international flights to Schengen countries.

Fleet Renewal

IBERIA continued to renew its long-, short- and medium-haul aircraft, with the objective of making more comfortable, fuel-efficient and environmentally-respectful aircraft available to its passengers. The addition of eleven new aircraft in 2006, which replaced some of the older aircraft, reduced the average age of the fleet as a whole to 7.92 years in 2006.

The aircraft renewal plan also aims at achieving complete aircraft uniformity in both fleets, a fact which drives the reduction of maintenance and technical crew costs, while offering advantages in the operational management of the commercial programme and facilitating the increase in the productivity of resources.

Since July 2006 the Company has been operating all its long-haul flights with a single type of aircraft, the Airbus A-340, the last two B747s having been retired. With the addition of three new A-340/600 aircraft in the first four months of 2006, the long-haul fleet comprised 31 A-340 aircraft (18 of the 300 version and 13 of the 600) at the end of 2006, with an average age of 5.2 years. Therefore, IBERIA has positioned itself as one of the airlines with the most modern long-haul fleets in the global air transport industry.

In July 2005 the Company arranged a major contract with Airbus to renew the short-and medium-haul fleet, which includes the addition of up to 79 aircraft (30 units outright and 49 with a purchase option) of the A-319, A-320 and A-321 models from 2006 onwards. The new aircraft will replace the oldest of the Airbus A-320s, and all the McDonnell Douglas MD-87 and MD-88, and the Boeing B-757. Accordingly, when the process of retiring the MD-87/88 concludes in 2009, IBERIA's short-and medium-haul fleet will be made up entirely of aircraft belonging to the same family manufactured by Airbus.

As planned, the Company added eight new aircraft (two A-321, two A-320 and four A-319) in 2006, and a total of thirteen aircraft were retired, therefore, at the end of the year the operating aircraft employed on domestic routes and medium-haul international flights was made up of 119 aircraft, of which 82 were manufactured by Airbus. Also, a further five B-757 aircraft that were held under operating leases by the Company were given over to wet leases (lease plus crews), thereby completing the retirement process of these aircraft from own-aircraft operation. IBERIA's crews now only operate two families of aircraft (A-320 and MD-87/88) on short-and medium-haul flights.

T4 Terminal

Since 5 February 2006, IBERIA has been operating at the new T4 Terminal at Madrid-Barajas Airport, together with its oneworld alliance partners and its regional flight franchisee Air Nostrum.

Coinciding with the coming into service of the T4 Terminal on the aforementioned date, IBERIA abandoned terminals T1, T2 and T3, after having operated at them for 72 years, and concentrated all its flights at the new installations. This migration of the Company's operations was extremely complex and entailed investment of EUR 43 million, to which a cost of EUR 17 million must be added in relation to the physical transfer of operations.

The T4 Terminal stands out for its amplitude and innovative architectural design, and has received several awards (among others, the "Riba European Awards 2006" granted by the Royal Institute of British Architects, and the "Best Engineering Project Award 2005", granted by the Spanish Institute of Engineering). It features a core building, called New Terminal Building (T4), and a satellite building (T4S), which together extend over 743,000 m^2. Its installations are completed by a parking structure and a Terminal used as a State Pavilion. Most domestic flights operate out of the New Terminal Building (including the Madrid-Barcelona Shuttle) as well as flights to the Schengen area (comprising a total of 15 European countries that have eliminated border controls among each other). The satellite building is used mainly for non-Schengen international flights. The core building and the satellite have an underground interconnection which houses the passenger and baggage transfer systems and an airport services tunnel (TSA).

With its four terminals and four runways operating simultaneously, Madrid-Barajas Airport consolidated itself among the five European airports with the highest traffic levels. In 2006, Madrid-Barajas Airport handled more than 45 million passengers, an increase of 8.7% with respect to 2005 -the highest increase among the five largest European airports. Ongoing increases in its activity are projected, to reach its potential capacity of 120 aircraft operations an hour.

In the first months of operation, processes were adjusted and both passengers and Company personnel adapted to the new operations at the T4 Terminal. Once the problems of the installations' operational adjustments had been overcome, and with the break caused by the strikes by cabin crew members and flight technicians in summer, punctuality indexes improved on an ongoing basis. The Company currently has better punctuality rates than those obtained in the old terminals.

At Terminal 4, IBERIA offers preferential handling to its high-value passengers. Accordingly, three VIP lounges are available extending over a total surface area of 4,500 m^2, where numerous facilities are to be found; there are new areas for limousine services and VIP parking and exclusive check-in areas.

Another of the patent passenger service improvements that the enlargement of Madrid Airport has given rise to is that 93% of flights are directly boarded using boarding bridges.

The T4 Terminal also saw an increase in auto check-in and it has been estimated that 19% of passengers used it. Of this figure, 50% of passengers check in using IBERIA's self-service automated kiosks and thus waiting times are reduced.

Surveys among passengers to assess the operation of the new facilities, gave a highly positive valuation of the T4Terminal, considered in a global context and in comparison with terminals at other airports. Furthermore, the Madrid underground train network is projected to reach the T4 Terminal before the end of the first six months of 2007, which will signify a major qualitative advance in the means of access to the new Terminal.

Changes in the governing bodies

On 18 April 2006, Ángel Mullor tendered his voluntary resignation as Managing Director of IBERIA to the Company's Appointments and Remuneration Committee, with effect on 30 May.

In June, the Board of Directors of IBERIA approved the reorganisation of the senior management and a new organisation chart, to meet the two strategic objectives of the Master Plan: reduce the number of first-level executive positions and give more responsibility to the members of the Executive Committee. In the new organisation chart, the Executive Chairman of the Company has all the powers delegated by the Board of Directors. Also, the Maintenance and Airport (handling) business lines were boosted, raising them to the rank of Division. Therefore, the Company will have three divisions, the two mentioned above and the Airline Division, already in existence.

2. Financial and operational performance

2.1. Activity

The 2006 consolidated directors' report provides a more detailed description of the operational performance of IBERIA, both as regards transport and the other businesses. This Parent's report only contains a brief summary.

2.1.1. Transport

Passenger traffic

In the network as a whole, IBERIA improved the passenger load factor by 2.7 percentage points with respect to 2005, achieving 79.8% in 2006, which is a new load factor record for the Company. Revenue passenger kilometers (RPK) increased by 7.0%, as compared with 3.4% in the volume of supply. Both the growth in traffic and the improvement in IBERIA's load factor stood above the average posted by the main European network airlines. Total AEA member traffic increased by 5.2% with respect to 2005, and the load factor increased 0.6 percentage points.

In spite of fierce competition and the growth of IBERIA's average passenger haul, which increased by 6.5%, passenger revenue per RPK (yield) increased by 2.6% with respect to 2005, thereby contributing to the increase in passenger revenue to 9.8%.

The table below reflects the changes in the main aggregates of IBERIA's passenger traffic activity for the network as a whole:

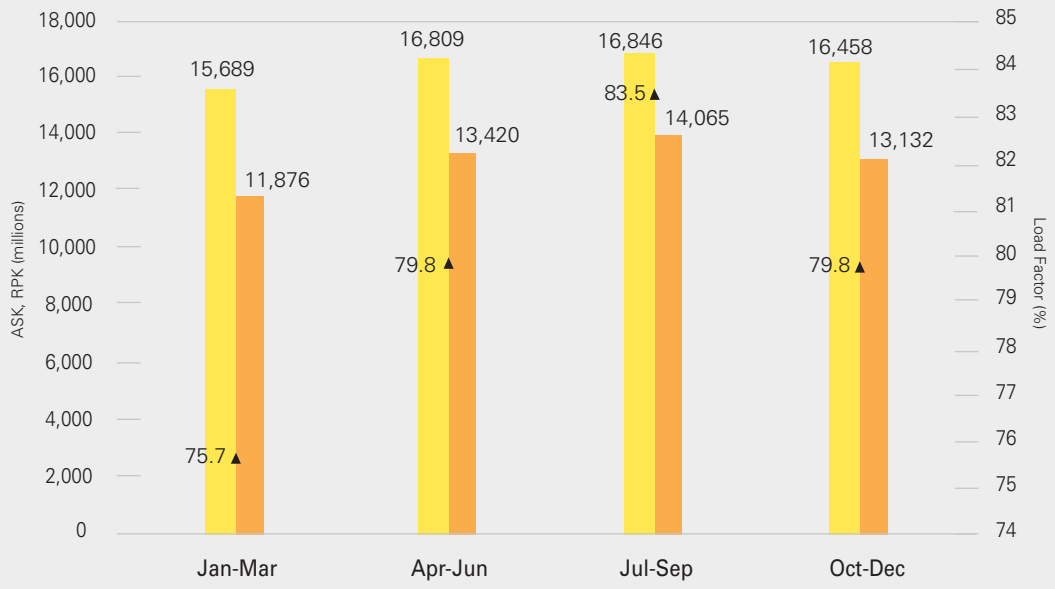
Passenger Traffic	2006	2005	Change 06/05	% Change
AASK (millions)	65,802	63,628	2,174	3.4
RPK (millions)	52,493	49,060	3,433	7.0
Load factor (%)	79.8	77.1	2.7	n/a
Passengers (thousands)	27,799	27,675	123	0.4
Block hours	506,747	509,309	(2,562)	(0.5)
Passenger revenue per RPK (€ cents)	7.55	7.36	0.19	2.6
Passenger revenue per ASK (€ cents)	6.02	5.67	0.35	6.2
Passenger revenue (millions of Euros)	3,963.2	3,610.0	353.2	9.8

n/a: not applicable

If we analyse the changes that occurred during the year, demand increased with respect to 2005 in the four quarters of 2006, with increases above those in the volume of supply, also beating the Company's RPK record. Therefore, improvements in the load factor were significant and ongoing, of

particular note being the 3.6% increase seen in the fourth quarter and the 4.5% increase in the second, although in this case the year-on-year comparison was benefited in part by the difference in the way Easter fell –in April in 2006 and in March in 2005).

Passenger traffic. Quarterly changes in 2006

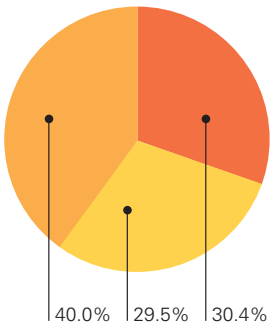


Over the twelve months of 2006 taken as a whole, the Company achieved 65,802 million available seat kilometres (ASK) in the aggregate of all its flights. Pursuant to the strategy of network restructuring established in the 2006/08 Master Plan, IBERIA increased its flight supply selectively, focusing most growth on the long-haul sector (8.6%), increasing medium-haul by 0.7% and decreasing the domestic sector by 5.7%. A portion of the capacity increase relates to the reconfiguration and optimisation of passenger cabin space in long- and short-/medium-haul aircraft, which led to a 3.7% increase in the number of ASK with respect to 2005 for the network as a whole.

IBERIA's passenger aircraft production, measured in block-hour terms, decreased by 0.5% with respect to 2005, due to the aforementioned adjustments to the programme. A salient feature of 2006 was the increase in the hours operated under wet lease, which is an instrument that affords flexibility to adapt production to demand cycles, which represented 4.9% of the total hours produced in 2006.

IBERIA transported 27.8 million passengers in 2006 (0.4% more than in 2005). International medium-haul increased 5.7% (of particular note being the 11.6% increase in Africa and the Middle East) and long-haul by 10.3%, while the domestic sector decreased by 4.8%. Also, the Company continued to consolidate its position of leadership in the Europe-Latin America market, achieving a market share of 19.0%, which represents an increase of 1.4 percentage points with respect to 2005.

Distribution of revenue in 2006



Total: EUR 3,963 millions

Long-haul
Domestic
Medium-haul

RPK stood at 52,493 million in the network as a whole, due to the 10.3% increase in traffic on international flights with respect to 2005. The long-haul sector saw the highest growth in traffic (11.9%), due mainly to the notable increase in demand in South America, which increased by 26.1% with respect to 2005.

Compared with 2005, the load factor remained stable in the domestic sector and showed significant improvement in the international networks: 2.5 percentage points in the long-haul sector and 4.0 points in the medium-haul sector.

The major growth in long-haul business traffic, and to a lesser extent, in Europe, had a beneficial effect on the increase in passenger revenue per RPK (yield).

Passenger revenue per ASK rose 6.2% with respect to 2005 due to the significant improvement in the load factor and to the favourable effect of the increase in yield. Unit revenue increased in the three sectors with respect to 2005, noteworthy being the 16.6% increase obtained in the long-haul sector.

IBERIA's average passenger revenue per ASK amounted to EUR 3,963 million over the network as a whole, due to the widespread improvement in unit revenue per ASK and the increase in the

volume of international traffic. Long-haul revenue increased by 26.7% with respect to 2005, and represented 40% of the 2006 total (as compared with 34.7% in 2005).

Cargo transport

IBERIA's RTK amounted to 1,118.5 million in 2006, an increase of 8.3% with respect to the volume achieved in 2005. 94% of total RTK was transported in the holds of the Company's passenger aircraft, which is a percentage that remained stable compared with 2005. The total of number of available tonne kilometres (ATK) increased by 3.4% with respect to 2005, while the load factor improved 3.1 percentage points. The changes in the activity with respect to 2005 traced an upward trend throughout 2006. Revenue from the transport of goods and post stood at EUR 288.2 million, including income from fuel and security surcharges, which represented an increase of 7.2% with respect to the 2005 figure.

The main cargo aggregates are as follows:

Cargo Transport	2006	2005	Change 06/05	% Change
ATK (millions)	1,643.6	1,589.3	54.3	3.4
RTK (millions)	1,118.5	1,033.1	85.4	8.3
Load factor (%)	68.1	65.0	3.1	n/a
Cargo revenue/RTK (€ cents)[a]	25.76	26.03	(0.26)	(1.0)
Cargo revenue (millions of Euros)[a]	288.2	268.9	19.3	7.2

[a] Including fuel and security surcharges; n/a: not applicable

2.1.2. Handling

In 2006 the production of the Airports Division (Iberia Handling), measured in terms of the weighted number of aircraft handled, decreased by 4.2% with respect to 2005, with decreases of a similar magnitude in services to other airlines, subsequent to the cessation of handling services to Binter Canarias from October 2005, and in the case of handling services provided to IBERIA itself, due to the lower number of flights programmed in Spain and to the cancellations owing to flight crew and handling employee strikes called in July.

Operating revenue (including billings to Iberia Transporte) amounted to EUR 641.2 million in 2006, an increase of EUR 28.1 million (4.6%) with respect to 2005.

On 25 July the award was made public of the new concessions regarding the ramp handling services to third parties throughout the entire state airport network, in accordance with the agreement adopted by the Board of Directors of AENA (the Spanish public airports and aviation agency), thereby completing the public call for tenders that have furthered the deregulation of the industry. IBERIA is the operator that obtained most licences, a total of 21, maintaining its presence in 36 airports (plus the heliport at Ceuta). The Company did not have the ramp-handling licences renewed that it held at Fuerteventura, Lanzarote, Jerez de la Frontera, Almeria and Barcelona. At Jerez de la Frontera, Almeria and Barcelona, IBERIA reached agreements with other concession holders to join their unincorporated joint ventures (UTE) which held the handling licenses. The new licences will have a term of seven years and the new agents began to operate from February 2007.

The following table shows Iberia Handling's main activity aggregates:

Iberia Handling	2006	2005	Change 06/05	% Change
Weighted no. of aircraft handled (thousands)	468.4	489.1	(20.7)	(4.2)
Operating revenue (millions of Euros)	641.2	613.2	28.1	4.6
Operating revenue/weighted aircraft (Euros)	1,369.0	1,253.6	115.4	9.2

2.1.3. Maintenance

In 2006 IBERIA's Maintenance and Engineering Division (Iberia Maintenance) carried out a total of 116 major inspections (C, D, E, and IL), the same number as in 2005. Work performed for other airlines represented 20.3% of the total, an increase of 3.4 percentage points with respect to 2005.

Engine Workshop total production, measured in equivalent engines, amounted to 142.3 units in 2006. There was less need to repair the engines of IBERIA's own aircraft, due to the renewal process. Therefore, work on other airlines' engines increased to 54.5% of the total work performed in 2006, as compared with 53.1% in 2005.

The average number of equivalent employees managed by IBERIA's Maintenance and Engineering Division stood at 3,864 persons in 2006, a fall of half a percentage point with respect to 2005.

Iberia Maintenance continued to strengthen its position as a reliable internationally-acknowledged supplier of integral aeronautical maintenance services. Today, IBERIA is the second largest Spanish aeronautical company in terms of resources and billings (behind CASA/Airbus), and worldwide it is the 12th largest company in terms of volume of billings, excluding global aeronautical manufacturers.

Iberia Maintenance's total external revenue (for technical assistance services to third parties and other sales, leases and sundry services) amounted to EUR 229.9 million in 2006, up 36.3% on 2005.

Iberia Maintenance's extensive customer base comprises Spanish and international air operators, engine and fuselage manufacturers and aircraft lessors, totalling approximately 150 customers. Also, it continues to provide technical assistance services to Spain's Ministry of Defence.

In 2006 Iberia Maintenance entered into and renewed close to 100 agreements, particularly noteworthy being the consolidation of the Rolls Royce RB211-535E4 engine line where IBERIA is the only European airline certified to inspect and repair these engines. Similarly, in 2006 Iberia Maintenance entered into two major exclusive agreements, one with Continental Airlines and the other with British Airways, to service this type of engine. Also in 2006, Iberia Maintenance reached an agreement with the North American manufacturer General Electric, whereby it obtained the licence to repair its CF-34 engines.

Iberia Maintenance successfully passed the audits for the renewal of the ISO 9001:2000 certificate granted by AENOR in 2006. It also received certification as a design organisation, awarded by the European Aviation Safety Agency (EASA).

2.2. Resources

2.2.1. Fleet

At 2006 year-end, the IBERIA had a total of 150 passenger aircraft available. There were 31 long-haul aircraft in service and 119 short- and medium-haul aircraft available. The following table shows the composition of the fleet by aircraft type:

Aircraft Type[a]	Owned	Aircraft under Finance Lease	Aircraft under Operating Lease	*Wet lease*	Total Operated
A340 / 300	5		11	2	18
A340 / 600			13		13
Long-haul	**5**		**24**	**2**	**31**
A319			11		11
A320[b]	10	10	33		53
A321		4	14		18
B757				7	7
MD87	18				18
MD88	12				12
Short-/medium haul	**40**	**14**	**58**	**7**	**119**
TOTAL	**45**	**14**	**82**	**9**	**150**

[a] Excluding inactive aircraft.
[b] Also, at 31 December 2006 IBERIA had three Airbus A-320 leased to another company.

At 31 December 2005 the Company had a total of 154 aircraft available. The following list shows the detail of aircraft additions and retirements in 2006:

Additions

- 2 A-320 under operating lease.
- 2 A-321 under operating lease.
- 4 A-319 under operating lease.
- 3 A-340/600 under operating lease.

Retirements

- 9 A-320 under operating lease, one of which was leased to Mexicana de Aviación.
- 3 B-757: 2 under operating lease and 1 under wet lease.
- 2 B-747/400 under wet lease.
- 1 MD-87 owned.

Also, changes were made to the operating regimes of certain aircraft in 2006, the following operations being of particular note:

- Two A-340/300 that were operated under operating lease converted to wet lease (aircraft plus crew) from mid- 2006 onwards.
- Five B-757 aircraft operated under operating lease converted to wet lease for IBERIA.

Since July 2006, subsequent to retiring the last two B-747s operated under wet lease, all IBERIA's long-haul flights were operated using one single family of aircraft, the Airbus A-340, in its two versions: the 300, with 260 seats, and the 600, with 352. In February, March and April 2006 the last three A-340/600s were added to the fleet, which arrived from the factory with the new cabin layout, including Business Plus, IBERIA's business class for the long-haul flights.

Pursuant to the plan for the renewal and standardisation of the short-and medium-haul fleet, approved in 2005, from the second quarter of 2006 onwards the Company added eight new Airbus aircraft under operating leases (two A-321s, two A-320s and four A-319s).

Since September 2006, the Company has ceased to operate Company-owned B-757s, thereby completing the process of retirement of this class of aircraft that had been initiated mid-2005. Accordingly, at 2006 year-end IBERIA only operated two types of its own aircraft (the A-320 and MD-87/88 families) on medium-haul international and domestic flights, while the B-757 aircraft only operated under wet lease, with a total of seven aircraft under agreements of varying terms (from three months to three years). *Wet lease* affords the Company greater flexibility to adjust its capacity to changes in the market.

In 2006 IBERIA began a second programme of cabin space reconfiguration and optimisation affecting its entire short- and medium-haul Airbus fleet, which will be completed early in 2008. The seats currently used will be replaced by other latest generation ones, whose structural design affords greater comfort to our passengers and, in parallel, enables the number of seats per aircraft in the various models of the fleet to be increased: A-319 (from the current 132 seats to 141), A-320 (from 162 to 171) and A-321 (from 194 to 200). The eight aircraft in this family that IBERIA received in 2006 already featured this layout when they left the factory.

The average usage of total passenger aircraft, measured in block hours per aircraft and day, stood at 9.1 hours in 2006. The use of the Company's owner aircraft improved by 0.7% in the case of long-haul aircraft, and fell by 2.2% in the case of short- and medium-haul aircraft.

BH/Aircraft/Day	2006	2005
Average short- and medium-haul aircraft usage	7.9	8.1
Average long-haul aircraft usage	13.5	13.4
Average usage of own aircraft	**9.1**	**9.1**
Average usage of aircraft under wet lease[(a)]	9.4	10.3
Average usage of total aircraft	**9.1**	**9.1**

[(a)] In 2006 aircraft operating under wet lease for IBERIA included: two B-747/400s, one until June and the other until July; two A-340/300s in the second half of the year; and eight B-757s: one until July, two all year round, two since March, one since May and two since October.

2.2.2. Personnel

IBERIA's average headcount in 2006 decreased by 1.8% with respect to 2005 to 23,713 equivalent employees. Its distribution by management area was as follows:

	Ground		Flight		Total	
	2006	2005	2006	2005	2006	2005
TRANSPORT[*]	4,246	4,568	6,163	6,263	10,409	10,831
HANDLING	8,988	8,972			8,988	8,972
MAINTENANCE	3,864	3,885			3,864	3,885
SYSTEMS	452	472			452	472
TOTAL IBERIA	**17,550**	**17,897**	**6,163**	**6,263**	**23,713**	**24,160**
Change 2006/2005 (%)	(1.9)		(1.6)		(1.8)	

[*] Including corporate

The average headcount of flight employees, which represent 26% of the total, decreased by 4.0% in the case of technical crews and 0.5% in passenger cabin crew members. In 2006 there were no flight technicians in the flight headcount (the last of these employees had left the Company in May 2005, as a result of the progressive retirement of Boeing B-747 aircraft).

The average headcount of ground staff dropped by 1.9%. The number of employees decreased in all management areas, both in Spain and abroad, except for the Airports area that increased slightly to 8,988 equivalent employees, due to the greater number of employees required for the transfer to T4 Terminal at Madrid-Barajas Airport. Noteworthy was the decrease of 322 equivalent employees in the Transport area, which in 2006 amounted to 4,246 employees and represented a reduction of 7% with respect to 2005.

On 16 December 2004 the Directorate-General of Employment authorised the extension of IBERIA's collective redundancy procedure until 31 December 2007 for ground employees, cabin crew members and flight technicians, with whose representatives the Management had reached an agreement. At December 2006 a total of 1,160 of IBERIA's ground employees had availed themselves of one or other of the redundancy methods provided for in the extension, substantially all of whom took early retirement. A further 48 ground employees in Spain left the Company in 2006 for reasons unconnected with the collective redundancy procedure.

Also, in 2006 111 employees left the Company abroad, thereby taking the number of ground employees who departed from the Company in 2006 to 1,319.

Productivity

In terms of ASK produced, the staff productivity increased by 5.4% to 2.8 million ASK per employee in 2006. In the case of ground employees, productivity increased by 5.5%, although this figure rises to 7.8% if the Airports staff, who provide ground handling services to IBERIA and other companies, and whose production for other airlines represented more than half the total in 2006, are excluded. Productivity in terms of block hours per employee increased by 2.2% in the case of the pilots and decreased slightly (0.1%) in the case of passenger cabin crew.

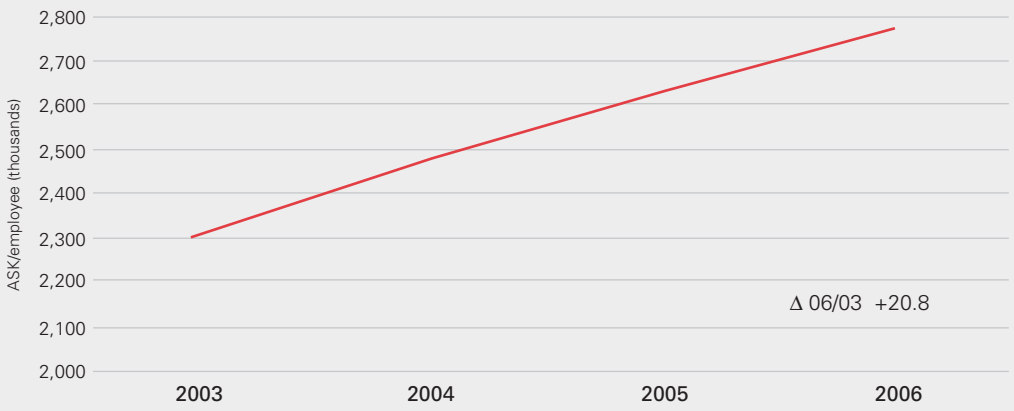
The following table details the performance of productivity by group of employees:

Productivity of IBERIA's employees	2006	2005	Change 06/05
Total workforce (thousands of ASK per employee)	2,775	2,634	5.4
Ground workforce (thousands of ASK per employee)	3,749	3,555	5.5
Ground workforce without Handling (thousands of ASK per employee)	7,685	7,129	7.8
Handling workforce (man hours per weighted aircraft)[a]	32.85	31.41	4.6
Technical crews (B.H. per crew member)[b]	273.3	267.5	2.2
Auxiliary crews (B.H. per crew member)[b]	120.3	120.4	(0.1)

[a] Total labour hours per weighted aircraft. Positive change means lower productivity.
[b] Productivity calculated on the basis of weighted average number of equivalent production employees.

Productivity –measured in terms of ASK per employee– showed a cumulative increase of 20.8% over the last three years.

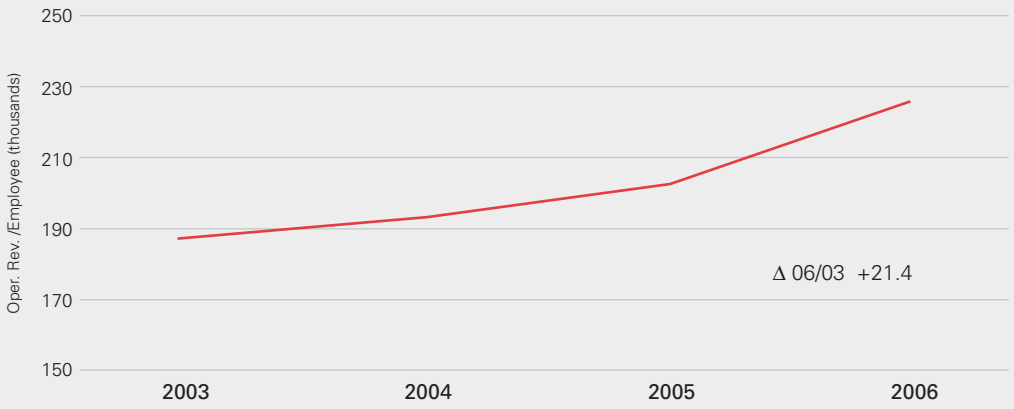
Productivity Performance of IBERIA in terms of ASK per employee



The economic productivity of IBERIA's workforce as a whole –measured in operating revenue per employee– increased by 11.4% in 2006 with respect to 2005.

The graph below shows productivity performance over recent years:

Economical Productivity Performance of IBERIA in terms of operating revenue per employee



2.3. Results

2.3.1. Operating profit

Following are the comparative 2006 and 2005 figures, per IBERIA's management operating statements, which differs from the income statement in the Annual Report due to the fact that the various revenue items are aggregated for management purposes:

Millions of euros

IBERIA	2006	2005	Change 06/05	% Change
OPERATING REVENUE				
Passenger revenue	4,174.9	3,820.7	354.2	9.3
Cargo revenue	301.8	281.7	20.1	7.1
Handling	331.2	322.1	9.1	2.8
Maintenance	219.0	155.7	63.3	40.7
Commercial revenue	80.1	79.7	0.5	0.6
Other operating revenue	252.4	243.9	8.5	3.5
TOTAL OPERATING REVENUE	**5,359.4**	**4,903.9**	**455.6**	**9.3**
OPERATING EXPENSES				
Staff costs	1,388.9	1,434.2	(45.3)	(3.2)
Fuel	1,173.8	863.1	310.7	36.0
Traffic services	454.3	430.2	24.1	5.6
Aircraft lease expenses	424.5	435.2	(10.7)	(2.5)
Aircraft maintenance	337.8	294.9	42.8	14.5
Navigation charges	285.8	276.4	9.3	3.4
Commercial expenses	247.7	265.0	(17.3)	(6.5)
Amortisation and depreciation charge	224.4	184.4	40.0	21.7
Booking systems	147.8	139.7	8.0	5.7
In-flight services	87.4	81.5	5.8	7.2
Indemnity payments for passengers and baggage	51.6	35.5	16.1	45.5
Insurance	29.6	32.7	(3.1)	(9.5)
Other operating expenses	364.8	350.3	14.5	4.1
TOTAL OPERATING EXPENSES	**5,218.3**	**4,823.2**	**395.1**	**8.2**
OPERATING PROFIT	**141.1**	**80.6**	**60.5**	**75.0**
EBITDAR	**790.1**	**700.3**	**89.8**	**12.8**
EBITDA	**365.5**	**265.0**	**100.5**	**37.9**

IBERIA's operating profit amounted to EUR 141.1 million in 2006, an increase of 75.0% with respect to 2005. This profit figure represents 2.6% of operating revenue, up one percentage point on the 2005 margin.

The EBITDA (operating profit before amortisation and depreciation), was EUR 365.5 million in 2006, up EUR 100 million on 2005. If we also exclude the cost of aircraft leases we obtain EBITDAR generated by the Company in 2006 which stood at EUR 790.1 million, exceeding the amount for 2005 by 12.8%. EBITDAR as a percentage of income reached 14.7%, an improvement of 0.5 percentage points on 2005.

Operating revenue

IBERIA's operating income increased by 9.3% with respect to 2005 to EUR 5,359.4 million in 2006. Passenger and cargo revenue, which represent 83.5% of the amount, increased by 9.1% to

EUR 4,476.7 million. The aggregate amount of other operating income totalled EUR 882.8 million, an increase of 10.1% with respect to 2005. All the items showed an upward trend, of particular note being the 40.7% increase in revenue from maintenance services provided to other airlines with respect to 2005.

Revenue from passenger traffic amounted to EUR 4,174.9 million, an increase of EUR 354.2 million with respect to 2005, due mainly to the growth in revenue in the long-haul sector, which surpassed the 2005 figure by EUR 334.8 million.

The difference between the amount of passenger revenue that appears in the operating statement and the amount that figures in the tables of "Main Aggregates" and "Transport" (section 2.1.1.) is explained by the fact that the latter relates directly to the actual production in each year, excluding accounting adjustments and revaluations, and also the revenue arising from the unused ticket recovery process, which are included in the figure in the operating statement.

In the network as a whole, passenger revenue from tickets effectively flown in 2006 amounted to EUR 3,963.2 million, which exceeded the figure for 2005 by EUR 353.2 million, representing an increase of 9.8%. Of this increase of EUR 353.2 million, EUR 155.4 million were due to the growth in traffic (7.0% RPK terms), which was bolstered by the 3.4% increase in the volume of supply and the significant improvement in the load factor (2.7 percentage points). The 2.6% increase in average revenue per RPK compared with 2005, brought about mainly by the solid performance of the long-haul sector, gave rise to an increase of EUR 198.5 million (excluding the exchange rate effect) in passenger revenue. Lastly, the changes in the exchange rates of various currencies against the Euro led to a minor decrease of EUR 0.7 million with respect to 2005. The unit passenger revenue stood at cents 6.02 per ASK, 6.2% higher than in 2005, despite being significantly affected by the 6.5% increase in the average passenger haul.

The aggregate amount of other passenger income (not linked to the activity) stood at EUR 211.7 million in 2006, EUR 1 million above the figure for 2005.

IBERIA's cargo revenue (including the billings for goods and mail transport, fuel and security charges or surcharges and excess baggage revenue) amounted to EUR 301.8 million in 2006, up 7.1% on 2005. IBERIA's revenue tonne kilometres increased by 8.3%, with growth concentrated mainly on the routes between Spain and Latin America, and the average revenue (by RTK) decreased by 1.0% over the network as a whole, adversely affected by the 4.6% increase in the average cargo haul.

Revenue from ground handling services to other airlines' passengers and aircraft increased by 2.8% with respect to 2005 to EUR 331.2 million.

Revenue from maintenance services to other airlines amounted to EUR 219 million, which exceeded the 2005 figure by EUR 63.3 million and represented an increase of 40.7%. The increase in revenue related mainly to technical workshop services, due to the higher volume of activity with other companies and to specialising in work and services that contribute more value. Noteworthy was the increase in revenue from engine inspections, particularly RB-211 engines, inspection of avionic components and D inspections.

Passenger and cargo sales commission, together with various other commissions, increased slightly with respect to 2005 by 0.6% to EUR 80.1 million in 2006. Accordingly, this revenue account steadied after experiencing ongoing reductions (parallel, in part, to the fall in related costs) in recent years.

The aggregate amount of other operating revenue amounted to EUR 252.4 million in 2006, increasing by EUR 8.5 million with respect to 2005, which represented an increase of 3.5%. Noteworthy among the items included were: income from using the Amadeus booking system, which amounted to EUR 44.5 million in 2006, an increase of EUR 5.5 million with respect to 2005, due in part to increased sales through Iberia.com; income from the Iberia Plus programme and from the commercial agreements entered into with other airlines, mostly belonging to the oneworld alliance, the aggregate amount of which increased by EUR1.5 million to stand at EUR 41.3 million; income from in-house work on non-current assets, which amounted to EUR 23.3 million, representing an increase of EUR 6.5 million over 2005; and income from leases (mainly aircraft and engines) which amounted to EUR 22.1 million in 2006, exceeding the figure for 2005 by EUR 6.3 million.

"Other Operating Revenue" includes "Adjustment of Traffic Revenue Not Allocable to Passenger Routes" and "Other Traffic Revenue", which are included under "Passenger Revenue"

in the notes to consolidated financial statements. Also, this heading includes "Adjustment of Traffic Revenue Not Allocable to Passenger Routes" for cargo, which appears as "Cargo Revenue" in the notes to consolidated financial statements.

Operating expenses

IBERIA's operating expenses amounted to EUR 5,218.3 million in 2006, up 8.2% on 2005, caused mainly by the sharp increase in price of aviation kerosene and, to a lesser degree, by the growth in the maintenance services provided to other airlines. These increases in expenses were offset in part by the implementation of cost cutting initiatives designed in the 2006/08 Master Plan.

Unit operating cost stood at cents 7.93 per ASK in 2006, increasing by 4.6% with respect to the figure recognised in 2005. Excluding the fuel expense in the two years unit operating cost would decrease 1.2% with respect to 2005 and would stand at cents 6.15 per ASK.

IBERIA's staff costs dropped by 3.2% with respect to 2005 to EUR 1,388.9 million, due mainly to the initiatives designed to increase productivity that led to a reduction in the workforce. Of this amount, EUR 1,044.7 related to wages, salaries and other similar costs and the other EUR 344.2 million to social security costs, contributions to employee pension funds and other employee welfare expenses. IBERIA's average headcount was 23,713 equivalent employees in 2006, decreasing by 1.8% with respect to 2005. The staff unit cost (per ASK) decreased by 6.4%, due mainly to the 5.4% increase in average productivity of the workforce (in terms of ASK per employee), and the enhanced salary mix arising from the early-retirement process.

The fuel expense amounted to EUR 1,173.8 million in 2006, representing 22.5% of total expenses, exceeding the 2005 amount by EUR 310.7 million. The following table shows the detail of the items that were involved in the increase in expenses:

Millions of euros

	Causes of the Changes in the Fuel Expense				Total Change
	Price(*)	Volume	Exchange Rate(*)	Efficiency	2006/2005
IBERIA	293.7	34.8	20.3	(38.1)	310.7

(*) The changes due to price and exchange rate include the effect of hedges.

The fuel expense increased by 36% compared with 2005, due mainly to the rise in kerosene prices. The growth in production and the average appreciation of the dollar against the Euro during the year as a whole also had an influence, although to a lesser extent, on the increase in the fuel expense. These increases were offset in part by the improvement in aircraft fuel consumption efficiency, which led to a reduction in the fuel expense of EUR 38.1 million in 2006. Over the last three years taken as a whole, lower fuel consumption due to the enhanced aircraft efficiency exceeded EUR 80 millions.

For more than the first six months of 2006, oil and refined product prices, as in the case of aviation kerosene, continued to rise on the markets, reaching an all-time-high in August. From then on the price of oil fell gradually, to levels of around USD 55 per barrel in the final months of the year. In spite of this decrease, the average annual dollar price of crude oil in the European market increased by around 20% with respect to 2005.

IBERIA manages the cost of aviation fuel through active risk control policies, which take the form of fuel price hedges. These hedges cushioned a portion of the impact of the rise in prices on the international markets, permitting a reduction in the fuel expense of EUR 4.2 million for the twelve months of 2006 taken as a whole. The Company also arranged dollar exchange rate hedges, which led to a reduction in the annual fuel expense of EUR 1.3 million.

The greatest increase in expenses as compared with 2005 arose in the first half of the year, when the greatest year-on-year differences in crude oil prices were recorded, which then followed an upward trend until August 2006.

As a result of the foregoing, in 2006 the unit cost of fuel amounted to € cents 1.78 per ASK, increasing by 31.5% with respect to 2005.

The traffic services cost amounted to EUR 454.3 million in 2006, increasing by EUR 24.1 million with respect to 2005, which represented an increase of 5.6%, caused in part by the growth in the air transport area (3.4% in ASK terms) and by the major increase in the cost of using boarding bridges, apron stands and other airport services (29.7%). The salient feature of the year was the increase in the usage of boarding bridges at Madrid-Barajas Airport due to the greater availability thereof subsequent to the enlargement of the airport. The unit cost of traffic services was € cents 0.69 per ASK, 2.1% higher than in 2005.

Aircraft lease expenses decreased by EUR 10.7 million (2.5% with respect to 2005) to EUR 424.5 million. The expense of leasing passenger aircraft amounted to EUR 411.9 million, decreasing by EUR 8.5 million with respect to 2005, while the cost of leasing freight carriers stood at EUR 12.6 million in 2006, down EUR 2.2 million on 2005. The unit cost of aircraft lease would decrease by 5.7% with respect to 2005. A portion of this decrease was due to the exercise of the purchase option in 2005on five A-340/300 aircraft that were being operated under operating leases, which transferred this cost to the amortisation and depreciation account.

The aircraft maintenance expense amounted to EUR 337.8 million in 2006, increasing by 14.5% with respect to 2005, due mainly to the higher volume of work performed for other airlines. Consumption of spare parts (including parts with a limited life) amounted to EUR 158 million, increasing by 3.7% with respect to 2005; expenses for outside aircraft repair and upkeep services amounted to EUR 158.2 million, increasing by 28.6% with respect to 2005; lastly, provisions recorded for major aircraft repairs amounted to EUR 21.6 million, an increase of 10.4%. The unit cost of aircraft maintenance solely for the air transport business decreased by 10.1%, to € cents 0.63 per ASK.

The aggregate cost of air traffic control services increased by EUR 9.3 million with respect to 2005, an increase of 3.4% to EUR 285.8 million in 2006, caused mainly by the growth in the Company's production and the increase of around 2% in the average unit price. The cost of in-flight services increased by EUR 8.3 million to EUR 228.4 million. Airport approach expenses increased by EUR 1 million, an increase of 1.9% with respect to 2005, due to the increase in unit rates in 2006, which was 5% at the Spanish airports. The average increase in Eurocontrol's navigation charges for all the countries over which IBERIA flies was 0.1% with respect to 2005.

In 2006 commercial expenses (commissions, advertising and promotional expenses and development expenditure) amounted to EUR 247.7 million, a decrease of 6.5% with respect to 2005. The unit commercial cost decreased by 9.6% with respect to 2005 taken as a whole and amounted to EURcent 0.38 per ASK, due to the implementation of the new travel agency remuneration model in Spain and its extension to the other markets. The ratio of net commercial expenses, i.e., after deducting commission income, to traffic revenue stood at 3.7% which signified a decrease of 0.8 percentage points with respect to 2005.

Booking system costs amounted to EUR 147.8 million in 2006, increasing by 5.7% with respect to 2005, while the volume of bookings made remained substantially at the same level as in 2005 (an increase of 0.1%). Taking into account the increase in revenue related to bonuses pacted with certain of the booking systems, the net unit cost per booking increased by 2.8% with respect to 2005.

The cost of in-flight services increased by EUR 5.8 million with respect to 2005, an increase of 7.2%, due to the greater increase in the number of passengers on long-haul routes and, in particular, the significant increase in passengers travelling in Business Class.

The amortisation and depreciation charge increased by 21.7% (17.7% in unit terms per ASK) with respect to 2005, caused mainly by the addition to the balance sheet of five A-340/300 aircraft in December 2005 which had until then been operated under operating lease. Excluding this effect, the increase in the amortisation and depreciation charge was 9%, which was a result of the increase in assets arising from investments made (T4, the new Business Plus Class, among other items).

The expense relating to indemnity payments for passengers and baggage suffered an exceptional increase of EUR 16.1 million with respect to 2005, caused by the operating inefficiencies

during the initial period of operation of the T4 Terminal and by the effects of the illegal strike by ground handling employees at the Barcelona airport. The coming into force of EU Regulation 261/2005, of 17 February 2005, which raised indemnity payments and assistance to travellers in the event of denied boarding due to overbooking, and extended compensation to passengers affected by delays, flight cancellations and loss of baggage.

The aggregate amount of "Other Operating Expenses" was EUR 364.8 million in 2006, increasing by EUR 14.5 (4.1%) with respect to 2005.

2.3.2. Other results

IBERIA obtained profit before tax amounting to EUR 185.1 million in 2006, down EUR 329.1 million on 2005, caused by the decrease recognised in extraordinary profit, as shown in the following table:

Millions of euros

IBERIA	2006	2005	Change 06/05	% Change
OPERATING PROFIT	**141.1**	**80.6**	**60.5**	**75.0**
Finance income	88.5	56.9	31.6	55.4
Finance costs	54.4	46.2	8.2	17.8
Exchange differences (gains and losses)	(1.1)	(0.1)	(0.9)	n/m
FINANCIAL RESULTS	**33.0**	**10.6**	**22.4**	**210.8**
Extraordinary revenues	81.4	852.2	(770.8)	(90.5)
Extraordinary expenses	70.4	429.2	(358.9)	(83.6)
EXTRAORDINARY PROFIT	**11.0**	**423.0**	**(412.0)**	**(97.4)**
PROFIT BEFORE TAXES	**185.1**	**514.2**	**(329.1)**	**(64.0)**
TAXES	(99.9)	(1.2)	(98.7)	n/m
PROFIT FOR THE YEAR	**85.2**	**513.0**	**(427.8)**	**(83.4)**
NET PROFIT (BEFORE ADJUSTMENTS FOR TAXES)	**125.6**	**513.0**	**(387.4)**	**(75.5)**

n/m: Not meaningful.

Financial profit amounted to EUR 33 million in 2006, increasing by EUR 22.4 million with respect to 2005. Finance income amounted to EUR 88.5 million, a rise of 55.4% with respect to 2005, due in part to the increase in interest rates and the rise in the average balance of the Company's short- and long-term deposits. Finance income also includes EUR 11 million relating to 2005 and 2006 dividends from IBERIA's 11.68% ownership interest in the share capital of WAM. Finance costs, which increased 17.8% with respect to 2005, were also affected by the increase in interest rates.

Extraordinary income amounted to EUR 81.4 million in 2006, down EUR 770.8 million on 2005, due to the fact that the 2005 figure includes a gain of EUR 820 million, obtained from the sale of holdings in Amadeus GTD and SAVIA. In 2006 extraordinary income included a gain of EUR 14.7 million from the final settlement of the sale of the ownership interest in Musini, SEPI's former insurance company in which IBERIA had an ownership interest. Also, due to the reclassification of engine repairable parts, which from the second quarter of 2006 onwards began to be considered as inventories instead of depreciable items, EUR 53.3 million was recovered from the accumulated depreciation recognised on these items.

Extraordinary expenses amounted to EUR 70.4 million in 2006. Provisions of EUR 25.8 million were recorded to cover the future payments to be made under the collective redundancy procedure, due to the increase in the number of ground employees who left the Company in 2006, mainly as a result of the bringing forward of departures initially foreseen for 2007. Also, a provision of EUR 26.4 million was recorded for inventory obsolescence, subsequent to the reclassification of the aforementioned engine repairable parts and to adjust the value thereof. In 2005 the extraordinary expenses amounted to EUR 429.2 million and included a provision of EUR 280 million was

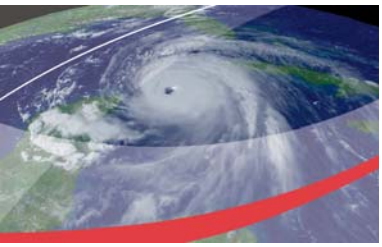
recorded to cover the costs associated with the restructuring plans included in the 2006/2008 Master Plan, and also an extraordinary provision of close to EUR 105 million was recorded to write-down the MD-87/88 aircraft, which will be replaced with new Airbus aircraft.

Law 35/2006, which includes a partial modification of Spanish Corporation Tax, whereby the standard income tax rate was reduced from 35% to 32.5% in 2007 and to 30% from 2008 onwards, was approved on 28 November. Accounting rules establish that deferred tax assets must be recognised at the effective tax rate of the year in which they will foreseeably be recovered. The aforementioned reduction in the income tax rate led to a proportionate reduction in the deferred tax assets that the Company had recognised (at the tax rate of 35%) in its balance sheet at 31 December 2006. Therefore, this valuation adjustment to its assets must be made in the 2006 financial statements.

Although this reduction in the tax rate will have a beneficial effect for IBERIA from 2007 onwards, from an accounting viewpoint it has had an impact of EUR 40.4 million on the income tax charge for 2006, which stands at EUR 85.2 million.

In line with the agreement adopted by the Council of the Spanish National Securities Market Commission (CNMV), the Company resolved to reflect in this report the net profit obtained from its ordinary activity (EUR 125.6 million in 2006) prior to making the exceptional tax adjustment mentioned in the preceding paragraph, thereby endeavouring to provide adequate information to investors who can thus value the normal performance of operations in the year and the changes in the businesses.

2.4. Balance sheet



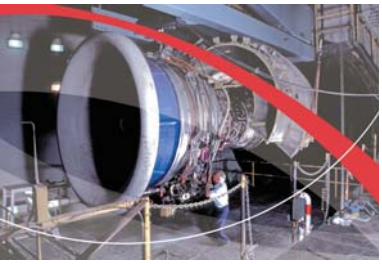
IBERIA'S shareholders' equity amounted to EUR 1,683.1 million at 31 December 2006, increasing by EUR 78 million with respect to the 2005 year-end figure, mainly as a result of the increase in reserves.

Long-term provisions for contingencies and charges amounted to EUR 1,388.4 million at 2006 year-end, a decrease of 1.6% with respect to 2005. The detail of the balance at 31 December 2006 is as follows: EUR 62.2 million of provisions for major aircraft repairs; EUR 618.3 million of provisions for pensions and obligations to employees, including allowances for flight crew members placed on the reserve; and EUR 707.9 million of provisions for third-party liability, which include close to EUR 540 million the provisions recorded for the restructuring of the workforce.

Interest-bearing current and non-current liabilities (issue of convertible debentures and bank borrowings, including interest borne on finance leases) amounted to EUR 796.9 million at 2006 year-end, a decrease of EUR 131.7 million (14.2%) with respect to 2005.

The cash balance (current financial assets plus cash) increased by EUR 472.2 million over 2005 year-end to EUR 2,411.9 million at the close of 2006.

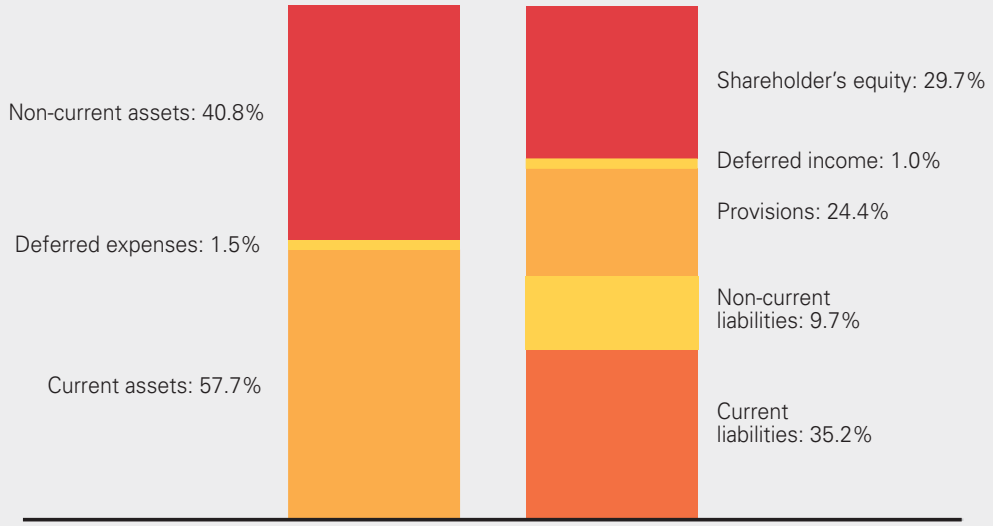
IBERIA's net indebtedness continued to improve and was clearly negative, i.e. the balance of the current asset finance accounts exceeded interest-bearing liabilities, excluding interest on finance leases (amounting to EUR 85.1 million at 31 December 2006). Accordingly, net indebtedness stood at EUR -1,700.1 million at year-end, as compared with EUR -1,119.3 million at 31 December 2005. Adjusted net debt, which includes the conversion to debt of the operating lease instalments (excluding in 2005 the income from five A-340/300 under operating leases which were added to assets in December) and other balance sheet adjustments, amounted to EUR 1,368.7 million, a decrease of 22.3% with respect to 2005.



IBERIA voluntarily reclassified engine repairable spare parts for accounting purposes, since their new accounting treatment as inventories better reflects their economic reality, because their rotation has increased gradually over the years to finally less than twelve months. This item is the principal reason for the decrease in the balance of "Property, Plant and Equipment" at 31 December 2006 (EUR -92.2 million with respect to 2005 year-end) and for the EUR 72.9 million increase in inventories over the same period.

The balance of "Long-Term Investments" amounted to EUR 619.5 million at 31 December 2006, down EUR 96.5 million on 2005. Derecognitions relate mainly to the refunding of advances on aircraft, recognised under "Guarantees and Long-Term Deposits". Also, the balance of Iberbond PLC 1999 Bonds is classified in current financial assets because they mature at less than twelve months.

IBERIA's Balance Sheet at December 31, 2006



TOTAL ASSETS/LIABILITIES: EUR 5,676 millions

2.5. Outlook

The latest IATA forecasts for 2007 state that international air traffic will continue to grow, although at a rate somewhat lower than in 2006; IATA envisages an average increase of around 5% in 2007, driven mainly by the Asian and North American markets. As regards cargo traffic, IATA foresees average growth within the range of 4.5%-5%, in line with the 4.6% growth experienced in 2006.

In reference to the performance of revenue in 2007, IATA forecasts that the air transport sector will enter a period of moderate growth, and expects an increase of 4.5% for 2007, as compared with 8% in 2006. In terms of earnings, it is expected that the industry as a whole will return to profit in 2007, which IATA puts at USD 2,500 million. However, the industry's financial earnings could be adversely affected by the slowdown in the growth of the US economy in 2007 and by higher inflation and interest rates. All these factors could lead to lower growth in traffic revenue, which would make it more difficult to increase profitability unless new cost-cutting programmes and improvements in efficiency are developed, all of this assuming that fuel prices remain stable.

In this projected global scenario for the industry, the Iberia Group will also have to meet its own particular challenges, to which the measures established in the 2006/08 Master Plan are intended to respond.

In the coming years Spain's transport infrastructures will grow significantly: in the 2006/07 winter season Madrid-Barajas Airport increased its number of aircraft operations (from 78 to 90 per hour), and it will continue to progressively increase capacity until it eventually reaches 120 operations per hour; in October 2007 the new airport at Ciudad Real is forecast to come into service; the enlargement of the Barcelona-El Prat Airport will foreseeably be completed by the end of 2008. In addition, the development of the high-speed railway network in Spain must be included, in relation to which the completion of the corridors that connect Madrid with Barcelona, Malaga and Valladolid at the end of 2007 is of particular significance. All these new infrastructures represent an opportunity to develop the Iberia Group's transport business, although they also entail an intensification of the competition from other airlines and other means of transport.

In accordance with the strategy established in the 2006/2008 Master Plan, in 2007 IBERIA will continue to restructure the short- and medium-haul network and selectively increase the flight offering. The Company will focus its growth on long-haul routes and on the connecting flights that feed them. Accordingly, in 2007 the total number of ASKs will show a slight increase on the 2006 figure, although the increase in the long-haul sector offering will be around 3% with respect to 2006, and in the international medium-haul sector approximately 2%.

Under its plan to renew its short- and medium-haul aircraft fleet, IBERIA plans to introduce new Airbus A-320 aircraft over the next two years, continuing the process of replacing the oldest A-320s and permitting the retirement of the MD aircraft. The Company estimates that it will have a total of 132 operating aircraft at 2008 year-end, as compared with the 150 units at 2006 year-end. In any case, IBERIA has various options in the agreement entered into with Airbus, which together with the aircraft contracted under wet lease, provide it with ample flexibility to adjust its capacity to changes in the market. The process of renewal and unification of the short- and medium-haul fleet will lead to a decrease of 7.3% in operating cost per seat, due to lower fuel, maintenance, technical crew and lease expenses.

The price of fuel will continue to be a factor that conditions airline profitability. IBERIA continues to hedge the price of fuel, using a combination of financial tools to do so. Outstanding hedges at 31 December 2006 make it possible to ensure the price of USD 61 per barrel for 50% of the volume of kerosene that will be consumed in 2007.

The 16th Collective Labour Agreement covering IBERIA's ground staff, the Company's largest group of employees (exceeding 19,000 employees at 2006 year-end) expired in December 2006. In January 2007 meetings began with the negotiating committee, with the objective of reaching a new agreement to renew this collective labour agreement for the coming years. The Company's management has informed the ground employees' union representatives of its preliminary proposal in which they propose that a portion of salary be subject to the attainment of objectives.

IBERIA's management and the flight employee representatives were still negotiating their new labour agreement at the date of completion of this report. Management's priority objectives in these negotiations are to achieve a significant productivity increase and to reduce unit costs through the application of various measures, in accordance with the strategic lines established in the Master Plan.

3. Management of non-operating risks

IIBERIA has in place a global non-operating risk management programme aimed at controlling and limiting the possible impact of exchange rate, interest rate and aviation fuel price fluctuations on the Company's earnings.

With this objective and within the framework established for the arrangement of hedges in accordance with International Accounting Standards (IAS), IBERIA uses a VAR (Value at Risk) model with the aim of evaluating on a probabilistic basis the possible impact of market variables on its earnings, and defines the maximum objectives of volatility and the Hedging Programme required to attain them.

Hedging programme

I) Exchange rate risk

Due to the nature of its activities, IBERIA is exposed to exchange rate risk, at both operating (cash flows) and balance sheet level. The detail of the main hedging transactions in dollars is as follows.

Cash flows

The Company took a short dollar-position of around USD 900 million in 2006, since US dollar revenue (20.6% of the total) was lower than expenses in US dollars (34.5% of the total).

In accordance with the Hedging Programme, this position is covered as follows:

- Up to 50% by strategic hedging of up to a five-year term, by means of swaps of aircraft lease income with other currencies, principally the Euro. Similarly, option structures are put into effect with terms and amounts associated with the hedged income.

- The remaining percentage is managed through tactical transactions with a time horizon of between one and three years, which can be adapted to market trends and which are also associated with the Company's actual flows of US dollar payments.

At 31 December 2006 IBERIA had hedged 87% of its US dollar cash-flow positions for 2007 and 59% of the 2008 position.

Balance sheet

The Company has assets denominated in US dollars amounting to USD 663 million, as a result of the loans granted to Iberbus and the advances paid to aircraft and engine suppliers. It also has a liability position in dollars amounting to USD 460 million which, together with arranged swaps, enables the Company to neutralise the effect of the translation differences.

Aircraft additions

In order to limit the volatility of currency markets and the impact thereof on the financing or acquisition of new aircraft, the Company hedges the exchange rate risk relating to aircraft financing/acquisition/additions through forward purchase transactions and option structures that make it possible to assure a certain level or range. At 2006 year-end the Company had taken a short position on the addition of new aircraft projected for 2007 of USD 147 million, hedged 95%.

II) Interest rate risk

Although IBERIA has negative net debt in its balance sheet, if the notional debt relating to operating lease payments (multiplying by eight the aircraft lease payments and making the related adjustments thereto) is included, the adjusted total net debt amounts to EUR 1,368.7 million. Of this amount, at 31 December 2006 83% bore fixed-rate interest and the other 17% bore floating-rate interest. The Company expects to continue to maintain at least 70% of this debt at a fixed or protected interest rate in order to avoid the adverse impact of possible interest rate rises.

In 2006 the Company had between 85% at 2005 year-end and 83% at 2006 year-end of its total adjusted net debt hedged at a fixed interest rate. Sensitivity to a 1% rise in interest rates is EUR 2.1 million.

Liquidity risk

IBERIA has a policy of maintaining a cash position approximately equal to three months' revenue. At 31 December 2006 this position amounted to EUR 2,411.9 million (cash plus current financial assets) and had been invested in highly liquid short-term instruments, debt repos, Eurodeposits, commercial paper and securitisation transactions through leading financial institutions, in accordance with the prevailing risk policy. The portfolio matures at a maximum of one year.

Apart from the current financial assets and the cash position, the Company has credit facilities amounting to EUR 203 million that guarantee its liquidity requirements.

III) Fuel risk

IBERIA controls the cost of aviation fuel, which is directly linked to changes in oil prices, through active risk management policies in order to mitigate the impact of fluctuations in the price of kerosene in the international market and limit deviations from the Company's budget in this respect.

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

In 2006, the price of fuel once again exceeded the all-time-highs experienced in 2005. In August the price of a barrel touched USD 80, to then fall sharply shortly after, leading the reference price of Brent crude to stand at around USD 60 per barrel. Despite this fall, the average price of crude oil increased by close to 20% with respect to 2005.

The hedges of the price of fuel stood at around 85% of the volume consumed over the year. In the year taken as a whole, the average final price for IBERIA, after hedges, was around USD 64 per equivalent barrel.

IBERIA consumes something over two million metric tonnes per year at current production levels. This volume, measured at the average price for 2006, entailed an expense of EUR 1,173.8 million in the Company's financial statements. The price hedges arranged enabled the Company to reduce the fuel expense by EUR 4.2 million in 2006, resulting in a cost per ASK of EURcent 1.78.

4. Responsibility for the environment

In 2006 IBERIA continued to boost the ongoing improvement in the area of corporate responsibility, in line with the conclusions of the White Paper presented in December by the Lower House of the Spanish Parliament.

As regards flight operations, IBERIA continued to develop certain measures aimed at reducing the impacts arising from sound and air emissions. Amongst other factors, the progressive replacement of less efficient aircraft, the optimisation of the assignment of aircraft to the various routes in flight programming, the improvement of the load factor and the growth of the average haul all contributed to enhanced fuel-consumption efficiency. Accordingly, specific consumption (litres of fuel per revenue tonne kilometre) once again decreased in 2006 with respect to 2005.

IBERIA actively participated in the airline association working groups (IATA and AEA) in relation to the forthcoming European directive for the reduction of CO_2 (the principal greenhouse gas according to the Kyoto Protocol) produced by the aviation industry. In these groups the Company promoted a regulatory approach aimed at reducing emissions from air transport and the protection of the environment.

In the area of ground operations, in 2006 the ISO 14001 Environmental Management System was expanded, which currently covers the activities carried out in the Madrid industrial zone (La Muñoza), to also include IBERIA's industrial zone at Madrid-Barajas Airport. The next certification, together with the existing ones, signifies that all of the Company's significant environmental issues are covered by annually audited management systems.

In 2006 IBERIA was admitted to the select Dow Jones Sustainability Index, which values the Company's performance as regards economic, social and environmental matters. Admittance to this index places the Company among the leading 250 companies in the world in this subject and only three airlines can figure in the index worldwide.

More detailed information on our sustainability management, which includes environmental management, is contained in or Corporate Responsibility Report, which complements this Annual Report prepared in accordance with the rules established by GRI (Global Reporting Initiative) -an internationally renowned standard.

5. Acquisition of treasury shares

Treasury shares held by the Parent at 31 December 2006 represented 0.707% of share capital and totalled 6,702,368 shares, with an overall par value of EUR 5,228 thousand and an average acquisition price of EUR 2.0772 Euros per share.

IBERIA had set up the related treasury share reserve in its year-end balance sheet.

Governing Bodies

Board of Directors of Iberia, L.A.E. as of December 31, 2006

CHAIRMAN & CHIEF EXECUTIVE OFFICER
Mr. Fernando Conte García

VICE-PRESIDENT
Mr. Miguel Blesa de la Parra

MEMBERS
Mr. José Manuel Fernández Norniella
Lord Garel-Jones
Mr. Antonio Masa Godoy
Mr. Roger Paul Maynard
Mr. José Pedro Pérez-Llorca Rodrigo
Mr. Jorge Pont Sánchez
Mr. José B. Terceiro Lomba
Mr. Antonio Vázquez Romero
Mr. Gregorio Villalabeitia Galarraga

SECRETARY
Ms. Lourdes Máiz Carro

Committees of the Board as of December 31, 2006

EXECUTIVE COMMITTEE
Mr. Fernando Conte García (Chairman)
Mr. Miguel Blesa de la Parra
Mr. Roger Paul Maynard
Mr. José B. Terceiro Lomba
Mr. Gregorio Villalabeitia Galarraga
Ms. Lourdes Máiz Carro (Secretary)

NOMINATION AND REMUNERATION COMMITTEE
Mr. Jorge Pont Sánchez (Chairman)
Mr. José Manuel Fernández Norniella
Lord Garel-Jones
Mr. Antonio Masa Godoy
Dña. Lourdes Máiz Carro (Secretary)

AUDIT AND COMPLIANCE COMMITTEE
Mr. Gregorio Villalabeitia Galarraga (Chairman)
Mr. Antonio Masa Godoy
Mr. José Pedro Pérez-Llorca
Mr. Antonio Vázquez Romero
Ms. Lourdes Máiz Carro (Secretary)

SAFETY COMMITTEE
Mr. Roger Paul Maynard (Chairman)
Mr. José Pedro Pérez-Llorca
Mr. Jorge Pont Sánchez
Ms. Lourdes Máiz Carro (Secretary)

Management Board of Iberia, L.A.E., S.A.

Chairman & Chief Executive Officer
Mr. Fernando Conte García

General Manager of the Airline
Mr. Enrique Donaire Rodríguez

General Manager Maintenance & Engineering
Mr. Manuel López Aguilar

General Manager of Airports
Mr. Jose Luis Freire Santos

Manager Legal Dept. & Secretary Board
Ms. Lourdes Máiz Carro

Internal Audit & Quality Manager
Mr. Martín Cuesta Vivar

Corporate Communications Manager
Mr. Luis Díaz Güell

CFO & Corporate Strategy Manager
Mr. Enrique Dupuy de Lôme Chávarri

International Relations Manager
Ms. Elvira Herrero Mateo

Control & Administration Manager
Mr. José Mª Fariza Batanero

Human Resources Manager
Mr. Sergio Turrión Barbado

Shared Services Center Manager
Mr. Juan Losa Montañés

Systems Manager
Mr. Antonio Bugallo Siegel

Production Management Manager
Mr. Juan Bujía Lorenzo

Commercial Manager
Mr. Manuel López Colmenarejo

Costumer Relationship Manager
Mr. Félix García Viejobueno

Cargo Manager
Mr. Alfonso Fuertes Suárez

Operations Manager
Mr. Ricardo Génova Galván

Inflight Services Manager
Mr. Víctor Sánchez García

Chief Safety Officer
Mr. Jesús de la Morena Bustillo

Financial Statements & Management Report

Iberia Group

Deloitte.

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www.deloitte.es

Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs as adopted by the European Union (see Notes 3.1 and 29). 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 at December 31, 2006 and the related consolidated income statement, consolidated cash flow statement, consolidated statement of changes in equity and notes to the consolidated financial statements for the year then ended. The preparation of these consolidated financial statements is the responsibility of the Parent'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 in Spain, which require examination, by means of selective tests, of the evidence supporting the consolidated financial statements and evaluation of their presentation, of the accounting policies applied and of the estimates made.

As required by Spanish corporate and commercial law, for comparison purposes the Parent's directors present, in addition to the figures for 2006 for each item in the consolidated balance sheet, consolidated income statement, consolidated cash flow statement and consolidated statement of changes in equity, the figures for 2005. Our opinion refers only to the 2006 consolidated financial statements. On March 29, 2006, we issued our auditors' report on the consolidated financial statements for 2005, in which we expressed an opinion qualified for a lack of uniformity since the Group availed itself of the exemption provided for in IFRS 1, which permits the application of International Accounting Standards 32 and 39 in relation to financial instruments from January 1, 2005 onwards, without requiring that the comparative figures for the previous year be adapted.

In our opinion, the accompanying consolidated financial statements for 2006 present fairly, in all material respects, the consolidated equity and consolidated financial position of Iberia, Líneas Aéreas de España, S.A. and Subsidiaries at December 31, 2006 and the consolidated results of their operations, the changes in the consolidated equity and their consolidated cash flows for the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with International Financial Reporting Standards as adopted by the European Union applied on a basis consistent with that of the preceding year.

The accompanying consolidated directors' report for 2006 contains the explanations which the Parent's 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 directors' report is consistent with that contained in the consolidated financial statements for 2006. Our work as auditors was confined to checking the consolidated directors' report with the aforementioned scope, and did not include a review of any information other than that drawn from the accounting records of Iberia, Líneas Aéreas de España, S.A. and Subsidiaries.

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

Luis de la Mora
March 29, 2007

Consolidated Financial Statements
Iberia Group

IBERIA GROUP

Consolidated balance sheets at 31 December 2006 and 2005

Thousands of euros

ASSETS	Notes	2006	2005
NON-CURRENT ASSETS:			
Intangible assets	6	48,853	47,417
Property, plant and equipment	7	1,350,909	1,463,584
Aircraft		998,336	1,079,430
Other property, plant and equipment		352,573	384,154
Investments in associates	8	16,750	12,126
Non-current financial assets		623,394	731,711
Held-to-maturity investments	9.1.1	25,174	55,984
Loans and receivables	9.1.2	255,166	260,417
Other non-current financial assets	9.1.3	331,017	392,035
Derivative financial instruments	19	12,037	23,275
Deferred tax assets	20	445,355	484,513
Other non-current assets		6,075	7,855
Total non-current assets		2,491,336	2,747,206
NON-CURRENT ASSETS HELD FOR SALE	7.8	–	3,013
CURRENT ASSETS:			
Inventories	10	187,594	114,682
Receivables	11	607,292	643,380
Current financial assets	9.2	1,489,334	1,190,673
Other current assets		11,963	23,525
Cash and cash equivalents	12	963,731	821,439
Total current assets		3,259,914	2,793,699
TOTAL ASSETS		5,751,250	5,543,918

The accompanying Notes 1 to 29 are an integral part of the consolidated balance sheets at 31 December 2006 and 2005.

Thousands of euros

EQUITY AND LIABILITIES	Notes	2006	2005
EQUITY:			
Share capital	13.1	739,492	735,666
Share premium	13.4	115,405	111,285
Differences due to the adjustment of capital to euros	13.5	1,201	1,201
Reserves of the Parent-		835,444	631,417
Legal reserve	13.6	147,133	104,757
Merger reserve		165	165
Revaluation reserve		38	38
Reserves generated due to IFRSs		164,913	126,543
Treasury shares	13.2	(13,922)	(28,372)
Voluntary reserves		595,684	424,707
Valuation adjustments	13.9	(58,567)	3,579
Reserves at fully consolidated companies	13.7	(16,749)	(12,842)
Reserves at companies accounted for using the equity method	13.8	6,260	155,876
Translation differences	13.8	(361)	(176)
Profit attributable to the Parent-	23	56,725	395,789
Consolidated profit for the year		56,969	396,019
Profit attributable to minority interests		(244)	(230)
Interim dividend		–	(281,026)
Equity attributable to shareholders of the Parent		1,737,417	1,737,190
Minority interests	13.11	1,179	1,043
Total equity		1,738,596	1,738,233
NON-CURRENT LIABILITIES:			
Convertible debenture issue	14	–	9,153
Bank borrowings and other financial liabilities	15	205,248	254,008
Non-current obligations under finance leases	16	276,021	442,946
Long-term provisions	17	1,359,057	1,381,179
Other non-current liabilities		51,709	17,138
Deferred tax liabilities	20	1,915	17,357
Total non-current liabilities		1,893,950	2,121,781
CURRENT LIABILITIES:			
Convertible debenture issue	14	10,362	9,153
Bank borrowings	15	69,756	78,365
Current obligations under finance leases	16	158,226	33,331
Customer advances	5.18	435,541	359,723
Trade and other payables	18	1,382,351	1,171,482
Tax payables	20	169,141	108,476
Other payables		1,213,210	1,063,006
Deferred income		62,468	31,850
Total current liabilities		2,118,704	1,683,904
TOTAL EQUITY AND LIABILITIES		5,751,250	5,543,918

The accompanying Notes 1 to 29 are an integral part of the consolidated balance sheets at 31 December 2006 and 2005.

IBERIA GROUP

Consolidated income statements for the years ended 31 December 2006 and 2005

Thousand of euros

	Notes	(Debit) 2006	Credit 2005
Revenue	21.1	5,187,953	4,759,417
Other operating income	21.2	276,593	186,898
Recurring		199,828	169,714
Non-recurring		76,765	17,184
Procurements	22.1	(1,405,109)	(1,063,514)
Recurring		(1,378,694)	(1,063,514)
Non-recurring		(26,415)	–
Staff costs	22.2	(1,421,002)	(1,733,209)
Recurring		(1,395,202)	(1,442,336)
Non-recurring		(25,800)	(290,873)
Depreciation and amortisation charge		(219,371)	(177,730)
Other operating expenses	22.3	(2,288,108)	(2,146,198)
Recurring		(2,272,560)	(2.128.961)
Non-recurring		(15,548)	(17.237)
Net gains on disposal of non-current assets	21.3	(2,350)	656,749
Impairment losses	7.1.1	6,555	(104,548)
RECURRING ORDINARY PROFIT		121,954	116,590
PROFIT FROM OPERATIONS		135,161	377,865
Finance income	22.5	88,050	58,904
Finance costs	22.4	(60,625)	(46,128)
Exchange differences (gains and losses)		(1,112)	(139)
Share of results for the year of associates	8	4,518	2,508
Other income and expenses		(799)	492
PROFIT BEFORE TAX		165,193	393,502
Income tax	20	(49,095)	2,517
Negative adjustments to income tax		(59,129)	
PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		56,969	396,019
PROFIT FOR THE YEAR BEFORE ADJUSTMENTS FOR TAXES		116,098	396,019
Attributable to:			
Shareholders of the Parent	23	56,725	395,789
Minority interests	14.12	244	230
BASIC EARNINGS PER SHARE (in euros)	13.3.1	0.061	0.428
DILUTED EARNINGS PER SHARE (in euros)	13.3.2	0.060	0.422

The accompanying Notes 1 to 29 are an integral part of the consolidated income statements for 2006 and 2005.

IBERIA GROUP

Consolidated cash flow statements for the years ended 31 December 2006 and 2005

Thousands of euros

	2006	2005
1. OPERATING ACTIVITIES		
Consolidated profit before tax	165,193	393,502
Adjustments for:		
Depreciation and amortisation charge and impairment losses	219,329	282,278
Provisions (net) (+/-)	107,437	370,658
Provisions used (-)	(129,657)	(189,986)
Gains/losses on disposal of property, plant and equipment and intangible assets (+/-)	(24,334)	6,530
Gains/losses on disposal of investments (+/-)	-	(663,278)
Result of associates accounted for using the equity method (+/-)	(4,518)	(2,508)
Gains/losses on hedging transactions (+/-)	28,889	(27,442)
Effect of foreign exchange rate changes that do not generate cash flow	(2,920)	5,218
Other cash flow adjustments (+/-)	(42,837)	74,373
Adjusted profit	316,582	249,345
Net change in assets/liabilities that do not generate cash flow	128,760	49,016
Taxes paid	101,105	(164,091)
Total net cash flows from operating activities (I)	546,447	134,270
2. INVESTING ACTIVITIES		
Net investment		
Net investments in Group companies, joint ventures and associates	(15,683)	821,484
Net investments in property, plant and equipment, intangible assets and investment property	(115,979)	35,924
Net investments in non-current financial assets	-	(79,272)
Net investments in financial investments and other current financial assets	(294,148)	(219,052)
Net investments in other assets	39,290	(168,001)
	(386,520)	391,083
Dividends and interest collected (+)	55,460	48,770
Total net cash flows from investing activities (II)	(331,060)	439,853
3. FINANCING ACTIVITIES		
Dividends paid (-)	(18,727)	(322,482)
Change in bank borrowings (+/-)	(35,538)	13,848
Interest paid on debts (-)	(41,661)	(24,638)
Other payables	435	1,315
Capital increase	7,946	9,224
Changes in treasury shares (+/-)	14,450	3,589
	(73,095)	(319,144)
Total net cash flows from financing activities (III)	(73,095)	(319,144)
5. NET INCREASE/DECREASE IN CASH AND CASH EQUIVALENTS (I+II+III)	142,292	254,979
Cash and cash equivalents at beginning of year	(821,439)	(566,460)
Cash and cash equivalents at end of year	(963,731)	(821,439)

The accompanying Notes 1 to 29 are an integral part of the consolidated income statements for 2006 and 2005.

IBERIA GROUP

Consolidated statements of changes in equity for the years ended 31 December 2006 and 2005 (Note 14)

Thousands of euros

				Reserves of the Parent						
	Share Capital	Share Premium	Adj. of Share Capital to euros	Legal Reserve	Reserve for Treasury shares	Treasury shares	Voluntary reserves	Reserves Arising of IFRSs	Other reserve	Valuation adjust-ments
Balance at 31 December 2004	**731,225**	**106,501**	**1,201**	**86,247**	**31,961**	**–**	**272,416**	**141,830**	**203**	**–**
Effect of first–time application of IASs 32 and 39	–	–	–	–	(31,961)	(31,961)	31,961	–	–	(149,118)
Distribution of profit										
To Reserves	–	–	–	18,510	–	–	120,330	(20,999)	–	–
To Dividends	–	–	–	–	–	–	–	–	–	–
Capital increase	4,441	4,784	–	–	–	–	–	–	–	–
Translation differences	–	–	–	–	–	–	–	–	–	–
Changes in treasury shares	–	–	–	–	–	3,589	–	–	–	–
Net effect of hedging transactions	–	–	–	–	–	–	–	–	–	152,697
Net profit for 2005	–	–	–	–	–	–	–	–	–	–
Changes in minority interests (Note 14.12)	–	–	–	–	–	–	–	–	–	–
Other changes	–	–	–	–	–	–	–	5,712	–	–
Balance at 31 December 2005	**735,666**	**111,285**	**1,201**	**104,757**	**–**	**(28,372)**	**424,707**	**126,543**	**203**	**3,579**
Distribution of profit										
To Reserves	–	–	–	42,376	–	–	170,977	36,315	–	–
To Dividends	–	–	–	–	–	–	–	–	–	–
Capital increase	3,826	4,120	–	–	–	–	–	–	–	–
Translation differences	–	–	–	–	–	–	–	–	–	–
Changes in treasury shares	–	–	–	–	–	14,450	–	(1,228)	–	–
Net profit for 2006	–	–	–	–	–	–	–	–	–	–
Changes in minority interests (Note 14.12)	–	–	–	–	–	–	–	–	–	–
Other changes	–	–	–	–	–	–	–	3,283	–	(62,146)
Saldos al 31 de diciembre de 2006	**739,492**	**115,405**	**1,201**	**147,133**		**(13,922)**	**595,684**	**164,913**	**203**	**(58,567)**

The accompanying Notes 1 to 29 are an integral part of the consolidated statements of changes in equity for the years ended 31 December 2006 and 2005.

Thousand of euros

Reserves at Consolidated Companies							
Fully consolidated	Equity method	Translation differences	Interim dividend	Profit	Total	Minority interests	Total equity
(12,961)	(119,455)	(344)	0	201,111	1,678,845	5,324	1,684,169
–	–	–	–	–	(181,079)	–	(181,079)
593	36,421	–	–	(154,855)	–	–	–
–	–	–	–	(46,256)	(46,256)	–	(46,256)
–	–	–	–	–	9,225	–	9,225
–	–	(168)	–	–	168	–	168
–	–	–	–	–	3,589	–	3,589
–	–	–	–	–	152,697	–	152,697
–	–	–	(281,026)	395,789	114,763	230	114,993
–	–	–	–	–	–	(4,511)	(4,511)
(474)	–	–	–	–	5,238	–	5,238
(12,842)	155,876	(176)	(281,026)	395,789	1,737,190	1,043	1,738,233
(3,907)	(149,616)	–		(96,145)	–	–	–
–	–	–	281,026	(299,644)	(18,618)	–	(18,618)
–	–	–	–	–	7,946	–	7,946
–	–	(185)	–	–	(185)	–	(185)
–	–	–	–	–	13,222	–	13,222
–	–	–	–	56,725	56,725	244	56,969
–	–	–	–	–	–	(108)	(108)
–	–	–	–	–	(58,863)		(58,863)
(16,749)	6,260	(361)		56,725	1,737,417	1,179	1,738,596

Notes to the Consolidated Financial Statements for 2006 and 2005, prepared in accordance with International Financial Reporting Standards (IFRSs)

Iberia Group

1. Activity of the Parent and 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 and aircraft maintenance.

As a carrier of passengers and cargo, Iberia, Líneas Aéreas de España, S.A. operates through a large network serving three main 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 Parent and in order to supplement these activities or to conduct transport-related businesses, various companies have been incorporated that form part of the Iberia Group of which Iberia, Líneas Aéreas de España, S.A. is the Parent.

The registered office of Iberia, Líneas Aéreas de España, S.A. is located in Madrid and since April 2001, its shares have been listed on the stock market.

2. Group companies

2.1 Subsidiaries

Subsidiaries are defined as companies included in the scope of consolidation in which the Parent owns directly or indirectly half or more of the share capital and, accordingly, has the capacity to exercise control thereof.

The basic information on the fully consolidated companies making up the Iberia Group and on their equity positions at 31 December 2006 and 2005 is as follows:

Thousands of euros

Business Name Registered Office Company Object	% of Direct and Indirect Ownership		Equity					
			2006			2005		
	2006	2005	Capital	Reserves	Profit (Loss)	Capital	Reservas	Profit (Loss)
Compañía Auxiliar al Cargo Exprés, S.A. Centro de Carga Aérea Parcela 2 p.5 nave 6, Madrid. Transport of cargo	75.00	75.00	192	3,401	928	192	2,967	866
Cargosur, S.A. Velázquez, 130, Madrid Air transport of cargo	100.00	100.00	6,058	(938)	73	6,058	(973)	35
VIVA Vuelos Internacionales de Vacaciones, S.A. Camino de la Escollera, 5, Palma de Mallorca Aircraft maintenance	100.00	100.00	644	2,354	612	644	1,870	484
Campos Velázquez, S.A. Velázquez, 34, Madrid Acquisition and ownership of urban properties	100.00	100.00	902	241	25	902	228	13
Auxiliar Logística Aeroportuaria, S.A. Centro de Carga Aérea Parcela 2 p 5 nave 6, Madrid. Transport of cargo	75.00	75.00	180	109	84	180	71	75
Iberia Tecnología, S.A. Velázquez, 130, Madrid Air maintenance services	100.00	100.00	1,442(*)	79	(803)	1,442(*)	15	74
Consultores Hansa, S.A. Velázquez, 130, Madrid Market consulting services	100.00	100.00	60	–	1	60	–	1
Binter Finance B.V. Strawinskian 3105 100 BL Ámsterdam Financing and cash	100.00	100.00	454	108	15	454	95	13

(*) At year-end, EUR 1,081 thousand of this amount had not been paid.

Iberia, Líneas Aéreas de España, S.A. sold its holding in Sistemas Automatizados de Viaje, S.A. for EUR 86,887 thousand in 2005. The gain arising from this transaction (EUR 75,555 thousand) was recognised under "Net Gains on Disposal of Non-Current Assets" in the accompanying consolidated income statement for 2005 (see Note 21.3).

2.2 Associates

Associates are companies over which the Parent is in a position to exercise significant influence, i.e. it has the power to participate in decisions regarding the investee's financial and operational decisions, but not control. In general, the Group considers that it has significant influence when its ownership interest in the subsidiary is 20% or more.

Exceptionally, the Iberbús companies (see Note 9.1.1), in which the Group owns 20% or more of the voting rights, are not considered to be associates and, accordingly, are not consolidated, since the commitments undertaken by the majority shareholder, Airbus, guarantee that Iberia, Líneas Aéreas de España, S.A., a minority shareholder of and lender to the two companies, will recover its investment in full.

The basic information on the associates and on their equity position, assets and ordinary income at 31 December 2006 and 2005 is as follows:

Thousands of euros

Business Name Registered Office Company Object	Percentage of Direct and Indirect Ownership		2006		
			Equity		
	2006	2005	Share Capital	Reserves[b]	Profit (Loss)
Multiservicios Aeroportuarios, S.A. Bravo Murillo, 52, Madrid Provision of auxiliary airport services	49.00	49.00	130	4,765	1,896
Iber-América Aerospace, LLC Miami, Florida Purchase and sale of aircraft components and engines	49.00	49.00	1,178	(311)	169
Empresa Logística de Carga Aérea, S.A. (ELCA) Aeropuerto Jose Martí. Ciudad de La Habana Operation of a cargo terminal at Havana airport	50.00	50.00	444	286	797
Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A. Aeropuerto Jose Martí. Ciudad de La Habana Aircraft maintenance	50.00	50.00	111	151	1,253
Handling Guinea Ecuatorial, S.A. (HANGESA)[a] Malabo. Handling services at Malabo airport	51.00	51.00	301	1.161	(57)
Sociedad Conjunta para la Emisión y gestión de Medios de Pago EFC, S.A. (IBERIA CARDS) Ortega y Gasset, 22, Madrid Issuance and management of means of payment	43.50	43.50	6,000	6,032	2,955
Grupo Air Miles Avda. de Bruselas, 20, Alcobendas, Madrid Multi-industry customer-loyalty	25.00[c]	22.50	72	582	1,362
Serpista, S.A. Velázquez, 130, Madrid Maintenance of airport equipment	39.00	39.00	1,170	2,344	822
International Supply Management, S.L. Pozuelo de Alarcón. Madrid Sale of chemical products	49.00	–	1,050	(3)	1,411

[a] Due to the limits on the exercise of effective control of this subsidiary, it is classified as an associate.
[b] Including the translation differences on the translation of equity to euros.
[c] The increase in this percentage relates to the increase in treasury shares.

Thousand of euros

		2005				
		Equity				
Assets	Ordinary Profit	Capital	Reserves[b]	Profit (Loss)	Assets	Ordinary Profit
25,840	60,313	130	4,145	1,239	13,860	49,017
4,274	2,384	1,178	(189)	174	5,890	2,161
2,034	1,382	444	127	295	1,722	754
1,973	2,595	111	196	908	1,284	2,010
1,960	1,832	301	538	1,245	2,555	2,957
22,625	47,295	6,000	5,135	897	27,037	46,563
93,753	67,785	72	77	505	89,493	62,052
9,620	11,665	1,170	2,074	270	8,669	10,190
10,731	6,684	–	–	–	–	–

Changes in the scope of consolidation

In 2006, Iberia, Líneas Aéreas de España, S.A., together with other shareholders, incorporated Clickair, S.A. The Parent's ownership interest in this subsidiary is 20%, which is the percentage that determines its voting rights regarding the subsidiary. The capital investment amounted to EUR 379 thousand, which were subscribed with a share premium of EUR 379 thousand. Iberia, Líneas Aéreas de España, S.A. also subscribed and paid 9,480 preferred shares of EUR 10 par value each, issued with a share premium of EUR 1,510 per share (see Note 8).

As envisaged in the agreement between the shareholders of this investee, the ownership interest of Iberia, Líneas Aéreas de España, S.A. in the net equity of Clickair, S.A. will be from 80% from the date the company commences operations up to a limit of the investment actually made by the Parent. Considering the foregoing, the market value of Clickair, S.A. will not foreseeably have a material impact on equity.

In 2006, Iberia, Líneas Aéreas de España, S.A. acquired a holding of 49% in International Supply Management, S.L. for EUR 514 thousand.

Also, in 2005 the Group sold its holding in Amadeus Group and received as a consideration an 11.68% holding the acquirer company (Wam Acquisition, S.A.) and EUR 734,605 thousand in cash. The gain of approximately EUR 587,721 thousand arising from the transaction is included in "Net Gains on Disposal of Non-Current Assets" in the accompanying consolidated income statement for 2005 (Note 21.3). As a result of this transaction, Opodo, Ltd was excluded from the scope of consolidation, since the Group's holding therein fell to 4.08%.

3. Basis of presentation of the financial statements and basis of consolidation

3.1. Basis of presentation of the financial statements and basis of consolidation

The consolidated financial statements for 2006 were obtained from the accounting records and financial statements of the Parent and the Group companies.

The consolidated financial statements for 2005 were formally prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, in conformity with Regulation (EC) no. 1606/2002 of the European Parliament and with Law 62/2003, of 30 December, on Tax, Administrative, Labour and Social Security Measures, so that they present fairly the Group's consolidated equity and financial position at 31 December 2006, and the results of its operations, the changes in consolidated equity and the consolidated cash flows in the year then ended, pursuant to current accounting legislation.

The 2006 consolidated financial statements of the Group and the 2006 financial statements of the Group companies, which were prepared by the respective directors, have not yet been approved by their shareholders at their respective Annual General Meetings. However, the Parent's Board of Directors considers that the aforementioned financial statements will be approved without any material changes.

3.2. Main decisions relating to IFRSs

The Group took the following decisions in relation to the presentation of the financial statements and other disclosures included herein:

1. The Group's functional currency is the euro; accordingly, the financial statements are expressed in euros.
2. The balance sheet is presented distinguishing between current and non-current items; and the income statement is presented by nature.
3. The Group has elected to submit the cash flow statement using the indirect method.

3.3. Responsibility for the information and use of estimates

The information in these consolidated financial statements is the responsibility of the directors of the Parent.

In the Group's consolidated financial statements for 2006 estimates were made by the Group's directors in order to quantify certain of the assets, liabilities, income, expenses and commitments reported herein. These estimates relate basically to the following:

1. The assessment of possible impairment losses on certain assets
2. The assumptions used in the actuarial calculation of the obligations to employees
3. The useful life of the property, plant and equipment and intangible assets
4. The methods used to measure certain assets
5. The amount of tickets and unused traffic documents sold that will not finally be used
6. The calculation of the accrued liability at year-end in relation to the value of the unused points granted to the holders of "Iberia Plus" loyalty cards.
7. The calculation of provisions.

These estimates were made on the basis of the best information available at 31 December 2006 on the events analysed.

3.4. Basis of consolidation

The financial statements of the subsidiaries are fully consolidated. Accordingly, all material balances and effects of the transactions between consolidated companies are eliminated on consolidation.

The share of third parties of the Group's equity and results are presented under "Minority Interests" in the consolidated balance sheet and the consolidated income statement, respectively.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date of acquisition or to the date of disposal, as appropriate.

In the consolidated financial statements, investments in associates are accounted for using the equity method, i.e. at the Group's share of net assets of the investee, after taking into account the dividends received therefrom and other equity eliminations. The Group's share of the profits obtained by the investee in the year are presented under "Share of Results of Associates" in the accompanying consolidated income statement. However, the percentage of ownership used to calculate the value of the investment in Clickair, S.A. was 80%, with a limit of the investment made by the Parent pursuant to the shareholders agreement entered into by the shareholders of the investee.

In the case of transactions with an associate, the related profits and losses are eliminated to the extent of the Group's interest in the associate.

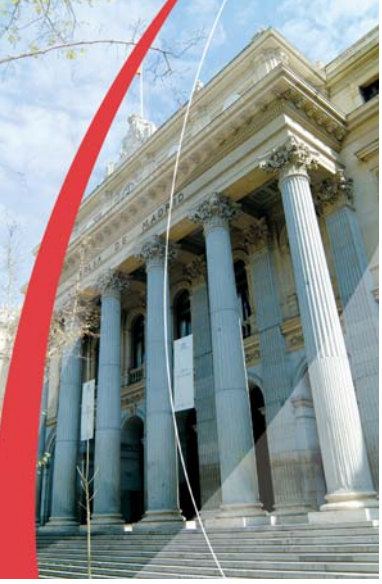
If as a result of losses incurred by an associate its equity were negative, the investment should be presented in the Group's consolidated balance sheet with a zero value, unless the Group is obliged to give it financial support.

The accounting principles and policies used by the companies included in the scope of consolidation were unified in consolidation with those of the Group.

The balances in the balance sheets and income statements of the foreign companies included in consolidation are translated as follows:

1. Assets and liabilities were translated by applying the official closing exchange rate.
2. Equity and reserves were translated at the historical exchange rates.
3. Income and expense items are translated at the average exchange rates for the year.

The exchange differences arising from the use of these criteria were included in equity under "Translation Differences".



4. Distribution of the Parent's profit

The directors of Iberia, Líneas Aéreas de España, S.A. propose that the Company's profit for 2006 be distributed as follows: a dividend of EUR 0.035 per share, EUR 765 thousand to the legal reserve and the remainder to voluntary reserves.

5. Accounting policies and measurement bases applied

The principal accounting policies and measurement bases used in preparing the Group's consolidated financial statements for 2006 were as follows:

5.1. Intangible assets

Intangible assets are defined as specifically identifiable non-monetary assets which have been acquired from third parties or developed internally by the Group. Assets from which the consolidated companies consider it probable that future economic benefits will be generated are recognised at cost.

Intangible assets include mainly computer software and are amortised on a straight-line basis.

5.2. Property, plant and equipment

Property, plant and equipment are measured at historical cost.

Group companies depreciate their property, plant and equipment using the straight-line method over the years of estimated useful life of the related assets.

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

	Years of Estimated Useful Life
Aircraft:	
Fuselage and engines[a]	18 - 22
Components	4 - 7
Buildings and other structures	20 - 50
Machinery, fixtures and tools	10 - 15
Transport equipment	7 - 10
Furniture and fixtures	10
Computer hardware	4 - 7
Repairable spare parts - fuselage	8 -10
Rotatable parts	18
Flight simulators	12 - 14

[a] Except for the aircraft acquired from Aviación y Comercio, S.A. which, because they are second-hand, are being depreciated over 12 years (MD-88) and 10 years (MD-87).

In the case of owned aircraft, except for the MD aircraft, the Group separates from the cost of the aircraft the cost relating to the components that will be replaced in the major repairs that take place every four to seven years.

Assets subject to an administrative concession whose years of useful life exceed the term for which the Group 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 resi-

dual value of repairable fuselage parts is 10% of acquisition cost. The Group depreciates in full the acquisition cost of other items of property, plant and equipment.

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

In general, engine, fuselage and other aircraft component repair and maintenance costs are charged to the income statement for the year in which they are incurred. However, based on the terms of the aircraft operating lease agreements, the Group recognises an allowance based on the individual estimated cost for each leased aircraft of the total cost to be incurred in major repairs and allocates this cost on a straight-line basis during the period between two consecutive major repairs (see Note 17).

5.3. Impairment losses on property, plant and equipment and intangible assets

Each year the Group reviews whether there are any indications that property, plant and equipment and intangible assets assigned to each cash-generating unit may be impaired to determine whether there is any indication that those assets have suffered an impairment loss.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the Group recognises an impairment loss in the income statement. If an impairment loss subsequently reverses, the carrying amount of the asset is increased up to the limit of the original amount at which the asset was recognised prior to the recognition of the impairment losses.

5.4. Leases

Leases are classified as finance leases whenever the terms of the lease include an option for the lessee to acquire the asset (purchase option) and Group management has decided to exercise the option. All other leases, whether or not they include a purchase option, are classified as operating leases unless, based on the agreed terms and irrespective of management's decision, the transaction can be equated to an acquisition.

5.4.1. Finance leases

The Group recognises finance leases in the balance sheet at the commencement of the lease term by recognising an asset and a liability for the amount of the present value calculated by using the interest rate for the agreed minimum lease payments stipulated in the contract.

The value of assets acquired under finance lease agreements is presented in the consolidated balance sheet according to the nature of the leased asset (see Note 7.2).

Assets acquired under finance leases are depreciated using the same criteria as those applied to similar owned items.

Finance charges are recognised over the lease term on a time proportion basis.

5.4.2. Operating leases

The costs arising from operating leases are charged to the income statement in accordance with the terms of the related agreements since the Group considers that this allocation basis best reflects the time pattern of the benefits generated.

5.5. Inventories

Inventories are recognised at the lower of acquisition cost and net realisable value (market value).

The acquisition cost is calculated by using the weighted average cost formula.

The net realisable value is assessed at the end of each period taking into account factors such as obsolescence and rate of consumption, the relevant provisions are recognised when the net realisable value is less than acquisition cost and the provisions recognised in prior years are reversed.

In 2006 the Group reclassified the repairable spare parts for engines from "Property, Plant and Equipment – Spare Parts for Property, Plant and Equipment" to "Inventories" since the rotation of the spare parts used to repair engines is now less than one year.

5.6. Non-current assets classified as held for sale

The Group classifies as "Non-Current Assets Held for Sale" in the consolidated balance sheet the assets that it has decided to sell when they are in a condition in which they can be realised immediately, provided that it is highly probable that the planned sale transaction will take place within one year.

Non-current assets classified as held for sale are measured at the lower of carrying amount and net realisable value.

5.7. Financial assets

The financial assets held by the Group companies are classified as follows:

1. Held-to-maturity investments: assets with fixed or determinable payments and a fixed maturity that the Group has the intention and ability to hold to the date of maturity.
2. Loans and receivables: financial assets originated in exchange for supplying cash, goods or services to a third party (debtor).
3. Other non-current financial assets: securities acquired that are not held for immediate trading purposes.

Held-to-maturity investments, loans granted and receivables are measured at the amount receivable at the balance sheet date, which includes the amount delivered at the transaction date plus any unpaid accrued interest or any other accrued premium. Accrued interest or repayment premiums are calculated at the internal rate of return using the interest method.

The aforementioned balances are recognised in the accompanying consolidated balance sheets as a reduction of the estimated allowance for uncollectible amounts.

In general, "other financial assets" are measured at fair value and the changes therein are recognised directly in equity until the asset is disposed of or has become fully impaired, at which time the cumulative gains or losses previously recognised in equity are transferred to net profit or loss for the year. The fair value of a financial instrument on a given date is taken to be its quoted price or the amount for which it could be bought or sold by two knowledgeable, willing parties in an arm's length transaction acting prudently. When this fair value cannot be determined reliably, the assets are measured at cost less impairment losses.

5.8. Cash and cash equivalents

The Group includes under "Cash and Cash Equivalents" cash and short-term highly liquid investments maturing in less than three months that are readily convertible to cash and which are subject to an insignificant risk of changes in value.

5.9. Financial liabilities

Loans obtained from financial institutions are measured at the amount effectively received, net of arrangement costs and commissions.

These loan arrangement costs and finance charges arising on the loans are charged to income on a time proportion basis over the term of the loan.

The amount of the loan arrangement costs already recognised in income and finance charges relating to unpaid accrued interest are presented in the accompanying consolidated balance sheets as an addition to the balance of "Bank Borrowings".

5.10. Treasury shares of the Parent

The shares of the Parent held by consolidated companies at the reporting date are measured at acquisition cost and are presented in the consolidated balance sheet as a reduction of equity.

The net gain or losses from transactions with treasury shares are recognised in equity.

5.11. Share-based payments

In 2002 the Parent implemented a share option plan for executive directors, certain managers and other line personnel. The plan involves shares of the Parent and will expire in 2008. This obligation is being settled through the delivery of shares on the established option exercise dates.

The Group recognises an expense in this respect under "Staff Costs" in the accompanying consolidated income statement with a credit to equity. This expense is calculated by allocating on a straight-line basis, the fair value of the options at the grant date over the vesting period.

The fair value of the options was determined on the basis of the Black-Scholes valuation model, using the following parameters at the grant date of the plan (11 April 2003): share price: EUR 1.57; option exercise price: EUR 1.62; expected volatility: 45%; risk-free interest rate: 2.4%; expected dividend yield: 2%.

The expected volatility was determined on the basis of the historical volatility over the last year (from the commencement of listing on the Stock Exchange). The valuation assumes that all the beneficiaries will ultimately exercise their purchase options.

5.12. Derivative financial instruments and hedge accounting

The derivatives held by the Group relate mainly to OTC exchange rate, interest rate, or fuel price hedges, the purpose of which is to significantly reduce these risks in the underlying hedged transactions.

Derivatives are initially recognised at acquisition cost in the consolidated balance sheet and the required value adjustments are subsequently made to reflect their fair value at all times; increases in value are recognised under "Derivative Financial Instruments" and reductions in value under "Other Non-Current Liabilities" in the consolidated balance sheet. Gains and losses from these changes are recognised in the consolidated income statement and are thus offset, unless the derivative has been designated as a hedging instrument and the resulting hedge is highly effective, in which case the recognition criteria are as follows:

1. Fair value hedges: the hedged item and the hedge are both measured at fair value, and any changes in the fair values are recognised in the consolidated income statement; the effects of these changes are offset under the same heading in the consolidated income statement.
2. Cash flow hedges: changes in the fair value of derivatives are recognised, with the respect to the effective portion of the hedge, under "Equity – Valuation Adjustments" (see Note 13.9). The cumulative gain or loss recognised in this heading is transferred to the consolidated income statement to the extent of the impact of the underlying (resulting from the risk hedged) on the consolidated income statement; thus this effect is netted off under the same heading in the consolidated income statement.

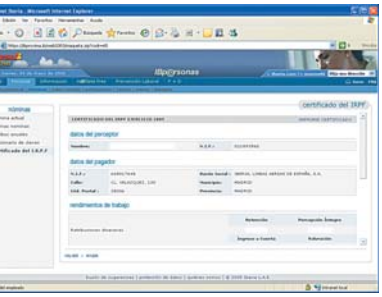
The fair value of the various derivative financial instruments is measured by discounting the expected cash flows based on spot and futures market conditions at year-end.

5.13. Current / Non-current classification

In the consolidated balance sheet, assets and liabilities that are expected to be settled or fall due within 12 months from the balance sheet date are classified as current items and those which fall due or will be settled within more than 12 months are classified as non-current items.

5.14. Provisions for restructuring costs

In 1999 the Parent launched a voluntary redundancy scheme and in December 2001 obtained authorisation from the employment authorities for a voluntary collective redundancy procedure. Subsequently, the required authorisations were obtained (the last of which was granted in December 2004) to extend the procedure to various employee groups. The procedure will remain in force until 31 December 2007.



These procedures basically provide for the payment of certain amounts until the statutory retirement age to employees who meet certain conditions and decide to request early retirement.

The Parent recognises the total estimated costs of the voluntary redundancy scheme and the successive extensions of the voluntary collective redundancy procedure in the income statement when these measures, duly authorised, have been made public and the employees have been informed.

The actuarial studies used to determine the liability to the employees who have opted for early retirement under these conditions are based on similar assumptions to those described in Note 5.15. The successive payments resulting from these commitments are deducted from the provisions recorded.

5.15. Obligations to employees

Under the collective labour agreements in force at the Parent, on reaching the age of 60 flight crew cease to discharge their duties and are placed on the reserve, although their employment relationship remains in place until their statutory retirement age. The Parent recognises the costs of staff placed on special reserve throughout the active working life of each employee based on the related actuarial studies.

The collective labour agreements in force at the Parent also provide that flight crew who meet certain conditions may take early retirement. The Company is required to pay certain amounts of remuneration to these employees until they reach the statutory retirement age. The Parent recognises, 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 meet the future payment obligations to the employees concerned. 153 employees are currently on special leave and 384 on special reserve.

"Other Long-Term Provisions" includes inter alia, the liabilities incurred in this connection (see Note 17).

The aforementioned amounts were calculated on the basis of actuarial studies conducted by independent actuaries using the projected unit credit method and based on a discount rate of 3.5% and PERM/F-2000 P life expectancy tables. The main assumption used was 2% growth in pensions and the CPI.

5.16. 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 other welfare benefits in certain circumstances (death or permanent disability).

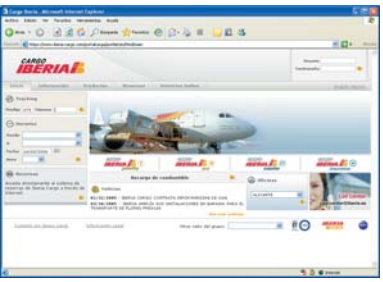
Under the current collective labour agreements, the Parent and its employees make the statutory contributions (defined contributions) to the Montepío, as established in these labour agreements. The Montepío's bylaws limit the company's liability to the payment of the statutory contributions.

In 2006 the Group's contributions amounted to EUR 23,066 thousand (2005: EUR 22,837 thousand) and were recognised under "Staff Costs – Recurring" in the accompanying consolidated income statements.

5.17. Other long-term provisions

In the preparation of the consolidated financial statements, the directors drew a distinction between:

1. Provisions: credit balances covering present obligations at the balance sheet date arising from past events which could give rise to a loss for the companies, which is certain as to its nature but uncertain as to its amount and/or timing; and
2. Contingent liabilities: possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly within the control of the consolidated companies.



The Group's consolidated financial statements include, under "Long-Term Provisions – Provisions for Third-Party Liability" the estimated amount required for certain liabilities arising from legal proceedings and litigation in progress, indemnity payments, collateral and other guarantees provided with respect to which it is considered that it is highly probable that the obligation will have to be settled. Contingent liabilities are not recognised in the consolidated financial statements until the related obligations arise.

Provisions are quantified on the basis of the best information available on the situation of and the possible changes in the events giving rise to them and are fully or partially reversed when such obligations cease to exist or are reduced.

5.18. Revenue and expense recognition

Revenue and expenses are recognised 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 "Customer Advances" in the consolidated balance sheet reflects the estimated liability for tickets and traffic documents sold each year prior to 31 December but not yet used at that date. The revenue relating to these items is recognised when the transport or service is performed.

Iberia, Líneas Aéreas de España, S.A. has in place the "Iberia Plus" card the purpose of which is to foster customer loyalty. Cardholders accumulate points for taking certain flights, using certain hotels, renting cars or making purchases with credit cards covered by the programme. The points can be exchanged for free tickets or other services offered by the companies included in the programme. "Trade and Other Payables" in the accompanying consolidated balance sheets at 31 December 2006 and 2005 include provisions of EUR 91,809 thousand and EUR 77,574 thousand in this connection, based on the estimated redemption value of the unused points accumulated at those dates.

Interest income is accrued on a time proportion basis by reference to the principal outstanding and the effective interest rate applicable.

Dividend income from investments is recognised when entitlement to receive the dividend arises, based on the conditions approved by the entity paying the dividend.

In general, any incentives, bonuses or reductions received in cash or in kind by the Company for the acquisition of aircraft subsequently used under operating leases are allocated to the income statement over the term of the lease agreement or when the discounted consumption occurs.

5.19. Income tax; deferred tax assets and liabilities

The income tax of each year for each consolidated company is calculated on the basis of accounting profit before tax, increased or decreased, as appropriate, by the permanent differences from taxable profit, net of tax relief and tax credits, excluding tax withholdings and prepayments.

Since 1 January 2002 Iberia, Líneas Aéreas de España, S.A. and certain subsidiaries file consolidated tax returns under the tax system provided for by Chapter VII of Title VII of the

Consolidated Corporate Income Tax Law (Legislative Royal Decree 4/2004, of 5 March) as a part of Tax Group 148/02 of which Iberia, Líneas Aéreas de España, S.A. is the Parent. The companies comprising the Consolidated Tax Group are the fully consolidated companies except for Binter Finance, BV, which does not meet the legally established requirements to be included in the group.

Deferred tax assets and liabilities relate to the amounts that will be recoverable or payable in the future on differences between the carrying amounts of assets and liabilities and their tax bases, and tax loss and tax credit carryforwards. These assets and liabilities are calculated and recognised at the tax rates that are expected to apply in the period when the temporary difference is recovered or settled.

Deferred tax assets, tax loss and tax credits carryforwards are recognised when it is probable that the Company will recover them in the future regardless of the date of recovery. Deferred tax assets and liabilities are presented at face value and are classified under non-current assets or liabilities in the consolidated balance sheet.

The deferred tax assets and liabilities recognised are reassessed at each balance sheet date in order to ascertain whether they still exist, and the appropriate adjustments are made on the basis of the findings of the analyses performed.

5.20. Earnings per share

Basic earnings per share are calculated by dividing net profit or loss attributable to the Parent by the weighted average number of ordinary shares outstanding during the year, excluding the average number of shares of the Parent held by the Group companies.

Diluted earnings per share are calculated by dividing net profit or loss attributable to the Parent by the weighted average number of shares that would have been outstanding during the year if at the beginning of the year all the convertible financial instruments issued by the Parent and outstanding at year-end had been converted into ordinary shares of the Parent.

5.21. Foreign currency balances and transactions

Transactions in currencies other than the euro and the resulting receivables and payables are recognised at their equivalent euro value at the transaction date.

The balances of accounts receivable and payable denominated in currencies other than the euro are translated to euros at the exchange rates prevailing at 31 December of each year. However, following customary airline practice, the balance of the liability for unused traffic documents is reflected in the consolidated balance sheet at the exchange rate prevailing 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.

The changes in value arising from the differences between the official exchange rates at year-end and the exchange rates at which the receivables and payables in currencies other than the euro were recognized and those arising at the date of collection or payment of receivables and payables in currencies other than the euro are allocated to "Exchange Differences" in the consolidated income statement.

5.22. Consolidated cash flow statements

The following terms, with the meanings specified, are used in the consolidated cash flow statements, which were prepared using the indirect method:

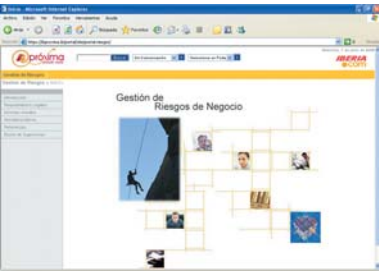
1. Cash flows: inflows and outflows of cash and cash equivalents, which are short-term, highly liquid investments that are subject to an insignificant risk of changes in value.
2. Operating activities: the principal revenue-producing activities of the Company and other activities that are not investing or financing activities.

3. Investing activities: the acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents.
4. Financing activities: activities that result in changes in the size and composition of the equity and borrowings of the Company that are not operating activities.

5.23. Risk management policy

The Iberia Group has adopted numerous measures to control and manage risks and has implemented systems to enable it to identify, assess, manage and mitigate the main risks that affect the various activities of the Group.

The measures taken in this respect cover the key parameters and levers of the Group's management, i.e. the income statement, indebtedness, investments and disinvestments and the implementation of the Master Plan, in order to optimise the income statement and indebtedness and to take balanced decisions in terms of the risk and return on new investments.



With regard to financial risks, the Group uses a global management programme designed to control and reduce the potential adverse effect of fluctuations in exchange rates, interest rates, and fuel prices on the Group's earnings and to maintain the required liquidity for its operational needs and investments.

In order to attain this objective, the Group uses a VAR (Value at Risk) model to conduct probabilistic assessments of the possible impact of these market variables on its results, defines maximum volatility targets and designs the hedging programmes required to achieve them.

Exchange rate risk

Due to the nature of the Group's international business, it generates collections and payments in currencies other than the euro. The greatest risk exposure relates to the appreciation of the US dollar against the euro, since its payments in US dollars exceed its income in this currency.

Exchange rate risk is managed basically by a combination of two strategies: firstly, strategic hedges (up to five years) are arranged using currency swaps and options and other derivative products for an amount hedging a given percentage of the position; secondly, tactical hedges with a time horizon of one year or less are arranged; these hedges, which are associated with actual changes in the Company's US dollar payments, enable it to respond to market trends.

Interest rate risk

As a result of the Company's net debit position (including operating lease transactions on aircraft), the Group is exposed to interest rate increases in the currencies in which its debt is denominated.

In order to manage this risk, a minimum percentage of the Group's debt bears fixed interest or has hedged interest rates. Also, by diversifying the currencies of its financing (US dollar, euro, Swiss franc and pound sterling), the Group is able to reduce the risk of an overall rise in the interest rates on its borrowings.

Fuel price risk

The Group manages the cost of aircraft fuel using active risk control policies and directly hedges the price of kerosene (JET Kero CIF-NWE).

This risk is normally reduced by arranging swaps and options.

Liquidity risk

In view of the cyclical nature of its business and the investment and financing requirements resulting from the renewal of its aircraft, the Group has a liquidity policy to ensure a significant volume of available cash, equivalent to approximately three months' revenue.

This cash position is invested in highly liquid, short-term instruments such as debt "repos", eurodeposits, bank promissory notes and securitisations, all of which are arranged through leading financial institutions, in accordance with the Group's current counterparty risk policy.

In addition to the short-term investments and the cash position, the Company has ongoing credit facilities which guarantee its liquidity requirements.

5.24. Activities with an environmental impact

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 measured at acquisition cost and are capitalised as an addition to non-current assets in the year in which the related expenses are incurred.

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.

6. Intangible assets

The changes in "Intangible Assets" in 2006 and 2005 were as follows:

Thousands of euros

	Balance at 01/01/05	Additions or Charge	Changes in the Scope	Retirements or reductions	Balance at 31/12/05
Cost:					
With finite useful life					
Computer software	104,473	21,545	(3,466)	406	122,958
Intellectual property, leasehold assignment rights and other	853	12	–	–	865
	105,326	21,557	(3,466)	406	123,823
Accumulated amortisation:					
Computer software	(59,261)	(18,161)	1,682	2	(75,738)
Intellectual prop. & leasehold assign. rights	(625)	(43)	-	-	(668)
	(59,886)	(18,204)	1,682	2	(76,406)
Total	45,440				47,417

Thousands of euros

	Balance at 01/01/06	Additions or Charge	Retirements	Transfers	Balance at 31/12/06
Coste:					
With finite useful life					
Computer software	122,958	21,112	(1,146)	(574)	142,350
Intellectual property, leasehold assignment rights and other	865	119	–	–	984
	123,823	21,231	(1,146)	(574)	143,334
Accumulated amortisation:					
Computer software	(75,738)	(19,179)	1,146	–	(93,771)
Intellectual prop. & leasehold assign. rights	(668)	(42)	–	–	(710)
	(76,406)	(19,221)	1,146	–	(94,481)
Total	47,417				48,853

The cost of the Group companies' fully amortised intangible assets at 31 December 2006 and 2005 amounted to EUR 50,285 thousand and EUR 28,674 thousand, respectively, the detail being as follows:

Thousands of euros

	2006	2005
Leasehold assignment rights	394	394
Computer software	49,891	28,280
Total	50,285	28,674

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

Substantially all the Group's intangible assets were acquired from third parties.

7. Property, plant and equipment

The changes in this heading in the consolidated balance sheet in 2006 and 2005 were as follows:

Thousands of euros

	01/01/05	Additions or Charges	Derecog-nitions	Exclusions from Scope	Other transfers	Exchange differences	31/12/05
Cost:							
Aircraft	2,042,972	607,755	(364,934)	-	141,973[a]	-	2,427,766
Other property, plant and equipment							
Land	2,518	-	-	-	-	-	2,518
Buildings and other structures	156,891	15	(269)	-	-	-	156,637
Machinery, fixtures and tools	427,037	23,156	(8,660)	-	519	-	442,052
Transport equipment	29,641	3,978	(418)	-	-	-	33,201
Furniture and fixtures	19,300	789	(736)	(211)	99	-	19,241
Computer hardware	129,505	11,318	(2,721)	(26,066)	61	-	112,097
Spare parts	292,415	94,177	(107,277)	-	-	-	279,315
Flight simulators	11,102	-	-	-	-	-	11,102
Other property, plant and equipment	105	-	-	(105)	-	-	-
Property, plant and equipment in the course of construction	20,708	43,062	(17,010)	-	(13,104)	(2,080)	31,576
Accumulated depreciation:							
Aircraft	(1,010,313)	(100,235)	38,168	-	(82,998)[a]	-	(1,155,378)
Other property, plant and equipment							
Buildings and other structures	(110,272)	(3,614)	77	-	-	-	(113,809)
Machinery, fixtures and tools	(304,967)	(21,886)	8,291	-	7	-	(318,555)
Transport equipment	(18,935)	(3,013)	405	-	-	-	(21,543)
Furniture and fixtures	(13,512)	(1,054)	656	83	(5)	-	(13,832)
Computer hardware	(86,078)	(12,916)	2,686	18,165	(5)	-	(78,148)
Spare parts	(139,454)	(16,574)	11,475	-	-	-	(144,553)
Flight simulators	(8,755)	(206)	-	-	-	-	(8,961)
Other property, plant and equipment	(88)	-	-	88	-	-	-
	(682,061)	(59,263)	23,590	18,336	(3)	–	(699,401)
Impairment losses and provisions:							
Aircraft	(63,840)	(104,600)	10,796	-	(19,322)	-	(176,966)
Provision for major repairs	(7,597)	-	1,327	-	(9,722)	-	(15,992)
Other property, plant and equipment	(2,790)	(1,400)	6	-	-	-	(4,184)
	1,365,593						**1,463,584**

[a] Including mainly the transfer of EUR 101,164 thousand of cost and EUR 81,842 thousand of accumulated amortisation from "Non-Current Assets Held for Sale". The transfers shown under "Cost - Aircraft" also include transfers from "Other Non-Current Financial Assets - Deposits for the Acquisition of Aircraft" amounting to EUR 30,212 thousand.

Thousands of euros

	01/01/06	Additions or Charges	Derecog-nitions	Other transfers	31/12/06
Cost:					
Aircraft	2,427,766	60,427	(100,781)	(18,083)[a]	2,369,329
Other property, plant and equipment					
Land	2,518	-	-	-	2,518
Buildings and other structures	156,637	-	(4,660)	-	151,977
Machinery, fixtures and tools	442,052	32,534	(18,582)	5,023	461,027
Transport equipment	33,201	6,650	(390)	-	39,461
Furniture and fixtures	19,241	3,725	(2,513)	(30)	20,423
Computer hardware	112,097	11,042	(3,989)	80	119,230
Spare parts	279,315	14,081	(5,628)	(86,867)[b]	200,901
Flight simulators	11,102	-	(8,402)	-	2,700
Property, plant and equipment in the course of construction	31,576	22,196	(19,180)	(15,678)	18,914
	1,087,739	90,228	(63,344)	(97,472)	1,017,151
Accumulated depreciation:					
Aircraft	(1,155,378)	(145,443)	70,912	24,982	(1,204,927)
Other property, plant and equipment:					
Buildings and other structures	(113,809)	(3,587)	3,741	(6)	(113,661)
Machinery, fixtures and tools	(318,555)	(23,158)	16,984	-	(324,729)
Transport equipment	(21,543)	(3,404)	362	(282)	(24,867)
Furniture and fixtures	(13,832)	(1,506)	2,313	-	(13,025)
Computer hardware	(78,148)	(13,463)	3,949	-	(87,662)
Spare parts	(144,553)	(9,384)	56,848[b]	-	(97,089)
Flight simulators	(8,961)	(206)	8,401	-	(766)
	(699,401)	(54,708)	92,598	(288)	(661,799)
Impairment losses and provisions:					
Aircraft	(176,966)	-	10,885	8,939	(157,142)
Provision for major repairs	(15,992)	-	7,068	-	(8,924)
Other property, plant and equipment	(4,184)	-	1,405	-	(2,779)
	1,463,584				1,350,909

[a] Including mainly transfers to "Non-Current Assets Held for Sale" amounting to EUR 30,620 thousand and transfers from property, plant and equipment in the course of construction (see Note 7.7).
[b] Relating to repairable engine spare parts transferred from "Inventories" since they are rotated in periods of less than one year (see Note 5.5).

7.1. Aircraft

7.1.1. Main period changes

he detail of the additions shown in the foregoing tables is as follows:

Thousands of euros

	2006	2005
Aircraft	18,176	435,590
Engines	8,854	125,106
Refurbishments	33,397	47,059
	60,427	607,755

The detail of the 2005 additions includes EUR 207,851 thousand and EUR 51,963 thousand under "Aircraft" and "Engines", respectively, relating to the addition of five A-340-300 aircraft previously used under operating leases. The lessors of these aircraft were the five Iberbús companies in which the Parent has an ownership interest and to which it has granted a loan. These aircraft were included in Property, Plant and Equipment as a result of the agreement under which Iberia, Líneas Aéreas de España, S.A. irrevocably undertook, in advance, to exercise in 2008 and 2010, as stipulated in each operating lease contract, the related purchase options provided for therein. The value of the purchase options was established as the sum of the Parent's investment in the capital of the related Iberbús company and the face value of the loan granted to it. The amounts at which these options were added to "Aircraft" include, in addition to the purchase option, the lease payments payable until the exercise date of the option. "Current Liabilities – Bank Borrowings" and "Non-Current Balances – Bank Borrowings" include EUR 259,814 thousand and EUR 210,977 thousand at 31 December 2005 and 2006, respectively, as a result of this transaction.

The other additions to "Aircraft" in 2005 relate to the acquisition of three A-320 aircraft, one A-319 aircraft, and one A-321 which were subsequently sold and leased back under operating lease contracts. Finance lease contracts were also entered into for two A-320 aircraft and two A-321 aircraft.

The 2006 derecognitions were as follows:

Thousands of euros

	Cost	Accumulated Depreciation	Provisions
MD-87	16,441	(13,375)	(3,066)
B-757	34,678	(19,641)	(4,692)
Other derecognitions	49,662	(37,896)	(10,195)
	100,781	**(70,912)**	**(17,953)**

The Company derecognised one MD-87 aircraft with a net carrying amount of zero, and sold one B-757 aircraft for its net carrying amount (EUR 10,345 thousand).

"Other Derecognitions" in the foregoing table also includes sales of engines and derecognitions of refurbishments made to aircraft on operating lease which were withdrawn from service in 2006.

As part of its aircraft renewal policy, in 2005 the Group recognised an allowance of EUR 104,600 thousand to reduce the carrying amount of the MD aircraft to their estimated realisable value, taking into account that these aircraft will be disposed of between 2007 and 2009. The allowance was recognised under "Impairment Losses" in the consolidated income statement for 2005.

7.1.2. Commitments and other guarantees on aircraft

The Group is using three aircraft under finance lease contracts and seven aircraft under operating leases the payments under which are securing, together with the aircraft, the repayment of a bond issue launched by the lessor in the European market in 2000. EUR 192,016 thousand of the bonds had not been repaid at 31 December 2006.

In addition, the Parent is guaranteeing the use of twenty aircraft under operating or finance lease for periods of between nine and 14 years vis-à-vis the subscribers of a bond issue with outstanding amounts of USD 128,713 thousand and EUR 120,300 thousand at 31 December 2006.

The Group is currently implementing a fleet renewal plan instrumented through various agreements entered into with Airbus for A-320-type and A-340-type aircraft. The aircraft not yet delivered at 31 December 2006 and the year in which they are scheduled to be added to the fleet pursuant to the agreements entered into are as follows:

Type of Aircraft	2007	2008	Total
A-319	8	5	13
A-320	6	4	10
A-321	1	–	1
	15	9	24

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered at 31 December 2006 amounted to approximately EUR 909 million.

The Company also has options on two A-340-600 aircraft and forty nine A-320-type aircraft.

7.1.3. Aircraft in service

Following is a summary of the Group's aircraft in service at 31 December 2006:

Type of Aircraft	Owned	Under Finance Lease	Under Operating Lease	Under *Wet Lease*[d]	Total
B-747	–[a]	–	–	–	–
B-757	–	–	–	7	7
A-319	–	–	11	–	11
A-320	10	10[b]	33[c]	–	53
A-321	–	4	14	–	18
A-340-300	5	–	11	2	18
A-340-600	–	–	13	–	13
MD-87	18	–	–	–	18
MD-88	12	–	–	–	12
	45	14	82	9	150

[a] Excluding five aircraft grounded at 31 December 2006, because they were to be sold or scrapped. The net carrying amount of these aircraft, after deducting the related impairment losses, is zero.
[b] Excluding two aircraft leased to Compañía Mexicana de Aviación.
[c] Excluding one aircraft leased to Compañía Mexicana de Aviación and two aircraft the cabins of which are being reconfigured prior to return.
[d] Lease type which includes the aircraft, crew, maintenance and insurance.

Aircraft operated under operating lease and wet lease contracts

In 2006, four A-319 aircraft, three A-340-600 aircraft, two A-320 aircraft and two A-321 aircraft were leased under an operating lease arrangement. Also, six A-320 aircraft and two B-757 aircraft the operating lease contracts for which expired in 2006 were returned under early return agreements. The leases of five B-757 aircraft operated under operating lease in 2005 were transformed into wet leases.

The expiry dates of the operating lease contracts entered into by the Parent are summarised as follows:

Aircraft	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Nr. of aircraft
A-319	–	2	2	–	–	4	–	–	–	–	–	–	3	11
A-320	10	2	1	1	1	1	5	2	1	–	–	–	9	33
A-321	–	–	–	–	–	–	1	–	2	2	2	1	6	14
A-340-300	–	1	2	3	1	3	–	1	–	–	–	–	–	11
A-340-600	–	–	–	–	–	–	–	–	3	2	3	4	1	13
Total	10	5	5	4	2	8	6	3	6	4	5	5	19	82

The foregoing table includes eleven A-320 aircraft and four A-319 aircraft that are being leased from International Lease Finance Corporation. As a result of the execution of this contract, the Parent has deposited completion bonds totalling EUR 10,118 thousand and this amount is recognised under "Other Non-Current Financial Assets" in the accompanying consolidated balance sheet at 31 December 2006 (see Note 9.1.3).

Certain of the operating lease contracts include a purchase option on the aircraft that can be exercised during the lease term, and the possibility of extending the lease for periods ranging from one to nine years.

In 2006, the Parent entered into wet lease contracts on seven B-757 aircraft and two A-340-300 aircraft that were used under operating leases in 2005.

The wet lease contracts on two B-747 aircraft and one B-757 aircraft (which is owned by the Company) expired in 2006.

Lease expenses

The lease payments accrued in 2006 and 2005 on aircraft operating lease contracts amounted to EUR 406,458 thousand and EUR 399,711 thousand, respectively, and these amounts are included under "Other Operating Expenses - Recurring" in the consolidated statements of income (see Note 22.3). The detail of the approximate total operating lease payments payable for these aircraft and of the related due dates is as follows:

Millions of euros

Years	
2007	373
2008	335
2009	311
2010	275
2011 and subsequent years	1,363
	2,657(*)

(*) Equivalent to USD 3,499 million at the year-end exchange rate. The exchange rate risk on these lease payments is partially hedged with derivatives (see Note 20).

At the date of preparation of these consolidated financial statements the Parent's directors did not intend to exercise the purchase options on the aircraft that were being operated under operating lease contracts at 31 December 2006, or to extend contracts that would give rise to using aircraft for periods exceeding 16 years.

7.2. Assets held under finance lease

At 31 December 2006 there were property, plant and equipment items held under finance leases, mainly aircraft, with a cost of EUR 582,995 thousand and accumulated depreciation of EUR 133,946 thousand (2005: cost of EUR 593,518 thousand and accumulated depreciation of EUR 114,979 thousand).

The lease payments outstanding at 31 December 2006, including the amount of the purchase options, fall due as detailed in Note 16.

7.3. Other property, plant and equipment

The additions to "Machinery, Fixtures and Tools" relate mainly to acquisitions of airport equipment.

The carrying amount of the buildings and facilities constructed on land owned by the State, mostly at Spanish airports, amounted to EUR 26,297 thousand and EUR 20,468 thousand at 31

December 2006 and 2005, respectively. The Parent's directors do not expect any material losses to arise as a result of the reversion process since the Company's maintenance programmes ensure that the items are always in good operating condition.

The changes in "Property, Plant and Equipment in the Course of Construction" in the foregoing detail include derecognitions amounting to EUR 19,180 thousand relating to refurbishing the cabins of aircraft operated under lease-back arrangements.

7.4. Revaluation reserve Royal Decree-Law 7/1996, of 7 June

On 31 December 1996, the Group revalued its property, plant and equipment pursuant to Royal Decree-Law 7/1996, of 7 June, and paid the single 3% tax. The detail of the revaluation surplus and the effect thereof at 31 December 2005 and 2006 is as follows:

Thousands of euros

	Balance at 31/12/04	2005 Charges	Disposals	Balance at 31/12/05	2006 Charges	Disposals	Balance at 31/12/06
Aircraft	20,310	(2,082)	(698)	17,530	(2,014)	(481)	15,035
Land	699			699	–	–	699
Buildings and other structures	5,376	(412)	(30)	4,934	(401)	(54)	4,479
Machinery, fixtures and tools	143	(45)	–	98	(29)	–	69
Transport equipment	1	–	–	1	–	–	1
	26,529	**(2,539)**	**(728)**	**23,262**	**(2,444)**	**(535)**	**20,283**

The revaluation increased the depreciation charge for 2006 and 2005 by approximately EUR 2,444 thousand and EUR 2,539 thousand, respectively, and will increase the 2007 depreciation charge by approximately EUR 2,430 thousand.

The revaluation surplus, net of the single 3% tax, was credited to "Revaluation Reserve", with a charge to the appropriate revalued asset accounts, without altering the recognised accumulated depreciation. On 22 January 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.

7.5. Fully depreciated items

The cost of the Group's fully depreciated property, plant and equipment amounted to EUR 345,874 thousand and EUR 345,065 thousand at 31 December 2006 and 2005, the detail being as follows:

Thousands of euros

	2006	2005
Buildings	57,927	59,913
Machinery, fixtures and tools	189,018	188,627
Furniture and fixtures	6,880	8,639
Computer hardware	54,191	44,932
Flight simulators	146	8,549
Transport equipment and other items of property, plant and equipment	12,777	9,199
Aircraft	24,935	25,206
Total	**345,874**	**345,065**

7.6. Insurance coverage

The Group companies have taken out insurance policies for their property, plant and equipment and intangible assets which sufficiently covered their carrying amount at 31 December 2006. Also, the Group has taken out insurance policies for the aircraft leased from third parties, in accordance with the conditions established in the related lease contracts.

7.7. Non-current assets not in service

The Group has recognised certain assets in the consolidated balance sheet, mainly aircraft and engines, which are not in service. The carrying amount of these assets is zero, the detail being as follows:

Thousands of euros

	2006			2005		
	Cost	Accumulated Depreciation	Impairment Losses	Cost	Accumulated Depreciation	Impairment Losses
Aircraft (fuselage and engines):						
DC 9 and DC-10	-	-	-	9,287	(7,429)	(1,858)
A-300	4,698	(3,758)	(940)	9,230	(7,384)	(1,846)
B-727	869	(695)	(174)	869	(695)	(174)
B-747	333,186	(270,041)	(63,145)	371,863	(301,268)	(70,595)
Total	**338,753**	**(274,494)**	**(64,259)**	**391,249**	**(316,776)**	**(74,473)**

7.8. Non-current assets classified as held for sale

The Group recognises under "Non-Current Assets Classified as Held for Sale" the aircraft that will foreseeably be derecognised in the near future and, accordingly, their carrying amount will be recovered mainly through sale transactions rather than through continuing use.

The detail of the non-current assets classified as held for sale is as follows:

Thousands of euros

	2006			2005		
	Cost	Accumulated Depreciation	Impairment Losses	Cost	Accumulated Depreciation	Impairment Losses
Aircraft:						
B-747	49,238	(39,589)	(9,649)	18,618	(14,895)	(710)
Total	**49,238**	**(39,589)**	**(9,649)**	**18,618**	**(14,895)**	**(710)**

8. Investments in associates accounted for using the equity method

The changes in 2005 and 2006 in "Investments in Associates Accounted for by the Equity Method" were as follows:

Thousands of euros

	Balances at 31/12/04	Share of results	Distribution of dividends	Additions	Excl. from the Scope (Note 2.2.)	Transfers and other	Balances at 31/12/05
Amadeus Group	174,458	–	–	–	(174,458)	–	–
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.	4,455	333	–	447	–	–	5,235
Multiservicios Aeroportuarios, S.A.	2,433	607	(339)	–		–	2,701
Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A.	362	448	(296)	–	–	89	603
Empresa Logística de Carga Aérea, S.A.	242	148	–	–	–	46	436
Handling Guinea Ecuatorial, S.A.	712	635	(271)	–	–	(13)	1,063
Iber-América Aerospace LLC	514	85	(104)	–	–	75	570
Grupo Air Miles	34	114	–	–	–	–	148
Serpista, S.A.	1,232	138	–	–	–	–	1,370
Opodo, Ltd.	378	–	–	–	(378)	–	–
Total	**184,820**	**2,508**	**(1,010)**	**447**	**(174,836)**	**197**	**12,126**

Thousands of euros

	Balances at 31/12/05	Inclusions in the Scope	Share of results	Distribution of dividends	Other	Balances at 31/12/06
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.	5,235	–	1,285	–	–	6,520
Multiservicios Aeroportuarios, S.A.	2,701	–	931	(303)	–	3,329
Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A.	603	–	530	(265)	(111)	757
Empresa Logística de Carga Aérea, S.A.	436	–	398	–	(71)	763
Handling Guinea Ecuatorial, S.A.	1,063	–	(44)	(302)	–	717
Iber-América Aerospace LLC	570	–	51	(87)	(27)	507
Grupo Air Miles	148	–	356	–	–	504
Serpista, S.A.	1,370	–	321	–	–	1,691
International Supply Management, S.L.	–	514	690	–	–	1,204
Clickair, S.A.	–	758	–	–	–	758
Total	**12,126**	**1,272**	**4,518**	**(957)**	**(209)**	**16,750**

9. Financial assets

9.1. Non-current financial assets

9.1.1. Held-to-maturity investments

The changes in the accounts under this heading in 2005 and 2006 were as follows:

Thousands of euros

Description	Balance at 01/01/05	Transfers	Balance at 31/12/05	Transfers	Balance at 31/12/06
Fixed-income securities:					
Iberbond PLC 1999	31,980	(1,170)	30,810	(30,810)	–
Government debt securities	244	–	244	–	244
	32,224	(1,170)	31,054	(30,810)	244
Iberbús companies	24,930	–	24,930	–	24,930
	57,154	**(1,170)**	**55,984**	**(30,810)**	**25,174**

Fixed-income securities

The Iberbond PLC 1999 bonds partially finance the acquisition by third parties of six A-320 aircraft which are operated under finance lease by the Parent. The bonds earn annual interest of 5.90% which is settled half-yearly. The principal is being repaid at an annual rate of 3% until 1 March 2007. The remaining 76% of the principal falls due in September 2007 and, accordingly, the Group has reclassified the uncollected amount to short term under "Current Financial Assets" (see Note 9.2).

Iberbús companies

The information relating to the Iberbús companies, which own most of the A-340-300 aircraft operated by Iberia, Líneas Aéreas de España, S.A. at 31 December 2006 and 2005, drawn from their provisional financial statements, is as follows:

Thousands of euros

		2006				2005			
	% of Direct Ownership	Cost	Share Capital	Reserves	Ordinary Profit (Loss)	Cost	Share Capital	Reserves	Ordinary Profit (Loss)
Iberbús Concha, Ltd.	40.00	2,029	5,206	(4,545)	356	2,029	5,812	(5,132)	58
Iberbús Rosalía, Ltd.	40.00	2,056	5,166	(3,860)	211	2,056	5,768	(4,166)	47
Iberbús Chacel, Ltd.	40.00	2,283	5,723	(5,303)	414	2,283	6,389	(5,822)	281
Iberbús Arenal, Ltd.	40.00	2,362	5,854	(10,436)	(368)	2,362	6,536	(11,242)	(403)
Iberbús Teresa, Ltd.	40.00	2,504	5,293	(2,280)	666	2,504	5,909	(3,152)	606
Iberbús Emilia, Ltd.	40.00	2,497	5,317	(2,405)	688	2,497	5,935	(3,308)	623
Iberbús Agustina, Ltd.	40.00	2,587	5,319	(3,556)	762	2,587	5,938	(4,382)	412
Iberbús Beatriz, Ltd.	40.00	2,556	5,336	(3,420)	765	2,556	5,957	(4,482)	665
Iberbús Juana Inés, Ltd.	45.45	1,896	3,182	(5,444)	(95)	1,896	3,553	(5,635)	(439)
Iberbús María de Molina, Ltd	45.45	1,983	3,346	(5,950)	(63)	1,983	3,737	(6,200)	(445)
Iberbús María Pita, Ltd	45.45	2,177	3,523	(5,865)	(77)	2,177	3,933	(6,102)	(446)
		24,930				**24,930**			

The majority shareholder of these companies, Airbus, has guaranteed for Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of its investments in and loans to the Iberbús 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 are not included the scope of consolidation.

9.1.2. Loans and receivables

The detail of the items making up this heading in the accompanying consolidated balance sheets at 31 December 2005 and 2006 is as follows:

Thousands of euros

	Balance at 31/12/04	Additions	Exchange Differences	Derecognit./ Transfers	Balance at 31/12/05
Loans to Venezolana Internacional de Aviación, S.A.[a]	25.623	–	–	–	25,623
Loans to Iberbús companies	145,400	-	22,479[b]	-	167,879
Loan to Aerolíneas Argentinas, S.A.	36,810	-	(284)	(861)	35,665
Loan to Wam Acquisition, S.A.	-	40,388	-	-	40,388
Loans to Iberlease 2004 Ltd.	-	41,999	3,366	-	45,365
Other	16,355	60	-	(1,873)	14,542
Total cost	**224,188**	**82,447**	**25,561**	**(2,734)**	**329,462**
Allowances	**(70,190)**	**-**	**-**	**1,145**	**(69,045)**

Thousands of euros

	Balance at 31-12-05	Additions	Exchange Differences	Derecognit./ Transfers	Balance at 31/12/06
Loans to Venezolana Internacional de Aviación, S.A.[a]	25.623	–	–	–	25,623
Loans to Iberbús companies	167,879	-	(17,502)[b]	-	150,377
Loan to Aerolíneas Argentinas, S.A.	35,665	-	-	-	35,665
Loan to Wam Acquisition, S.A.	40,388	5,660	-	-	46,048
Clickair, S.A. - preferred shares	-	14,410	-	-	14,410
Loans to Iberlease 2004 Ltd.	45,365	-	(4,729)	-	40,636
Other	14,542	79	-	(10,926)	3,695
Total cost	**329,462**	**20,149**	**(22,231)**	**(10,926)**	**316,454**
Allowances	**(69,045)**	**-**	**-**	**7,757**	**(61,288)**

[a] The loans granted to Venezolana Internacional de Aviación, S.A. (VIASA) in prior years had been provisioned in full at 31 December 2005 and 2006.
[b] Classified under "Exchange Differences (Gains and Losses)" in the consolidated income statement and hedged.

Iberia, Líneas Aéreas de España, S.A. has granted a loan to each of its Iberbús investees. The principal ranges, depending on the company in question, from USD 11,049 thousand to USD 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 in a one-off lump-sum upon maturity, which, depending on the company concerned, will take place in the period from 2008 to 2011.

The outstanding amounts in this connection, by maturity, are as follows:

Thousands of euros

Maturing in	
2008	62,920
2009	15,240
2010	30,544
2011	8,390
2012	33,283
Total	**150,377**

The balance of EUR 35,665 thousand with Aerolíneas Argentinas, S.A. relates to the subrogation of the Parent to a loan of USD 43 million secured by a mortgage on two B-747 aircraft. Furthermore, the Parent provided guarantees totalling USD 6 million to Aerolíneas Argentinas, S.A. The exposure to this company has been fully provisioned.

"Loan to Wam Acquisition, S.A." relates to a subordinated loan granted to this investee maturing in a single one-off payment in 2020, except under certain circumstances, and which earns interest at an annual rate of 13.75%. The accrued interest is capitalised and is also payable when the principal falls due.

As a result of the investment in Clickair, S.A., the Group has subscribed and paid 9,480 preferred shares of EUR 10 par value each and a share premium of EUR 1,510 each.

The preferred shares earn a fixed cumulative dividend of 6% of their nominal amount plus the related share premium and also entitle holders to collect a variable dividend if the company records a profit, the amount of which is calculated as the lower of 6% of the total investment in preferred shares and 50% of the investee's profit for the year after offsetting accumulated losses and transfers to the legal and bylaw reserves. The preferred shares entitle holders to collect 76% of the ordinary dividend.

Iberlease 2004 Ltd., the lessor of four aircraft held by the Company under finance leases, is in turn the recipient of four loans granted by Iberia, Líneas Aéreas de España, S.A. for a term identical to that established in the finance leases and which are repayable in a single one-off payment in December 2014. The principal amount of these loans is USD 53,518 thousand and the annual interest rates range from 6% to 6.5% payable quarterly.

9.1.3. Other non-current financial assets

The changes in the accounts under this heading in 2005 and 2006 were as follows:

Thousands of euros

	% of ownership at 31/12/05	Balance at 31/12/04	Additions	Retirements and Recoveries	Excl. from the Scope	Transfers	Exchange Differences	Balance at 31/12/05
Deposits and guarantees:								
Deposits for acquisition of aircraft (Note 7)		235,929	261,444	(146,814)	–	(30,212)	31,313	351,660
Deposit for convertible debentures (Note 14)		18,354	–	–	–	(9,201)	–	9,153
Deposits and guarantees for operation of aircraft leased from ILFC (Note 7)		9,911	383	(522)	–	–	1,523	11,295
Dep. and guarant. for op. of aircraft under dry and wet lease arrangements (Note 7)		12,375	105	(307)	–	(3,391)	1,887	10,669
Other deposits and guarantees		4,031	90	(360)	(35)	–	272	3,998
		280,600	262,022	(148,003)	(35)	(42,804)	34,995	386,775
Exchange differences due to hedging transactions		17,653	25,834	(7,235)	6,491	–	(62,064)	(19,321)
Other financial assets:								
Venezolana Internacional de Aviación, S.A.	45.00	88,446	–	–	–	–	–	88,446
Interinvest, S.A.	0.14	30,244	–	–	–	–	–	30,244
Opodo, Ltd.	2.38	–	–	–	–	19,246	–	19,246
Servicios de Instrucción de Vuelo, S.L.	19.90	8,853	–	–	–	–	–	8,853
Wam Acquisition, S.A. (Nota 9.1.2)	11.68	–	14,107	–	–	–	–	14,107
Other	–	6,416	–	–	–	–	–	6,416
Allowances		(123,916)	(248)	299	–	(18,866)	–	(142,731)
		10,043	13,859	299	–	380	–	24,581
Total		**308,296**	**301,715**	**(154,939)**	**6,456**	**(42,424)**	**(27,069)**	**392,035**

Thousands of euros

	& of ownership at 31/12/06	Balance at 31/12/05	Additions	Retirements and Recoveries	Transfers	Exchange Differences	Balance at 31/12/06
Deposits and guarantees:							
Deposits for acquisition of aircraft (Note 7)		351,660	160,507	(191,060)	(1,358)	(30,751)	288,998
Deposit for convertible debentures (Note 14)		9,153	–	–	(9,153)	–	–
Dep.& guarant. for op. of airc. leased from ILFC (Note 7)		11,295	–	–	–	(1,177)	10,118
Deposits and guarantees for operation of aircraft under dry and wet lease arrangements (Note 7)		10,669	1,615	(510)	–	(1,161)	10,613
Other deposits and guarantees		3,998	420	(858)	–	–	3,560
		386,775	162,542	(192,428)	(10,511)	(33,089)	313,289
Exchange differences due to hedging transactions		(19,321)	2,714	(5,376)	–	15,086	(6,897)
Other financial assets:							
Venezolana Internacional de Aviación, S.A.	45.00	88,446	–	–	–	–	88,446
Interinvest, S.A.	0.14	30,244	–	–	–	–	30,244
Opodo, Ltd.	2.38	19,246	–	–	–	–	19,246
Servicios de Instrucción de Vuelo, S.L.	19.90	8,853	–	–	–	–	8,853
Wam Acquisition, S.A. (Note 9.1.2)	11.68	14,107	–	–	–	–	14,107
Other	–	6,416	–	(3)	–	–	6,413
Allowances		(142,731)	(37)	84	–	–	(142,684)
		24,581	(37)	81	–	–	24,625
Total		**392,035**	**165,219**	**(197,723)**	**(10,511)**	**(18,003)**	**331,017**

The investments in Venezolana Internacional de Aviación, S.A., Interinvest, S.A. and Opodo, Ltd. have been provisioned in full.

The investment in Wam Acquisition, S.A. was acquired as partial consideration for the sale of Amadeus, S.A. and is instrumented in ordinary shares and preferred shares. The latter entitle holders to collect a fixed cumulative dividend of 13.75% of their nominal amount. "Finance Income" in the accompanying consolidated income statement for 2006 includes EUR 10,987 thousand in this connection. These shares are convertible into ordinary shares in the event the investee is floated.

Deposits and guarantees

The amounts included in "Deposits for Acquisition of Aircraft" relate to the reimbursable advances paid for the acquisition of aircraft and engines, the detail being as follows:

Thousands of euros

	2006		2005	
	Outright Purchase	**Option/Right**	**Outr. Purchase**	**Option/Right**
A-319	135,069		117,469	–
A-320	112,319	3,721[(a)]	74,177	4,154[(a)]
A-321	16,158		49,064	–
A-340	–	1,519	92,612	1,695
Engines	20,212	–	12,489	–
	283,758	**5,240**	**345,811**	**5,849**

[(a)] Deposits paid for all the A-320-type aircraft.

Based on scheduled aircraft deliveries, the Group considers that deposits amounting to EUR 204 million will be taken to income in 2007.

9.2. Current financial assets

The detail of this heading in the accompanying consolidated balance sheets at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Held-to-maturity investments:		
Current financial assets	1,378,238	1,098,750
Unmatured interest receivable	25,373	17,173
Restricted deposits for convertible debentures (Note 14)	10,362	9,211
Iberbond bonds (Note 9.1.1)	30,810	1,170
Other short-term deposits and guarantees	11,585	11,411
Derivative financial instruments (Note 19)	11,271	42,765
Accrued uncollected dividends (Note 9.1.2)	10,987	–
Other current financial assets	10,708	10,193
	1,489,334	**1,190,673**

The average return on the amounts placed in current financial assets, mainly deposits, eurodeposits, euronotes, time deposits and promissory notes was 2.27% in 2005 and 2.87% in 2006.

10. Inventories

The detail of this heading at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Repairable engine spare parts[(a)]	111,847	15,345
Aircraft spare parts	63,025	59,267
Fuel	37,707	34,789
Other	19,077	24,368
Write-downs	(44,062)	(19,087)
Total	**187,594**	**114,682**

[(a)] See Notes 5.5 and 7.

11. Trade and other receivables

The detail of this heading in the accompanying consolidated balance sheets at 31 December 2005 and 2006 is as follows:

Thousands of euros

	2006	2005
Passenger and cargo agencies	204,955	193,723
Other trade receivables for sales and services	211,250	132,135
Tax receivables (Note 20)	14,743	139,154
Receivable from public agencies	38,936	39,572
Sundry receivables	51,684	62,495
Receivable from airlines	52,997	41,161
Receivable from customers at regional sales offices	19,724	25,183
Credit card receivables	19,870	16,943
Doubtful debts	23,193	21,770
Allowances	(30,060)	(28,756)
Total	**607,292**	**643,380**

The collection periods established by the Group companies range from 20 to 45 days.
The Group recognises provisions for doubtful debts on the basis of an aging of the receivables.

12. Cash and cash equivalents

The detail of this heading in the accompanying consolidated balance sheets at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Cash	30,473	37,852
Current financial assets	933,258	783,587
Total	**963,731**	**821,439**

Cash and Cash Equivalents" includes mainly the Group's cash and financial assets –basically eurodeposits, promissory notes and time deposits– maturing within no more than three months. The average interest rate obtained by the Group on its cash and cash equivalent balances amounted to 3.16% in 2006 (2005: 2.31%).

13. Equity

13.1. Share capital

The changes in 2005 and 2006 in the Parent's share capital were as follows:

	Number of shares	Par Value (Euros)
Number of shares and par value of the share capital at 1 January 2005	937,467,468	0.78
Capital increase	5,694,471	0.78
Number of shares and par value of the share capital at 31 December 2005	943,161,939	0.78
Capital increase	4,904,693	0.78
Number of shares and par value of the share capital at 31 December 2006	948,066,632	0.78

In 2005 the Parent increased capital by EUR 4,441 thousand by issuing 5,694,471 ordinary shares of EUR 0.78 par value each, with a share premium of EUR 0.84 per share. This capital increase was performed to cater for the conversion into shares of the same number of convertible debentures issued to cover the share option plan approved by the shareholders at the Annual General Meeting in 2002 and aimed at certain executive directors, executives and other employees. For the same reason, capital was increased in 2006 by EUR 3,826 thousand, represented by 4,904,693 shares with the same share premium per share.

At 31 December 2006, 6,396,236 share options had been subscribed but not yet exercised. These options may be exchanged for shares at a price of EUR 1.62 per share on the following dates: 10 March 2007, 10 September 2007 and 25 April 2008.

At 31 December 2005 and 2006, the shareholders of the Parent were as follows:

	2006		2005	
	Nr. of shares	% of ownership	Nr. of shares	% of ownership
British Airways	94,309,090	9.95	94,309,090	10.00
Caja de Ahorros y Monte de Piedad de Madrid	91,290,716	9.63	91,290,716	9.68
Banco Bilbao Vizcaya Argentaria, S.A.	69,492,448	7.33	69,219,377	7.34
Compañía de Distribución Integral Logista, S.A.	61,164,780	6.45	61,164,780	6.49
Sociedad Estatal de Participaciones Industriales	49,212,526	5.19	49,212,526	5.22
El Corte Inglés, S.A.	27,387,215	2.89	27,387,215	2.90
Other, including employees	555,209,857	58.56	550,578,235	58.37
Total	**948,066,632**	**100.00**	**943,161,939**	**100.00**

At 31 December 2006 all the shares were of the same class, were fully subscribed and paid and were traded by the book-entry system. The shares of the Parent are listed on the continuous market of the Spanish stock exchanges and all carry the same voting and dividend rights.

13.2. Treasury shares of the Parent

The changes in "Treasury Shares" in 2006 and 2005 were as follows:

	2006		2005	
	Nr of shares	Thousands of €	Nr of shares	Thousands of €
At beginning of year	13,924,050	28,372	16,669,560	31,961
Additions	4,062,318	8,981	5,311,848	12,592
Disposals	(11,284,000)	(23,431)	(8,057,358)	(16,181)
At end of year	**6,702,368**	**13,922**	**13,924,050**	**28,372**

The treasury shares held by Iberia, Líneas Aéreas de España, S.A. at 31 December 2006 represent 0.71% of the share capital, with an aggregate par value of EUR 5,228 thousand. The average purchase price of the shares of the Parent held by the Group at 2006 year-end was EUR 2.0772 per share and the average selling price of the shares was EUR 2.44 per share in 2006.

The treasury shares held by the Group at 31 December 2006 were intended for trading on the market.

The sale of treasury shares, the only item included in "Disposals" in the foregoing table, gave rise to gains of EUR 4,098 thousand and EUR 4,056 thousand in 2006 and 2005, respectively, which were recognised under "Equity - Reserves Generated due to IFRSs" in the consolidated income statement.

13.3. Earnings per share

13.3.1. Basic earnings per share

The basic earnings per share for 2006 and 2005 were as follows:

	2006	2005
Profit for the year attributable to the Parent (thousands of euros)	56,725	395,789
Weighted average number of shares outstanding (thousands of shares)	932,049	925,434
Basic earnings per share (euros)	0.061	0.428

13.3.2. Diluted earnings per share

The diluted earnings per share were calculated as follows:

	2006	2005
Profit for the year attributable to the Parent (thousands of euros)	56,725	395,789
Average number of shares outstanding (thousands of shares)	932,049	925,434
Dilutive effect of:		
Adjusted profit for the calculation of diluted earnings per share (in thousands of euros)	56,676	395,518
Adjusted average number of shares for the calculation of diluted earnings per share (millions of shares)	938,445	936,734
Diluted earnings per share (euros)	0.060	0.422

13.4. Share premium

The Consolidated Spanish Companies Law expressly permits the use of the share premium balance to increase capital and does not establish any specific restrictions as to its use.

13.5. Difference due to the adjustment of capital to euros

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

13.6. Legal reserve

Under the Consolidated Spanish Companies Law, 10% of net profit for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of the share capital.

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

13.7. Reserves at fully consolidated companies

The detail, by company, of the balances of this heading in the consolidated balance sheets at 31 December 2006 and 2005 is as follows:

Thousands of euros

Company	2006	2005
Iberia, Líneas Aéreas de España	70,431	63,846
Compañía Auxiliar al Cargo Exprés, S.A.	2,350	2,008
Campos Velázquez, S.A.	56	43
Cargosur, S.A.	0	6
VIVA, Vuelos Internacionales de Vacaciones, S.A.	1,415	906
Sistemas Automatizados Agencias de Viajes, S.A.	–	11,137
Iberia Tecnología, S.A.	86	356
Auxiliar Logística Aeroportuaria, S.A.	112	70
Consultores Hansa, S.A.	3	2
Binter Finance B.V.	232	218
Total	74,685	78,592
Adjustments due to application of IFRSs	(91,434)	(91,434)
Total	**(16,749)**	**(12,842)**

13.8. Reserves at companies accounted for using the equity method

The detail, by company, of the balance of this heading in the consolidated balance sheets at 31 December 2006 and 2005 is as follows:

Thousands of euros

Entidad	2006	2005
Amadeus Group	–	146,465
Multiservicios Aeroportuarios, S.A.	1,143	875
Iber-America Aerospace LLC	126	177
Empresa Logística de Carga Aérea, S.A.	248	100
Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A.	554	395
Handling Guinea Ecuatorial, S.A.	920	556
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.	750	417
Serpista, S.A.	914	776
Air Miles Group	123	9
Other companies	(12)	(6)
Total	4,766	149,764
Adjustments due to application of IFRSs	1,494	6,112
Total	**6,260**	**155,876**

13.9. Valuation adjustments

"Valuation Adjustments" include mainly the changes in the value of hedging derivatives.

13.10. Other matters

The restricted reserves of consolidated investees amounted to EUR 561 thousand and EUR 557 thousand at 31 December 2006 and 2005, respectively.

13.11. Minority interests

The detail, by company, of the balance of "Minority Interests" in the consolidated balance sheets at 31 December 2006 and 2005 and of the profit for 2006 and 2005 attributable to minority interests is as follows:

Thousands of euros

	2006		2005	
Company	**Profit Attrib. to Minority Interests**	**Minority Interests**	**Profit Attrib. to Minority Interests**	**Minority Interests**
Compañía Auxiliar al Cargo-Exprés, S.A.	232	1,130	216	1,006
Auxiliar Logística Aeroportuaria, S.A.	12	49	14	37
	244	**1,179**	**230**	**1,043**

The changes in this heading in 2005 and 2006 are summarised as follows:

Thousands of euros

	2006	**2005**
Beginning balance	1,043	5,324
Share of profit	244	230
Exclusion from the scope of consolidation	–	(4,408)
Dividends paid to minority interests	(108)	(103)
Ending balance	**1,179**	**1,043**

14. Convertible debenture issue

As indicated in Note 13, in 2003 the Parent of the Group issued 18,259,241 debentures with a face value of EUR 1.62 face value each convertible into shares in the proportion of one to one.

This debenture issue is earmarked to cater for the share option plan described in Note 13, the interest rate thereon is tied to three-month Euribor, the maturity dates coincide with the exercise dates of the option plan and redemption is guaranteed by an unrestricted deposit (Note 9.2).

The changes in the accounts under "Convertible Debenture Issue" in 2006 and 2005 were as follows:

Thousands of euros

	2006	**2005**
Beginning balance	18,306	27,532
Redemption	(7,944)	(9,226)
Ending balance	**10,362**	**18,306**

15. Bank borrowings and other financial liabilities

The detail, by maturity, of the bank borrowings at 31 December 2006 and 2005, is as follows:

Thousands of euros

Debt	2006			2005			
		Foreign Currencies				Foreign Currencies	
Due in	Euros	(US Dollars)	Total	Due in	Euros	(US Dollars)	Total
Principal:				Principal:			
2006	–	–	–	2006	54,316	23,856	**78,172**
2007	46,314	23,084	**69,398**	2007	3,695	25,750	**29,445**
2008	4,276	123,503	**127,779**	2008	4,276	138,323	**142,599**
2009	5,463	9,862	**15,325**	2009	4,826	11,010	**15,836**
2010	1,768	54,528	**56,296**	2010	1,132	60,874	**62,006**
2011	1,768	–	**1,768**	Subsequent years	4,122	–	**4,122**
Subsequent years	4,080	–	**4,080**				
Interest:				Interest:			
2007	358		**358**	2006	193	–	**193**

These loans bore weighted average annual interest of 5.28% in 2006 and 3.84% in 2005.

The Group has arranged credit lines with limits of EUR 284 million in 2005 and EUR 267 million in 2006, against which EUR 233,295 thousand and EUR 224,363 thousand had not been drawn down at 31 December 2005 and 2006, respectively.

16. Obligations under finance leases

The detail of the Group's finance leases at 31 December 2006 and 2005 is as follows:

Thousands of euros

	Obligations Denominated in Euros		Obligations Denominated (US Dollars)	
	2006	2005	2006	2005
Amounts payable under finance leases:				
Within one year	158,851	36,575	13,003	14,608
Between two and five years	96,718	242,130	52,406	58,391
After five years	70,818	79,874	119,739	148,304
Less: future finance charges:				
Within one year	(10,859)	(10,570)	(2,769)	(7,282)
Between two and five years	(17,877)	(18,237)	(20,663)	(24,904)
After five years	(5,193)	(15,316)	(19,927)	(27,296)
Present value of finance lease obligations	**292,458**	**314,456**	**141,789**	**161,821**
Less- amount due for settlement within 12 months (shown under current liabilities)	147,992	26,005	10,234	7,326
Amount due for settlement after 12 months (shown under non-current liabilities)	144,466	288,451	131,555	154,495

The Group's most important finance leases relate to aircraft (see Note 7.2).

The terms of the finance leases on aircraft range from 7 to 16 years.

In the year ended 31 December 2006, the average effective borrowing rates on the obligations under finance leases was 5.05% for the euro borrowings and 5.38% for the US dollar borrowings (2005: 4.48% for the euro borrowings and 5.24% for the US dollar borrowings). The interest rates are set on the contract dates, taking into account that the effective interest rate of the interest rate hedging transactions arranged in 2006 was 1.93% (2005: 2.68%).

17. Long-term provisions

The changes in 2006 in "Long-Term Provisions" in the consolidated balance sheet were as follows:

Thousands of euros

	Balance at 31/12/05	Additions or Charge	Amounts used	Other	Balance at 31/12/06
Provisions for obligations to employees (Note 5.15)	573,223	65,648	(20,539)	–	618,332
Provision for major repairs (Note 5.2)	61,148	21,570	(20,361)	(163)	62,194
Provisions for restructuring costs (Note 22.2)	608,100	25,800	(94,133)	–	539,767
Provision for liability (Note 5.17)	138,708	10,958	(10,515)	(387)	138,764
	1,381,179	**123,976**	**(145,548)**	**(550)**	**1,359,057**

17.1. Provisions for obligations to employees

The additions to "Provisions for Obligations to Employees" include the period provision for the normal cost and for the amounts relating to the interest income from the provision already recognised, which is recognised under "Staff Costs" (EUR 45,584 thousand) and under "Finance and Similar Costs" (EUR 20,064 thousand) in the consolidated income statement for 2006. The annual disbursements in this connection are amortised on an approximately straight-line basis.

17.2. Provision for restructuring costs

Of the balance at 31 December 2006 of "Provisions for Restructuring Costs", EUR 348,889 thousand relate to the current value of the amounts payable in the future to early retirees in accordance with the terms of the workforce rejuvenation plan implemented in 2000 (341 employees at 31 December 2006) and the voluntary collective redundancy procedure approved in 2001 and extended until 2007 (3,307 employees at 31 December 2006). In addition, the Group recognised a provision of EUR 190,878 thousand for the estimated cost of the group of employees who are expected to avail themselves of these measures. In 2006, 1,034 employees availed themselves of the collective redundancy procedure and the provision in this connection amounted to EUR 25,800 thousand (see Note 22.2).

The disbursements related to this provision will continue over the next seven years in accordance with the age of the employees who finally avail themselves of the procedure.

17.3. Provisions for liability

"Provisions for Liability" includes the estimated amount required for probable liabilities of a diverse nature related mainly to litigation, unresolved tax assessments, etc (see Note 5.17).

18. Trade and other payables

The detail of the Group's "Trade and Other Payables" at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Accounts payable for purchases and services	936,142	830,284
Other non-trade payables	216,477	147,793
Remuneration payable	159,762	166,466
Derivative financial instruments	62,004	17,850
Accrual accounts	7,966	9,089
Total	**1,382,351**	**1,171,482**

In general, the average payment period to suppliers and trade creditors is 60-90 days.
"Other Non-Trade Payables" mainly includes tax payables (see Note 20).

19. Derivative financial instruments

In line with the risk management policy described in Note 5.23, the Iberia Group arranges derivative transactions, mainly foreign exchange, interest rate and aviation fuel hedges.
The most frequently used foreign exchange derivatives are cross currency swaps, forwards and options. The most commonly used interest rate derivatives are interest rate swaps. The fuel price derivatives are mainly options.
The Company classifies its derivatives into three types pursuant to International Financial Reporting Standards (IFRSs):
1. Derivatives designated as cash-flow hedges: derivatives that mainly enable the cash flows from operating leases, ticket sales in currencies other than the euro and fuel purchases to be hedged.
2. Derivatives designated as fair value hedges: derivatives that enable the fair value of balance-sheet assets and liabilities to be hedged.
3. Other derivatives: those which have not been designated as hedges or do not meet the requirements established in IFRSs.

Foreign exchange hedges

At 31 December 2006, the derivatives hedging exchange rate fluctuations which were not specifically designated as hedges under IFRSs (since they are naturally offset in the income statement) were as follows:

Underlying	Currency	Amount (Millions of Currency)	Derivative	Nominal Amount (Millions of Currency)
Loans to Iberbús companies	USD	198	Cross currency swaps	82
Advances on aircraft and engines	USD	381	Fx forward	121
Guarantees	USD	31		
A-320 equities	USD	53		
4 A-320/321 debt	USD	(182)		
5 A-340 debt	USD	(278)		
Total		**203**		**203**

The fair value of these derivatives at 31 December 2006 was negative for the amount of EUR 8.3 million and the change in value of EUR 11 million with respect to 31 December 2005 was recognised as profit for the year, having been offset by the valuation losses on asset items.

At the balance sheet date, the total notional amount, by foreign exchange risk, of cash flow hedges was as follows:

Underlying	Currency	Amount (Millions of Currency)	Type of Hedge	Forecast Cash Flows (Millions of Currency) 2007	2008	2009	2010	2011
Foreign currency expenses	USD	(1.317)	Cross Currency Swaps	240	231	230	128	60
			Options:					
			USD "Four Ways"	511	430	–	–	–
			USD "cylinders"	40				
			Fx Forwards	329	47	–	–	–
Foreign currency income	GBP	91	Fx Forwards	28	–	–	–	–
	CHF	124	Fx Forwards	7	–	–	–	–
New aircraft	USD	(147)	Options:					
			USD "Four Ways"	92	–	–	–	–
			USD "cylinders"	9				
			Fx Forwards	38	–	–	–	–

The market value at 31 December 2006 of the exchange rate derivatives (Fx forwards and options) was negative and amounted to EUR 36.8 million (2005: a negative amount of EUR 19.2 million). EUR 5.1 million of this amount was recognised under current and non-current derivative financial instruments and liabilities of EUR 41.9 million were recognised under "Trade and Other Payables" and "Other Non-Current Liabilities" in the accompanying consolidated balance sheet.

Changes in the fair value of foreign exchange derivatives that are effective as cash flow hedges for a negative amount of EUR 55.1 million were deferred in equity.

Changes in the fair value of the ineffective portion of foreign currency forwards and options (temporary value) of EUR 0.8 million were charged to income in 2006.

The foreign currency rate and interest rate risks related to aircraft leases were hedged with cross currency swaps (CCS) which convert payments originally in dollars to euros.

Cash flow hedges at 31 December 2006

Amount (Thousands of Currency)(*)

Instrument	IBERIA	IBERIA	Nom. amount at 31/12/06	Nom. amount 31/12/07	Nom. amount 31/12/08	Nom. amount 31/12/09	Nom. amount 31/12/10
Cross Currency Swaps:							
Floating to fixed	Receives USD	Pays EUR	470,809	261,820	201,244	-	-
Floating to floating	Receives USD	Pays EUR	883,710	762,005	608,799	412,013	190,476
Floating to floating	Receives EUR	Pays USD	824,084	698,676	538,240	386,173	76,723
Fixed to fixed	Receives USD	Pays EUR	723,122	543,031	470,096	290,317	123,013

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

Interest rate hedges

The Group uses cross currency swaps and interest rate swaps to manage its exposure to interest rate movements on its aircraft financing transactions.

Instrument	Currency	31/12/06
Interest Rate Swaps		
Fixed to floating[1]	EUR	49,141
Floating to fixed[2]	USD	137,981

[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 fair value of the cross currency swaps and interest rate swaps outstanding at 31 December 2006 was a negative amount of EUR 45.4 million (2005: a negative amount of EUR 9.7 million). This amount is made up of assets of EUR 17.1 million (current and non-current "Derivative Financial Instruments") and liabilities of EUR 62.5 million ("Trade and Other Payables" and "Other Non-Current Liabilities").

The changes in value accumulated by the effective portion of the cash-flow hedges were recognised in equity for a negative amount of EUR 30.5 million. The changes in value accumulated by the inefficient portion (a negative amount of EUR 24.6 million) were allocated to profit for the year.

Fuel price hedges

Underlying	Amount (mT)	Type of Hedge	2006 Nominal (Tm)
Fuel purchases	Approx. 2 million	Options bought	1,870,000
		Options sold	1,870,000

Fuel price risk is hedged through options structures that hedge cash-flow fluctuations due to changes in fuel prices within a certain range.

The outstanding hedges at 31 December 2006 enable the Company to partially hedge the price of fuel at a price of USD 61.5/bbl for 50% of the volume of kerosene consumption projected for all of 2007.

The fair value of the fuel derivatives at 31 December 2006 was a negative amount of EUR 6.7 million, which was recognised in full as a liability under "Trade and Other Payables" and "Other Non-Current Liabilities" in the accompanying consolidated balance sheet. In addition, the effective portion of the hedge, a negative amount of EUR 6.4 million, was recognised under "Equity – Valuation Adjustments" in the consolidated balance sheet at 31 December 2006.

20. Tax matters

Consolidated Tax Group

The corporation tax for each fully consolidated company is calculated on the basis of accounting profit, which does not necessarily coincide with taxable profit.

Since 1 January 2002 Iberia, Líneas Aéreas de España, S.A. and part of its subsidiaries have filed consolidated tax returns under the tax system provided for by Chapter VII of Title VII of the Consolidated Corporate Income Tax Law (Legislative Royal Decree 4/2004, of 5 March) as part of Tax Group 148/02 of which it is the Parent. The companies comprising the Consolidated Tax Group are fully consolidated, except for Binter Finance, BV, which does not meet the legally established requirements for forming part of the Group.

Years open for review by the tax authorities

As a result of successive tax audits, the tax authorities issued certain assessments for 1993 to 1997 (relating mainly to personal income tax withholdings), which were signed on a contested basis and appealed against by the Parent.

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).

The directors of Iberia, Líneas Aéreas de España, S.A. consider that no tax liabilities additional to those recognised under "Provisions for Liability" will arise from the resolution of the various appeals described above (see Note 17).

In connection with the years open to possible tax audit, in general 2002 to 2005 for income tax and 2003 to 2006 for the other taxes applicable to the Parent and the other fully consolidated companies, the directors of Iberia, Líneas Aéreas de España, S.A., consider that such contingent liabilities as might materialise would be of the same nature as those relating to the assessments described above. There are no other significant contingent liabilities other than those indicated in this Note.

Tax receivables and payables

The detail of the tax receivables at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Deferred tax assets	445,355	484,513
Current tax receivables:		
Foreign tax receivables	4,075	4,848
VAT	10,655	13,953
Income tax withholdings and pre-payments	–	120,321
Other tax receivables	13	32
Total	14,743	139,154

The deferred tax assets relate mainly to the provisions for obligations to employees and other provisions which will become tax-deductible in the future.

The detail of the tax payables at 31 December 2006 and 2005 is as follows:

Thousands of euros

	2006	2005
Deferred tax liabilities	1,915	17,357
Current tax payables:		
Take-off and security charges at airports	31,677	26,024
Foreign tax payables	48,278	27,219
Social security taxes	42,256	24,085
Personal income tax withholdings	30,581	30,893
Other tax payables	16,349	255
Total	169,141	108,476

Law 35/2006 on Personal Income Tax and partially amending the Spanish Corporation Tax, Non-Resident Income Tax and Wealth Tax Laws, of 28 November, provides, inter alia, for the reduction

over two years of the standard Spanish corporation tax rate from 35% at 31 December 2006 to 32.5%% in 2007 and 30% in subsequent years.

As a result of the above, in 2006 the Group recalculated its tax assets and liabilities taking into account that they will foreseeably be reversed. Consequently, an adjustment of EUR 59,129 thousand was recognised under "Negative Adjustments to Income Tax" in the accompanying income statement for 2006.

Deferred tax assets and liabilities are recognised in the balance sheet under "Deferred Tax Assets" and "Deferred Tax Liabilities" on the basis of their recovery date, the detail being as follows:

Thousands of euros

	2006		2005	
	Deferred Tax Assets	**Deferred Tax Liabilities**	**Deferred Tax Assets**	**Deferred Tax Liabilities**
Temporary differences arising in the period	46,334	-	118,941	–
Unallocated temporary differences				
arising in prior years	276,686(*)	1,915	250,739(*)	2,763
Tax effect of IFRS adjustments	122,335(*)	-	114,833(*)	14,594
Temporary differences arising in the period	-	-	19,175	13,677
Temporary differences arising in prior years	122,335	-	95,658	917
Total	**445,355**	**1,915**	**484,513**	**17,357**

(*) Relating mainly to deferred tax assets arising from provisions for obligations to employees and other provisions.

The deferred tax assets at 31 December 2006, are expected to be recovered as follows:

Thousands of euros

Year of Recovery	
2008	40,000
2009	40,000
2010 and subsequents years	365,355
	445,355

Reconciliation of the accounting profit to the taxable profit

The reconciliation of consolidated accounting profit for 2005 and 2006 of the Consolidable Group companies to the taxable profit for income tax purposes is as follows:

Thousands of euros

	2006			2005		
	Increase	Decrease	Amount	Increase	Decrease	Amount
Accounting profit for the year (before tax and after minority interests)			164,950			393,272
Permanent differences	2,407	(127)	2,280	1,613	(158)	1,455
Temporary differences:						
Arising in the year	171,116[a]	-	171,116	396,140[a]	-	396,140
Arising in prior years	1,426	(149,355)[b]	(147,929)	268	(143,546)[b]	(143,278)
Consolidation adjustments:						
Permanent differences	32,208	(10,504)	21,704	150,463	(27,438)	123,025
Tax loss carryforwards	-	-	(601)	-	-	(541)
Taxable profit			**211,520**			**770,073**

[a] Relating mainly to period provisions for obligations to employees and deferred income arising from credit memorandums and other incentives.
[b] Relating basically to amounts used of provisions recognised in prior years for obligations to employees, of other provisions for contingencies and expenses and the income from credit memorandums and other incentives received in prior years and allocated to the income statement in 2006.

Income tax

The detail of the balance of "Income Tax" in the accompanying consolidated income statements for 2005 and 2006 relates to the sum of the income tax expenses recognized by each fully consolidated company, the detail being as follows:

Thousands of euros

	2006	2005
Application of the 35% tax rate to accounting profit adjusted by permanent differences	66,127	181,213
Add/(Less)		
Tax credits	(13,959)	(196,428)
Adjustment of previous years' income tax	(5,714)	(3,431)
Other	15,566	23,931
Tax effect of IFRS adjustments	(12,925)	(7,802)
Income tax	**49,095**	**(2,517)**

Current Spanish corporation tax regulations provide certain tax incentives to encourage investments and contributions to employees' mutual funds. The consolidated companies availed themselves of certain tax benefits in this connection and deducted tax credits of EUR 9,194 thousand in the income tax return for 2005 and intend to deduct tax credits amounting to EUR 7,400 thousand in the income tax return for 2006.

The Iberia Group recognized domestic and international double taxation tax credits amounting to EUR 64,221 thousand in 2005 and intends to deduct tax credits amounting to EUR 6,472 thousand in this connection in 2006.

In 2005 and 2006 the Group reinvested EUR 824,576 thousand and EUR 569 thousand arising from the sale of assets which gave rise to tax assets of EUR 128,710 thousand and EUR 87 thousand, respectively. The amounts reinvested in recent years and the related tax credits are as follows:

Thousands of euros

	Reinvestment	Tax Credits
2002	72,794	4,423
2003	31,516	4,822
2004	124,869	16,980
2005	824,576	128,710
2006	569	87

21. Income

21.1. Revenue

The breakdown of the Consolidable Group's revenue in 2005 and 2006 is as follows:

Thousands of euros

By Activity	2006	2005
Passenger ticket revenue[a]	4,222,904	3,883,870
Cargo revenue	329,738	313,278
Handling (aircraft dispatching and airport services)	331,154	322,088
Technical assistance to airlines	219,038	155,723
Other income	85,119	84,458
Total	**5,187,953**	**4,759,417**

[a] Including other income (recovery of unused tickets, commercial agreements, etc.) amounting to EUR 259,904 thousand and EUR 273,871 thousand in 2006 and 2005, respectively.

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

Millions of euros

	2006	2005
Domestic	1,206	1,238
Medium-haul	1,170	1,120
Long-haul	1,587	1,252
Total	**3,963**	**3,610**

21.2. Other operating income

The detail of "Other Operating Income" in the accompanying consolidated income statements is as follows:

Thousands of euros

Description	2006	2005
Commissions	80,149	79,670
Rental income	22,122	15,676
Other sundry income	97,557	74,368
Recovery of provisions for repairable parts	53,279	–
Sale of Musini	14,738	–
Other non-recurring operating income	8,748	17,184
	276,593	**186,898**

The income from commissions relates basically to the commissions on the sale of tickets for other airlines and the commissions arising from the franchise agreement with Air Nostrum.

As indicated in Note 5.5, due among other reasons to the substantial improvement in the computer and warehouse management systems, in 2006 there was a highly significant increase in the turnover of repairable engine parts and, accordingly, the value of these spare parts, which until 2005 were classified as property, plant and equipment and depreciated annually as slow-moving goods, were reclassified to "Inventories" and the allowance for depreciation required at 31 December 2006 was recalculated, giving rise to net income of EUR 26,864 thousand in the consolidated income statement (see Note 22.1).

Also, "Sale of Musini" for EUR 14,738 thousand arose from the final settlement of the sale in 1997 of the ownership interest in Musini, the former SEPI insurance company and Iberia investee.

21.3. Net gains on disposal of non-current assets

The detail of the balance of "Net Gains on Disposal of Non-Current Assets" in the accompanying consolidated income statements for 2005 and 2006 is as follows:

Thousands of euros

	2006	2005
Disposal of Sistemas Automatizados de Viaje, S.A. (Note 2.1)	–	75,555
Disposal of Amadeus Group (Note 2.2)	–	587,721
Disposal of aircraft and engines	(1,599)	(6,527)
Other	(751)	–
	(2,350)	**656,749**

22. Expenses

22.1. Procurements

The detail of "Procurements" in the accompanying income statements for 2005 and 2006 is as follows:

Thousands of euros

	2006	2005
Recurring:		
Aircraft fuel	1,177,516	865,761
Aircraft spare parts	157,953	154,374
Catering materials	24,073	23,241
Other purchases	19,152	20,138
Non-recurring:		
Provision for repairable engine parts	26,415	–
	1,405,109	**1,063,514**

The aircraft fuel expense in 2006 totalled EUR 1,179,332 thousand (2005: EUR 1,019,033 thousand). However, the related hedging derivatives transactions (price and exchange rate hedges), –including the valuation at the reporting date of the inefficient derivatives– reduced this expense by EUR 1,816 thousand (2005: EUR 153,272 thousand).

22.2. Headcount and other staff costs

The detail of "Staff Costs" in the accompanying consolidated income statements for 2005 and 2006 is as follows:

Thousands of euros

	2006	2005
Wages, salaries and similar	1,049,905	1,088,990
Employee welfare costs	345,297	351,690
Other	–	1,656
Non-recurring staff costs		
Provisions for extension of collective redundancy procedure (Note 17.2)	25,800	288,876
Other period provisions for contingencies and expenses	–	1,997
	1,421,002	**1,733,209**

The average number of employees at the fully consolidated Group companies, measured in terms of equivalent average headcount, by professional category, in 2005 and 2006 was as follows:

Number of Employees

	2006	2005
Ground personnel:		
Senior managers and other line personnel	1,194	1,226
Clerical staff	6,386	6,581
Other	10,158	10,278
	17,738	18,085
Flight personnel:		
PPilots	1,826	1,887
Flight engineers	–	16
Cabin crew	4,337	4,360
	6,163	6,263
	23,901	**24,348**

22.3. Other operating expenses

The detail of "Other Operating Expenses" in the accompanying consolidated income statements for 2005 and 2006 is as follows:

Thousands of euros

	2006	2005
Commercial expenses	246,054	259,622
Aircraft lease payments:		
Dry lease[a]	351,864	372,958
Wet lease[a]	51,245	42,477
Cargo	12,597	14,797
Cash-flow derivative transactions	24,605	(29,627)
Other	8,839	4,991
Air traffic services	387,684	367,480
Stopover expenses	41,899	41,711
Incident expenses	22,172	18,716
Navigation charges	285,758	276,441
Aircraft maintenance[b]	179,806	142,621
General maintenance	41,435	38,384
Booking system expenses	147,767	139,747
In-flight services	67,957	63,178
Other rent	76,376	76,285
Indemnities for passengers, luggage and cargo	51,638	35,491
Other[c]	274,864	263,689
Other non-recurring expenses	15,548	17,237
	2,288,108	**2,146,198**

[a] Aircraft lease payments amounted to EUR 399,711 thousand in 2006 (2005: EUR 406,458 thousand). The related interest rate and foreign exchange hedging transactions reduced these expenses by EUR 13,903 thousand in 2005 and increased them by EUR 27,954 thousand in 2006.
[b] Including the expenses for subcontracted maintenance work and the provision for major repairs of aircraft operated under operating leases.
[c] The fees for financial audit services provided to Iberia, Líneas Aéreas de España, S.A. and its subsidiaries by the principal auditor and by other entities related to the auditor during 2006 amounted to EUR 501 thousand (2005: EUR 458 thousand).
Also, the fees for other professional services provided to Iberia, Líneas Aéreas de España, S.A., and its subsidiaries by the main auditors and by other entities related thereto amounted to EUR 145 thousand in 2006 (2005: EUR 62 thousand).

22.4. Finance costs

The detail of "Finance Costs" in the accompanying consolidated income statements is as follows:

Thousands of euros

	2006	2005
Interest on loans	16, 131	7,120
Interest on obligations under finance leases	22,121	18,748
Interest on employee liabilities	20,063	19,138
Other finance costs	2,310	1,122
	60,625	**46,128**

22.5. Finance income

The detail of "Finance Income" in the accompanying consolidated income statements is as follows:

Thousands of euros

	2006	2005
Interest on short-term deposits	57,458	41,307
Interest on loans to associates	7,187	7,500
Other finance income	23,405	10,097
	88,050	**58,904**

23. Contribution of subsidiaries and associates to consolidated profit

The contribution of subsidiaries and associates to the consolidated profit in 2005 and 2006 is as follows:

Thousands of euros

	Profit (Loss)	
Company	**2006**	**2005**
Iberia, Líneas Aéreas de España, S.A.	51,546	391,950
Compañía Auxiliar al Cargo Exprés, S.A.	696	649
VIVA Vuelos Internacionales de Vacaciones, S.A.	612	484
Iberia Tecnología, S.A.	(802)	74
Other subsidiaries	188	124
Multiservicios Aeroportuarios, S.A.	929	607
Handling Guinea Ecuatorial, S.A. (HANGESA)	(44)	635
Empresa Logística de Carga Aérea, S.A. (ELCA)	398	148
Empresa Hispanocubana de Mantenimiento de Aeronaves Ibeca, S.A.	498	448
Sociedad Conjunta para la Emisión y gestión de Medios de Pago EFC, S.A. (IBERIA-CARDS)	1,286	333
Internacional Supply Management, S.L.	689	–
Serpista, S.A.	320	138
Air Miles Group	358	114
Other associates	51	85
Beneficios atribuidos a la Sociedad dominante	**56,725**	**395,789**

24. Business and geographical segments

Basis of segmentation

Segment reporting is structured on a primary basis by business segment and on a secondary basis by geographical segment.

Primary segments - business segments

The business lines described below were established on the basis of the Iberia Group's organisational structure at 2006 year-end and take into account the nature of the services provided and the customer segments at which they are targeted.

In 2006 the Iberia Group engaged mainly in the following major lines of business, which provides the basis for the Group's primary segment reporting:

1. Transport business (including passenger and cargo transport)
2. Airports business (mainly handling)
3. Maintenance and engineering business
4. Other business activities

Income and expenses that cannot be specifically attributed to any operating line or that are the result of decisions affecting the Group as a whole –including expenses incurred in projects or activities affecting several lines of business, or income from strategic investments, and income tax expenses, etc– are attributed to a "Corporate Unit" to which the reconciling items arising from the reconciliation of the result of integrating the financial statements of the various lines of business (prepared using a management approach) to the Group's consolidated financial statements are also allocated.

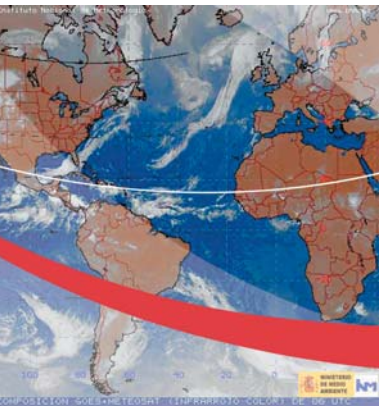
The costs incurred by the Corporate Unit are allocated among the various lines of business using an internal cost allocation system.

Secondary segments - geographical segments

The Group's activities are also classified into geographical segments: Domestic (Spain), Short- and Medium-Haul International (Europe, Africa excluding South Africa, and the Middle East) and Long-Haul markets.

Basis and methodology for segment reporting

The segment reporting below is based on monthly reports prepared by the Iberia Group which are generated on the basis of the Group's analytical accounting system which classifies transactions carried out by the Group by business line and geographical segment.



Segment revenue relates to the external and internal revenue directly attributable to the segment and excludes finance income, dividends or proceeds from the disposal of investments.

The expenses of each segment are determined by the directly allocable expenses incurred in the operating activities of the segment plus the corresponding proportion of the corporate expenses which can be allocated to the segment using reasonable distribution bases. The expenses thus allocated do not include interest, losses arising from the disposal of investments or the income tax expense that are not related to the segments' operating activities and, therefore, that cannot be allocated using reasonable allocation bases.

Segment assets and liabilities are those directly related to each segment's operations, plus the assets and liabilities that can be directly attributed thereto using the aforementioned allocation bases. Segment liabilities do not include income tax debts.

Segment information about these businesses is presented below:

Thousands of euros

Segment reporting	Transport 2006	Transport 2005	Airports 2006	Airports 2005	Maintenance 2006	Maintenance 2005	Corporate Unit and Other Businesses 2006	Corporate Unit and Other Businesses 2005	Total Group 2006	Total Group 2005
Operating income:										
External	4,780,593	4,399,906	333,840	323,873	229,940	168,657	43,408	36,691	5,387,781	4,929,127
Inter-segment	4,667	4,524	307,402	289,296	376,572	405,495	337,088	311,988	1,025,729	1,011,303
Operating expenses:										
External	3,938,164	3,546,206	590,532	550,822	553,659	518,752	183,472	196,757	5,265,827	4,812,537
Inter-segment	775,558	793,677	32,005	37,478	27,176	30,556	190,990	149,592	1,025,729	1,011,303
Operating profit	**71,538**	**64,547**	**18,705**	**24,869**	**25,677**	**24,844**	**6,034**	**2,330**	**121,954**	**116,590**
E.B.I.T.D.A.R.	685,808	591,412	35,340	39,437	49,702	55,459	19,626	13,608	790,476	699,916
Aircraft lease payments	(449,252)	(405,406)	-	-	190	(190)	(89)	-	(449,151)	(405,596)
E.B.I.T.D.A.	236,556	186,006	35,340	39,437	49,892	55,269	19,537	13,608	341,325	294,320
Deprec. & amortisation charge	(165,018)	(121,459)	(16,635)	(14,568)	(24,215)	(30,425)	(13,503)	(11,278)	(219,371)	(177,730)
	71,538	64,547	18,705	24,869	25,677	24,844	6,034	2,330	121,954	116,590
Non-recurring income							13,207	261,275	13,207	261,275
Financial profit							25,514	13,129	25,514	13,129
Investments in companies accounted for using the equity method							4,518	2,508	4,518	2,508
Profit before tax							165,193		165,193	393,502
Income tax							(49,095)	2,517	(49,095)	2,517
Negative adjustments to income tax							(59,129)	–	(59,129)	–
Net profit									**56,969**	**396,019**
Equivalent headcount	9,707	10,077	8,988	8,972	3,864	3,885	1,342	1,414	23,901	24,348
Investments	91,636	264,518	44,610	24,730	25,409	142,310	16,991	20,572	178,646	452,130
Property, plant and equipment	1,054,155	1,139,105	100,882	73,904	157,350[a]	211,626[a]	38,522	38,949	1,350,909	1,463,584
Inventories	44,786	42,289	496	442	137,345[a]	62,206[a]	4,967	9,744	187,594	114,681
Other assets	-	-	-	-	-	-	4,212,747	3,966,388	4,212,747	3,965,653
TTotal assets									**5,751,250**	**5,543,918**
Customer advances	435,541	359,723	-	-	-	-	-	-	435,541	359,723
Remuneration payable	91,680	95,974	37,429	37,352	20,447	21,127	10,206	11,054	159,762	165,507
Other liabilities	-	-	-	-	-	-	5,155,947	3,280,672	5,155,947	3,280,455

[a] See Notes 5.5 and 7 on repairable engine parts.

Inter-segment sales are made applying a system of internal transfer prices based on market prices on the basis of equivalent areas and volumes.

The following table shows the geographical breakdown of the Group's revenue:

Secondary Segment	Revenue 2006	Revenue 2005
Domestic	2,234,997	2,204,743
Short- and Medium Haul International	1,253,803	1,205,429
Long-Haul	1,898,981	1,518,955
Total	**5,387,781**	**4,929,127**

All the Group's assets would be allocable to the domestic market except for the aircraft, which do not have defined geographical location. The percentages of use of the aircraft in each geographical market, measured in terms of total block hours, are as follows:

Secondary Segment	Percentage of Use 2006	2005
Domestic	33.05%	33.78%
Short- and Medium Haul International	38.08%	38.29%
Long-Haul	28.88%	27.93%
Total	**100%**	**100%**

25. Related party transactions

Balances and transactions with other related parties

In 2005 and 2006 the Group companies performed the following transactions with related parties:

Thousands of euros

Significant Shareholders	2006 Collected from Iberia Group	2006 Paid to Iberia Group	2005 Collected from Iberia Group	2005 Paid to Iberia Group
American Airlines	4,576	7,972	7,767	7,571
British Airways	9,494	34,538	8,233	31,935
El Corte Inglés	23,716	32	26,894	35
Logista, S.A.	162	26	177	24
BBVA	3,204	1,216	2,740	794
Caja Madrid	9,014	20	5,564	485
Total	**50,166**	**43,804**	**51,375**	**40,844**

The transactions with American Airlines and British Airways relate mainly to commissions on passenger tickets collected from and paid to these companies, for tickets issued by one company with the related flight being flown by the other, collections and payments arising from loyalty building programmes, results from the joint operation of certain routes (BA) and collections for handling services provided by Iberia, Líneas Aéreas de España, S.A.

The main transactions with El Corte Inglés relate to the supply of uniforms for ground staff and flight personnel, commissions and incentives for passenger ticket sales under commercial agreements, technical advisory services and the maintenance and development of computer software and hardware.

The payments to Logista relate to handling and delivery of tickets to customers' homes.

Lastly, the transactions with BBVA and Caja Madrid relate mainly to the interest on aircraft financing transactions, guarantees given on aircraft and other financial transactions.

In addition, the accompanying consolidated balance sheets at 31 December 2006 and 2005 include the following balances with related parties arising in the normal course of business:

Thousands of euros

Related Parties	31/12/06	31/12/05
American Airlines	91	8
British Airways	1,210	1,399
El Corte Inglés Group	7,351	7,395
Logista	6	–
	8,658	8,802

26. Remuneration of directors and senior executives

The detail of the remuneration received in 2006 and 2005 by the members of the Board of Directors in their capacity as directors of the Company is as follows:

Thousands of euros

Directors' Remuneration	2006	2005
Fixed remuneration	628	660
Attendance fees	578	545
Compensation in kind	85	71
Total remuneration	1,291	1,276

In 2006 Iberia Líneas Aéreas de España, S.A. incurred expenses related to the performance of non-executive directors' functions amounting to EUR 9 thousand (2005: EUR 8 thousand).

In addition, certain directors occupy executive positions in the Company for which they received the following remuneration in 2006:

Thousands of euros

Executive directors	2006	2005
Fixed remuneration	838	1,002
Variable remuneration[(a)]	755	842
Compensation in kind	21	23
Options[(b)]	350	576
	1,964	2,443

[(a)] Relating to payments for achieving objectives for the year prior to that indicated in the column.
[(b)] Relating to payments made under the share option plan approved in 2003.

The social security, insurance and other costs recognised by Iberia Líneas Aéreas de España, S.A. in relation to the activities performed by the executive directors amounted to EUR 571 thousand in 2006 (2005: EUR 580 thousand).

In 2006 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.

In 2006 the Company incurred expenses amounting to EUR 1,849 thousand associated with the termination of an executive director in connection with a non-competition covenant, variable remuneration and the surrender of an insurance policy.

Lastly, at 31 December 2006 the Company's executive directors hold 200,000 unexercised stock options.

Remuneration of senior executives

The remuneration of the Company's senior executives – excluding those who are simultaneously members of the Board of Directors (whose remuneration is disclosed above) – in 2005 and 2006 is summarised as follows:

Thousands of euros

Description	2006 (19 Persons)	2005 (20 Persons)
Salary (fixed and variable)[a]	4,073	4,267
Other long-term benefits	177	162
Share-option-based payments[b]	662	806
Other	204	219
	5,116	5,454

[a] Variable remuneration relates to payments for achieving objectives for the year prior to that indicated in the column.
[b] Relating to payments made under the share option plans approved in 2001 and 2003.

The Management Committee has been granted options on a total of 3,178,151 shares, of which 992,711 options were exercised in 2006, leaving 1,000,840 outstanding.

In 2005 and 2006 no advances or loans were granted to the members of the Management Committee of Iberia, Líneas Aéreas de España, S.A., and there are no pension obligations to them.

27. Detail of the investments in companies engaging in similar activities and of the performance, by the directors, as independent professionals or as employees, of similar activities

Pursuant to Article 127 ter.4 of the Spanish Companies Law, introduced by Law 26/2003, of 17 July, which amends Securities Market Law 24/1988, of 28 July, and the Consolidated Spanish Companies Law, in order to reinforce the transparency of listed corporations, following is a detail of the activities carried on in 2006, as independent professionals or as employees, by the various members of the Board of Directors that are identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A. and subsidiaries:

Name	Line of Business	Type of Arrangement	Company	Position/ Function
Roger Maynard	Air transport	Employee	British Airways	Director of Alliances & Investments
	Air transport	Employee	British Airways Citiexpress	Chairman
Lord Garel-Jones	Handling	Employee	Acciona	Director
Antonio Vázquez	Distribution and logistics	Employee	Logista	Chairman

Fernando Conte is also a member of the Board and Chairman of the Audit Committee of IATA.

Also, pursuant to the aforementioned Law, it is hereby stated that no member of the Board of Directors owns any equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A. and subsidiaries.

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.

28. Information on the environment

Within the framework of its environmental policy, the Group continued to undertake various activities and projects in 2006 in order to guarantee the proper management of the main environmental impacts of the air transport business as a whole.

In 2006 the Group incurred environmental expenses of EUR 3,926 thousand (2005: EUR 3,138 thousand), the detail being as follows:

Thousands of euros

	2006	2005
Environmental repair and maintenance	1,676	1,174
Environmental technical services	919	715
Staff costs relating to environmental management	1,009	993
Environmental taxes and other	338	256
Total	**3,942**	**3,138**

At 31 December 2006, the acquisition cost and accumulated depreciation of the environmental assets, which include, inter alia, water-treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, amounted to EUR 60,285 thousand and EUR 29,633 thousand, respectively (2005: EUR 55,177 thousand and EUR 24,817 thousand, respectively).

With respect to its aircraft, the Group has a renewal policy in which the environment (minimising the impact of noise and air emissions) is an important factor to be borne in mind. Accordingly, the Group is continuing to add new aircraft models that reduce fuel consumption by approximately 20% compared to earlier generation aircraft. In 2005 four A-340-600 aircraft were added for long-haul flights and three B-747 were retired; ten aircraft of the A-320 family were added and three B-757, one A-320 and seven MD aircraft were retired. In 2006 three A-340-600 were added for long-haul routes and two B-747 were retired. Eight aircraft of the A-320 family were also acquired and three B-757, six A-320 and one MD aircraft were retired.

As far as ground operations are concerned, the ISO 14001: 2004 Environmental Management System certification was renewed for the aircraft maintenance activity in the Madrid facilities and for the handling business at 39 Spanish airports.

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.

29. Explanation added for translation to English

These consolidated financial statements are presented on the basis of IFRSs, as adopted by the European Union. Certain accounting practices applied by the Group that conform with IFRSs may not conform with other generally accepted accounting principles.

Consolidated Management Report
Iberia Group

Key data

IBERIA GROUP [1]	2006	2005	% Change
Result (millions of Euros)			
Operating revenue	5,387.8	4,929.1	9.3
EBITDAR	790.5	699.9	12.9
Operating profit	122.0	116.6	4.6
Operating profit (excluding IAS 39)	150.3	89.6	67.6
Profit from operations [2]	135.2	377.9	(64.2)
Profit before tax	165.2	393.5	(58.0)
Consolidated profit for the year	57.0	396.0	(85.6)
Profit for the year attributable to the Parent	56.7	395.8	(85.7)
Consolidated profit before adjustments for taxes	116.1	396.0	(70.7)
Basic earnings per share (€ cents) [3]	6.1	42.8	(85.8)
Dividends per share (€ cents)	3.5	32.2	(89.1)
Passenger traffic: capacity and revenue			
ASK (millions)	65,802	63,628	3.4
RPK (millions)	52,493	49,060	7.0
Passenger load factor (%)	79.8	77.1	2.7 p.
Passenger revenue (millions of Euros)	3,963.2	3,610.0	9.8
Passenger revenue per RPK (€ cents)	7.55	7.36	2.6
Passenger revenue per ASK (€ cents)	6.02	5.67	6.2
Financial aggregates and ratios			
Equity (millions of Euros)	1,738.6	1,738.2	0.0
Net debt (millions of Euros) [4]	(1,722.2)	(1,142.4)	50.8
Adjusted net debt (millions of Euros) [5]	1,346.6	1,739.1	(22.6)
EBITDAR margin (%)	14.7	14.2	0.5 p.
Operating profit margin (%)	2.3	2.4	(0.1 p.)
Consolidated profit margin (%)	1.1	8.0	(7.0 p.)
ROE (%) [6]	3.3	22.8	(19.5 p.)
Operating revenue per ASK (€ cents)	8.19	7.75	5.7
Operating cost per ASK (€ cents)	8.00	7.56	5.8
Operating cost per ASK excluding fuel (€ cents)	6.21	6.20	0.2
Operating cost per ASK excluding fuel and IAS 39 (€ cents)	6.18	6.25	(1.2)
Resources			
Avg. number of full-time equivalent employees [7]	23,901	24,348	(1.8)
Operating revenue per employee (thousands of Euros) [8]	226.0	203.0	11.4
Productivity (thousands of ASK per employee) [8]	2,775	2,634	5.4
Aircraft in service at December 31	150	154	(2.6)
Usage of the fleet (B.H. per aircraft per day)	9.1	9.1	(0.6)

[1] Consolidated data based on International Financial Reporting Standards (IFRSs).
[2] Profit from operations includes profit from recurring and non-recurring items.
[3] Average weighted number of outstanding shares (in thousands): 932,049 in 2006; 925,434 in 2005.
[4] Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding the valuation of hedges at year-end 2006 and 2005).
[5] Calculated as follows: Net debt + Capitalised aircraft leases (excluding hedge values and in 2005 also income from the five A340 included in the balance sheet in December) – (Iberbond Bonds + Capitalised interest on Iberbus loans)
[6] Return on equity: Consolidated profit/Equity.
[7] Including the employees of IBERIA, CACESA, ALAER and BINTER FINANCE.
[8] Productivity of the total IBERIA workforce.

1. Highlights

The air transport industry taken as a whole saw passenger traffic on regular international flights –measured in revenue passenger kilometers (RPK)– grow by 5.9% in 2006, according to data published by the International Air Transport Association (IATA). This increase was in line with the industry's average historical growth rate, although it represented a slowdown with respect to the 7.6% increase in 2005. Worldwide, the 4.6% increase in capacity was somewhat more modest in 2006, although the load factor increased by 0.9 percentage points with respect to 2005.

As in 2005, Middle Eastern airlines continued to represent the region that saw the highest levels of traffic growth, 15.4%, while Latin American airlines achieved growth of 11.5% (excluding Varig, which is immersed in a rigorous restructuring plan). North American airlines were the companies that achieved the highest load factors, with an annual average of 80.2% in 2006.

The increase in international traffic carried by European network airlines was 5.5% as compared with 2005, according to data from the Association of European Airlines (AEA). Total AEA traffic, including domestic flights, saw a 5.2% increase in RPK, while growth in availability of seat-kilometers (ASK) was more modest at 4.4% for the year taken as a whole. As a result, the load factor improved by 0.6 percentage points with respect to 2005.

In 2006 the price of fuel once again exceeded the all-time-highs reached in 2005. Prices in August approached USD 80 a barrel and then went on to fall, leaving the price of Brent crude at around USD 60 a barrel at year-end. In spite of this adjustment, the average annual price of crude oil increased by close to 20% with respect to the average price in 2005.

In 2006, the net results of the air transport industry improved with respect to the 2005, despite the increase in the price of fuel, and according to the latest estimates published by IATA losses will have fallen by USD 500 million as compared with the USD 3,200 million in 2005. These improved results were favoured by economic growth, which led to increased revenue, together with the cost containment plans implemented by the airlines and by the moderate growth in capacity. The most pronounced improvement in results was seen in the US, where the majority of airlines returned to profit after five years of major losses.

In this scenario, the Iberia Group addressed the first year of implementation of the 2006/08 Master Plan, achieving most of the objectives established for 2006 and improving on operating profit in 2005.

Thus, complying with one the Plan's strategic lines, the Company commenced to undertake a far-reaching restructuring and review of its flight programme, promoting growth in services in the long-haul sector. To execute this strategy, the Iberia Group has a new location in the T4 Terminal at Madrid-Barajas airport, which came into service in February 2006 and offers optimal conditions for the Company to continue to strengthen its hub and improve service quality.

In 2006, the RPK of Iberia, Líneas Aéreas de España, S.A. ("IBERIA") increased by 7.0% as compared with 2005, compared to an increase in supply of 3.4%, and the passenger load factor improved 2.7 percentage points, reaching 79.8%, which was –for the second successive year- an all-time-high in the Company's load factor, which is one of the highest among the European network airlines.

IBERIA focused the growth of its air transport business on its long-haul flights, in particular the routes to Central and South America, and received an excellent response in terms of demand, which enabled it to consolidated its position of leadership in the Europe – Latin America market with market share increasing to 19% in 2006 and widening the advantage it has over its main competitors. Adjustments were also made in the medium-haul and domestic sectors in order to ensure suitable levels of return.

Despite the 6.5% growth in the average haul in 2006, passenger revenue per RPK increased by 2.6% with respect to 2005, after three years of decreases. Unit passenger revenue per ASK improved in all the sectors with respect to 2005, increasing by 6.2% in the network as a

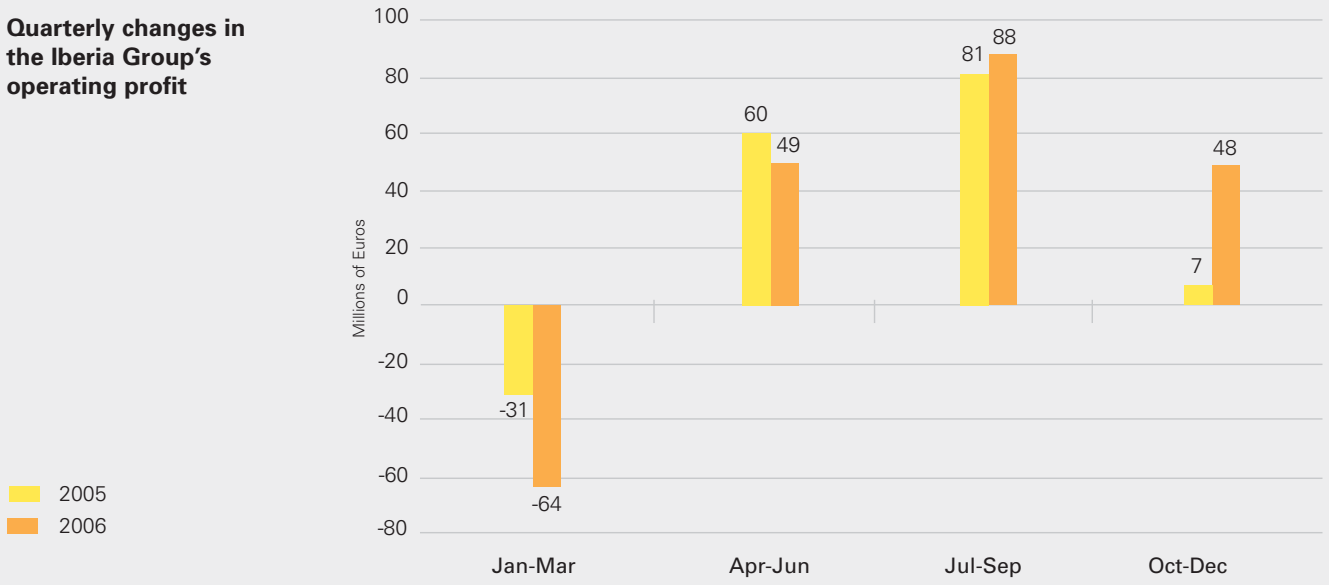
whole, due mainly to the marked 16.6% increase in the unit revenue in the long-haul sector, which was, in part, driven by the significant improvement in the class mix, increasing 25% with respect to 2005 in the number of passengers flying Business Plus, the new business class that the Company consolidated in 2006 with an exceptional response from passengers who value it is one of the best products to fly to America offered by the European airlines.

Passenger revenue from flights in 2006 increased by 9.8% with respect to 2005, and aggregate operating revenue increased in the same proportion to EUR 5,387.8 million. Other operating revenue also increased with respect to 2005, most notably the major increase in revenue from aircraft maintenance services (nearly 41% as compared with 2005), a business area that is surpassing the demanding objectives set out in the 2006/08 Master Plan and carries on its business activity in a services market that has high growth potential, in which IBERIA is becoming as one of the leading suppliers in Europe.

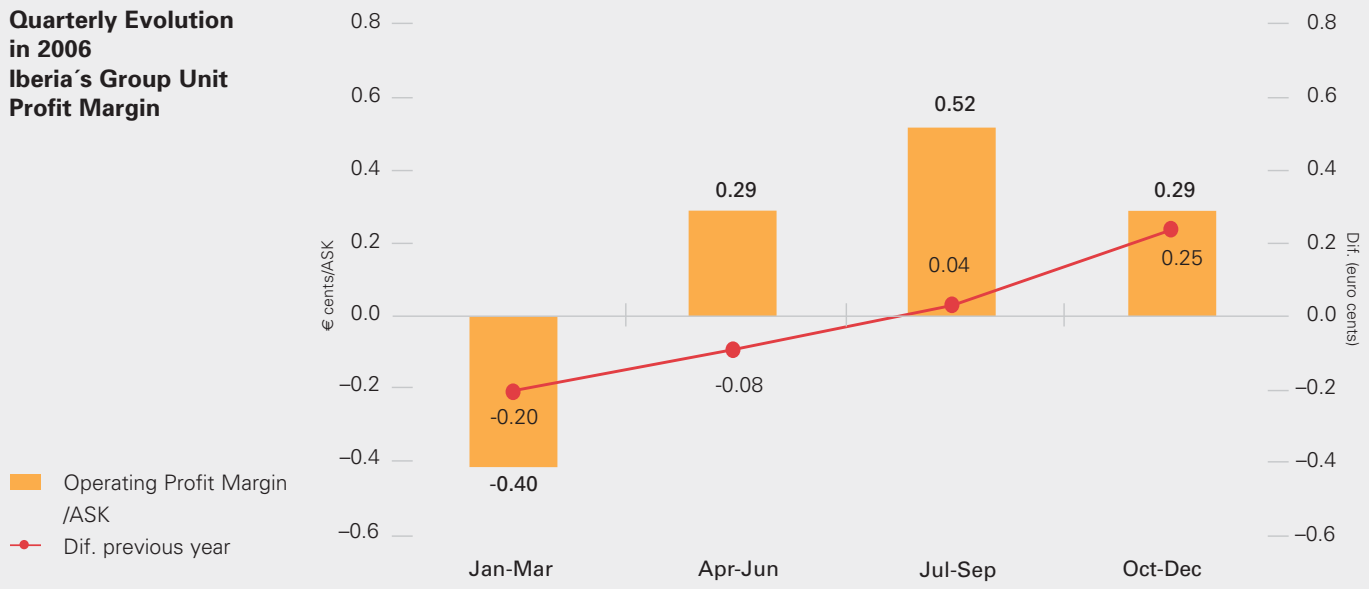
Consolidated operating expenses increased by 9.4% compared to 2005, due mainly to the 36% increase of EUR 311.8 million in the fuel expense, driven by the aforementioned increase in kerosene prices and to a lesser extent by the effect of the application of IAS 39 on the measurement of hedges which had an opposite effect in the two years with an adverse impact of EUR 55.3 million on comparing 2006 costs with 2005. These increases were partly offset by the implementation of a range of cost cutting measures established in the 2006/08 Master Plan. Therefore, in 2006, the Iberia Group's unit operating cost per ASK increased by 5.8% with respect to 2005; this increase is limited to 0.2% if we exclude the fuel expense. If the effect of IAS 39 is also eliminated (thus comparing the Company's operating performance in a uniform manner), IBERIA's unit operating cost would have decreased by 1.2% with respect to 2005. Notable among the cost reductions was the 3.3% decrease in staff costs, based on improved productivity and the containment of salary increases.

Consolidated operating profit, which does not include non-recurring income and expenses, amounted to EUR 122 million, an increase of 4.6% as compared with 2005. If the effect of the application of IAS 39 on the income statements for the two years (negative in 2006 and positive en 2005) is excluded, the Company's operating profit in 2006 exceeded the figure for 2005 by 67.6%.

Quarterly changes in the Iberia Group's operating profit



The favourable effect of the measures contained within the 2006/08 Master Plan implemented throughout 2006, together with the gradual narrowing of the year-on-year fuel price differential, meant that the change in the unit operating margin per ASK was extremely positive throughout the year, as illustrated in the following graph.



In accordance with applicable regulations, the decrease in the standard Spanish Corporation Tax rate from 2007 onwards entails a proportionate reduction in the value of the Company's tax credits recognised in its balance sheet at year-end, with an impact of EUR 59.1 million on the net consolidated profit for 2006 which amounted to EUR 57 million. The net consolidated profit obtained by the Company from its ordinary activity, excluding this exceptional tax adjustment, was EUR 116.1 million in 2006. Consolidated profit had amounted to EUR 396 million in 2005, when the capital gain on the sale of the ownership interests in Amadeus Global Travel Distribution, S.A. (Amadeus) and in SAVIA was recognised.

2006 was not free from tense labour relations, mainly involving the flight crews. The IBERIA section of the Spanish Airline Pilots Union (SEPLA) called seven consecutive days of strikes between 10 and 16 July 2006, as a result of its opposition to the involvement of IBERIA, together with four other partners, in the launch of Clickair, a new generation airline that began operating in October; finally, stoppages occurred only on July 10, 11 and 12, despite which the Company was forced to cancel 1,032 flights between Monday 10 and Sunday 16, with an estimated impact of around EUR 15 million. Also in summer, the Cabin Crew's union called a strike, although with less disruption of Company activity.

On 25 July the award was made public of the new concessions for third-party ramp handling services throughout the entire state airport network, in accordance with the resolution adopted by the Board of Directors of AENA (the Spanish public airports and aviation entity), thereby completing the public calls for tenders that have further deregulated the industry. IBERIA is the operator that obtained most licences, a total of 21, maintaining its presence at 36 airports (plus the heliport at Ceuta). The new licences will have a term of seven years.

The aforementioned competition of the calls for tender meant the loss of the licence held by IBERIA at the El Prat airport. In protest at this decision, on 28 July the Barcelona handling employees went on an illegal strike that forced the cancellation of 300 IBERIA flights, affecting some 30,000 passengers and causing losses to the Company of more than EUR 6 million.

Corporate culture

IBERIA's mission is to offer air transport, airport and aircraft maintenance services that live up to the expectations of our customers and create economic and social value on a sustainable basis.

IBERIA seeks to become the leading Company in terms of customer satisfaction in its strategic markets (Latin America, Europe and Spain), and to offer the optimal price/quality relationship. The Company wishes to offer its shareholders notable and sustained profitability and strives to attain the maximum professional development of all its employees.

The Iberia Group wants to be recognised for its transparency and its firm social and environmental commitment. Thus, pursuant to its Corporate Responsibility policy, the Company backs entities that implement social cooperation projects and improve living conditions by means of sponsorship agreements with various institutions, promoting the involvement of its customers and suppliers in social action initiatives and counting on the active participation of its employees. Also, IBERIA pursues a global environmental protection policy that includes all its activities, both on the ground and in flight. The Social Responsibility Report and the Annual Corporate Governance Report provide ample information on these matters.

As regards the Risk Management System, in 2006 IBERIA updated the Risk Map on two occasions, at the end of each calendar half-yearly period, in compliance with the procedures that regulate the Risk Management System. Both Maps were presented for approval by the Audit Committee of the Board of Directors.

Also, in 2006 IBERIA analysed the degree to which the Risk Management System complied with the risk control recommendations contained in the "Report of the Special Working Group on Good Governance of Listed Companies, of 19 May 2006", even though they did not apply to 2006, and it was observed that the current configuration of the system in place covered all the recommendations made.

In this respect, it should be noted that the recommendation relating to the IT systems forms part of the current System, due to the fact that on 12 May 2006 the Company brought online the Business Risk Management Portal on the IBERIA intranet, through which all the relevant System information is distributed, with levels of accessibility sufficient to bear influence upon the system, although the portal's objective is the real-time updating of the risk information by its owners, using the intranet.

Also, IBERIA complies with the recommendation relating to internal control, inherent in the System since its creation in 2004, since both the risks whose control is integrated in the Company's management processes and those of an ad hoc nature are included in the Annual Internal Audit Plan, which is performed using the Risk Map analysis as a starting point.

In September 2006 IBERIA joined the select Dow Jones Sustainability Index (DJSI World). This index selects the 250 companies in the world with the best practices in economic, social and environmental matters, of which only three can be airlines.

Fulfilment of the 2006/2008 Master Plan

The 2006/08 Master Plan, approved by the Board of directors in October 2005, has the objective of providing an adequate response to the challenges faced by the Company over the three-year period 2006/2008, with a backdrop characterised by the development of air transport and railway infrastructures in Spain, the expansion of low-cost carriers on short-and medium-haul routes, and the sustained growth in air traffic. The Master Plan's strategic lines are: to give priority to profitability over growth, to improve quality and to optimise the use of resources. On the basis of these guidelines, the Plan established the implementation of 230 specific measures that will lead to increased revenue and productivity and a decrease in expenses and will ensure the maintenance of adequate profitability.

One of the cornerstones of the 2006/08 Master Plan is the revision and optimisation of the flight programme, prioritising the strengthening of the Madrid hub and the growth of the long-haul network, which will enable the Company to consolidate its position of leadership in the market between Europe and Latin America. In the Plan's first year of execution, the number of ASK in the long-haul sector increased by 8.6% with respect to 2005, in line with the projections for that year. The weight of long-haul production represented 54.4% of total ASK in 2006, increasing by 2.6 percentage points compared with 2005, and it will go on to represent 56% in 2008 according to Plan estimates.

The Iberia Group also commenced the restructuring of the short- and medium-haul programme in 2006, in accordance with the Plan, and adjusted capacity on certain domestic and European routes, subordinating growth to the improvement of profitability. After initiating the restructuring, passenger yield per ASK increased by 3.3% in the domestic sector and by 3.8% in the medium-haul sector with respect to 2005.

One of the strategic objectives of the 2006/08 Master Plan is to raise the quality of the product that we offer our customers, which will also lead to increased revenue. The comfort and the entertainment systems that Business Plus class offers, the in-flight care and original service, the improvements made to the VIP lounges, the personalised attention given during flight connections and the operation of the T4Terminal at Barajas airport, among other factors, all had an influence on the offer of the air transport area. In particular, the long-haul routes saw an increase in Business Plus class passenger numbers of 25% with respect to 2005, with an upward trend throughout the year, radically changing the class mix. The Business Plus passenger load factor increased by more than ten percentage points in 2006, far exceeding the objective established in the Plan. Also, Business Plus average passenger revenue similarly exceeded the projected level; the favourable effect of both factors therefore led to increased Business Plus revenue above the increases projected in the Plan for 2006.

The revenue management advanced intelligence project progressed as scheduled, and its effects on revenue will be noted in 2008. Assessment tests have been performed, with satisfactory results, in order to optimise the revenue management model point by point, specifically to adapt the model to the competition from low-cost carriers' fare structures. Also, work is being performed to implement an origin-destination space management model.

The second cabin-reconfiguration programme for the short- and medium-haul Airbus aircraft aimed at improving the product offered to our passengers and optimising cabin space was initiated in the second half of 2006, as scheduled. IBERIA will make an investment of more than EUR 30 million, fitting latest-generation seats, more comfortable than the current ones and less voluminous, which will mean the number of seats on flights to domestic and European destinations can be increased by 5%.

The 2006/08 Master Plan also includes an ambitious objective relating to revenue from aircraft maintenance services provided to third parties, which is to double the volume of revenue obtained in 2005 by 2008. To this end, IBERIA's Maintenance and Engineering Division has designed a more aggressive commercial policy, which promotes the use or proprietary resources in the performance of work for third-parties with a higher level of added value, mainly the checking of engines and components, outsourcing the less qualified tasks. The objective set in the Plan for 2006 was exceeded by 18% and total billings to third parties amounted to EUR 230 million, thereby exceeding the figure for 2005 by over 36%.

The increase in productivity of resources and the reduction of unit costs is the Master Plan's third strategic initiative. As regards the passenger fleet, in 2006 the Iberia Group managed to increase the number of ASK by 3.4% with a number of operating aircraft (as an annual average) similar to 2005. If the economic productivity of the workforce is considered, operating revenue per employee grew by more than 11%.

The Company and the representatives of the ground staff reached an agreement to sign their collective labour agreement in February 2006, applicable in 2005 and 2006, which includes the productivity measures included in the 2006/08 Master Plan. Accordingly, the productivity of IBERIA's ground staff (in terms of ASKs per employee) increased by 5.5% in 2006 with respect to 2005.

At 2006 year-end, a total of 1,160 of ground employees in Spain had availed themselves of the extension of the collective redundancy procedure, as compared with the 1,033 early retirements of ground employees projected in the 2006/08 Master Plan for that date, due to the fact that the schedule for retirements had been brought forward in most areas of the Company. Also, in 2006 a further 159 ground employees left the Company, including personnel abroad, for various reasons.

The collective labour agreements relating to the flight employees are currently being negotiated. The productivity improvement objectives envisaged in the Master Plan and other measures aimed at reducing expenses depend on the final outcome of these negotiations.

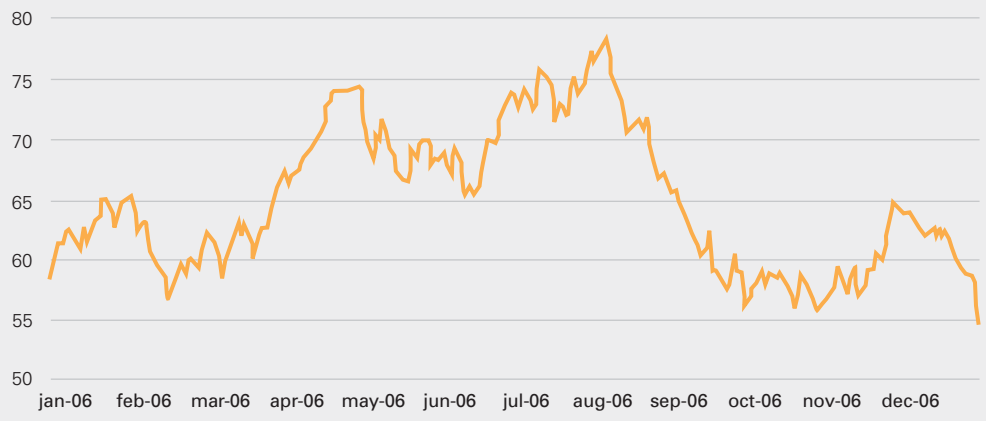
Lastly, in relation to the initiatives contained in the 2006/08 Master Plan aimed at reducing unit operating costs, the following are of particular note:

- As part of the ground staff collective labour agreement, the annual cost of which represents approximately 55% of IBERIA's total staff costs, a salary freeze and a new non-consolidable profit sharing scheme were agreed upon for 2005 and 2006.
- The call centre was outsourced and new relationship models with the distribution channel were strengthened.
- The renewal and growing standardisation of the fleet also contributed to reducing unit costs per ASK, through more efficient consumption of fuel, a reduction in maintenance costs and control of property costs.
- The process of extending the agency remuneration model developed in Spain to the international markets continued.
- From 1 January 2007 onwards the new fixed commission paid by IBERIA to Spanish travel agencies is 0.4%, as compared with the 1% paid throughout 2006.
- In the cargo area, the unit cost of leasing cargo carriers has decreased since January 2006, and the closure has been initiated of the loss-making cargo terminals.
- In 2006 the number of purchasing projects using new techniques was increased, such as purchases made with other partners through Adquira or carrying out e-auctions, thereby achieving major savings.

Fuel

The price of a barrel of Brent crude began 2006 at around USD 60, climbed to all-time-highs of close to USD 80 a barrel in August and ended the year by returning to levels of around EUR 60 a barrel.

Brent crude
Year 2006



With this backdrop of historically high prices, IBERIA had hedged approximately 85% of the volume of fuel consumed in 2006 at average prices slightly below market. This policy of price hedging, plus EUR/USD exchange rate hedges, enabled IBERIA to mitigate the risk involving this basic item of consumption and to reduce the fuel expense by EUR 5.5 million over the twelve months taken as a whole.

Product and Quality

Pursuant to the strategy established in the 2006/08 Master Plan of improving quality, the Company continued to promote the products that provide the greatest added value to the passenger and to the Company, offering differentiated services that have been well valued by our passengers. Noteworthy among the projects implemented, in terms of the investment made and the significant effect on revenue, was the aforementioned launch of the new long-haul business class named Business Plus, which IBERIA began to market in mid- 2005.

The Business Plus class features ergonomic seats with ample legroom which can be reclined to form a bed. It also offers passengers the most advanced communications systems (telephone, SMS and e-mail) and in-flight entertainment (interactive games and audio and video chan-

nels on request). All the aircraft in the long-haul fleet have been operating since July 2006 with this new class.

In parallel, the Company also changed its in-flight catering items and redesigned in-flight service, renewing the menus and wines, whose high quality has been recognised by various international awards.

The passengers have valued the Business Plus class highly. From January 2006 the number of tickets and the volume of billings in this service class had monthly increases with respect to 2005. Over the twelve months taken as a whole, the passenger revenue obtained in the Business Plus class increased by 36% in relation to 2005 while the number of seats offered to the market increased by only 2.5%.

In 2006 IBERIA initiated a programme to reconfigure the passenger cabins of the entire Airbus fleet (A319, A320 and A321 models) with which it operates its domestic and European connections. This renovation of the interiors of the aircraft includes the fitting of latest-generation seats, upholstered in prime-quality materials, with a structural design that affords maximum comfort and room, especially at knee height.

In addition, with the aim of also improving service to Business Class passengers on medium-haul flights, IBERIA ceased to market the central seats of the rows in its business class.

Iberia Plus, the Company's loyalty programme, represents one of the Iberia Group's strengths and it is one of the greatest attractions for our passengers. The number of Iberia Plus card holders has had an average annual increase of 22% over the last four years, achieving close to three million card holders at year-end 2006.

Innovation and Technology

The Iberia Group focused its endeavours on using new technologies to simplify all its processes, facilitate passenger accessibility and reduce expenses.

Throughout 2006, IBERIA continued to improve the functionality of its website and to introduce new products for its passengers, such as, inter alia, the online issue of tickets or the minimum price guarantee. It also continued to expand internationally, launching new specific versions in 13 countries, mainly in Central America and Africa, and entered into new agreements with various partners to offer online purchases to its passengers. The number of air transport tickets sold by the Company through Iberia.com in 2006 increased by 41.6% with respect to 2005, and the volume of flight sales increased by 56% to exceed EUR 447.1 million.

For several years now, IBERIA has promoted the use of the e-ticket (its flight coupons are an electronic registration in the database), to replace the traditional paper ticket. This new type of ticket provides the passenger with greater convenience and security and at the same time reduces airline costs.

At year-end 2006 the e-ticket was valid for all destinations (except Naples and Pisa) on the Iberia Group network and it had become the format used by the great majority of its passengers. In 2006, e-tickets represented 90% of all tickets issued, establishing IBERIA as the clear leader in this area among the European network carriers; in the case of tickets issued by travel agencies, the increase was 81.3%. It should also be mentioned that the growth in the use of the e-ticket on the Madrid-Barcelona Shuttle flights, subsequent to its introduction mid-2005, exceeded 87% in the last quarter of 2006. Also, IBERIA continued to extend the use of interline e-ticketing for the flights that combine IBERIA flights with those of other airlines.

The Iberia Group also offers its passengers auto check-in through Iberia.com (auto check-in online) or by using the self-service automated kiosks at the airports. Auto check-in, by either means, enables passengers to obtain their boarding card directly and select their seat in a trouble-free way, without the need to go to the check-in desks, with the related time savings and greater degree of convenience. The auto check-in service can be used by all the passengers who are travelling to any destination where no passport or immigration documents or security procedures are required.

Auto check-in online has been well received since May 2005, when IBERIA afforded its passengers the possibility of auto checking-in online from their own home or office, whether or not they take baggage, up to two hours prior to the departure of the flight, travelling with an e-ticket or a paper ticket. The percentage of users of this service has grown solidly and in the last quar-

ter of 2006 stood at 9.8% of the total of passengers on domestic and Schengen destination flights. A daily average of 9,500 boarding cards issued through the website was achieved.

In 2006 the Company continued to increase the number of self-service automated kiosks installed at the airports, extending the service to new Spanish and European destinations. Accordingly, during 2006 IBERIA introduced this facility at Amsterdam, Athens, Brussels, Copenhagen, London, Munich, Rome and Venice airports, which joined Frankfurt and Paris, where the Company was already offering the service. In Spain, by the end of December, a total of 137 kiosks had been installed at 19 stopovers, including 20 specific kiosks for the Madrid-Barcelona Shuttle at Madrid and Barcelona. In April the Company extended the use of these 20 kiosks, until that time limited to Iberia Plus programme members, to all the passengers on the Madrid-Barcelona Shuttle that used the e-ticket (close to 90%). In 2006 the number of passengers using the self-service automated kiosks increased by 22% with respect to 2005, of particular note being the growth witnessed in the use of Madrid-Barcelona Shuttle kiosks, which increased two-fold.

Auto check-in taken as a whole (using conventional machines, Madrid-Barcelona Shuttle kiosks and online) performed extremely satisfactorily, with the greatest growth being seen in auto check-in online. The total number of passengers using auto check-in in the last quarter of 2006 represented 19.1% of all the passengers on domestic and international flights to Schengen countries.

Fleet Renewal

IBERIA continued to renew its long-, short- and medium-haul aircraft, with the objective of making more comfortable, fuel-efficient and environmentally-respectful aircraft available to its passengers. The addition of eleven new aircraft in 2006, which replaced some of the older aircraft, reduced the average age of the fleet as a whole to 7.92 years in 2006.

The aircraft renewal plan also aims at achieving complete aircraft uniformity in both fleets, a fact which drives the reduction of maintenance and technical crew costs, while offering advantages in the operational management of the commercial programme and facilitating the increase in the productivity of resources.

Since July 2006 the Company has been operating all its long-haul flights with a single type of aircraft, the Airbus A-340, the last two B747s having been retired. With the addition of three new A-340/600 aircraft in the first four months of 2006, the long-haul fleet comprised 31 A-340 aircraft (18 of the 300 version and 13 of the 600) at the end of 2006, with an average age of 5.2 years. Therefore, IBERIA has positioned itself as one of the airlines with the most modern long-haul fleets in the global air transport industry.

In July 2005 the Company arranged a major contract with Airbus to renew the short-and medium-haul fleet, which includes the addition of up to 79 aircraft (30 units outright and 49 with a purchase option) of the A-319, A-320 and A-321 models from 2006 onwards. The new aircraft will replace the oldest of the Airbus A-320s, and all the McDonnell Douglas MD-87 and MD-88, and the Boeing B-757. Accordingly, when the process of retiring the MD-87/88 concludes in 2009, IBERIA's short-and medium-haul fleet will be made up entirely of aircraft belonging to the same family manufactured by Airbus.

As planned, the Company added eight new aircraft (two A-321, two A-320 and four A-319) in 2006, and a total of thirteen aircraft were retired, therefore, at the end of the year the operating aircraft employed on domestic routes and medium-haul international flights was made up of 119 aircraft, of which 82 were manufactured by Airbus. Also, a further five B-757 aircraft that were held under operating leases by the Company were given over to wet leases (lease plus crews), thereby completing the retirement process of these aircraft from own-aircraft operation. IBERIA's crews now only operate two families of aircraft (A-320 and MD-87/88) on short-and medium-haul flights.

T4 Terminal

Since 5 February 2006, IBERIA has been operating at the new T4 Terminal at Madrid-Barajas Airport, together with its oneworld alliance partners and its regional flight franchisee Air Nostrum.

Coinciding with the coming into service of the T4 Terminal on the aforementioned date, IBERIA abandoned terminals T1, T2 and T3, after having operated at them for 72 years, and concentrated all its flights at the new installations. This migration of the Company's operations was extremely complex and entailed investment of EUR 43 million, to which a cost of EUR 17 million must be added in relation to the physical transfer of operations.

The T4 Terminal stands out for its amplitude and innovative architectural design, and has received several awards (among others, the "Riba European Awards 2006" granted by the Royal Institute of British Architects, and the "Best Engineering Project Award 2005", granted by the Spanish Institute of Engineering). It features a core building, called New Terminal Building (T4), and a satellite building (T4S), which together extend over 743,000 m2. Its installations are completed by a parking structure and a Terminal used as a State Pavilion. Most domestic flights operate out of the New Terminal Building (including the Madrid-Barcelona Shuttle) as well as flights to the Schengen area (comprising a total of 15 European countries that have eliminated border controls among each other). The satellite building is used mainly for non-Schengen international flights. The core building and the satellite have an underground interconnection which houses the passenger and baggage transfer systems and an airport services tunnel (TSA).

With its four terminals and four runways operating simultaneously, Madrid-Barajas Airport consolidated itself among the five European airports with the highest traffic levels. In 2006, Madrid-Barajas Airport handled more than 45 million passengers, an increase of 8.7% with respect to 2005, the highest increase among the five largest European airports. Ongoing increases in its activity are projected, to reach its potential capacity of 120 aircraft operations an hour.

In the first months of operation, processes were adjusted and both passengers and Company personnel adapted to the new operations at the T4 Terminal. Once the problems of the installations' operational adjustments had been overcome, and with the break caused by the strikes by cabin crew members and flight technicians in summer, punctuality indexes improved on an ongoing basis. The Company currently has better punctuality rates than those obtained in the old terminals.

At Terminal 4, IBERIA offers preferential handling to its high-value passengers. Accordingly, three VIP lounges are available extending over a total surface area of 4,500 m2, where numerous facilities are to be found; there are new areas for limousine services and VIP parking and exclusive check-in areas.

Another of the patent passenger service improvements that the enlargement of Madrid Airport has given rise to is that 93% of flights are directly boarded using boarding bridges.

The T4 Terminal also saw an increase in auto check-in and it has been estimated that 19% of passengers used it. Of this figure, 50% of passengers check in using IBERIA's self-service automated kiosks and thus waiting times are reduced.

Surveys among passengers to assess the operation of the new facilities gave a highly positive valuation of the T4Terminal, considered in a global context and in comparison with terminals at other airports. Furthermore, the Madrid underground train network is projected to reach the T4 Terminal before the end of the first six months of 2007, which will signify a major qualitative advance in the means of access to the new Terminal.

Initiatives involving investees

On 25 April 2006 Iberia, Líneas Aéreas S.A. (IBERIA) joined Nefinsa, S.A., Iberostar Hoteles y Apartamentos, S.L., Cobra Ingeniería de Montajes, S.A. (part of the ACS Group) and the private equity fund Quercus Equity (Agrolimen Inversiones S.C.R., S.A.) to launch a new airline, called Catair Líneas Aéreas, S.A., trading under the name Clickair. Clickair's share capital amounted to EUR 2.37 million at 2006 year-end, with each of the five partners holding an ownership interest of 20%. The joint investment made by the partners, including the paid-in share premium, amounted to EUR 31.6 million.

The objective of this investment is to take advantage of the solid growth in the low-cost carrier segment. Accordingly, Clickair began operations with three aircraft on 1 October 2006 with an ambitious expansion plan for the coming two years, operating point-to-point domestic and European routes to build up a fleet of 30 aircraft by 2008. Its main base of operations is Barcelona

Airport, and its offices are located in the Mas Blau Business Park, in El Prat de Llobregat, adjacent to the airport.

IBERIA and GECI Española Levante S.A. incorporated International Supply Management (ISM) in March 2006, and launched its business operations in June. IBERIA holds a 49% ownership interest in this company, which has share capital amounting to EUR 1.1 million, and GECI holds the other 51%. ISM's main business line is the purchase and sale of chemical products, industrial machinery, spare parts and accessories mainly for the aeronautical industries. Its target markets are Spain and Portugal during the first two years and from the third year onwards, the markets of Latin America and the rest of Europe, in accordance with the Business Plan.

GECI specialises in the marketing and logistics of special chemicals used in aircraft maintenance; it also distributes various manufacturers' products.

The objective of IBERIA's investment in ISM is to develop market opportunities and attain greater purchasing efficiency as a result of placing higher-volume orders along with its partner. Also, the investment constitutes an alternative to the need to invest in new facilities, since the environmental issues related to oils and chemicals compel IBERIA to redesign its facilities and make significant investments therein.

Once the award of the ramp-handling concession licences in Spain became known, IBERIA entered into agreements with other concession-holders to join unincorporated joint ventures (UTE) which hold licences in three airports. Accordingly, IBERIA entered into an agreement with Groundforce (part of the Globalia Group) and SPDH (Servicios Portugueses de Handling S.A.), which had won the licence in the Barcelona-El Prat Airport, to join (with a 32% interest) their UTE to provide handling services at that airport. Also, IBERIA entered into an agreement to join one of the concessionary UTEs (Clece-Evergreen) at Fuerteventura and Lanzarote Airports.

Changes in the governing bodies

On 18 April 2006, Ángel Mullor tendered his voluntary resignation as Managing Director of IBERIA to the Company's Appointments and Remuneration Committee, with effect on 30 May.

In June, the Board of Directors of IBERIA approved the reorganisation of the senior management and a new organisation chart, to meet the two strategic objectives of the Master Plan: reduce the number of first-level executive positions and give more responsibility to the members of the Executive Committee. In the new organisation chart, the Executive Chairman of the Company has all the powers delegated by the Board of Directors. Also, the Maintenance and Airport (handling) business lines were boosted, raising them to the rank of Division. Therefore, the Company will have three divisions, the two mentioned above and the Airline Division, already in existence.

2. Operational performance in management areas

2.1. Transport

Passenger and cargo air transport is the Iberia Group's main business activity. In 2006 revenue generated by this activity represented 83.7% of total consolidated operating revenue.

Set forth below are the statistics of Iberia, Líneas Aéreas de España, S.A. ("IBERIA") on production, traffic and passenger transport revenue for 2006 and 2005, broken down into the three following commercial sectors: domestic, which includes the connections among Spanish airports; medium-haul, which groups together the international flights that connect Spain with destinations in Europe, the Middle East and North and Central Africa; and long-haul, which includes the connections to America and South Africa.

2.1.1. Capacity and passenger traffic

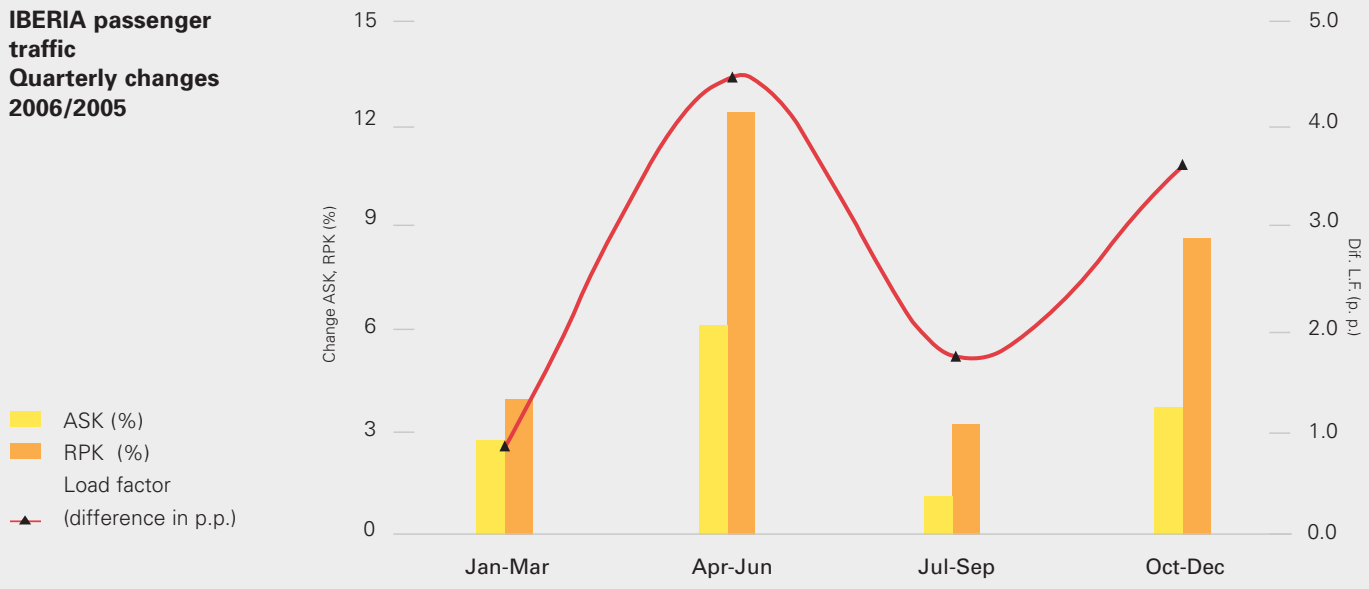
In 2006 the total number of revenue passenger kilometers (RPK) on international flights operated by members of the AEA increased by 5.5% with respect to 2005, slightly below the figure for the industry taken as a whole. However, there were notable differences between the route areas: the areas experiencing the strongest growth were South America, North Africa and Asia with increases of 12.8%, 10.4% and 9.8%, respectively, while the North Atlantic area saw the lowest growth at 0.7%. Total AEA member traffic, including domestic flights, increased by 5.2% with respect to 2005, and the load factor increased 0.6 percentage points to 76.5%.

In the IBERIA network taken as a whole, RPK increased by 7.0% in 2006 with respect to 2005, compared with an increase of 3.4% in the availability of seat-kilometers (ASK). Accordingly, the passenger load factor increased 2.7 percentage points to 79.8%, which was the highest annual average in the Company's history.

Pursuant to the network restructuring strategy established in the 2006/2008 Master Plan, in 2006 IBERIA increased its supply on a selective basis, concentrating majority growth in the long-haul segment. Total available capacity increased more in the first six months (4.5% with respect to 2005) than in the second half of the year (2.4%), due mainly to the adjustments made in the flight programme from the beginning of the summer season onwards.

Demand increased with respect to 2005 in all four quarters of 2006, with increases above those in the volume of supply; the Company's RPK record was also beaten. As a result, the passenger load factor increased in all four quarters, despite the fact that the strikes called by IBERIA personnel in July impacted on the activity data in the third quarter of 2006.

IBERIA passenger traffic
Quarterly changes
2006/2005



At 2006 year-end IBERIA covered 76 destinations (24 domestic, 31 medium-haul international and 21 long-haul). If we add the additional airports out of which its franchisee Iberia Regional Air Nostrum operates, the Group's network covers a total of 102 cities. Also, during 2006 IBERIA continued to develop some of the code-share agreements that it had previously entered into with other airlines (British Airways, GB Airways, Avianca, Mexicana de Aviación, the TACA group, Royal Air Maroc, American Airlines, etc.), and also added other new ones (Malev, Iberworld, etc.) which enabled it to increase the number of destinations it offers its passengers.

In the year as a whole, the Company achieved 65,802 million ASKs in all its operations, with the following breakdown by market:

Millions

ASK	2006	2005	Change 06/05	% Change
DOMESTIC	13,232	14,028	(797)	(5.7)
MEDIUM-HAUL	16,787	16,664	123	0.7
The Continent of Europe	14,945	14,872	73	0.5
Africa and the Middle East	1,842	1,792	50	2.8
LONG-HAUL	35,783	32,936	2,848	8.6
TOTAL	**65,802**	**63,628**	**2,174**	**3.4**

The implementation of the reconfiguration and space optimisation programmes in the passenger cabins of long- and short-/medium-haul aircraft led to an average increase in supply, measured in ASK, of 3.7% in the aggregate of the flight network.

The volume of supply in the long-haul sector increased by 8.6% with respect to 2005. Close to 72% of this increase related to flights to South America, which increased by 20.3% with respect to 2005, thereby achieving a relative weight of 18.3% in the Company's total supply. All the destinations in this region showed significant growth, with the highest levels seen in Brazil and Uruguay.

The ASK of Mid-Atlantic flights increased 3.4% with respect to 2005, with a major restructuring of the supply due to optimising the combination of the two versions of aircraft from the A-340 fleet: the 300, with 260 seats, and the 600, that has 352.

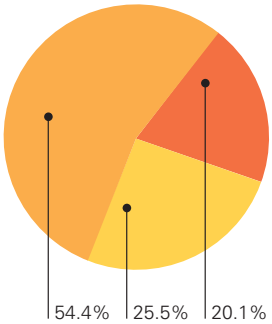
In the year as a whole, the volume of supply in the North Atlantic connections decreased by 0.9% with respect to 2005, due to the reduction implemented in the first quarter. Lastly, noteworthy in the long-haul sector was the 25.2% increase in supply in flights to South Africa.

As regards the international medium-haul sector, the Company increased available capacity by 0.5% on the flights between Spain and other destinations on the Continent of Europe, a market characterised by the intense competition and the rapid growth of low-cost carriers. Salient in 2006 was the growth in supply in Russia, Italy and, above all, Greece, where the ASK increased by 55.8% as a result of an additional five direct flights between Madrid and Athens from January onwards. These increases offset the capacity adjustments in France, Portugal and Germany.

IBERIA increased its supply on its flights to the Middle East and North and Central Africa by 2.8% with respect to 2005, due mainly to the 8.8% increase in capacity made available for flights to North Africa, above all Morocco (taking into consideration the direct flight between Barcelona and Marrakech launched in 2005). Central Africa and the Middle East saw scant increases, as a result of the cessation of operations to the Lebanon due to the instability in the region in the case of the latter, the excess capacity of which was transferred to Israel. Although the flights to Africa and the Middle East have a low weight in the context of the network total (2.8% of total ASK), their growth contributed to the 0.7% increase in the number of ASK in the international medium-haul sector as a whole with respect to 2005.

In the Spanish domestic market, IBERIA continued with its strategy focused on improved profitability, through the increase in unit revenue and the selective ordering of supply, the number of ASK falling by 5.7% with respect to 2005. Available capacity decreased 4.5% on the flights between the Peninsula and the Canary Islands and the other domestic flights (internal peninsula flights and connections with the Balearic Islands) fell by 6.3%.

ASK distribution in 2006



TOTAL: 65,802 millions

- Long-haul
- Domestic
- Medium-haul

IBERIA's passenger aircraft production in terms of block hours was 2.3% lower than in 2005. Noteworthy was the increase in the use of aircraft under wet lease agreements, an instrument that provides flexibility to adapt production to demand cycles. Hours operated under wet lease represented 4.9% of the total hours produced in 2006.

Passenger Aircraft Block Hours	2006	2005	Change 06/05	% Change
OWNED AIRCRAFT	481,976	493,081	(11,106)	(2.3)
WET LEASE	24,692	16,102	8,590	53.4
OTHER LEASES	80	126	(47)	(37.0)
Total	**506,747**	**509,309**	**(2,562)**	**(0.5)**

n.m.: not material.

The distribution, by sector, of the passengers transported by IBERIA was as follows:

Thousands

Passengers	2006	2005	Change 05/06	% Change
DOMESTIC	14,680	15,415	(734)	(4.8)
MEDIUM-HAUL	9,242	8,745	497	5.7
The Continent of Europe	8,668	8,231	437	5.3
Africa and the Middle East	574	514	60	11.6
LONG-HAUL	3,876	3,515	361	10.3
TOTAL	**27,799**	**27,675**	**123**	**0.4**

The number of passengers transported by IBERIA increased by 0.4% with respect to 2005, with growth of 5.7% in the international medium-haul sector and of 10.3% in long-haul flights, and a decrease of 4.8% in the domestic sector.

In 2006 IBERIA continued to consolidate its position of leadership in the Europe-Latin America market, achieving a market share of 19.0% that represented an increase of 1.4 percentage points with respect to 2005. The increase in IBERIA's share in this market was even higher in the business segment, in which it rose 2.9 percentage points with respect to 2005.

The distribution of RPK is shown in the following table:

Millions

RPK	2006	2005	Change 06/05	% Change
DOMESTIC	9,633	10,219	(587)	(5.7)
MEDIUM-HAUL	12,220	11,456	764	6.7
The Continent of Europe	10,891	10,236	654	6.4
Africa and the Middle East	1,329	1,220	109	9.0
LONG-HAUL	30,641	27,385	3,255	11.9
TOTAL	**52,493**	**49,060**	**3,433**	**7.0**

In the network as a whole, RPK increased 7.0% with respect to 2005, which was higher than the increase in the number of passengers due to the route mix and to the growth in the average stage length, with a 6.5% increase with respect to 2005 to reach 1,888 kilometres. International traffic as a whole increased by 10.3% with respect to 2005.

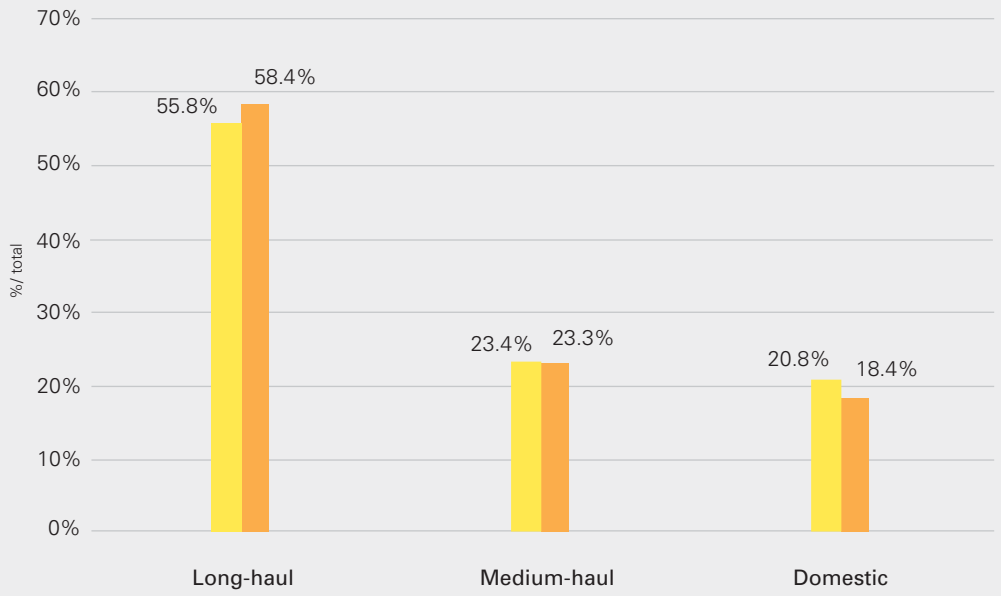
IBERIA's traffic increased most in the long-haul sector (close to 12%), due mainly to the demand in South America, which showed an increase of 26.1% with respect to 2005. Traffic in Central America increased 5.7%, aided in part by the agreement entered into with the TACA Group, which enabled connecting IBERIA operated long-haul flights to San José, Guatemala,

Miami and Havana with other Central American destinations using code-shared flights operated by the aforementioned group. Growth in North America was 2.1%.

Demand in the international medium-haul sector increased by 6.7% as a result of the significant 9.0% increase in traffic in Africa and the Middle East, where an RPK figure of 1,329 million was achieved in 2006, together with the solid performance of European flights, whose volume of traffic was 10,891 million, with a 6.4% increase with respect to 2005, despite the strong competition in the market. Of particular note was the highly satisfactory performance of the connection between Madrid and Moscow, which had been launched in March 2005.

IBERIA's domestic traffic decreased by 5.7% with respect to 2005. RPK of flights between the Peninsula and the Canary Islands fell by 5.5% with respect to 2005, and the other domestic flights by 5.9%.

Change in the distribution of RPK



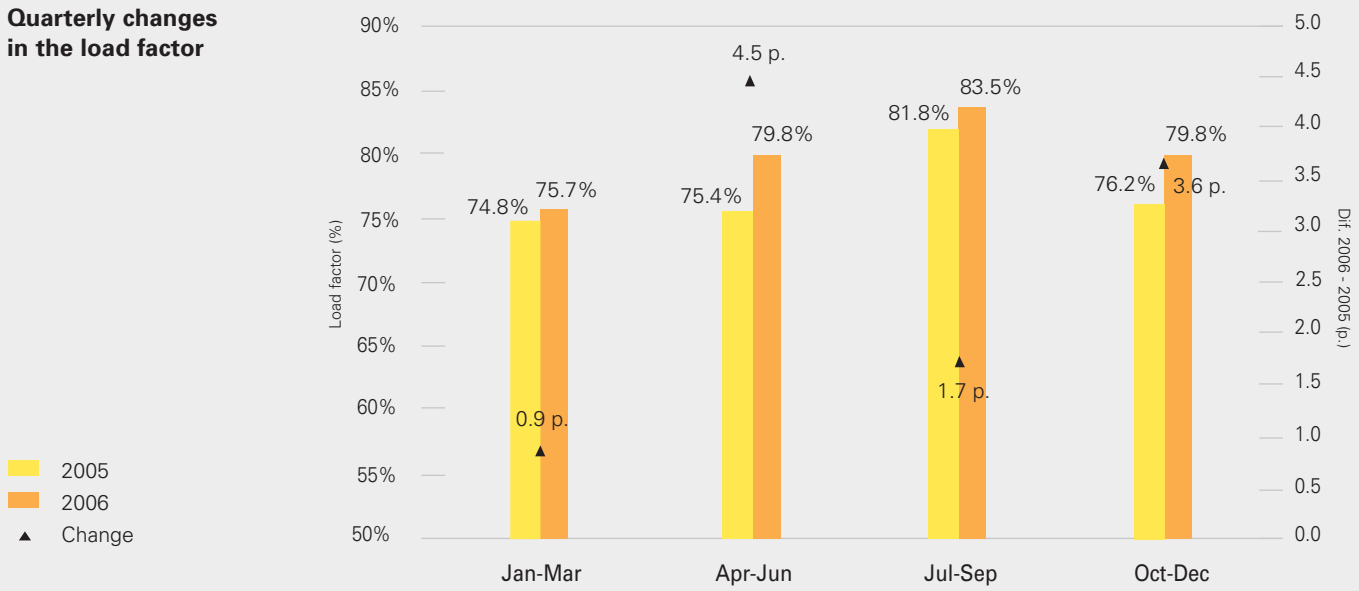
In the network as a whole, the passenger load factor increased 2.7 percentage points with respect to 2005, rising to 79.8%, the highest annual average in IBERIA's history.

The table below show the breakdown, by sector, of the changes in the passenger load factor:

Load Factor (%)	**2006**	**2005**	**Change 06/05**(*)
DOMESTIC	72.8	72.8	0.0
MEDIUM-HAUL	72.8	68.7	4.0
The Continent of Europe	72.9	68.8	4.0
Africa and the Middle East	72.1	68.1	4.1
LONG-HAUL	85.6	83.1	2.5
TOTAL	79.8	77.1	2.7

(*) The percentage point differences appear not to tally due to the rounding off.

Throughout the four quarters of 2006 the load factor of IBERIA aircraft continued to perform very positively, especially in the fourth quarter (the second quarter was benefited in part by the way Easter Week fell, in April 2006 and in March in 2005), as shown in the following graph:



The load factor held steady in the domestic sector in relation to 2005, and improved in the international networks, with the greatest increase relating to the long-haul sector. The load factor of flights to the Continent of Europe increased to 72.9%, up 4.0 percentage points on 2005. In Africa and the Middle East the load factor increased 4.1 percentage points to 72.1%.

The long-haul flight load factor reached 85.6% in the 12 months of 2006 taken as a whole, and improved 2.5 percentage points with respect to 2005, setting a new record in this sector in the Company's history.

In the domestic sector, the changes in the load factor continued on an upward trend throughout 2006 to an annual average of 72.8% which was similar to that of 2005. Although the load factor dropped in the first nine months with respect to 2005 (except in April, benefited by the way Easter Week fell), it improved in the last quarter.

2.1.2. Passenger traffic revenue

For the network as a whole, IBERIA's yield in 2006 increased by 2.6% with respect to 2005 in spite of the high level of competition, especially in the domestic and European markets, and of the increase in the average stage length. The major growth in business traffic in long-haul operations, and to a lesser extent in Europe, had a positive influence on the increase in average revenue.

Long-haul sector yield increased 13.3% with respect to 2005, buoyed by the significant improvement in the class mix, with an increase of 25% in the number of passengers in Business Plus class and higher average revenue.

The following table shows the breakdown by yield sector in 2006 and its comparison with 2005:

(Euro cents)

Yield	2006	2005	Change 06/05	% Change
DOMESTIC	12.52	12.12	0.40	3.3
MEDIUM-HAUL	9.58	9.77	(0.20)	(2.0)
LONG-HAUL	5.18	4.57	0.61	13.3
TOTAL	**7.55**	**7.36**	**0.19**	**2.6**

In the network as a whole, average revenue per ASK increased by 6.2% with respect to 2005, due to the significant improvement in the load factor together with the beneficial effect of the rise in yield. In uniform haul terms, the unit revenue per ASK in 2006 exceeded the figure for 2005 by 13%. The following table shows the breakdown, by sector, of average revenue per ASK:

Euro cents

Revenue per ASK	2006	2005	Change 06/05	% Change
DOMESTIC	9.11	8.83	0.29	3.3
MEDIUM-HAUL	6.97	6.72	0.25	3.8
LONG-HAUL	4.44	3.80	0.63	16.6
TOTAL	6.02	5.67	0.35	6.2

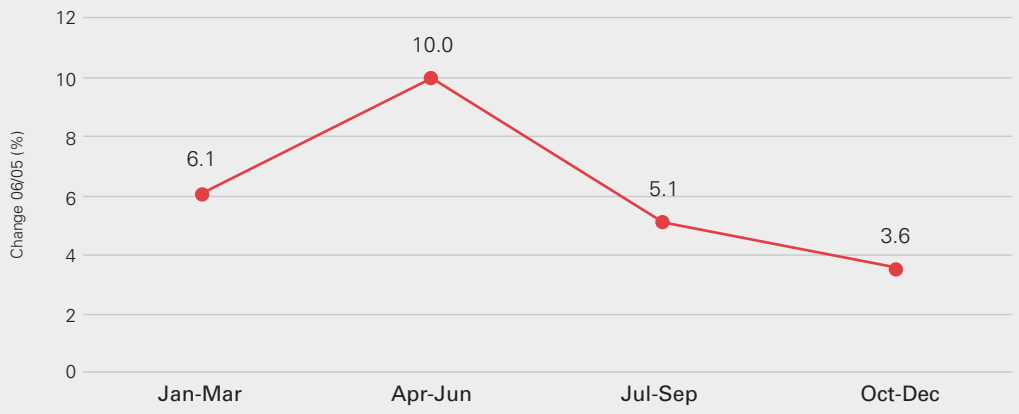
Average revenue per ASK in long-haul operations increased by 16.6% with respect to 2005, due to the aforementioned improvement in both the load factor and the yield, and in spite of adverse effect of the 1.5% increase in the average stage length.

Average revenue per ASK increased by 3.8% in the international medium-haul sector with respect to 2005. The beneficial effect of the improvement in the load factor (by 4.0 percentage points) overcame the adverse impact of the 2% fall in yield which arose, in part, due to the 0.9% increase in the average stage length in this sector and, mainly, to the strong level of competition from the low-cost carriers in the Spain-Europe market.

In the domestic sector, IBERIA continued with its strategy of focusing on improved profitability, which led to a 3.3% increase in yield. Since the load factor was the same as in 2005, average revenue per ASK saw a similar increase in yield over the year as a whole.

The following graph shows the quarterly evolution of changes in the average revenue per ASK in 2006 in relation to 2005. The progressive increase in the relative weight of intercontinental flights in the Company's activities taken as a whole led to an increase in the average haul throughout 2006, impacting on the slowdown of growth of unit revenue for the global network.

Quarterly change in revenue per ASK



The following table shows the breakdown, by sector, of the changes in revenue per ASK:

Millions of euros

Passenger Revenue	2006	2005	Change 06/05	% Change
DOMESTIC	1,205.8	1,238.1	(32.3)	(2.6)
MEDIUM-HAUL	1,170.2	1,119.6	50.6	4.5
LONG-HAUL	1,587.1	1,252.3	334.8	26.7
TOTAL	3,963.2	3,610.0	353.2	9.8

In 2006, IBERIA's passenger traffic revenue increased by 9.8% with respect to 2005, due to the improvement in unit revenue per ASK and to the increase in the volume of international traffic. There were increases of 26.7% and 4.5% in the long-haul and international medium-haul sectors, respectively.

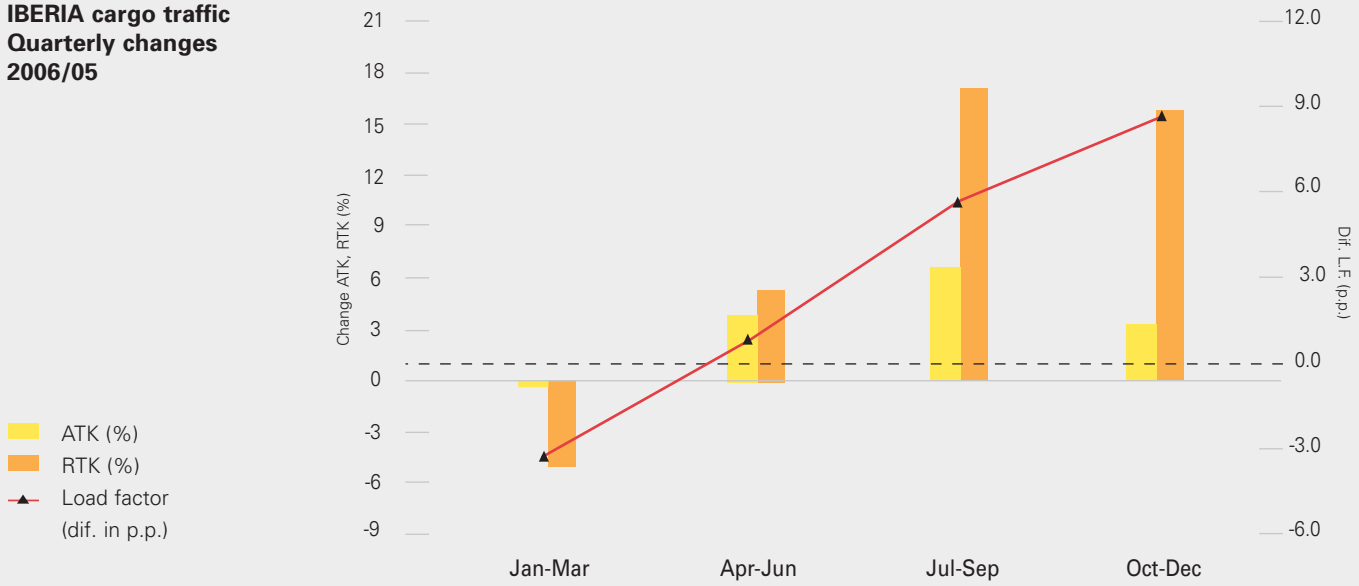
The Iberia Group's passenger traffic revenue amounted to EUR 3,963.2 million for the network as a whole. Noteworthy in the breakdown by sector was the progressive increase in the relative weight of the long-haul network, whose revenue represented more than 40% of the total in 2006, while in 2005 it represented 34.7%.

2.1.3. Cargo

According to data published by the Association of European Airlines (AEA), the European airlines' cargo traffic, measured in terms of revenue tonne kilometres (RTK), increased by 2.4% in 2006 with respect to 2005.

The RTK of goods and mail transported by IBERIA amounted to 1,118.5 million in 2006, an increase of 8.3% with respect to the volume achieved in 2005. 94% of the total tonne kilometres were transported in the holds of the Company's passenger aircraft, a percentage which remained stable compared with 2005. The total number of available tonne kilometres increased by 3.4% with respect to 2005, while the load factor improved by 3.1 percentage points.

IBERIA cargo traffic
Quarterly changes
2006/05



The early months of 2006 saw a low level of activity that began to recover from June onwards, performing extremely well in the second half of the year.

Goods and mail transport revenue stood at EUR 288.2 million in 2006 (up 7.2% on 2005). This amount includes the revenue from fuel surcharges (brought in to offset the sharp rise in the price of kerosene) and security surcharges, which together amounted to EUR 62.9 million in 2006 (2005: EUR 50.6 million). Average RTK revenue stood at EURcents 25.8 in 2006, dropping 1.0% with respect to 2005, adversely affected by the increase in the average stage length (4.6%).

Revenue from the various services provided in the cargo terminals amounted to EUR 20.6 million in 2006, a fall of 16.5% with respect to 2005, as a result of the closure process, due to the lack of profitability of the small-and medium-sized Spanish terminals that began in 2005 and was completed in 2006.

The workforce was reduced by 11.1% to 111 employees with respect to 2005, mainly as a result of the closures of the aforementioned terminals. The productivity of the four large Spanish terminals (Madrid, Barcelona, Las Palmas and Tenerife), measured in tones per employee, grew by 3.9% with respect to 2005.

For the third successive year, In 2006 Iberia Carga successfully passed the audits for the renewal of its Quality Certification under ISO 9001:2000 granted by AENOR, which it had initially obtained in July 2003. The main activity aggregates were as follows:

Cargo Transport	2006	2005	Change 06/05	% Change
ATK (millions)	1,643.6	1,589.3	54.3	3.4
Holds	1,498.2	1,447.8	50.4	3.5
Cargo carriers	145.4	141.5	3.9	2.8
RTK (millions)	1,118.5	1,033.1	85.4	8.3
Holds	1,050.4	970.9	79.5	8.2
Cargo carriers	68.1	62.2	5.9	9.5
Load factor (%)	68.1	65.0	3.1	n/a
Holds	70.1	67.1	3.1	n/a
Cargo carriers	46.8	44.0	2.9	n/a
Av. Rev. RTK (€ cents/ RTK) [(a)]	25.76	26.03	(0.26)	(1.0)
Cargo revenue (millions of Euros) [(a)]	288.2	268.9	19.3	7.2
Avg. number of full-time equivalent employees	884	995	(111)	(11.1)

[(a)] Including fuel and security surcharges; n.a.: not applicable.

2.2. Handling

The Airports Division (Iberia Handling) is responsible for the management of the ground handling services for other airlines and IBERIA itself at the Spanish airports.

Iberia Handling handled a total of 92.6 million passengers in 2006, somewhat fewer (-1.1%) than in 2005. In terms of weighted number of aircraft handled, Iberia Handling's activity decreased by 4.2% with respect to 2005 and the decreases in services to Iberia were in a similar proportion to the fall in services to other airlines. In the first case, the decrease was caused mainly by the fall in the number of flights programmed by the Company in Spain, the cancellations arising from the strikes called by flight crews and the events at Barcelona in July. Services to other airlines decreased by 10,630 weighted aircraft (4.2%) due mainly to the cessation of handling services to Binter Canarias since October 2005. Excluding this company, services to other airlines increased by 5.9%.

Operating revenue (including billings to Iberia Transporte) amounted to EUR 641.2 million in 2006, representing an increase of 4.6% (EUR 28.1 million) with respect to 2005.

The average annual headcount of Iberia Handling totalled 8,988 equivalent employees in 2006, which was substantially the same as in 2005. Productivity decreased, man-hours per aircraft increasing from 31.41 in 2005 to 32.85 in 2006, due mainly to the exceptional process of transferring operations to the new Madrid-Barajas Airport T4 Terminal, and to the extra staff required to re-establish normal operations at the Barcelona-El Prat Airport subsequent to the illegal protest by handling employees on 28 July.

The quality and environmental certifications were renewed under UNE-EN ISO9001 and ISO14001 standards.

On 25 July the award was made public of the new concessions regarding the ramp handling services to third parties throughout the entire state airport network, in accordance with the agreement adopted by the Board of Directors of AENA (the Spanish public airports and aviation agency), thereby completing the public call for tenders that have furthered the deregulation of the industry. IBERIA is the operator that obtained most licences, a total of 21, maintaining its presence in 36 airports (plus the heliport at Ceuta). The Company did not have the ramp-handling licences renewed that it held at Fuerteventura, Lanzarote, Jerez de la Frontera, Almería and Barcelona. The new licences will have a term of seven years and the new agents began to operate from February 2007.

IBERIA entered into agreements with other concessionary companies to join unincorporated joint ventures that held the licences for three airports. Accordingly, IBERIA entered an agreement with Groundforce and SPDH, which had won the licence in the Barcelona-El Prat Airport, to join (with a 32% interest) their UTE to provide handling services at the airport. Also, IBERIA entered into an agreement to join one of the concessionary UTEs (Clece-Evergreen) at Fuerteventura and Lanzarote Airports to provide handling services at the two Canary Island aerodromes.

The following table shows Iberia Handling's main activity aggregates:

	2006	2005	Change 06/05	% Change
Weighted no. of aircraft handled (thousands)	468.4	489.1	(20.7)	(4.2)
Operating revenue (millions of Euros)	641.2	613.2	28.1	4.6
Operating revenue/weighted aircraft (Euro)	1,369.0	1,253.6	115.4	9.2
Productivity (tot. hours/ weighted aircraft) [a]	32.85	31.41	1.44	4.6
Avg. number of full-time equivalent employees	8,988	8,972	16	0.2

[a] Total hours of labour per weighted aircraft.

2.3. Maintenance

Iberia Maintenance carried out a total of 116 major inspections (C, D, E and IL) in 2006, the same number as in 2005. Work performed for other airlines represented 20.3% of the total, an increase of 3.4 percentage points with respect to 2005.

Engine Workshop total production, measured in equivalent engines, amounted to 142.3 units in 2006. There was less need to repair the engines of IBERIA's own aircraft, due to the renewal process. Therefore, work on other airlines' engines increased to 54.5% of the total work performed in 2006, as compared with 53.1% in 2005.

The average number of equivalent employees managed by IBERIA's Maintenance and Engineering Division stood at 3,864 persons in 2006, a fall of half a percentage point with respect to 2005.

Iberia Maintenance continued to strengthen its position as a reliable internationally-acknowledged supplier of integral aeronautical maintenance services. Today, IBERIA is the second largest Spanish aeronautical company in terms of resources and billings (behind CASA/Airbus), and worldwide it is the 12th largest company in terms of volume of billings, excluding global aeronautical manufacturers. In 2006 operating revenue from third parties increased by 36.3% compared with 2005, to EUR 229.9 million.

Particularly noteworthy was the consolidation of the Rolls Royce RB211 and 535 E4 engines in B-757 aircraft. IBERIA is the only European company certified to inspect and repair these engines.

In 2006 close to 100 agreements were signed and renewed, the following being of particular note due to their special interest:

- The agreement with Continental Airlines to exclusively service the Rolls Royce RB211-535E4-B engines fitted on the American airline's new fleet of Boeing B-757-300s.
- The exclusive agreement with British Airways to maintain its 29 Rolls Royce RB211-535E4 engines for five years.
- Servicing of the RB211-535E4 engines belonging to Air Finland.
- The exclusive agreement with Swiftair to maintain the components of two McDonnell Douglas MD80-83 aircraft for the coming three years.
- The agreement with the North American manufacturer General Electric to win the repair licence for the CF34 engine. The Engine Workshop of IBERIA's engineering division is the only one in Spain and the third in Europe with the know-how to maintain this class of engine.
- The five-year cooperation agreement between Iberia and Meridiana, based on an exchange of work between the two companies to perform the maintenance of Airbus A-319, A-320 and A-321, MD80-82, Boeing B-717 and BAe-146 aircraft - the airlines that operate in southern Europe are their principal target market.

Iberia Maintenance extensive customer base comprises Spanish and international air operators, engine and fuselage manufacturers and aircraft lessors, totalling approximately 150 customers. Around 50 are internationally recognised airlines such as British Airways or Continental Airlines. In Spain, where Iberia Maintenance is the unquestionable leader, it has substantially all the airlines as customers, such as Air Nostrum, Spanair, Iberworld, Air Plus Comet, LTE, Hola Airlines or Pullmantur; and, in the rest of the world, Iberia Maintenance operates on all the continents with companies such as, Meridiana, Avianca, Olympic Airways, Xiamen Airlines, Santa Bárbara, Berkut, Armavia, Air Adriatic, Girjet, Privilege Style, China Eastern, Pegasus Aviation and Lan.

In July 2006 the agreement with the Spanish Ministry of Defence was renewed whereby maintenance services, operational support and complete handling services are provided to public-figure transport aircraft that include A-310 and Falcon 900 aircraft, and to B-707 and Falcon 20 aircraft employed for military transport. Also, the structural work and the CSCI4 and CSCI8 inspections were completed on the B-707 belonging to flight command 47 of the Spanish Air Force.

As regards repair and maintenance of components, Iberia Maintenance mainly provided services to Air Nostrum, Iberworld, Santa Barbara, Touchdown Aviation, Air Comet, Olympic Airways and Swiftair.

The maintenance revenue from other airlines amounted to EUR 229.9 million in 2006, increasing 36.3% with respect to 2005.

In 2006, IBERIA's Maintenance and Engineering Division successfully passed the audits for the renewal of the ISO 9001:2000 certificate granted by AENOR, which includes new Rolls Royce RB211-535E4 engine maintenance and engineering services.

Also, Iberia Maintenance obtained the Design Organisation certificate awarded by the European Aviation Safety Agency (EASA). This certificate qualifies Iberia Maintenance to make cabin modifications in commercial aircraft, either for IBERIA itself or for other airlines. It also successfully passed the audits under the IATA (IOSA) standard, thereby obtaining recognition of Operational Security in the maintenance of IBERIA's fleet.

Lastly, the Universidad Politécnica de Madrid and IBERIA entered into a framework cooperation agreement to continue with the development of projects and programmes on research, training and specialisation.

2.4. Project implementation

2.4.1. Improved service quality

In 2006, as part of the strategic framework of the 2006/2008 Master Plan, the Iberia Group implemented various initiatives aimed at improving quality and heightening customer satisfaction, offering value added services to set the Company apart from its competitors.

Business Plus Class

IBERIA began to market its "Business Plus" business class on its medium- and long-haul flights in the middle of 2005. The Company has invested over EUR 100 million in this new class, with the aim of offering passengers a top-quality product that features all the latest developments in terms of in-flight comfort, equipment and technology on its aircraft.

Business Plus features a new model of seat that can be converted into a 1.9 m by 66 cm bed, which has been judged to be one of the five best models in the world by the prestigious aviation consultancy Skytrax. In addition, the separation between the rows in the new Business Plus cabin is 152 cm, providing the passenger with greater space, privacy and comfort.

Also, IBERIA's new business class boasts one of the most modern on-request communications and entertainment systems for its passengers, which among other possibilities enables the passenger to send and receive e-mails or SMSs to mobile telephones, or hold Messenger-type online conversations.

Business Plus class has also seen changes to in-flight service. Catering items were renewed and the performance of in-flight service redesigned. Also, new menus based on Mediterranean cuisine and prime-quality new wines were introduced. In 2006, IBERIA was chosen as the airline that offered the best red wine on board its flights, according to the Global Traveler Magazine, exclusively devoted to business class travel.

Since July 2006, having completed the process of interior refurbishment, all IBERIA's long-haul aircraft feature the new cabin layout, with two service classes (Business Plus and Turista). The ten Airbus A-340/600 aircraft received since October 2004 arrived from the factory with the new class, and the Company has been changing the layout and refurbishing the cabins of the other 21 A-340 aircraft over the last 18 months. Accordingly, with the new layout, the 600 version of the A-340 has 352 seats, 52 in Business Plus, while the 300 version of this model has 260 seats, of which 42 are Business Plus seats.

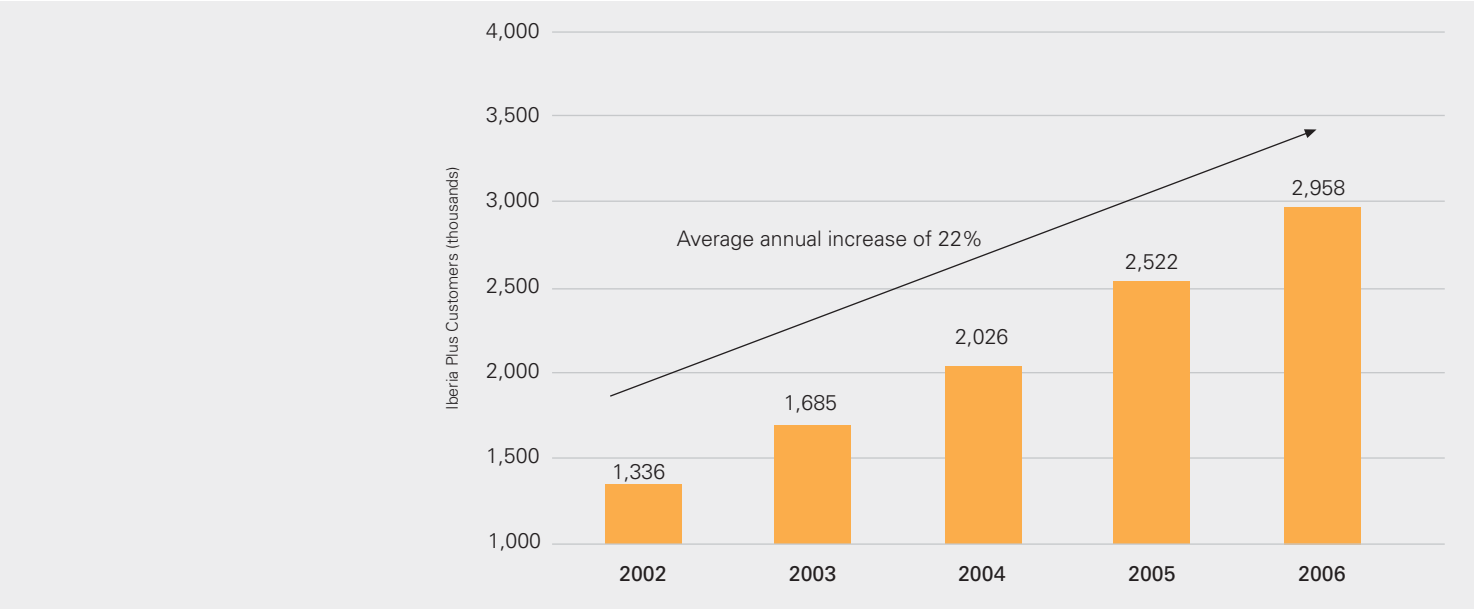
Iberia Plus

The Iberia Plus programme, created in 1991, was the first frequent-flyer loyalty programme in Europe. Throughout its 15 years of history it has become the benchmark loyalty programme in the Spanish market and in the European aviation industry.

The programme consists of the accumulation of points through the use of the Iberia Plus card, whether on IBERIA flights or on services with the companies associated with the programme. Using the points obtained, card holders have enjoyed over 600,000 free flights a year, in addition to stays at hotels, car rental, cultural or sporting events and tourist trips. There are four models of card depending on the type of customer: Iberia Plus Clásica, Plata, Oro and Platino, each one having benefits additional to the preceding one.

As a result of its loyalty programme, IBERIA attracts more customers and has a better understanding of them in order to identify their needs. The programme enables IBERIA to reward the loyalty of its regular flyers and to provide them with added value. It has been estimated that around 30% of the Company's revenue is associated with the programme's card holders. Furthermore, Iberia Plus sets IBERIA apart from its competitors.

At 2006 year-end Iberia Plus had attracted close to three million card holders, 17% more than in 2005, with average annual growth of approximately 22% over the last four years. Of these nearly three million card holders, more than one third are active members of Iberia Plus over the Internet. Of total card holders, 73% live in Spain, 17% in Europe, 9% in Latin America, and 1% in the rest of the world.



In 2006 14 new companies joined IBERIA's loyalty programme (among them Malév, Royal Jordanian, the TACA Group, Prosegur, Accord Hoteles and the online store "El placer de regalar"), thereby leading to 50 companies being associated with the programme at year-end. Airlines are included amongst these 50 companies (all the members of the oneworld alliance, Clickair and Mexicana de Aviación, among them), as well as major hotel chains, the leading car rental companies and various other companies from different sectors.

Within the framework of the Iberia Plus programme, in April 2005 the Company launched the Iberia Plus Empresas, aimed at SMEs and independent professionals. The success of Iberia Plus Empresas is evidenced by the more than 13,000 businesses that have registered with the programme since its launch (3,631 in 2006), by total cumulative sales amounting to EUR 32 million since the programme began, and by the members perception of the programme in terms of the ease, accessibility and better control of expenses that it offers them.

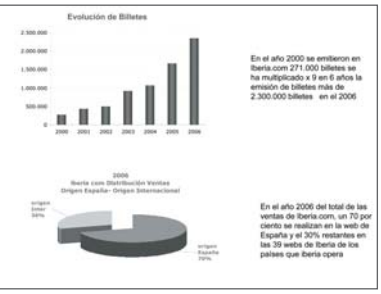
Iberia Plus Empresa's key to success lies, inter alia, in the fact that it rewards not only the company or the independent businessman that incurs the travel expense but also the employee that flies, through the accumulation of Puntos Empresa (Company Points) to one and Iberia Plus points to the other. Both may accumulate points to subsequently exchange them for flights or other free services. Also, this programme, the first of its type in Spain, gives its members the possibility of controlling their journeys and expenses through our website and also provides them with an exclusive call centre where they can pose any questions which might occur to them.

E-ticket

For several years now airlines have been introducing the e-ticket - a project included in the implementation of policies designed to reduce costs. This new form of ticket reduces the costs of printing and the materials used and the costs related to check-in staff, because it influences the growth of the number of passengers that use auto check-in. Over two yeas ago the International Air Transport Association (IATA) set 31 December 2007 as the date when paper air tickets would cease to exist.

Also, the e-ticket offers new benefits to passengers, such as the convenience of obtaining a booking and the ticket simultaneously, or the possibility of changing flights without the need to leave the home or office. There is also greater security, because it is not necessary to physically carry it, thereby eliminating the risk of loss or theft.

Currently, the e-ticket is the format most commonly used by IBERIA's passengers, whether they acquire their tickets at the Company's offices, using its website or at travel agencies. In 2006, e-tickets represented more than 93% of the tickets issued through the Company's own channels, and 89% of those issued by travel agencies.



At the end of 2006 the e-ticket was valid in practically the entire IBERIA network and it could be used on all domestic destinations and in 60 cities in its international network, which meant that only two of the international destinations do not yet admit this type of ticket (Naples and Pisa), operated by Iberia Regional/Air Nostrum.

Fifteen and a half million e-tickets were issued in 2006, an increase of 62% with respect to 2005, with growth especially in tickets issued by travel agencies which increased by 81%. The use of the e-ticket has also been a success on Madrid-Barcelona Shuttle flights, after its introduction mid-2005. The percentage of passengers that used it in the last quarter of 2006 exceeded 87%.

Quality indexes

IBERIA has various quality control and monitoring mechanisms in place, in terms of both service parameters and the level of passenger satisfaction.

Through the measuring of Level of Quality Obtained (LQO) indexes, the fulfilment of the provision of service quality standards set by the Company are supervised. To this end the overall process of customer service is controlled, both on the ground and in flight, ranging from the request for information and the booking of tickets to the handling of complaints and claims. In 2006 the new SIMCA (Integrated Quality Measurement System) application was brought into service. Through it, management has online access to information relating to service quality during the 2,000 inspections carried out both on the ground and in flight, as well as to the Company's databases and systems, thereby allowing them to define improvement measures more accurately.

To determine the passengers' opinion with respect to the fulfilment of their expectations (Perceived Level of Quality, PLQ), in 2006 close to 10,000 surveys were carried out among pas-

sengers at the end of heir flights, on 30 basic attributes of the service process. Also, a specific survey was carried out on passenger satisfaction with the treatment of their claims.

Also, the Quality Systems certified under ISO 9001:2000 standard include specific quality indicators related to the processes of the various activities that are controlled internally with sufficient regularity.

ISO Certificates

The IBERIA Group remains committed to the objective of improving the quality of all its activities and to favour the attainment thereof, ISO 9001:2000 quality management systems have been implemented in various areas of the Company, specifically in Cargo, Systems, Maintenance and Engineering, Operations, Infrastructure and In-flight Service, and in Airports (passenger and ramp handling) where an integrated quality and environmental system is in place with ISO 9001 and ISO 14001 certifications. Throughout 2006 these areas of the Company successfully passed the internal and external audits required to retain the related certifications.

2.4.2. Direct distribution channels

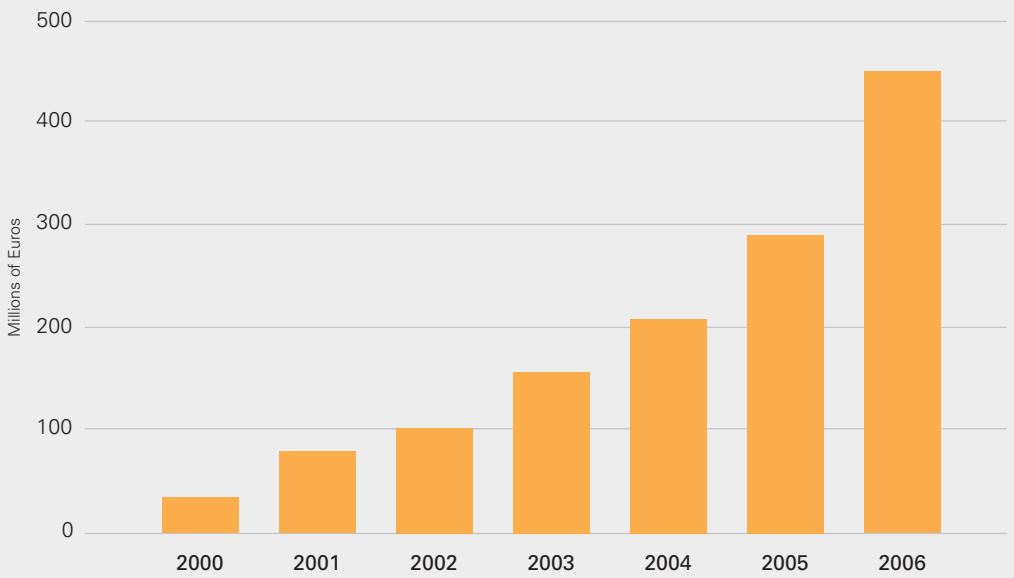
Iberia.com

During 2006, IBERIA launched new specific versions of its website, achieving a total of 36 different adaptations that cover all the countries with Company destinations in America, Europe, the Middle East and Africa, except Equatorial Guinea, Nigeria and Senegal, although work is in progress on these destinations. Also, Iberia.com improved its functionality throughout 2006, introducing new products for its users such as the issue of online tickets, discount tools, the introduction of systems to announce special offers and the guarantee of minimum price over the Internet in Spain.

In 2006 the Company sold more than 2.35 million air tickets through this channel, up 41.6% on 2005, and the volume of sales increased to EUR 447.1 million (excluding the billings of other products), a rise of 56% with respect to 2005. Considering only the sales made through the international websites, this increase rose to 75%. The number of customer hits to the website reached a daily average of over 300,000 sessions in 2006.

As a supplement to the sale of air tickets, other services can be contracted through Iberia.com such as car rental, hotel bookings, contracting of package holidays and travel insurance, as a result of the marketing agreements that IBERIA has entered into with other companies.

Iberia.com Sales Performance



Serviberia

Serviberia offers a personalised and efficient telephone assistance service that provides customers with information on flights, fares and special offers. Customers may also make bookings and purchase tickets through this telephone-based channel. Serviberia is available 24 hours a day, 365 days of the year, and handles more than four million calls a year. It also centralises the calls from most European countries, which are dealt with in six different languages.

During 2006 new technological advances were added, with the aim of improving the quality of service provided. Thus, in October a real-time alerting system was introduced (regarding flight changes, confirmations and cancellations) using SMSs to mobile telephones or e-mail addresses, thereby increasing the quality perceived. In addition, since November 2006, a customer telephone recognition service (computer telephony integration) has been included, which will permit the recognition and classification of all the users, so that loyalty campaigns can be proposed to them.

The telephone call centre specifically dedicated to holders of Iberia Plus Oro and Platino cards, forming part of the Iberia Plus loyalty programme, received close to 528,000 calls in 2006, up 32.9% on 2005.

In 2006 Serviberia sold close to 905,000 tickets, slightly above the figure for 2005, and had a total volume of sales of EUR 186.7 million. Europe saw the greatest increase in the volume of tickets sold, which increased by 5% with respect to 2005. Also, the degree of penetration of the e-ticket in the sales made by Serviberia was 97% in 2006 as a whole, 8 percentage points more than in 2005.

2.4.3. Revenue management

In 1998 IBERIA introduced the model known as leg/segment control in its revenue management, at that time the most advanced in the world and still used to this day by the great majority of airlines that manage their revenue using an optimisation model.

Within the 2006/08 Master Plan, the Revenue Management Department introduced two measures in relation to the change of management model and its related IT supports, with the objective of maintaining the Company at the industry's highest level of management in the field of revenue management. This idea is also strengthened by two facts:

- The growing weight of network traffic inherent to the strategic development decided on by IBERIA, based on the expansion and improvement of connections with the Madrid hub. To ensure the maximum effectiveness of network revenue management, it was resolved to use a management model known as Origin-Destination (O&D).
- An ever-more competitive environment, driven by the low-cost model. In this case it is necessary to use an additional model to optimise revenue from point-to-point traffic, especially on flights subject to strong competition from low-cost carriers. Such models, commonly known as low-fare modules, are very new in the industry.

2.4.4. Implementation of sales agreements

*The **one**world alliance*

oneworld is a global alliance made up of seven highly prestigious and internationally renowned airlines –American Airlines, British Airways, Qantas, IBERIA, Cathay Pacific Airways, LAN and Finnair– which constitute a worldwide network that serves more than 600 destinations in 130 countries. These airlines have come together in oneworld to provide improved services, benefits and added value to their passengers in a destination network covering the five continents.

On of the **one**world alliance's main objective is to extend the coverage of its destination network to areas where it does not operate. As a result, in 2006 Japan Airlines, Royal Jordanian and the Hungarian carrier Malév were invited to become members of **one**world, and their entrance into the alliance will be completed on 1 April 2007. In the category of affiliated airlines, currently numbering 18, the following airlines are going to join the alliance: five subsidiaries of Japan Airlines; two airlines from the LAN Group, LAN Argentina and LAN Peru; and the new subsidiary of Cathay Pacific, Dragonair. It is projected that all these airlines will join the oneworld alliance in 2007.

As regards the travel experience, **one**world allows a passenger to enjoy and benefit from a series of additional advantages such as: the possibility of obtaining and exchanging points from the

Frequent Flyer programmes of each airline throughout the **one**world network, the possibility of accessing over 400 VIP lounges distributed worldwide and the convenience of being able to travel on the alliance's entire network using the e-ticket. **one**world is the only airline alliance that has implemented this technology among all its members.

oneworld offers its passengers exclusive products both from the alliance itself and its individual member airlines, with Round-the-World Fares and Visit Passes in one or more continents, or for companies, with the specific businessflyer product. Accordingly, in 2006 **one**world 's website focused on the marketing of these products, with new tools available to passengers to organise their journeys and to select the best fares.

In recognition of its success, in 2006 oneworld received the World's Leading Airline Alliance award for the fourth successive year, presented as part of the World's Travel Awards; also in 2006 and for the second consecutive year, Business Traveller magazine named **one**world Best Airline Alliance.

Agreement with British Airways

Since January 2005 IBERIA and British Airways have been jointly operating routes between the airports of London Heathrow, Barcelona and Madrid, on the basis of an agreement entered into in 2004 which enables them to plan and manage these trunk routes together and share the profits. Customers of the two airlines have enjoyed greater possibilities of choice and greater flexibility in respect of timetables and services, and also better connections in the airports concerned, and a greater number of destinations.

The implementation of the agreement has given rise to highly positive operating and economic results over the last two years. In 2005 the two companies increased their joint profit from operating these routes with respect to 2004. The progress in 2006 was also significant, with increases in the load factor (an average of 1.7 percentage points to September with respect to 2005) and unit revenue.

Franchise agreement with Air Nostrum

IBERIA and the regional carrier Air Nostrum continued to implement the franchise agreement which has linked the two companies commercially since 1997.

Iberia Regional Air Nostrum continued to broaden its offer in 2006, through higher flight frequency and the launch of new international and domestic routes. Thus, in February the company began to operate a route connecting Madrid with Nantes; on 1 May it began to operate out of Zaragoza airport to Paris, Madrid, Ibiza and Mahón; and on 29 October it launched the route linking Alicante and Malaga. Further, in 2006 Iberia Regional Air Nostrum significantly increased its flight offering between the Canary Islands and various destinations (Lisbon, Santiago de Compostela, Málaga, Valencia, Granada, Seville and Santander) and augmented frequencies to reach a flight per day, thereby bolstering connections in the summer season. During the summer high season the Company also operated connections between Alicante and Palma de Mallorca and Bilbao and Granada. During the 2006-2007 winter season the company offered three new routes from the airport of San Pablo, Sevilla, to reach a total of eleven routes, adding Fuerteventura, San Sebastián and Valladolid to the existing routes (the last two began to be operated in mid-January 2007).

Iberia Regional Air Nostrum transported 5.17 million passengers in 2006. Therefore, the total number of passengers transported on commercial flights by IBERIA (i.e. adding together the passengers transported by IBERIA and by Air Nostrum) was 33 million in 2006. At 2006 year-end the two companies operated a total of 36 domestic destinations and 45 medium-haul international destinations.

Code-share agreements

IBERIA had code-share agreements of various types (free sale or block space) and dimensions with close to thirty airlines in the winter season 2006/07, which afford its passengers access to a greater number of destinations.

IBERIA and the Hungarian airline Malev entered into a code-share agreement in 2006, whereby the Company has offered, since April, direct flights between Madrid and Budapest, operated by Malev. This airline also operates code-share flights with IBERIA on connections from Malaga (since May), Frankfurt, Munich, Rome and Zurich to the Hungarian capital (the latter since Mid-

July). Also, Malev includes its code on the flights operated by IBERIA out of Madrid with destinations in Barcelona, Bilbao, Frankfurt, Malaga, Munich, Rome, Seville and Zurich; and from Barcelona to Frankfurt and Rome.

In May 2006 a new code-share agreement came into force that includes the Madrid-Cancún route operated daily by Iberworld and marketed by IBERIA, which increases the Company's connections with Mexico and contributes to strengthening its presence in the Caribbean.

Also, in 2006 IBERIA entered into a code-share agreement with Clickair, in force since the month of October. At 2006 year-end IBERIA marketed a total of six routes operated by Clickair that connected Barcelona with Geneva, Lisbon, Seville and Zurich; and Paris with Seville and Valencia. In 2007 other routes will be progressively introduced.

Code-share agreements were also executed with Lan Peru and Lan Ecuador in 2006 that will come into force in 2007.

Noteworthy among the agreements executed in previous years that are still in force are those with: American Airlines, British Airways, Finnair, Lan Chile, Avianca, Mexicana de Aviación, the TACA Group (Transportes Aéreos de Centroamérica) and Royal Air Maroc. Some of these agreements were modified in 2006. Since February, the routes beyond Bogotá provided for in the agreement with Avianca can be operated by SAM (a subsidiary of Avianca) sharing IBERIA's code. Also new routes have been added (London Heathrow –Warsaw and La Coruña– London Heathrow) in the wide-ranging agreement with British Airways.

2.4.5. Systems projects

In 2006 the Systems Department continued with its work of providing IT support to all the Company's businesses, while maintaining strict control of operating expenses. A disaster Recovery Plan was also developed, and the infrastructures were deployed to permit the use of digital certificates issued by Iberia.

With regard to support for the achievement of the objectives of all IBERIA's businesses, the Systems Department's initiatives can be grouped into two major areas: the improvement in the quality offered to the Company's customers and the review of internal processes to increase productivity and efficiency.

Of particular note in the first area were: the start-up of a new claim management system involving both passengers and baggage; the new product campaigns launched from Iberia.com, among them "Precios Estrella" (Star Prices); the implementation of a new website for the members of Iberia Plus, with information on the establishments associated with the programme and the points policy applied; and the installation of interactive kiosks as part of the programme, to facilitate joining for our customers.

As regards the projects pursuing improved productivity and process efficiency, highlights were: the implementation of the first phase of a new shift-management system, crucial to optimal management in areas that employee a high level of human resources, such as Maintenance and Engineering; the start-up of a system for valuing, billing and accounting for cargo revenue; the implementation of web tools to expedite the processes of selecting, recruiting and hiring personnel; and the introduction of new functions to the employees' portal that simplify administrative processes.

2.5. Corporate responsibility

The information on sustainability management, which includes environmental management and the Company's social action, is set forth at greater length in the Corporate Responsibility Report that accompanies this 2006 Financial Report. This information was prepared on the basis of the criteria established by the G3 Global Reporting Initiative, which is an internationally recognised standard.

2.5.1. Social action

IBERIA bases its social action strategy on supporting, through the provision of its usual services, entities that implement social aid programmes. Its main programmes relate to access to employment for the disabled, the voluntary service of its employees, the transportation of passengers that require any manner of assistance and the giving over of hold space to transport humanitarian aid. The Company's social action is based on four fundamental cornerstones: its employees, who created and drive the projects of the NGO Mano a Mano and the Asociación de

Empleados Padres de Minusválidos (Association of Employees' Parents of Disabled Children); cooperation with various institutions under cooperation agreements; the invitation to its customers to become involved in various projects (the Spanish Red Cross or the Special Olympics); and the involvement of its suppliers in humanitarian aid programmes.

2.5.2. Environment

In 2006 IBERIA continued to boost ongoing improvement in the area of corporate responsibility, in line with the conclusions of the White Paper presented in December by the Lower House of the Spanish Parliament.

As regards flight operations, IBERIA continued to apply measures aimed at reducing the impacts arising from sound and air emissions. Amongst other factors, the progressive replacement of less efficient aircraft, the optimisation of the assignment of aircraft to the various routes in flight programming, the improvement of the load factor and the growth of the average haul all contributed to enhanced fuel-consumption efficiency. Accordingly, specific consumption (litres of fuel per revenue tonne kilometre) once again decreased in 2006 with respect to 2005.

IBERIA participated actively in the working groups of the airline associations (IATA and AEA) in relation to the forthcoming European directive for the reduction of CO2 (the principal greenhouse gas according to the Kyoto Protocol) produced by the aviation industry. In these groups the Company has promoted a regulatory approach aimed at reducing emissions from air transport and protecting the environment.

In the area of ground operations, in 2006 the ISO 14001 Environmental Management System was expanded, which currently covers the activities carried out in the Madrid industrial zone (La Muñoza), to also include IBERIA's industrial zone at Madrid-Barajas Airport. The upcoming certification, together with the existing ones, signifies that all of the Company's significant environmental issues are covered by annually audited management systems.

In 2006 IBERIA was admitted to the select Dow Jones Sustainability Index, which values the Company's performance as regards economic, social and environmental matters. Admittance to this index places the Company among the 250 leading companies in the world in this field and only three airlines can figure in the index worldwide.

3. Resources

3.1. Fleet

At 2006 year-end, the Iberia Group had a total of 150 passenger aircraft available. There were 31 long-haul aircraft in service and 119 short- and medium-haul aircraft available. The following table shows the composition of the fleet by aircraft type:

Aircraft Type[a]	Owned	Aircraft under Finance Lease	Aircraft under Operating Lease	*Wet lease*	Total Operated
A340 / 300	5		11	2	18
A340 / 600			13		13
Long-haul	**5**		**24**	**2**	**31**
A319			11		11
A320 [b]	10	10	33		53
A321		4	14		18
B757				7	7
MD87	18				18
MD88	12				12
Short/medium-haul	**40**	**14**	**58**	**7**	**119**
Total	**45**	**14**	**82**	**9**	**150**

[a] Excluding inactive aircraft.
[b] Also, at 31 December 2006 IBERIA had three Airbus A-320 leased to another company.

At 31 December 2005 the Company had a total of 154 aircraft available. The following list shows the detail of aircraft additions and retirements in 2006:

Additions

- 2 A-320 under operating lease.
- 2 A-321 under operating lease.
- 4 A-319 under operating lease.
- 3 A-340/600 under operating lease.

Retirements

- 9 A-320 under operating lease, one of which was leased to Mexicana de Aviación.
- 3 B-757: 2 under operating lease and 1 under wet lease.
- 2 B-747/400 under wet lease.
- 1 MD-87 owned.

Also, changes were made to the operating regimes of certain aircraft in 2006, the following operations being of particular note:

- Two A-340/300 that were operated under operating lease converted to wet lease (aircraft plus crew) from mid- 2006 onwards.
- Five B-757 aircraft operated under operating lease converted to wet lease for IBERIA.

Since July 2006, subsequent to retiring the last two B-747s operated under wet lease, all IBERIA's long-haul flights were operated using one single family of aircraft, the Airbus A-340, in its two versions: the 300, with 260 seats, and the 600, with 352. In February, March and April 2006 the last three A-340/600s were added to the fleet, which arrived from the factory with the new cabin layout, including Business Plus, IBERIA's business class for the long-haul flights.

Pursuant to the plan for the renewal and standardisation of the short-and medium-haul fleet, approved in 2005, from the second quarter of 2006 onwards the Company added eight new Airbus aircraft under operating leases (two A-321s, two A-320s and four A-319s).

Since September 2006, the Company has ceased to operate Company-owned B-757s, thereby completing the process of retirement of this class of aircraft that had been initiated mid-2005. Accordingly, at 2006 year-end IBERIA only operated two types of its own aircraft (the A-320 and MD-87/88 families) on medium-haul international and domestic flights, while the B-757 aircraft only operated under wet lease, with a total of seven aircraft under agreements of varying terms (from three months to three years). *Wet lease* affords the Company greater flexibility to adjust its capacity to changes in the market.

In 2006 IBERIA began a second programme of cabin space reconfiguration and optimisation affecting its entire short- and medium-haul Airbus fleet, which will be completed early in 2008. The seats currently used will be replaced by other latest generation ones, whose structural design affords greater comfort to our passengers and, in parallel, enables the number of seats per aircraft in the various models of the fleet to be increased: A-319 (from the current 132 seats to 141), A-320 (from 162 to 171) and A-321 (from 194 to 200). The eight aircraft in this family that IBERIA received in 2006 already featured this layout when they left the factory.

The average usage of total passenger aircraft, measured in block hours per aircraft and day, stood at 9.1 hours in 2006. The use of the Company's owned aircraft improved by 0.7% in the case of long-haul aircraft, and fell by 2.2% in the case of short- and medium-haul aircraft.

BH/Aircraft/Day	2006	2005
Average short- and medium-haul aircraft usage	7.9	8.1
Average long-haul aircraft usage	13.5	13.4
Average usage of own aircraft	**9.1**	**9.1**
Average usage of aircraft under wet lease [(a)]	9.4	10.3
Average usage of total aircraft	**9.1**	**9.1**

[(a)] In 2006 aircraft operating under wet lease for IBERIA included: two B-747/400s, one until June and the other until July; two A-340/300s in the second half of the year; and eight B-757s: one until July, two all year round, two since March, one since May and two since October.

3.2. Personnel

3.2.1. Headcount

The table below shows the number of Iberia Group employees in 2006 and 2005, measured in terms of the average number of equivalent employees.

	GROUND		FLIGHT		TOTAL	
	2006	2005	2006	2005	2006	2005
IBERIA	17,550	17,897	6,163	6,263	23,713	24,160
CACESA	131	136			131	136
ALAER	53	48			53	48
BINTER FINANCE	4	4			4	4
IBERIA GROUP	**17,738**	**18,085**	**6,163**	**6,263**	**23,901**	**24,348**
Change 2006/2005 (%)	(1.9)		(1.6)		(1.8)	

The Group's average headcount decreased by 1.8% with respect to 2005 to 23,901 equivalent employees. The headcount at IBERIA, which represents more than 99% of the total, fell in the same proportion.

The average headcount of ground staff dropped by 1.9%, with decreases at IBERIA and CACESA, while BINTER FINANCE stayed stable and ALAER saw slight growth. In the case of IBERIA, the number of employees decreased in all management areas, both in Spain and abroad, except for the Airports area that increased slightly to reach 8,988 equivalent employees, due to the greater number of employees required for the transfer to T4 Terminal at Madrid-Barajas Airport. Noteworthy was the reduction of 322 equivalent employees in the Transport area, who in 2006 numbered 4,246 employees.

On 16 December 2004 the Directorate-General of Employment authorised the extension of IBERIA's collective redundancy procedure until 31 December 2007 for ground employees, cabin crew members and flight technicians, with whose representatives the Management had reached an agreement. At December 2006 a total of 1,160 of IBERIA's ground employees had availed themselves of one or other of the redundancy methods provided for in the extension, substantially all of whom took early retirement. A further 48 ground employees in Spain left the Company in 2006 for reasons unconnected with the collective redundancy procedure.

Also, in 2006 111 employees left the Company abroad, thereby taking the number of ground employees who departed from the Company in 2006 to 1,319.

The average headcount of flight employees, who represent 26% of the total, decreased by 4.0% in the case of technical crews and 0.5% in passenger cabin crew members. In 2006 there were no flight technicians in the flight headcount (the last of these employees had left the Company in May 2005, as a result of the progressive retirement of Boeing B-747 aircraft).

3.2.2. Productivity

It is more suitable to carry out the analysis of productivity performance, measured in terms of block hours per crew member and in available seat kilometres per employee, using data on the Parent, since IBERIA is the only Group company that currently engages in air transport, and because in this way the distortion due to changes in the scope of consolidation is avoided.

In terms of ASK produced, the staff productivity increased by 5.4% to 2.77 million ASK per employee in 2006. In the case of ground employees, productivity increased by 5.5%, although this figure rises to 7.8% if the Airports staff, who provide ground handling services to IBERIA and other companies, and whose production for other airlines represented more than half the total in 2006, are excluded. Productivity in terms of block hours per employee increased by 2.2% in the case of the pilots and decreased slightly (0.1%) in the case of passenger cabin crew.

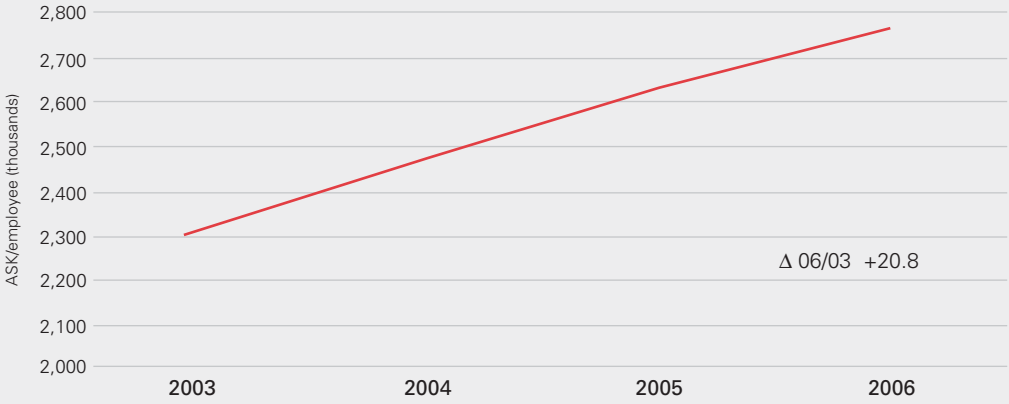
The following table details the performance of productivity by group of employees:

Productivity of IBERIA's employees	2006	2005	Change 06/05
Total workforce (thousands of ASK per employee)	2,775	2,634	5.4
Ground workforce (thousands of ASK per employee)	3,749	3,555	5.5
Ground workforce without Handling (thousands of ASK per employee)	7,685	7,129	7.8
Technical crews (B.H. per crew member)[a]	273.3	267.5	2.2
Auxiliary crews (B.H. per crew member)[a]	120.3	120.4	(0.1)

[a] Productivity calculated on the basis of weighted average number of equivalent production employees.

Productivity –measured in terms of ASK per employee– showed a cumulative increase of 20.8% over the last three years.

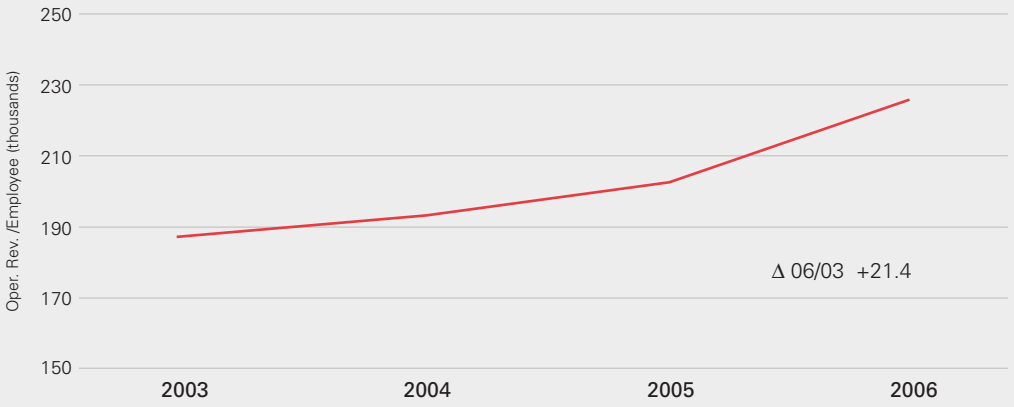
Productivity Performance of IBERIA in terms of ASK per employee



The economic productivity of IBERIA's workforce as a whole –measured in operating revenue per employee– increased by 11.4% in 2006 with respect to 2005.

The graph below shows productivity performance over recent years:

Economical Productivity Performance of IBERIA in terms of operating revenue per employee



4. Financial performance

4.1. Application of IFRSs

The consolidated financial statements for 2006 presented in this report were prepared in accordance with International Financial Reporting Standards (IFRSs), which have been applied since January 2004 (except IAS 32 and 39 which, as permitted under IFRSs, began to be applied from January 2005 onwards).

The application of IAS 39 (Financial Instruments: Recognition and Measurement) has had a particular impact on the Iberia Group's results in the last two years.

IBERIA uses various derivatives to implement its risk hedging policy. In the case of the hedges applied to aircraft operating leases, the objective of the derivative is to hedge foreign currency (dollar) and interest rate risks. Also, the Company uses price and exchange rate hedges in its fuel purchases. On 1 January 2005 the Company recognised at market value all its hedging transactions, in accordance with the first-time application of IFRSs. Subsequently, the hedges have been measured at each quarterly close, recognising the changes in value thereof. Most of the derivatives used by the Company are effective from the viewpoint of IFRSs, and the changes in value over time do not affect profit or loss and are recognised in reserve accounts in the balance sheet. However, some of the derivatives are considered "ineffective" and generate impacts on items in the income statement.

In 2005 the hedges were overstated, principally those applied to aircraft leases due mainly to the rise in dollar interest rates during the period. The application of IAS 39 gave rise to an increase of EUR 27.4 million in profit before tax.

Conversely, the changes in the difference between the dollar and euro interest rate curves in 2006, together with the changes in value of the fuel price derivatives, reduced the aforementioned overstatement and had an adverse effect on profit before tax of EUR 29.1 million, which breaks down as follows: EUR 24.6 million increase in expenses relating to the measurement of the financial instruments linked to aircraft operating leases; EUR 3.7 million increase in expenses arsing from the temporary and statistical "ineffectiveness" (according to IFRS terminology) of a portion of the fuel hedges; and EUR 0.8 million increase in expenses in the measurement of other financial instruments.

In summary, the measurement of the derivatives in accordance with IFRSs caused a EUR 56.5 million decrease in profit before tax in 2006 and 2005. Also, at 31 December 2006 the change in value of the derivatives decreased the reserves account by EUR 92.1 million with respect to the year-end close of 2005.

4.2. Operating profit

In 2006, the Iberia Group's operating profit, which excludes non-recurring items, amounted to EUR 122 million, up 4.6% with respect to 2005. The profit margin with respect to operating revenue was 2.3%, as compared with 2.4% in 2005.

If the effects of applying IAS 39 in the two years are excluded, with the objective of presenting more fairly the Company's operating performance, operating profit amounted to EUR 150.3 million in 2006, increasing by 67.6% with relation to adjusted profit (without IAS 39) for 2005 which amounted to EUR 89.6 million.

The EBITDAR (operating profit before depreciation and amortisation and aircraft leases) generated by the Iberia Group was EUR 790.5 million in 2006, an increase of 12.9% over the figure in 2005. The EBITDAR margin as a percentage of revenue stood at 14.7%, an improvement of 0.5 percentage points with respect to 2005.

The table below shows the breakdown, by company, of the Iberia Group's operating profit in the last two years in accordance with International Financial Reporting Standards (IFRSs):

Thousands of euros

Operating Profit	2006	2005
IBERIA	114,923	108,408
CACESA	1,351	1,311
ALAER	132	114
BINTER FINANCE	30	29
IBERIA GROUP[(a)]	**121,953**	**116,590**

[(a)] The Iberia Group's total figures include consolidation adjustments.

Following is the Iberia Group's management operating statement, that differs from the audited income statement due solely to the fact that the various revenue and expense items are aggregated for management purposes.

Millions of euros

IBERIA GROUP	2006	2005	Change 06/05	% Change
OPERATING REVENUE				
Passenger revenue	4,174.9	3,820.7	354.2	9.3
Cargo revenue	334.9	317.1	17.8	5.6
Handling	331.2	322.1	9.1	2.8
Maintenance	219.0	155.7	63.3	40.7
Commercial revenue	80.1	79.7	0.5	0.6
Other operating revenue	247.6	233.8	13.8	5.9
TOTAL OPERATING REVENUE	**5,387.8**	**4,929.1**	**458.7**	**9.3**
OPERATING EXPENSES				
Staff costs	1,395.2	1,442.3	(47.1)	(3.3)
Fuel	1,177.5	865.8	311.8	36.0
Traffic services	451.8	427.9	23.9	5.6
Aircraft lease expenses	449.2	405.6	43.6	10.7
Aircraft maintenance	337.8	294.9	42.8	14.5
Navigation charges	285.8	276.4	9.3	3.4
Commercial expenses	246.1	259.6	(13.6)	(5.2)
Amortisation and depreciation charge	219.4	177.7	41.6	23.4
Booking systems	147.8	139.7	8.0	5.7
In-flight services	87.4	81.5	5.8	7.2
Indemnity payments for passengers and baggage	51.6	35.5	16.1	45.5
Insurance	29.7	33.1	(3.3)	(10.1)
Other operating expenses	386.7	372.4	14.4	3.9
TOTAL OPERATING EXPENSES	**5,265.8**	**4,812.5**	**453.3**	**9.4**
OPERATING PROFIT	**122.0**	**116.6**	**5.4**	**4.6**
OPERATING PROFIT (exc. IAS 39)	**150.3**	**89.6**	**60.6**	**67.6**
EBITDAR	**790.5**	**699.9**	**90.6**	**12.9**
EBITDA	**341.3**	**294.3**	**47.0**	**16.0**

4.2.1. Operating revenue

The Iberia Group's operating revenue amounted to EUR 5,387.8 million in 2006, an increase of 9.3% with respect to 2005.

Passenger transport and cargo revenue, which represented 83.7% of operating revenue, amounted to EUR 4,509.9 million, up by 9.0% with respect to 2005. The aggregate amount of the other operating revenue amounted to EUR 877.9 million in 2006, an increase of 10.9%. All the items increased, although of particular note was the increase in the revenue generated by maintenance services to other airlines that rose 40.7% with respect to 2005.

Passenger revenue

Revenue from passenger traffic amounted to EUR 4,174.9 million, an increase of EUR 354.2 million with respect to 2005, due mainly to the growth in revenue in the long-haul sector, which surpassed the 2005 figure by EUR 334.8 million.

The difference between the amount of passenger revenue in the operating statement and the amount in the tables of "Main Aggregates" and "Passenger Traffic Revenue" (section 2.1.2.) is explained by the fact that the latter relates directly to the actual production in each year, excluding accounting adjustments and revaluations, and also the revenue arising from the unused ticket recovery process, which is included in the figure in the operating statement.

In the network as a whole, passenger revenue from tickets effectively flown in 2006 amounted to EUR 3,963.2 million, which exceeded the figure for 2005 by EUR 353.2 million, representing an increase of 9.8%, based both on the growth in the volume of traffic (7.0% in RPK terms) and on the average revenue per RPK (2.6%). The 3.4% increase in the capacity offered and, above all, the significant improvement in the load factor (2.7 percentage points) favoured the aforementioned increase in the volume of traffic, representing an increase of EUR 155.4 million with respect to 2005. The increase in average revenue, underpinned mainly by the solid performance of the long-haul sector, gave rise to an increase of EUR 198.5 million (excluding the exchange rate effect). Lastly, the changes in the exchange rates of various currencies against the Euro led to a minor decrease of EUR 0.7 million in passenger revenue in the 12 months of 2006 taken as a whole with respect to 2005. The unit passenger revenue stood at EURcents 6.02 per ASK, 6.2% higher than in 2005, despite being significantly affected by the 6.5% increase in the average passenger haul.

The aggregate amount of other passenger revenue (not linked to activity) stood at EUR 211.7 million in 2006, EUR 1 million above the figure for 2005.

Cargo revenue

The Iberia Group's cargo revenue (including the billings for goods and mail transport, fuel and security charges or surcharges and excess baggage revenue) amounted to EUR 334.9 million in 2006, up 5.6% on 2005. IBERIA's revenue tonne kilometres increased by 8.3%, with growth concentrated mainly on the routes between Spain and Latin America, and the average revenue (by RTK) decreased by 1.0% over the network as a whole.

Handling

Revenue from ground handling services to other airlines' passengers and aircraft increased by 2.8% with respect to 2005 to EUR 331.2 million.

Maintenance

Revenue from maintenance services to other airlines amounted to EUR 219 million, which exceeded the 2005 figure by EUR 63.3 million and represented an increase of 40.7%. The increase in revenue related mainly to technical workshop services, due to the higher volume of activity with other companies and to specialising in work and services that contribute more value. Noteworthy was the increase in revenue from engine inspections, particularly RB-211 engines, inspection of avionic components and D inspections.

Commercial revenue

Passenger and cargo sales commission, together with various other commissions, increased slightly with respect to 2005 by 0.6% to EUR 80.1 million in 2006. Accordingly, this revenue account steadied after experiencing ongoing reductions (parallel, in part, to the fall in related costs) in recent years.

Other operating revenue

The aggregate amount of other operating income amounted to EUR 247.6 million in 2006, increasing by EUR 13.8 million with respect to 2005, which represented an increase of 5.9%.

Noteworthy among the items included were: income from using the Amadeus booking system, which amounted to EUR 44.5 million in 2006, an increase of EUR 5.5 million with respect to 2005, due in part to increased sales through Iberia.com; income from the Iberia Plus programme and from the commercial agreements entered into with other airlines, mostly belonging to the oneworld alliance, the aggregate amount of which increased by EUR1.6 million to EUR 41.3 million; income from in-house work on non-current assets, which amounted to EUR 23.3 million, an increase of EUR 6.5 million 2005; and income from leases (mainly aircraft and engines) which amounted to EUR 22.1 million in 2006, exceeding the figure for 2005 by EUR 6.4 million.

"Other Operating Income" includes "Adjustment of Traffic Revenue Not Allocable to Passenger Routes" and "Other Traffic Revenue", which are included under "Passenger Revenue" in the notes to consolidated financial statements. Also, this heading includes "Adjustment of Traffic Revenue Not Allocable to Passenger Routes" for cargo, which appears as "Cargo Revenue" in the notes to consolidated financial statements.

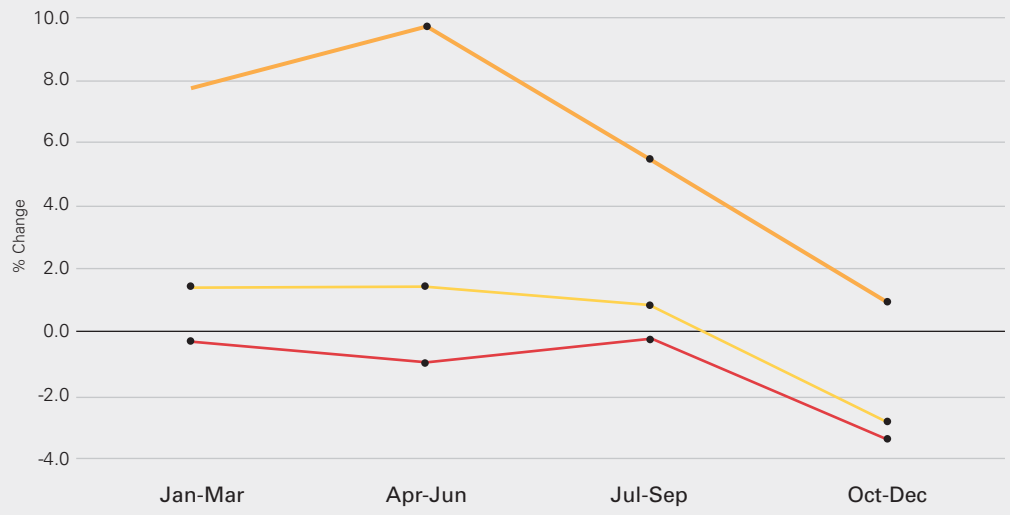
4.2.2. Operating expenses

The Iberia Group's operating expenses amounted to EUR 5,265.8 million in 2006, up 9.4% on 2005, caused mainly by the sharp increase in price of aviation kerosene. Also, the rise in expenses was prompted by the adverse impact of the application of IAS 39 (which explains the EUR 55.3 million difference between the operating expenses in the two years) and, to a lesser degree, by the growth in the maintenance services provided to other airlines. These increases in expenses were offset in part by the implementation of cost cutting initiatives designed in the 2006/08 Master Plan.

Unit operating cost stood at EURcents 8.0 per ASK in 2006, increasing by 5.8% with respect to the figure recognised by the Iberia Group in 2005. This increase would be limited to 0.2% excluding the fuel expense in the two years. Furthermore, excluding the effect of IAS 39, unit operating cost would decrease 1.2% with respect to 2005 and would stand at EURcents 6.18 per ASK.

During 2006, the change in unit operating cost excluding fuel with respect to 2005 followed a downward trend, achieving a reduction of 2.9% in the final quarter.

Quarterly changes in the Iberia Group's unit costs 2006/2005



Staff costs

The Iberia Group's staff costs dropped by 3.3% with respect to 2005 to EUR 1,395.2 million, due mainly to the initiatives designed to increase productivity that led to a reduction in the workforce. Of this amount, EUR 1,049.9 related to wages, salaries and other similar costs and the other EUR 345.3 million to social security costs, contributions to employee pension funds and other employee welfare expenses.

The Iberia Group's average headcount was 23,901 equivalent employees in 2006, decreasing by 1.8% with respect to 2005. The staff unit cost (per ASK) decreased by 6.5%, due mainly to the

5.4% increase in average productivity of the workforce (in terms of ASK per employee), and the enhanced salary mix arising from the early-retirement process.

Fuel

The fuel expense increased by 36% with respect to 2005 to EUR 1,177.5 million in 2006, representing 22.4% of the Iberia Group's total operating expenses (two years previously, in 2004, it represented 14.2%). The following table shows the detail of the items that were involved in this increase:

Millions of euros

	Causes of the Changes in the Fuel Expense					Total Chante
	Price[*]	Volume	Exchange rate[*]	Efficiency	Other	2006/2005
IBERIA	293.7	34.8	20.3	(38.1)	1.1	311.8

[*] The changes due to price and exchange rate include the effect of hedges.

The fuel expense exceeded the figure recognised in 2005 by EUR 311.8 million, due mainly to the escalation in prices. The growth in production and the average appreciation of the dollar against the Euro during the year as a whole also had an influence, although to a lesser extent, on the increase in the fuel expense. These increases were offset in part by the improvement in aircraft fuel consumption efficiency, which led to a reduction in the fuel expense of EUR 38.1 million in 2006. Over the last three years taken as a whole, lower fuel consumption due to the enhanced aircraft efficiency exceeded EUR 80 millions.

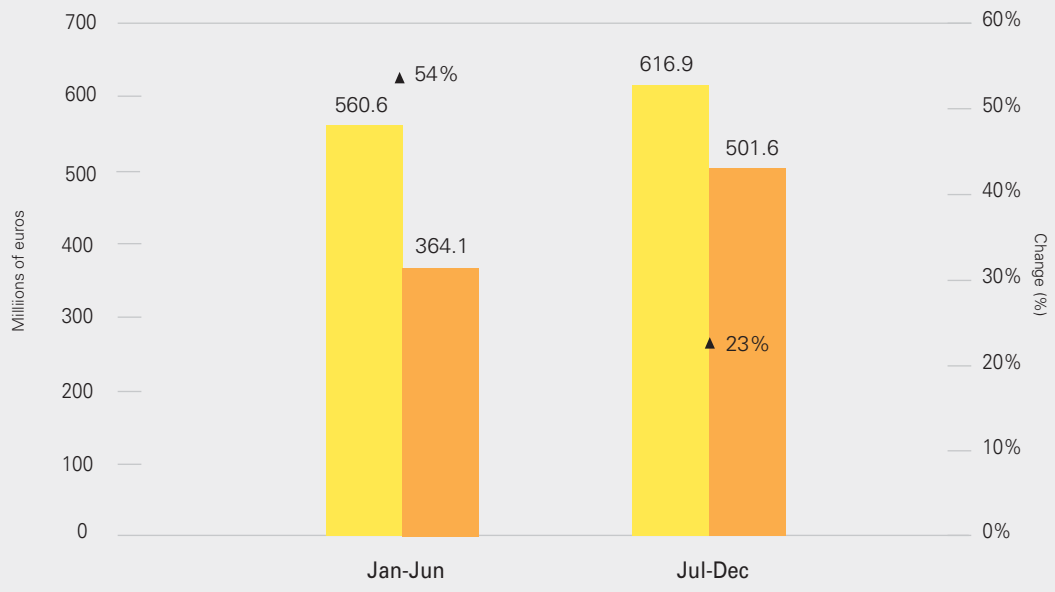
For more than the first six months of 2006, oil and refined product prices, as in the case of aviation kerosene, continued to rise on the markets, reaching an all-time-high in August. From then on the price of oil fell gradually, to levels of around USD 55 per barrel in the final months of the year. In spite of this decrease, the average annual dollar price of crude oil in the European market increased by around 20% with respect to 2005.

IBERIA manages the cost of aviation fuel through active risk control policies, which take the form of fuel price hedges. These hedges cushioned a portion of the impact of the rise in prices on the international markets, permitting a reduction in the fuel expense of EUR 4.2 million for the twelve months of 2006 taken as a whole. The Company also arranged dollar exchange rate hedges, which led to a reduction in the annual fuel expense of EUR 1.3 million.

Also, the measurement of "non-effective" fuel price hedges (applying IFRS terminology) increased the fuel expense by EUR 3.7 million (2005: EUR 2.7 million).

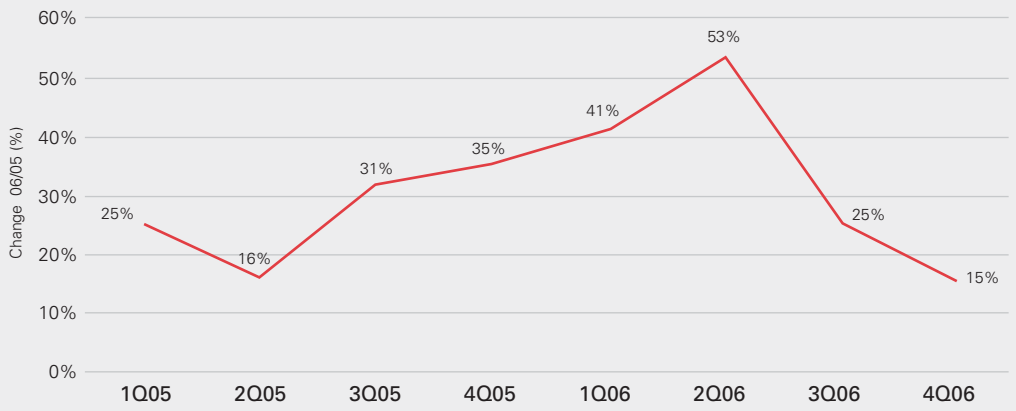
The greatest increase in expenses as compared with 2005 arose in the first half of the year, when the greatest year-on-year differences in crude oil prices were recorded, which then followed an upward trend until August 2006.

Six-monthly changes in the fuel expense



As a result of the foregoing, in 2006 the unit cost of fuel amounted to EURcents 1.79 per ASK, increasing by 31.5% with respect to 2005. The following graph shows the evolution of the quarterly changes in the unit cost of fuel in 2005 and 2006 with respect to the preceding years.

Quarterly changes in the unit cost of fuel (per ASK)



Traffic services

The traffic services cost amounted to EUR 451.8 million in 2006, increasing by EUR 23.9 million with respect to 2005, which represented an increase of 5.6%, caused in part by the growth in the air transport area (3.4% in ASK terms) and by the major increase in the cost of using boarding bridges, apron stands and other airport services (29.7%). The salient feature of the year was the increase in the usage of boarding bridges at Madrid-Barajas Airport due to the greater availability thereof subsequent to the enlargement of the airport.

The unit cost of traffic services was EURcents 0.69 per ASK, 2.1% higher than in 2005.

Aircraft lease expenses

Aircraft lease expenses increased by EUR 43.6 million (10.7% with respect to 2005) amount to EUR 449.2 million. The expense of leasing passenger aircraft amounted to EUR 436.6 million, increasing by EUR 45.8 million with respect to 2005, due mainly to the adverse effect of applying IAS 39 and the increase of activity under wet lease. The application of the aforementioned international accounting rule at 31 December 2006 meant an increase in aircraft lease expenses amoun-

ting to EUR 24.6 million, as compared to a reduction of EUR 29.6 million in 2005. Excluding this effect, the unit cost of aircraft lease decreased by 5.7% with respect to 2005. A portion of this decrease was due to the exercise of the purchase option in 2005 on five A-340/300 aircraft that were being operated under operating leases, which transferred this cost to the amortisation and depreciation account. The expense of leasing cargo carriers was EUR 12.6 million in 2006, decreasing by EUR 2.2 million with respect to 2005.

Aircraft maintenance

The aircraft maintenance expense amounted to EUR 337.8 million in 2006, increasing by 14.5% with respect to 2005, due mainly to the higher volume of work performed for other airlines. Consumption of spare parts (including parts with a limited life) amounted to EUR 158 million, increasing by 3.7% with respect to 2005; outside services of aircraft repair and upkeep amounted to EUR 158.2 million, increasing by 28.6% with respect to 2005; lastly, provisions recorded for major aircraft repairs amounted to EUR 21.6 million, an increase of 10.4%. The unit cost of aircraft maintenance solely for the air transport business decreased by 10.1% to EURcents 0.63 per ASK.

Navigation charges

The aggregate cost of air traffic control services increased by EUR 9.3 million with respect to 2005, an increase of 3.4%, EUR 285.8 million in 2006, caused mainly by the growth in the Company's production and the increase of around 2% in the average unit price. The cost of in-flight services increased by EUR 8.3 million to EUR 228.4 million. Airport approach expenses increased by EUR 1 million, an increase of 1.9% with respect to 2005, due to the increase in unit rates in 2006, which was 5% at the Spanish airports. The average increase in Eurocontrol's navigation charges for all the countries over which IBERIA flies was 0.1% with respect to 2005.

Commercial expenses

In 2006 commercial expenses (commissions, advertising and promotional expenses and development expenditure) amounted to EUR 246.1 million, decreasing by 5.2% with respect to 2005.

The unit commercial cost decreased by 8.4% with respect to 2005 as a whole and amounted to EURcent 0.37 per ASK, due to the implementation of the new travel agency remuneration model in Spain and its extension to the other markets.

The ratio of net commercial expenses, i.e., after deducting commission revenue, to traffic revenue stood at 3.6%, a decrease of 0.6 percentage points with respect to 2005.

Booking systems

Booking system costs amounted to EUR 147.8 million in 2006, increasing by 5.7% with respect to 2005, while the number of bookings made remained substantially at the same level as in 2005 (an increase of 0.1%). Taking into account the increase in revenue related to bonuses pacted with certain of the booking systems, the net unit cost per booking increased by 2.8% with respect to 2005.

In-flight services

The cost of in-flight services increased by EUR 5.8 million with respect to 2005, an increase of 7.2%, due to the aforementioned increase in the number of passengers on long-haul routes and, in particular, passengers travelling in business class.

Amortisation and depreciation charge

The amortisation and depreciation charge increased by 23.4% (19.4% in unit terms) with respect to 2005, caused mainly by the addition to the balance sheet of five A-340/300 aircraft in December 2005 which had previously been operated under operating lease. Excluding this effect, the increase in the amortisation and depreciation charge was 9%, which was a result of the increase in assets arising from investments made (T4, the new Business Plus class, among other items).

Indemnity payments for passengers and baggage

The expense relating to indemnity payments for passengers and baggage suffered an exceptional increase of EUR 16.1 million with respect to 2005, caused by the operating inefficiencies during the initial period of operation of the T4 Terminal and by the effects of the illegal strike by ground handling employees at the Barcelona airport. The coming into force of EU Regulation 261/2005, of 17 February 2005, which raised indemnity payments and assistance to travellers in the event of denied boarding due to overbooking, and extended compensation to passengers affected by delays, flight cancellations and loss of baggage.

Other operating expenses

The aggregate amount of "Other Operating Expenses" was EUR 386.7 million in 2006, increasing by EUR 14.4 million with respect to 2005.

4.3. Other results

The Iberia Group obtained profit from operations amounting to EUR 135.2 million in 2006, down EUR 242.7 million on 2005, caused by the decrease in the net balance of non-recurring items included therein, as shown in the following table:

Millions of euros

IBERIA GROUP	2006	2005	Change 06/05	% Change
OPERATING PROFIT	122.0	116.6	5.4	4.6
Non-recurring income	77.6	690.9	(613.3)	(88.8)
Non-recurring expenses	64.4	429.7	(365.3)	(85.0)
NON-RECURRING PROFIT	13.2	261.3	(248.1)	(94.9)
PROFIT FROM OPERATIONS	135.2	377.9	(242.7)	(64.2)
Finance income	88.0	58.9	29.1	49.5
Finance costs	60.6	46.1	14.5	31.4
Exchange differences (gains and losses)	(1.1)	(0.1)	(1.0)	n/m
Other income and expenses	(0.8)	0.5	(1.3)	(262.3)
FINANCIAL RESULTS	25.5	13.1	12.4	94.3
SHARE OF RESULTS FOR THE YEAR OF ASSOCIATES	4.5	2.5	2.0	80.1
PROFIT BEFORE TAX	165.2	393.5	(228.3)	(58.0)
INCOME TAX	(108.2)	2.5	(110.7)	n/m
PROFIT FOR THE YEAR	57.0	396.0	(339.1)	(85.6)
PROFIT ATTRIBUTABLE TO MINORITY INTERESTS	0.2	0.2	0.0	6.1
PROFIT ATTRIBUTABLE TO THE PARENT	56.7	395.8	(339.1)	(85.7)
PROFIT FOR THE YEAR (before adjustments for taxes)	116.1	396.0	(279.9)	(70.7)

n/m: Not material.

4.3.1. Non-recurring income and expenses

Non-recurring income amounted to EUR 77.6 million in 2006, a decrease of EUR 613.3 million with respect to 2005, due to the fact that the 2005 figure included a gain of EUR 663 million, on the sale of the holdings in Amadeus and SAVIA. In 2006 non-recurring income included a gain of EUR 14.7 million from the final settlement of the sale of the ownership interest in Musini, SEPI's former insurance company in which IBERIA had an ownership interest. Also, due to the reclassification of the engine repairable parts, which from the second quarter of 2006 onwards began to be considered as inventories instead of depreciable items, EUR 53.3 million was recovered from the accumulated depreciation recognised on these items.

Non-recurring expenses amounted to EUR 64.4 million in 2006. Provisions of EUR 25.8 million were recorded to cover the future payments to be made under the collective redundancy procedure, due to the increase in the number of ground employees who left the Company in 2006, mainly as a result of the bringing forward of departures initially foreseen for 2007. Also, a provision of EUR 26.4 million was recorded for inventory obsolescence, following the reclassifi-

cation of the aforementioned engine repairable parts and to adjust the value of these parts. In 2005 a provision of EUR 280 million was recorded to cover the costs associated with the restructuring plans included in the 2006/2008 Master Plan, and also an extraordinary provision of close to EUR 105 million was recorded to write-down the MD-87/88 aircraft, which will be replaced with new Airbus aircraft.

4.3.2. Financial results

Financial profit amounted to EUR 25.5 million in 2006, an increase of EUR 12.4 million with respect to 2005. Finance income amounted to EUR 88 million, up 49.5% on 2005, due in part to the rise in interest rates and the increase in the average balance of the Company's short- and long-term deposits. Finance income also included EUR 11 million relating to 2005 and 2006 dividends from IBERIA's 11.68% ownership interest in the share capital of WAM. Finance costs, which increased 31.4% with respect to 2005, were also affected by the increase in interest rates.

4.3.3. Profit for the year

The Company achieved consolidated profit before tax amounting to EUR 165.2 million in 2006, as compared with EUR 393.5 million in 2005. The income tax expense recognised in 2006 amounted to EUR 49.1 million.

On 28 November Law 35/2006 was enacted, which includes a partial modification of Spanish Corporation Tax, whereby the standard income tax rate was reduced from 35% to 32.5% in 2007 and to 30% from 2008 onwards. Accounting rules establish that deferred tax assets must be recognised at the effective tax rate of the year in which they will foreseeably be taken. The aforementioned reduction in the income tax rate led to a proportionate reduction in the deferred tax assets that the Company had recognised (at the 35% tax rate) in its balance sheet at 31 December 2006 and this valuation adjustment of its assets had to be made in the 2006 financial statements.

Therefore, this reduction in the tax rate will have a beneficial effect for IBERIA from 2007 onwards, although from the accounting viewpoint it had an impact of EUR 59.1 million on the income tax charge for 2006 and left consolidated profit after tax at EUR 57 million.

In line with the resolution adopted by the Council of the Spanish National Securities Market Commission (CNMV), the Company resolved to reflect in this report the net profit obtained from its ordinary activity (EUR 116.1 million in 2006) before the exceptional tax adjustment mentioned in the preceding paragraph, thus endeavouring to provide adequate information to investors who can thus assess the normal performance of operations in the year and the changes in the businesses.

4.4. Investments

The Iberia Group's net investments (net of divestments) in tangible and intangible assets amounted to EUR 105 million in 2006.

Aircraft investment transactions related to modifications made to the interiors of the A-340, A-320 and A-319 (EUR 41.7 million in total), and the capitalisation of inspections and service bulletins of owned A-340 aircraft amounting to EUR 15.6 million, and of leased A-320s and A-321s amounting to EUR 3.8 million. Also, a spare engine was purchased for the A-320 aircraft (EUR 2.3 million) and another for the A-340 aircraft (EUR 7.9 million). Also, the Company sold an owned B-757.

The main investments in other assets were: handling equipment (EUR 22.3 million), machinery and plant (EUR 21.4 million), and computer hardware and software (EUR 33.2 million).

The classification of engine repairable parts as inventories instead of as depreciable assets from 2006 onwards, in view of the fact that their turnover has increased over the years to less than twelve months, gave rise to an accounting divestment of EUR 89 million in 2006.

As regards non-current financial assets, the most significant investments were ownership interests in the new companies International Supply Management and Clickair. The capitalisation of the interest accrued on the loan granted by IBERIA to Wam Acquisition S.A. amounted to EUR 5.6 million.

The most significant financial divestments in terms of amount related to: the loans to Iberbus (EUR 17.5 million) due to the discounting of exchange differences; the refund of advances on A-340 and A-321 aircraft amounting to EUR 91.8 million and EUR 35.1 million, respectively, the latter amounts being included under long-term deposits; and the transfer to short-term of the bonds issued by Iberbond PLC and taken up by IBERIA (EUR 30.8 million), used to finance the six A-320 aircraft operated under finance lease, which will be redeemed in September 2007.

4.5. Balance sheet

The following table shows the main items in the consolidated balance sheet at 31 December 2006 and 2005:

Millions of euros

IBERIA GROUP	2006	2005	Change 06/05	% Change
IProperty, plant and equipment and intangible assets	1,399.8	1,511.0	(111.2)	(7.4)
Non-current financial assets	640.1	743.8	(103.7)	(13.9)
Other non-current assets	451.4	492.4	(40.9)	(8.3)
Non-current assets held for sale	0.0	3.0	(3.0)	(100.0)
Receivables and other current assets	806.8	781.6	25.3	3.2
Current financial assets	1,489.3	1,190.7	298.7	25.1
Cash and cash equivalents	963.7	821.4	142.3	17.3
Total Assets	**5,751.3**	**5,543.9**	**207.3**	**3.7**
Equity	1,738.6	1,738.2	0.4	0.0
Provisions for contingencies and expenses	1,359.1	1,381.2	(22.1)	(1.6)
Interest-bearing non-current liabilities	481.3	706.1	(224.8)	(31.8)
Other non-current liabilities	53.6	34.5	19.1	55.5
Interest-bearing current liabilities	238.3	120.8	117.5	97.2
Other current liabilities	1,880.4	1,563.1	317.3	20.3
Total Equity and Liabilities	**5,751.3**	**5,543.9**	**207.3**	**3.7**

The Iberia Group's equity amounted to EUR 1,738.6 million at 31 December 2006, practically the same as the amount recognised at 2005 year-end, despite the decrease in the reserves at companies accounted for using the equity method, due to the departure of Amadeus from the Group's scope of consolidation.

Long-term provisions for contingencies and charges amounted to EUR 1,359.1 million at 2006 year-end, a decrease of 1.6% with respect to 2005. The detail of the balance at 31 December 2006 is as follows: EUR 62.4 million of provisions for major aircraft repairs; EUR 618.3 million of provisions for pensions and obligations to employees, including the allowances for reserve flight crew members; and EUR 678.4 million of provisions for third-party liabilities, which include the provisions recorded for the restructuring of the workforce. The most significant use of provisions related to the payments made as a result of the various collective redundancy procedures which amounted to EUR 94.1 million in 2006.

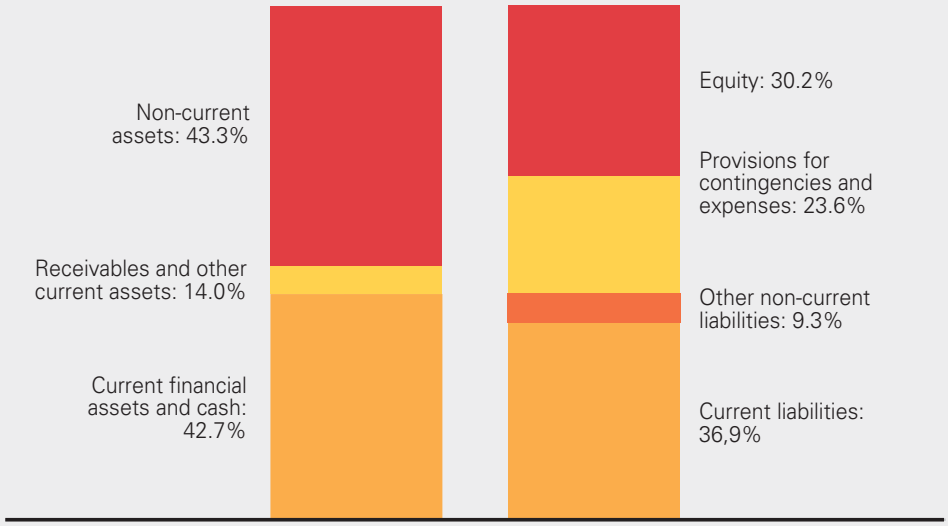
Interest-bearing current and non-current liabilities (debentures, bank borrowings and finance lease obligations) amounted to EUR 719.6 million at 2006 year-end, a decrease of EUR 107.3 million (13%) with respect to 2005.

The cash balance (current financial assets plus cash and cash equivalents) increased by EUR 441 million over 2005 year-end to EUR 2,453.1 million at the close of 2006. The measurement of hedging transactions (as required by IAS 39) at 31 December 2006 gave rise to an increase of EUR 11.3 million in current financial assets (2005 year-end: EUR 42.8 million).

The Iberia Group's net indebtedness continued to improve and be clearly negative, i.e. the balance of the current financial asset accounts (excluding the aforementioned measurement of hedges) exceeded the aggregate balance of interest-bearing debt. Accordingly, net indebtedness stood at EUR -1,722.2 million at 31 December 2006, as compared with EUR -1,142.4 million at 2005 year-end. Adjusted net debt, including the conversion to debt of the operating lease instalments (excluding the effect of the measurement of hedges at year-end in both years and in 2005 the income from five A-340/300 under operating leases which were added to assets in December) and other balance sheet adjustments, amounted to EUR 1,346.6 million, a decrease of 22.6% with respect to 2005.

IBERIA voluntarily reclassified engine repairable spare parts for accounting purposes, since their new accounting treatment as inventories better reflects the economic reality, because their rotation has increased gradually over the years to finally less than twelve months. This item is the principal reason for the decrease recognised in the balance of "Property, Plant and Equipment" and "Intangible Assets" at" 31 December 2006 (EUR -111.2 million with respect to 2005 year-end) and for the EUR 72.9 million increase in inventories over the same period. As regards "Non-Current Financial Assets", derecognitions related to Iberbus loans due to the discounting of exchange differences and the refunding of advances on A-340 and A-321 aircraft, recognised under long-term deposits. Also, the balance of Iberbond Bonds is classified in current financial assets because they mature at less than twelve months.

Consolidated Balance Sheet at December 31, 2006 (%)



TOTAL ASSETS / LIABILITIES: EUR 5,751 millions

4.6. Cash flow statement

The following table reflects the main aggregates of the consolidated cash flow statements for 2006 and 2005.

Millions of euros

IBERIA GROUP	2006	2005
Profit before tax	**165.2**	**393.5**
Depreciation and amortisation charge and impairment losses	219.3	282.3
Provisions (net)	107.4	370.7
Provisions used [(a)]	(129.7)	(190.0)
Proceeds from disposal of assets and investments intangible assets[(b)]	(24.3)	(656.7)
Other cash flow adjustments	107.4	98.7
Tax payments	101.1	(164.1)
Net cash flows from operating activities	**546.4**	**134.3**
Net investments in property, plant and equipment, intangible assets & investment property	(116.0)	35.9
Net investment in financial and other non-current assets [(b)]	23.6	574.2
Net investment in financial and other current assets	(238.7)	(170.3)
Net cash flows from investing activities	**(331.1)**	**439.9**
Dividends paid	(18.7)	(322.5)
Capital increase	7.9	9.2
Change in bank borrowings	(76.8)	(9.5)
Net change in treasury shares	14.5	3.6
Net cash flows from financing activities	**(73.1)**	**(319.1)**
Net increase/decrease in cash and cash equivalents	**142.3**	**255.0**
Balance of cash and cash equivalents at the beginning of the year	821.4	566.5
Balance of cash and cash equivalents at the end of the year	963.7	821.4

[(a)] Due mainly to payments related to the collective redundancy procedure and the return of aircraft.
[(b)] (b) 2005 includes the sale of the ownership interests in Amadeus and SAVIA.

4.7. Management of non-operating risks

IBERIA has in place a global non-operating risk management programme aimed at controlling and limiting the possible impact of exchange rate, interest rate and aviation fuel price fluctuations on the Company's earnings.

With this objective and within the framework established for the arrangement of hedges in accordance with International Accounting Standards (IAS), IBERIA uses a VaR (Value at Risk) model with the aim of evaluating on a probabilistic basis the possible impact of market variables on its earnings, and defines the maximum objectives of volatility and the Hedging Programme required to attain them.

Hedging programme

I) Exchange rate risk

Due to the nature of its activities, IBERIA is exposed to exchange rate risk, at both operating (cash flows) and balance sheet level. The detail of the main hedging transactions in dollars is as follows.

Cash flows

LThe Company took a short dollar-position of around USD 900 million in 2006, since US dollar revenue (20.6% of the total) was lower than expenses in US dollars (34.5% of the total).

In accordance with the Hedging Programme, this position is covered as follows:

- Up to 50% by strategic hedging of up to a five-year term, by means of swaps of aircraft lease income with other currencies, principally the Euro. Similarly, option structures are put into effect with terms and amounts associated with the hedged income.
- The remaining percentage is managed through tactical transactions with a time horizon of between one and three years, which can be adapted to market trends and which are also associated with the Company's actual flows of US dollar payments.

At 31 December 2006 IBERIA had hedged 87% of its US dollar cash-flow positions for 2007 and 59% of the 2008 position.

Balance sheet

The Company has assets denominated in US dollars amounting to USD 663 million, as a result of the loans granted to Iberbus and the advances paid to aircraft and engine suppliers. It also has a liability position in dollars amounting to USD 460 million which, together with arranged swaps, enables the Company to neutralise the effect of the translation differences.

Aircraft additions

In order to limit the volatility of currency markets and the impact thereof on the financing or acquisition of new aircraft, the Company hedges the exchange rate risk relating to aircraft financing/acquisition/additions through forward purchase transactions and option structures that make it possible to assure a certain level or range. At 2006 year-end the Company had taken a short position on the addition of new aircraft projected for 2007 of USD 147 million, hedged 95%.

II) Interest rate risk

Although IBERIA has negative net debt in its balance sheet, if the notional debt relating to operating lease payments (multiplying by eight the aircraft lease payments and making the related adjustments thereto) is included, the adjusted total net debt amounts to EUR 1,368.7 million. Of this amount, at 31 December 2006 83% bore fixed-rate interest and the other 17% bore floating-rate interest. The Company expects to continue to maintain at least 70% of this debt at a fixed or protected interest rate in order to avoid the adverse impact of possible interest rate rises.

In 2006 the Company had between 85% at 2005 year-end and 83% at 2006 year-end of its total adjusted net debt hedged at a fixed interest rate. Sensitivity to a 1% rise in interest rates is EUR 2.1 million.

Liquidity risk

IBERIA has a policy of maintaining a cash position approximately equal to three months' revenue. At 31 December 2006 this position amounted to EUR 2,411.9 million (cash plus current financial assets) and had been invested in highly liquid short-term instruments, debt repos, Eurodeposits, commercial paper and securitisation transactions through leading financial institutions, in accordance with the prevailing risk policy. The portfolio matures at a maximum of one year.

Apart from the current financial assets and the cash position, the Company has credit facilities amounting to EUR 203 million that guarantee its liquidity requirements.

III) Fuel risk

IBERIA controls the cost of aviation fuel, which is directly linked to changes in oil prices, through active risk management policies in order to mitigate the impact of fluctuations in the price of kerosene in the international market and limit deviations from the Company's budget in this respect.

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

In 2006, the price of fuel once again exceeded the all-time-highs experienced in 2005. In August the price of a barrel touched USD 80, to then fall sharply shortly after, leading the reference price of Brent crude to stand at around USD 60 per barrel. Despite this fall, the average price of crude oil increased by close to 20% with respect to 2005.

The hedges of the price of fuel stood at around 85% of the volume consumed over the year. In the year taken as a whole, the average final price for IBERIA, after hedges, was around USD 64 per equivalent barrel.

IBERIA consumes something over two million metric tonnes per year at current production levels. This volume, measured at the average price for 2006, entailed an expense of EUR 1,177.5 million in the Group's financial statements. The price hedges arranged enabled the Company to reduce the fuel expense by EUR 4.2 million in 2006, resulting in a cost per ASK of EURcent 1.79.

4.8. Outlook

The latest IATA forecasts for 2007 state that international air traffic will continue to grow, although at a rate somewhat lower than in 2006; IATA envisages an average increase of around 5% in 2007, driven mainly by the Asian and North American markets. As regards cargo traffic, IATA foresees average growth within the range of 4.5%-5%, in line with the 4.6% growth experienced in 2006.

In reference to the performance of revenue in 2007, IATA forecasts that the air transport sector will enter a period of moderate growth, and expects an increase of 4.5% for 2007, as compared with 8% in 2006. In terms of earnings, it is expected that the industry as a whole will return to profit in 2007, which IATA puts at USD 2,500 million. However, the industry's financial earnings could be adversely affected by the slowdown in the growth of the US economy in 2007 and by higher inflation and interest rates. All these factors could lead to lower growth in traffic revenue, which would make it more difficult to increase profitability unless new cost-cutting programmes and improvements in efficiency are developed, all of this assuming that fuel prices remain stable.

In this projected global scenario for the industry, the Iberia Group will also have to meet its own particular challenges, to which the measures established in the 2006/08 Master Plan are intended to respond.

In the coming years Spain's transport infrastructures will grow significantly: in the 2006/07 winter season Madrid-Barajas Airport increased its number of aircraft operations (from 78 to 90 per hour), and it will continue to progressively increase capacity until it eventually reaches 120 operations per hour; in October 2007 the new airport at Ciudad Real is forecast to come into service; the enlargement of the Barcelona-El Prat Airport will foreseeably be completed by the end of 2008. In addition, the development of the high-speed railway network in Spain must be included, in relation to which the completion of the corridors that connect Madrid with Barcelona, Malaga and Valladolid at the end of 2007 is of particular significance. All these new infrastructures represent an opportunity to develop the Iberia Group's transport business, although they also entail an intensification of the competition from other airlines and other means of transport.

In accordance with the strategy established in the 2006/2008 Master Plan, in 2007 IBERIA will continue to restructure the short- and medium-haul network and selectively increase the flight offering. The Company will focus its growth on long-haul routes and on the connecting flights that feed them. Accordingly, in 2007 the total number of ASKs will show a slight increase on the 2006 figure, although the increase in the long-haul sector offering will be around 3% with respect to 2006, and in the international medium-haul sector approximately 2%.

Under its plan to renew its short- and medium-haul aircraft float, IBERIA plans to introduce new Airbus A-320 aircraft over the next two years, continuing the process of replacing the oldest A-320s and permitting the retirement of the MD aircraft. The Company estimates that it will have a total of 132 operating aircraft at 2008 year-end, as compared with the 150 units at 2006 year-end. In any case, IBERIA has various options in the agreement entered into with Airbus, which together with the aircraft contracted under wet lease, provide it with ample flexibility to adjust its capacity to changes in the market. The process of renewal and unification of the short- and medium-haul fleet will lead to a decrease of 7.3% in operating cost per seat, due to lower fuel, maintenance, technical crew and lease expenses.

The price of fuel will continue to be a factor that conditions airline profitability. IBERIA continues to hedge the price of fuel, using a combination of financial tools to do so. Outstanding hedges at 31 December 2006 make it possible to ensure the price of USD 61 per barrel for 50% of the volume of kerosene that will be consumed in 2007.

The 16th Collective Labour Agreement covering IBERIA's ground staff, the Company's largest group of employees (exceeding 19,000 employees at 2006 year-end) expired in December 2006. In January 2007 meetings began with the negotiating committee, with the objective of reaching a new agreement to renew this collective labour agreement for the coming years. The Company's management has informed the union representatives of the ground employees of its preliminary proposal in it proposes that a portion of salary be subject to the attainment of objectives.

IBERIA's management and the representatives of the flight employees were still negotiating their new labour agreement at the date of completion of this report. Management's priority objectives in these negotiations are to achieve a significant productivity increase and to reduce unit costs through the application of various measures, in accordance with the strategic lines established in the Master Plan.

5. Performance in group companies

5.1. Fully-consolidated companies

5.1.1. CACESA

Compañía Auxiliar al Cargo Express, S.A. (CACESA) was incorporated in 1987 by IBERIA, which has an ownership interest of 75% in its share capital, and by Marítimas Reunidas S.A. (MARESA) which owns the other 25%. The company operates as a cargo forwarding agent and consignee, and also engages in goods transport, storage and distribution activities, as well as ancillary activities to airports.

CACESA's operating revenue amounted to EUR 50.5 million in 2006, up 4.8% on 2005.

Revenue from the express courier services (an Ibexpress product) amounted to EUR 21.7 million in 2006, exceeding the figure for 2005 by 2.2%, due to the strong performance of the international traffic. This growth was adversely affected towards the end of the year by the launches of two new product offerings by competitors in the cargo market to the Canary Islands, one out of Madrid and the other from Zaragoza.

Freight-forwarding product revenue (Ibertrás) amounted to EUR 26 million in 2006, up 4.4% on 2005. The performance of imports was acceptable due to the growing contribution of the Asian market which offset the sharp fall in fish imports from the North Atlantic that occurred in August. As regards domestic traffic, the Canary Islands product performed excellently.

CACESA's operating expenses amounted to EUR 49.2 million in 2006, an increase of 4.8% with respect to 2005. Transport costs increased by 3.9% with respect to 2005, and the company's in-house expenses increased by 9.4%, due mainly to the increase in the expense relating to the hiring of personnel from temporary employment agencies for the provision of the ancillary services at the cargo terminal and to cover the new operating requirements of the Barajas T4 Terminal.

Staff costs increased by 4.4%, a rise that covers the CPI plus the differential established in the industry's collective labour agreement and length-of-service promotions. CACESA's average headcount stood at 131 equivalent employees in 2006, down 3.2% on 2005.

CACESA (as an individual company, not consolidated with ALAER) obtained operating profit of EUR 1.35 million in 2006, an increase of 3.0% with respect to 2005, and also improved its financial earnings. Profit before tax amounted to EUR 1.43 million, up 7.2% on 2005.

In January 2006 CACESA successfully passed the annual audit review to obtain Quality Certification under ISO 9001.

5.1.2. ALAER

CACESA set up Auxiliar Logística Aeroportuaria, S.A. (ALAER) in June 2002, for the purpose of carrying on all its ancillary logistical services through the new company. This company also currently operates and manages cargo terminals. IBERIA has a 75% ownership interest in ALAER through CACESA, and both companies are included within the scope of the Iberia Group's fully-consolidated companies.

Operating revenue amounted to EUR 8.2 million in 2006, up 38.9% with respect to 2005. Three factors were basically responsible for this rise: the broadening, from mid-2006 onwards, of the activities carried out for IBERIA's Maintenance Division; increased production in the delayed-baggage delivery activity (24%); and, lastly, the launch of the activity of management of home-distribution of the Ibexpress product for CACESA.

In 2006 ALAER continued to capture new customers and increase the businesses outside the sphere of IBERIA, such as the delivery of baggage for other airlines, and the logistics management of Savia's systems materials, which is currently performed at owned warehouses.

Operating expenses were slightly above EUR 8.0 million in 2006, up 39.3%, due mainly to the increase in the arrangement of outside services to cover the strong upsurge in activity. The average number of staff hired by ALAER stood at 53 equivalent employees in 2006, up 8.7% on 2005, increasing staff costs by 7.5%.

Operating profit went up by 16.4% to reach EUR 132 thousand, increasing profit before tax by 11.8% with respect to 2005, to EUR 130 thousand (under IFRSs).

5.1.3. BINTER FINANCE

The Dutch company Binter Finance B.V., wholly-owned by IBERIA, began operating in 1991. Currently, through its permanent establishment in Spain, it performs its duties as IBERIA's international treasury department. The company manages and optimises the cash flows denominated in foreign currency generated by IBERIA outside Spain. It also advises on the management of and executes IBERIA's exchange and interest rate risk hedging transactions on international markets. In 2006 it obtained net profit before tax of EUR 30 thousand, up 3.7% on 2005.

5.2. Companies accounted for using the equity method

5.2.1. IBERIA CARDS

Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A. ("Iberia Cards"), was incorporated in April 2002 by IBERIA, which holds 43.5% of its share capital, and by the financial institutions Banco Popular, BBVA and Caja Madrid.

Iberia Cards is a credit finance establishment that engages in activities related to the issuance and management of credit cards and other means of payment. Since 2002 year-end it has been issuing the Visa Iberia card, whose main appeal is participation in the Iberia Plus loyalty programme.

In 2006 it was affected by the reduction in interchange rates, agreed-upon by merchants and the financial services industry in December 2005, with the concomitant reduction in the returns on month-end charge cards, which constitute the core product in Iberia Cards' portfolio. The marketing of these cards has therefore become less attractive. These interchange rates came fully into force from May 2006 onwards.

Towards the end of 2006 the total number of cards was slightly lower than the figure for 2005. However, the annual volume of billings increased by 8% with respect to 2005 to EUR 2,656 million in 2006, reflecting the bonding of Visa Iberia card holders.

As regards cost cutting, very good results were obtained in the contracts entered into with the main suppliers. Delinquency fell below the objective set for the year, having a beneficial effect on earnings. An issue of particular importance concerns the reduction of fraud, which finally reached an incidence similar to the average for the credit card market.

Iberia Cards obtained profit before tax amounting to EUR 4.7 million in 2006, up EUR 3.3 million on 2005.

In 2006 Iberia Cards prepared and approved a Strategic Plan, to apply from 2007 onwards, with the aim of adapting the company to the new situation of the credit card market and guaranteeing to its shareholders that the objectives for which the company was created would be met. The Strategic Plan places particular emphasis on the development of new business lines, such as the entry into the revolving credit card sector, and underlines the importance of company cards, an area in which Iberia Cards enjoys a position of leadership.

5.2.2. MASA

Multiservicios Aeroportuarios S.A. (MASA) was incorporated in April 2002 by ZENIT Servicios Integrales S.A., holding 51% of its share capital, and IBERIA, with 49%.

The company currently provides various ancillary services at substantially all the Spanish airports. It is leader in the sector of interior and exterior aircraft and airport facility cleaning services. Also, based on a diversification strategy, it is consolidating other service lines such as: goods, post and baggage handling; runway handling operations; and on-ground administrative assistance and oversight. IBERIA, AENA, Air Nostrum, Vueling and Atlántica de Handling are among its main customers.

MASA commenced operations at Madrid-Barajas Airport's T4 Terminal in February 2006, retaining the activities that it had been performing at the airport's old terminals. The company was the successful bidder for the management of the two VIP lounges and a Business Centre at the new terminal, and for the goods taxiing service between the Cargo Terminal and T4 Terminal. Additionally, it also began to perform part of the maintenance work on the interiors of IBERIA's A-319 and A-320 aircraft.

In 2006 it obtained profit before tax of EUR 2.5 million, exceeding the figure for 2005 by 29.7%.

5.2.3. CLICKAIR

Clickair is an airline that comes within the definition of new generation airlines and it began to operate on 1 October 2006. The company's shareholders are IBERIA and four other leading Spanish companies (Nefinsa, S.A., Iberostar Hoteles y Apartamentos, S.L., Cobra Ingeniería de Montajes, S.A. and Agrolimen Inversiones S.C.R., S.A.), each shareholder having an ownership interest of 20% and a medium-term minimum-stay commitment. The company has its central base of operations at El Prat Airport, and its head office is also located in Barcelona.

Clickair flies point-to-point, connecting major Spanish and European cities, using a single model of aircraft, the Airbus A-320. Its aircraft have an innovative image that combines a metal-finish fuselage with various tones of blue. The company combines the advantages of the low-cost carriers, such as low prices and high productivity, with the value added services typical of the traditional airlines, e.g. flexibility, flights to the main European airports (London Heathrow for example) and offering passengers the possibility of accumulating points on the Iberia Plus loyalty programme.

At the end of December 2006, Clickair already had six A-320 aircraft, a workforce of 223 employees and was operating 30 flights a day, connecting Barcelona with Seville, Geneva, Zurich and Lisbon, among other connections. The company transported 454,000 passengers in its first three months of activity.

Clickair's business plan envisages a rapid increase in the number of destinations and strong growth, based on the shareholders' commitment to invest EUR 120 million in the company by 2008, of which EUR 31.6 million were disbursed in 2006. Accordingly, Clickair will launch a further 12 routes in the first quarter of 2007, and over the following months the number of flights will continue to increase in parallel with the coming into service of new A-320s. It is hoped to close 2007 with a fleet of 23 aircraft. On the basis of its plan of expansion, the company foresees reaching a total of 30 aircraft and 10 million passengers transported in 2008.

5.2.4. Other investees

Other companies in which IBERIA has a significant ownership interest are:

IBECA, incorporated in March 2001 by IBERIA which has an ownership interest of 50% through Iberia Tecnología, and Cubana de Aviación, with the other 50% of the share capital. The company provides specialised maintenance technical assistance at aircraft lines at Cuban airports.

ELCA was created in October 2001 by Aerovaradero, with an ownership interest of 50%, and Cargosur, through which IBERIA holds the other 50%. It engages in the marketing and storage of air cargo in transit in Cuba.

SERPISTA was created in Madrid in June 2004. Its shareholders are COBRA (51%), IBERIA (39%), and TEMG (a subsidiary of electro-mechanical workshops GORRIS) with 10%. The company performs the activities of maintenance and repair of equipment for ground handling at Spanish airports.

HANGESA, incorporated in October 2000 to carry out passenger and cargo handling activities at Malabo Airport. IBERIA holds a 51% ownership interest in the company through Viva Air and local shareholders hold 49%.

6. IBERIA's share price

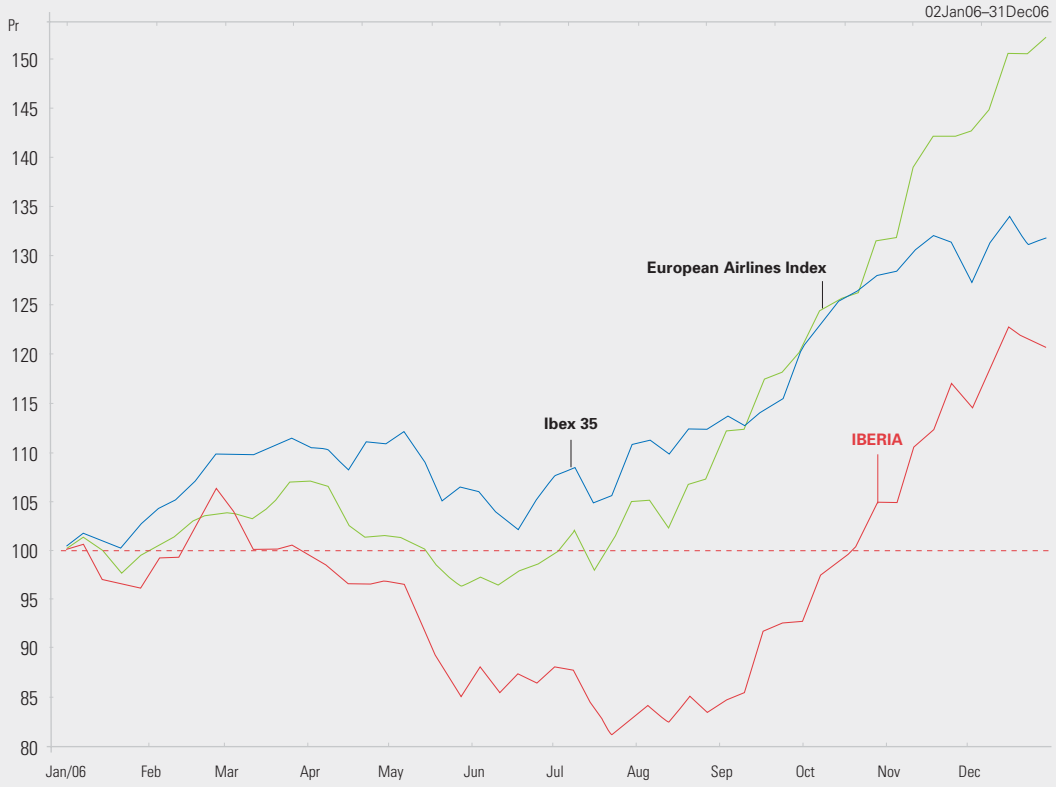
6.1. Share price performance

Share price at 30 December 2006	2.76
Share price at 30 December 2005	2.29
Average annual share price	2.21
High	2.81
Low	1.86
Daily average volume of trading (no. shares)	8,857,567

TAll the share prices are expressed in Euro.

In 2006 IBERIA's share price rose 20.5% with respect to the price at 2005 year-end. In the first seven months of the year, the share price fell continuously, to an annual low of EUR 1.86 on 21 July. From that date onwards, the share price not only recovered but went on to end the year with gains.

IBERIA - Ibex 35 - European Airlines Index
(Base 100 = 1 January 2006)



As a consequence of the share option plan for executives, 4,904,693 new shares began to be traded in 2006; therefore, at year-end the total number was 948,066,632 shares.

Also, in July 2006 the Company paid its shareholders a dividend of EUR 0.02 per share out of 2005 profit. In August 2006 an extraordinary dividend was paid of EUR 0.302 per share, related to the gain obtained on the divestment of Amadeus.

IBERIA's shares have risen more than those of its European peers since they were first floated in April 2001, with a cumulative increase of 131.2% to 2006 year-end.

IBERIA - Ibex 35 - European Airlines Index
(Base 100 = 3 April 2001)

6.2. Treasury shares

Treasury shares held by the Parent at 31 December 2006 represented 0.707% of share capital and totalled 6,702,368 shares, with an overall par value of EUR 5,228 thousand and an average acquisition price of EUR 2.0772 Euro per share. As required by IAS 32, the balance of "Treasury Shares" (EUR 13.9 million at 31 December 2006) appears in the balance sheet as a reduction of equity.