

# ANNUAL REPORT 1996

IBERIA, L.A.E.



**IBERIA** 



SOCIEDAD ESTATAL  
DE PARTICIPACIONES INDUSTRIALES

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*1996 Profits reported for the first time in the decade*



1996 was a reasonably satisfactory year for Iberia: profits were achieved after several years of increasing losses; the Company increased its activity despite a reduction in the Labor force, thus raising the productivity improvement rate to double digits; the financial position returned to normal as a result of the capital increase and the reduction of risks in Latin America; and the spectacular surge in sales and operations enabled us to respond swiftly and effectively to competition.

Iberia obtained income of Ptas. 2,722 million in 1996. Although this is a modest figure compared with the results of other larger companies in the industry, it is a considerable achievement in view of the fact that this is the first year this decade in which income has been obtained.

The Company improved prospects are the result of the favorable effects of the Competitive Adaptation Plan first implemented in 1995, combined with the expansion of the market. Under the Competitive adaptation Plan, two particularly important decisions were made, both based on the confidence in the Company shown by its shareholders and its employees; the capital increase, which made it possible to ameliorate the financial position, and the reduction of personnel costs as a result of the reduction in the Labor force and in unit costs.

On January 31, 1996, the European Union authorized a capital increase of Ptm. 87,000 million, with a second increase to be carried out in 1997, subject to compliance with various strict economic and productivity criteria. These criteria were easily met both in 1995 and 1996. This contribution was not considered to be a state aid, but an investment in accordance with market principles. The capital increase made it possible to restructure the Labor force, as envisaged in the Competitive Adaptation Plan, and to reduce debt.

In 1996 the rationalization of our shareholdings in Latin America companies was commenced in order to improve Iberia's financial stability. Iberia retains the management of and a minority holding in Aerolíneas Argentinas. With respect to Viasa, in the last quarter of the year Iberia presented a viability plan similar to the one which has enabled Iberia to return to a profit-making situation. Unfortunately the pilots' rejection of the plan led to the closure of the company.

The Latin American market and the traffic between Europe and Latin America form part of our natural market, and we have opted to maintain a significant presence in this traffic. We will now be defending our leadership position in this market by stepping up our role as an operator as opposed to an investor, backed up by trade agreements.

1996 was also characterized by a significant increase in productivity as a result of the agreements entered into in the first months of the year and the implementation of a more aggressive trading policy which placed us in a better position than our competitors as regards decision-making capacity.

*Noteworthy aspects of this policy were the launching of more competitive fares, such as the Star Fare for national flights; the stepping up of 'service quality, as evidenced by the new European Business Class, which provides passengers with more space and higher catering standards; and the addition of the new Airbus 340 aircraft, equipped with state-of-the-art technology and additional features, all of which improved service on intercontinental flights.*

*The signing of a franchise agreement with the regional company Air Nostrum, the first of its kind in Spain, was in line with our policy of taking steps to ensure our market share of domestic traffic in addition to increasing our network traffic.*

*We endeavored to rectify or make good the delays caused by saturation at Barajas airport. Our company was particularly affected, since Barajas is the hub of our connections. In the last months of the year due to the critical situation of Barajas, Iberia decided to compensate Iberia Plus members for delays experienced by them, by awarding these passengers points when they traveled on a full fare. This quality measure subsequently became institutionalized and is one of the benefits added to Iberia; loyalty-building program.*

*The entry of second operators at national airports continued, giving rise to various measures to defend our market share and the continuation of the subrogation process.*

*Although 1996 was a good year, this does not, in itself guarantee that we will continue to obtain income in a highly competitive industry which has been fully deregulated and in which all the airlines we are competing with are adopting new measures to ensure their competitiveness.*

*1996 saw the completion of the Competitive Adaptation Plan, which has been replaced by the 1997-1999 Master Plan designed to consolidate income in order to guarantee the Group's profitability in the future as well. This plan, which envisages measures to boost revenues, programs to cut costs, the adoption of a new management model aimed at improving the use of Group resources, and a differentiated management model tailored to each type of activity and business, will call for renewed effort from all of us.*

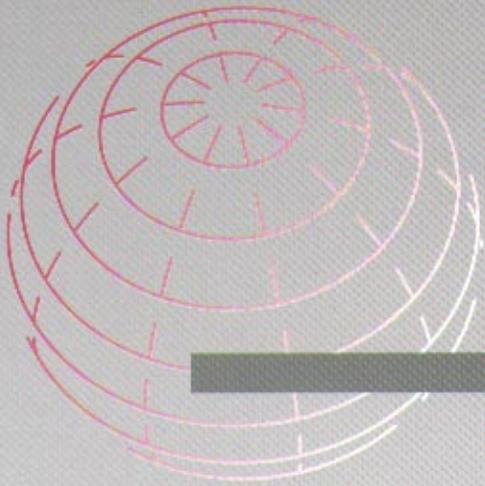
*Noteworthy decision in this respect were the creation of a joint Commercial Division for the whole Group and the implementation of unified network programming and management for the Group.*

*The Master Plan can be summed up in the following eight strategic targets: to boost marketing, improve the Group's connecting flight traffic at Barajas, reduce costs, integrate the subsidiaries in the Group's network, obtain strategic alliances and retain minority shareholdings or trade agreements in Latin America, defend our market share in handling, and equip the Iberia Group with a differentiated management model. We are working hard to meet all these goals with a view to ensuring Iberia's future success.*

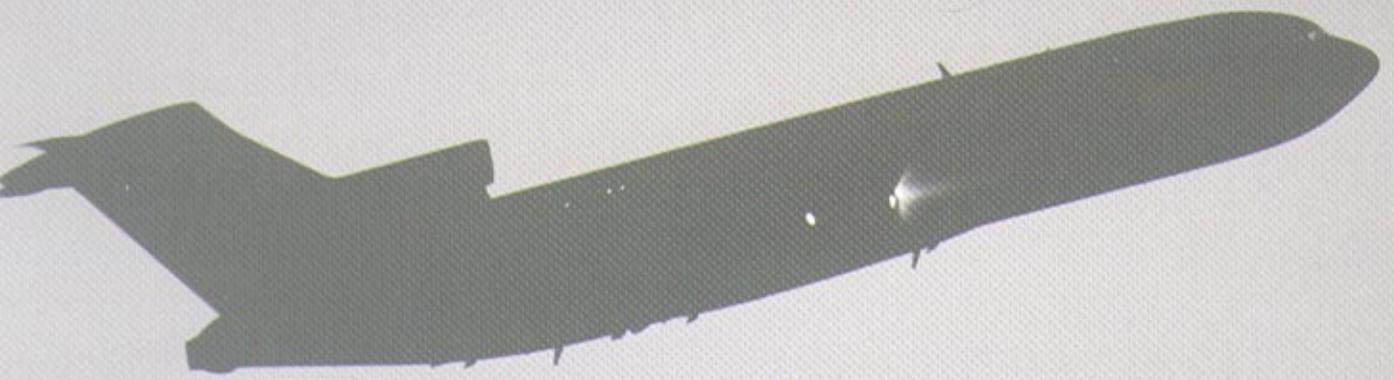


Xabier de Irala





**LEGAL INFORMATION**





# ARTHUR ANDERSEN

Translation of a report and financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 19).  
In the event of a discrepancy, the Spanish-language version prevails..

Raimundo Fdez. Villaverde, 65  
28003 Madrid

## 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. (a majority-owned investee of Sociedad Estatal de Participaciones Industriales) comprising the balance sheet as of December 31, 1996, and the related statement of income and notes to financial statements for the year then ended. The preparation of these financial statements is the responsibility of the Company's directors. Our responsibility is to express an opinion on the financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made.

For comparison purposes the directors present, in addition to the 1996 figures for each item in the financial statements referred to above, the figures for 1995. Our opinion refers only to the 1996 financial statements. Our auditors' report dated May 6, 1996, on the 1995 financial statements contained an opinion with one qualification.

The Company's directors also prepared the financial statements of the Iberia Group for 1996, disclosing the effect indicated in Note 4-e.

As indicated in Notes 4-c and 6 to the financial statements, the Company restated its assets pursuant to Royal Decree-Law 7/1996, which gave rise to a surplus, net of the single tax, of Ptas. 15,447 million, which is included under the "Restatement Reserve" caption in the balance sheet as of December 31, 1996.

In our opinion, the 1996 financial statements referred to above present, in all material respects, a true and fair view of the net worth and financial position of Iberia, Líneas Aéreas de España, S.A. as of December 31, 1996, and of the results of its operations and of the funds obtained and applied by it in the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with generally accepted accounting principles and standards applied on a basis consistent with that of the preceding year.

The accompanying management report for 1996 contains the explanations which the directors consider appropriate about the Company's situation, the evolution of its business and other matters, but is not an integral part of the financial statements. We have checked that the accounting information in the management report is consistent with that contained in the financial statements for 1996. Our work as auditors was confined to checking the management report with the aforementioned scope, and did not include a review of any information other than that drawn from the Company's accounting records.

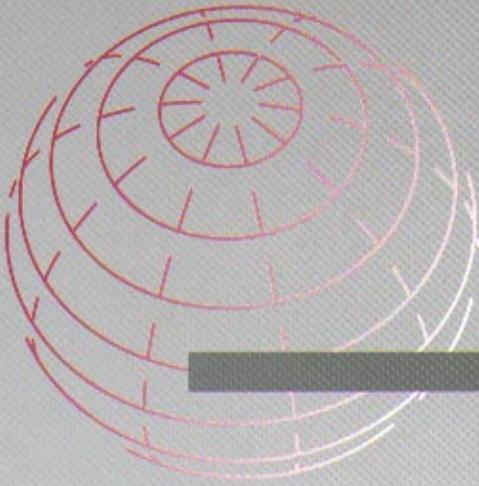
ARTHUR ANDERSEN



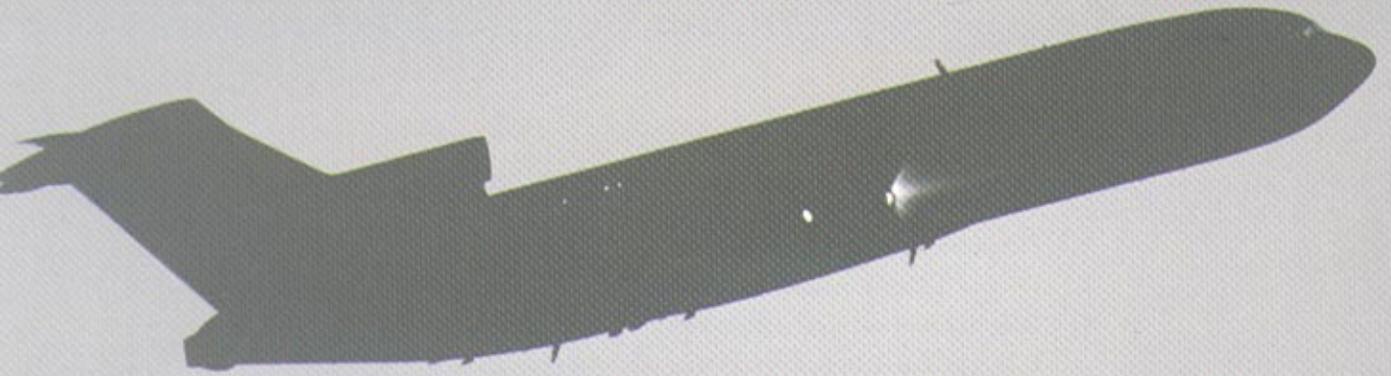
Jose Manuel Rodriguez

May 30, 1997





## FINANCIAL STATEMENTS



Translation of reports and financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 19). In the event of a discrepancy, the Spanish-language version prevails.

**IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A.**

**BALANCE SHEETS AS OF DECEMBER 31, 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

ASSETS	1996	1995
<b>FIXED AND OTHER NONCURRENT ASSETS:</b>		
Start-up expenses	826	372
Intangible assets (Note 5)	28,727	30,043
Property, plant and equipment (Note 6)	202,378	207,838
Aircraft		
Cost	303,492	305,434
Depreciation and provisions	(167,009)	(163,166)
	136,483	142,268
Other tangible fixed assets		
Cost	154,629	147,893
Depreciation and provisions	(88,734)	(82,323)
	65,895	65,570
Long-term financial investments (Note 7)	88,758	124,591
Holdings in Group and associated companies	77,162	205,576
Loans to Group and associated companies	29,335	16,656
Long-term receivables from Group companies (Note 14)	38,493	17,527
Investment securities and other loans	6,650	6,251
Provisions	(62,882)	(121,419)
<b>Total fixed and other noncurrent assets</b>	<b>320,689</b>	<b>362,844</b>
<b>DEFERRED CHARGES (Note 5)</b>	<b>9,531</b>	<b>13,440</b>
<b>CURRENT ASSETS:</b>		
Inventories	6,873	6,919
Receivable from Group companies (Note 14)	18,790	26,017
Accounts receivable (Note 2-c)	59,663	57,658
Short-term financial investments (Note 8)	44,119	3,763
Cash	2,054	1,242
Accrual accounts	4,173	3,272
<b>Total current assets</b>	<b>135,672</b>	<b>98,871</b>
<b>TOTAL ASSETS</b>	<b>465,892</b>	<b>475,155</b>

The accompanying Notes 1 to 19 are an integral part of these balance sheets.

IBERIA LINEAS AEREAS DE ESPANA. S.A.

**BALANCE SHEETS AS OF DECEMBER 31, 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

<b>SHAREHOLDERS' INVESTMENT AND LIABILITIES</b>	<b>1996</b>	<b>1995</b>
<b>SHAREHOLDERS' INVESTMENT (Note 9):</b>		
Subscribed capital stock	114,727	27,727
Restatement reserve	15,447	-
Prior years' losses	(45,006)	(86)
Income (loss) for the year	2,722	(44,920)
<b>Total shareholders' investment</b>	<b>87,890</b>	<b>(17,279)</b>
<b>DEFERRED REVENUES (Notes 4-f, 6 and 7)</b>	<b>5,209</b>	<b>4,108</b>
<b>PROVISIONS FOR CONTINGENCIES AND EXPENSES:</b>		
Provisions for pensions and similar obligations (Note 10)	53,175	49,354
Provision for major repairs	13,787	13,063
Provision for third-party liability (Note 4-k)	37,534	44,081
<b>Total provisions for contingencies and expenses</b>	<b>104,496</b>	<b>106,498</b>
<b>LONG-TERM DEBT:</b>		
Payable to credit entities (Note 12)	94,569	134,866
Payable to Group and associated companies (Note 14)	3,260	18,359
Uncalled capital payments payable	150	150
Other accounts payable	158	3,321
<b>Total current liabilities</b>	<b>98,137</b>	<b>156,696</b>
<b>CURRENT LIABILITIES:</b>		
Promissory notes issued (Note 12)	-	3,745
Payable to credit entities (Note 12)	15,834	80,663
Payable to Group and associated companies (Note 14)	7,361	5,060
Trade accounts payable	109,398	93,398
Customer advances	50,455	37,240
Payables or purchases or services	58,943	56,158
Compensation payable	18,617	25,116
Other nontrade payables (Note 2-c)	18,887	17,111
Accrual accounts	63	39
<b>Total current liabilities</b>	<b>170,160</b>	<b>225,132</b>
<b>TOTAL SHAREHOLDERS' INVESTMENT AND LIABILITIES</b>		

The accompanying Notes 1 to 19 are an integral part of the balance sheets.

**IBERIA, LINEAS AEREAS DE ESPANA. S.A.**

**STATEMENTS OF INCOME (LOSS) FOR 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

DEBIT	1996	1995
<b>EXPENSES:</b>		
Purchases (Note 16)	62,353	48,912
Personnel expenses (Note 16)		
Wages, salaries and similar expenses	116,641	112,915
Agreements with employees	5,806	11,738
Employee welfare expenses	35,393	34,964
Period depreciation and amortization	21,873	22,266
Variation in operating provisions	1,168	2,037
Other operating expenses (Note 16)	200,175	192,726
	443,409	425,558
<b>Operating income</b>	<b>34,198</b>	<b>25,117</b>
Financial and similar expenses	17,360	23,765
Variation in financial investment provisions (Note 7)	2,845	(2,900)
Exchange losses	6,168	8,245
	26,373	29,110
<b>Income from ordinary activities</b>	<b>17,985</b>	<b>6,347</b>
Variation in tangible fixed asset provisions	206	46
Variation in control portfolio provisions (Note 7)	1,633	23,056
Losses on fixed assets	3,696	303
Extraordinary expenses (Notes 4-k and 16)	18,413	49,111
Prior years' expenses and losses	95	343
	24,043	72,859
<b>Income before taxes</b>	<b>2,823</b>	<b>-</b>
Corporate income tax (Note 15)	101	(16,164)
<b>Income for the year</b>	<b>2,722</b>	<b>-</b>

The accompanying Notes 1 to 13 are an integral part of these statements of income (loss).

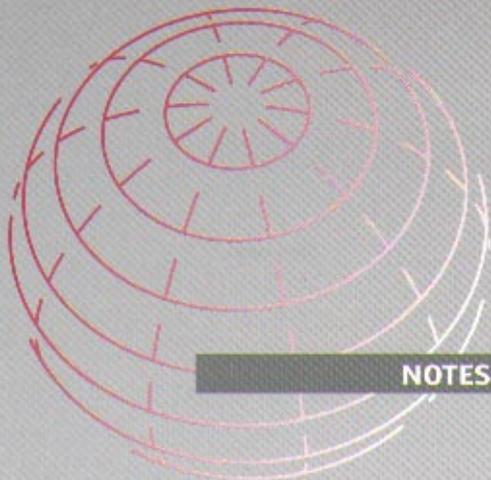
IBERIA, LINEAS AEREAS DE ESPANA, S.A.

**STATEMENTS OF INCOME (LOSS) FOR 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

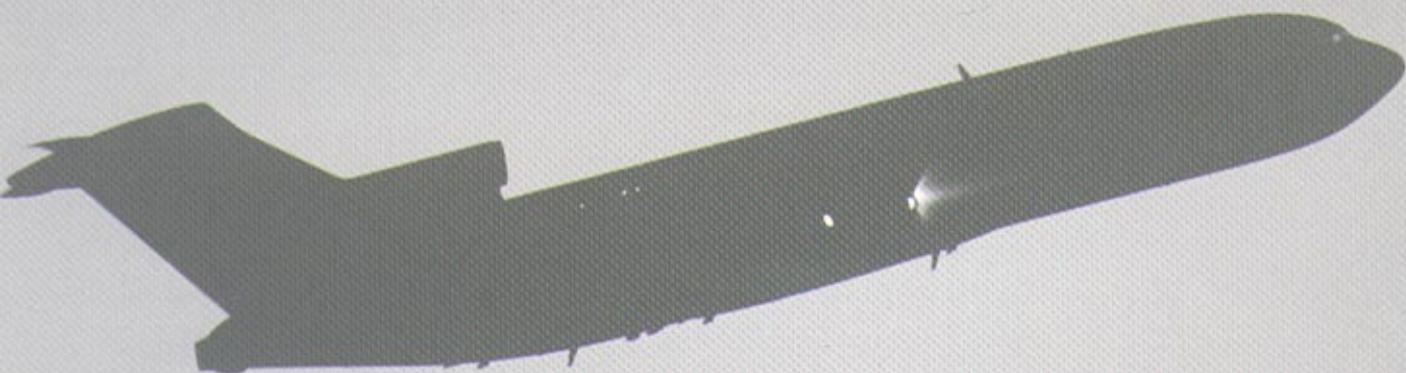
CREDIT	1996	1995
<b>REVENUES:</b>		
Net sales (Note 16)	452,636	426,123
Inventory variation	7	(19)
Capitalized expenses of in-house work on fixed assets	343	776
Other operating revenues (Note 16)	24,621	23,795
	477,607	450,675
Revenues from shareholdings	575	352
Other interest and similar revenues	3,805	4,730
Exchange gains	5,780	5,258
	10,160	10,340
<b>Financial loss</b>	<b>16,213</b>	<b>18,770</b>
Gains on fixed asset disposals (Note 6)	3,285	1,102
Extraordinary revenues	3,105	350
Prior years' revenues and income	2,491	3,976
	8,881	5,428
<b>Extraordinary loss</b>	<b>15,162</b>	<b>67,431</b>
<b>Loss before taxes</b>	<b>-</b>	<b>61,084</b>
<b>Loss for the year</b>		<b>44,920</b>





IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A.

**NOTES TO 1996 AND 1995 FINANCIAL STATEMENTS**



Translation of reports and financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 19). In the event of a discrepancy, the Spanish-language version prevails.

## ① Company Description and Plans

Iberia, Líneas Aéreas de España S.A. was incorporated on June 28, 1927, to engage mainly in the air transport of passengers and cargo. Under a Law of June 1940, the Company was authorized to operate scheduled passenger transport services throughout Spain, as Spain's flag airline.

Tineo, S.A. was the Company's majority shareholder until September 16, 1996, when it transferred all its shares in Iberia, Líneas Aéreas de España S.A. to Sociedad Estatal de Participaciones Industriales (SEPI).

In 1994 the Company drafted a Program of Measures and agreed on various actions for 1994, 1995 and 1996 with its employees.

### *Program of Measures*

The Program of Measures included a capital increase at the Company, which was submitted for approval by the European Commission.

On January 31, 1996, the European Commission authorized a capital increase by Ptas. 87,000 million, to be carried out in two stages: a first increase of Ptas. 37,000 million for the cost of reducing the labor force, and a second increase of Ptas. 50,000 million relating to the repayment of debt. These capital increases were disbursed on April 26 and May 24, 1996, respectively. The Company considers the operational and financial objectives to have been met and has requested authorization for notification of the additional capital increase of Ptas. 20,000 million in the first quarter of 1997.

The Program of Measures also envisaged a significant divestment in the capital stock of Aerolíneas Argentinas, S.A. and Líneas Aéreas del Cobre, S.A. The main features of the divestments in 1996 are detailed in Note 7.

### *Actions agreed on with the employees*

The actions agreed on with the employees, relating basically to wage cuts, increased productivity and an employee termination plan, were implemented in 1994, 1995 and 1996.

Among the measures agreed on with the employees was the reduction of the Company's headcount by 3,500 employees by the end of 1997 by means of early retirements and voluntary redundancy. The headcount had been reduced by 3,158 as of December 31, 1996.

In 1995 the Company recorded a provision of Ptas. 31,556 million for the estimated cost of the outstanding employee terminations. The "Provision for third-party liability" caption in the balance sheets as of December 31, 1995 and 1996, included Ptas. 7,625 million and Ptas. 31,556 million, respectively, in this connection.

The agreements entered into with the employees also included wage cuts and certain employee compensation payments (some of which were performance-related), which were recorded in 1995 and 1996 (see “Headcount and personnel expenses” in Note 16).

### **1997-1999 Master Plan**

In recent months, management of Iberia, Líneas Aéreas de España S.A. has prepared a Master Plan defining the strategic actions to be taken in 1997, 1998 and 1999. The Plan’s goal is to make the Iberia Group fully competitive. The specific actions to be taken are presently being defined and will require acceptance by all the worker’s groups in the Iberia Group.

## **2** Basis of Presentation of the Financial Statements

### **a) True and fair view**

The accompanying financial statements were prepared from the Company’s accounting records which were adjusted by the restatement made pursuant to Royal Decree-Law 7/1996, and are presented in accordance with the Spanish National Chart of Accounts and subsequent implementing regulations (see Note 4-f). Accordingly, they give a true and fair view of the Company’s net worth, financial position, results and funds obtained and applied in 1996 and 1995. The 1996 financial statements, which were prepared by the Company’s directors, will be submitted for approval by the Shareholders’ Meeting and it is considered that they will be approved without any changes. The 1995 financial statements were approved by the Shareholders’ Meeting on May 23, 1996.

### **b) Comparative information**

The balances of the “Property, plant and equipment” and “Shareholders’ investment” captions in the balance sheet as of December 31, 1996, are not comparable with those of 1995 because the Company restated its tangible fixed assets pursuant to Royal Decree-Law 7/1936.

### **c) Grouping of items**

The balances of the “Accounts receivable” and “Other nontrade payables” captions in the accompanying balance sheets consist of the following items:

	1996	1995
<b>Accounts receivable:</b>		
Public entities	19,886	21,479
Receivable from passenger and cargo agencies	18,787	18,001
Receivable from airlines	6,994	5,197
Sales office customer receivables	3,473	3,228
Credit card receivables	1,336	1,819
Other customer receivables for sales and services	7,103	5,900
Sundry accounts receivable	2,084	2,034
Doubtful accounts receivable	4,529	4,871
Provisions	(4,529)	(4,871)
	<b>59,663</b>	<b>57,658</b>
<b>Other nontrade payables:</b>		
Nontrade accounts payable	5,576	6,198
Accrued taxes payable	13,311	10,913
	<b>18,887</b>	<b>17,111</b>

### 3 Distribution of Income

The Company's Board of Directors propose that Ptas. 2,722 million of 1996 income be allocated to offset prior years' losses.

### 4 Valuation Standards

The main valuation methods applied by the Company in preparing its 1996 and 1995 financial statements, in accordance with the Spanish National Chart of Accounts and subsequent implementing regulations (see Note 4-f), were as follows:

#### a) Start-up expenses

These expenses consist basically of public deed execution and registration expenses relating to capital increases, and are amortized at an annual rate of 20%.

An addition of Ptas. 900 million was recorded under this caption in 1996 in connection with the public deed execution and registration expenses relating to the capital increase of Ptas. 87,000 million (see Note 9).

Ptas. 446 million and Ptas. 257 million of amortization of start-up expenses were charged to the statements of income (loss) in 1996 and 1995, respectively.

## **b) Intangible assets**

Leased assets are recorded as intangible assets at the cost of the related item, excluding interest cost, and are amortized by the same methods as those used to depreciate property, plant and equipment. The total debt for lease payments plus the amount of the purchase option is recorded as a liability. The difference between the two amounts, which represents the interest expenses of the transaction, is recorded under the "Deferred charges" caption in the accompanying balance sheets and is allocated to income each year by the interest method.

The Company adjusted the net book value of certain of its leased aircraft pursuant to a Ministry of Economy and Finance Order (see Note 4-f).

The balances of the "EDP applications" account relate basically to the start-up expenses of the Amadeus project, which are being amortized in a maximum period of five years.

Ptas. 1,760 million and Ptas. 1,878 million of amortization of intangible assets were charged to the 1996 and 1995 statements of income (loss), respectively.

## **c) Property, plant and equipment**

The valuation methods applied by the Company are as follows:

### **1. Aircraft:**

Aircraft acquired prior to October 31, 1983, are carried at cost restated pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1936. Aircraft acquired after that date are carried at cost restated pursuant to Royal Decree-Law 7/1996, except for certain aircraft, the value of which was modified pursuant to the provisions of a Ministry of Economy and Finance Order (see Note 4-f).

Through 1993, the financial expenses relating to the period in which advances were made to suppliers of aircraft, determined by applying to the amount of such advances the average interest rate on the loans obtained to finance the purchase, were capitalized.

### **2. Other tangible fixed assets:**

Land, buildings and complex installations acquired prior to October 31, 1983, are carried at cost restated pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1996. Those acquired after that date and the other tangible fixed assets recorded under the "Other Tangible Fixed Assets" caption in the accompanying balance sheets are carried at cost restated pursuant to Royal Decree-Law 7/1996.

3. Repairs, upkeep and maintenance:

The Company records a provision for the periodic major repairs of its B-747, H-757, DC-10, DC-8, MD-87, A-300, A-320 and A-340 aircraft based on the total estimated cost to be incurred, and allocates this cost to income on a straight-line basis during the period elapsing between two major successive repairs. As of December 31, 1996 and 1995, the balances of this provision were reflected under the "Provision for major repairs" caption in the accompanying balance sheets.

The costs of minor repairs to the aforementioned types of aircraft and of all repairs to the B-727 and DC-9) aircraft are expensed currently, since the annual expenses tend to be uniform.

Upkeep and maintenance expenses are expensed currently.

**d) Depreciation of property, plant and equipment**

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

The methods applied to calculate depreciation of the main items of property, plant and equipment are as follows:

1. Aircraft:

The depreciable cost of the aircraft is equal to their book value less the estimated residual value at the end of their useful lives. The residual value ranges from 10% to 20%, depending on the aircraft.

2. Aircraft spare parts:

Spare parts for aircraft maintenance are depreciated, depending on the type of part, as follows:

a. Rotatable parts

These are depreciated in a period of 18 years from the date of purchase, assuming a residual value of between 10% and 20%, depending on the aircraft.

b. Repairable parts

These are depreciated in a period ranging from 8 to 10 years, depending on the aircraft, from the date of purchase, assuming a residual value of 10% in all cases.

The Company also records provisions for depreciation of spare parts based on obsolescence.

### 3. Years of estimated useful life:

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

	Years
Aircraft	18
Buildings and other structures	20-50
Machinery, installations and tools	10 - 16.5
Transport equipment	7- 10
Furniture and fixtures	10
EDP equipment	5-7
Spare parts	8-18
Flight simulators	10 - 14

Buildings and facilities on land owned by the Spanish State, mostly at Spanish airports, with a net book value of Ptas. 1,455 million and Ptas. 1,663 million as of December 31, 1996 and 1995, respectively, are depreciated over the respective concession periods.

Depreciation is taken on the net amount of tangible fixed asset restatements from the date they are recorded, using the same useful life periods as for the cost values.

The detail of period depreciation of and provisions for property, plant and equipment charged to the statements of income (loss) for 1996 and 1995 is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Aircraft	13,010	12,615
Other tangible fixed assets	7,995	8,551
	21,005	21,166

### e) Marketable securities and other similar financial investments

#### 1. Holdings in Group and associated companies.

The Company carries its investments in other companies at cost, net, where appropriate, of the required provisions for diminution in value if cost exceeds fair market value at year-end, which in the case of the Latin American subsidiaries and the Amadeus Group was based on their provisional financial statements as of December 31 of each year.

The effects of consolidating the Company's 1996 and 1995 financial statements were increases of Ptas. 88,770 million and Ptas. 175,826 million in assets as of December 31, 1996 and 1995, respectively (the difference between the 1996 and 1995 increases reflects the effect of the variation in Iberia's percentage of ownership of Aerolíneas Argentinas, S.A.), an increase of Ptas. 798 million in the income for 1996 and a decrease of Ptas. 300 million in the loss for 1995, and an increase of Ptas. 727 million in reserves as of December 31, 1996, and a decrease of Ptas. 3,134 million in reserves as of December 31, 1995.

## 2. Government debt securities.

The Company carries its investments in government debt securities at cost. The interest on these securities is credited to income when earned and is charged through maturity to the "Short-term financial investments" caption.

### **f) Translation of foreign currency balances**

The balances of accounts denominated in foreign currencies are translated to pesetas at the exchange rates ruling at December 31 of each year. However, following customary airline practice, the balance of the liability for unused traffic documents is reflected in the balance sheet at the exchange rate for the month of the sale, as set by the International Air Transport Association (I.A.T.A.). The I.A.T.A. exchange rate for each month is the average exchange rate for the last five days of the preceding month.

Translation differences arising from translation at official year-end exchange rates and from variations in exchange rates from December 31 of the preceding year to the date of effective collection or payment are recorded under the "Exchange gains/losses" captions in the statement of income (loss), except for the net gains or losses arising from translating the financing obtained for the acquisition of certain aircraft and, exceptionally in 1996, the gains of Ptas. 9 18 million arising from the restatement of the balances receivable from the subsidiary Venezolana Internacional de Aviación, S.A., which were recorded under the "Deferred revenues" caption in the 1996 balance sheet.

### ***Exchange differences arising from aircraft financing***

Pursuant to Valuation Rule 14 in Section 5 of the Spanish National Chart of Accounts, on March 23, 1994, the Ministry of Economy and Finance issued, at the proposal of the Accounting and Audit Institute (ICAC), a Ministerial Order on the accounting treatment of certain foreign currency exchange differences.

Under this accounting regulation, from January 1, 1993, the net amount of foreign currency exchange differences arising in each year on debts for financing for the acquisition by the Company and other Iberia Group companies of aircraft added to the fleet in the same year and in the four immediately preceding years has to be recorded as an increase or decrease in the value of such aircraft.

In accordance with the above-mentioned Ministerial Order, in 1996 and 1995 the adjustments made to the cost and period depreciation of certain of the Company's aircraft were as follows:

	MILLIONS OF PESETAS	
	Increase 1996	(Decrease) 1995
Intangible assets		
Cost	173	(854)
Period depreciation	34	(137)
Property, plant and equipment		
Cost	65	(1,773)
Period depreciation	11	(345)

**g) Inventories**

Inventories, basically aeronautical supplies, are valued at average purchase cost, and the related provisions for depreciation are recorded.

**h) Recognition of revenues and expenses**

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

Ticket sales and the traffic documents for freight and other services are initially credited to "Customer advances" in the balance sheet. The balances of this caption in the accompanying balance sheets reflect the liability for tickets and traffic documents sold prior to December 31, 1996 and 1995, but not used at those dates.



The revenues relating to these items are recognized when the transport or service is performed.

1996 was the first full year of use of the new system introduced by Company management for controlling sales and the utilization of international flight tickets and for determining the balance of the "Customer advances" caption. Company management's initial analyses in 1997 of the balance of the "Customer advances" caption in the balance sheet as of December 31, 1996, in connection with the unused international flight tickets at that date disclosed an unquantified overstatement of the liability recorded for the possibility of tickets not being used in the future. When the analyses of the balance recorded as of December 31, 1996, has concluded, Company management will adjust the excess liability recorded at that date and will implement the additional control measures required to accurately determine the year-end balance in future years.

The Company has introduced the "Iberia Plus" card as an ongoing promotional tool whereby the holder of the card accumulates "points" for taking certain flights, using certain hotels, renting cars or making credit card purchases with credit cards covered by the program. The points can be exchanged for free tickets or other services offered by the companies included in the program. The accompanying balance sheets as of December 31, 1996 and 1995, include provisions of Ptas. 4,083 million and Ptas. 3,123 million, respectively, in this connection, based on estimates of the points accumulated at those dates.

#### **i) Supplementary pension payments to employees**

Under the collective labor agreements currently in force, the Company is required to pay full compensation to, or to supplement the social security benefits of, flight personnel who take early retirement or are placed on the reserve and to land personnel taking early retirement, in accordance with the conditions specified for each case.

The accompanying balance sheets as of December 31, 1996 and 1995, reflect the total liability incurred in this connection at those dates. The provisions to cover the estimated liability incurred in 1996 and 1995 and the interest allocable to the recorded allowance are booked under the "Personnel expenses" and "Financial expenses" captions, respectively, in the accompanying statements of income (loss) (see Note 10).

The actuarial studies used in 1996 and 1995 were prepared under the "unit credit" method and their main features were assumed interest rates of 6% and 8%, respectively, expected consumer price index increases of 3% and 4% per year, respectively, and annual provisions payable in arrears. The changes in the main assumptions used in the study in 1996 were made to bring the study more into line with the current trend in interest rates.

#### j) Montepio de Previsión Social Loreto

The main purpose of the Montepio 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 of spouse, transitory and permanent disability, etc.).

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

The Company's contributions of Ptas. 2,588 million in 1996 and Ptas. 2,661 million in 1995 were recorded under the "Personnel expenses" caption in the accompanying statements of income (loss).

#### k) Provision for third-party liability

This provision reflects basically the estimated amount of potential payment obligations whose exact amount cannot yet be determined or whose date of payment is uncertain, depending on the fulfillment of certain conditions. The allocations to and releases from this provision are recorded on the basis of the best estimates available at any given time.

The variations in these accounts in 1996 and 1995 were as follows:

	MILLIONS OF PESETAS	
	1996	1995
<b>Beginning balance</b>	<b>44,081</b>	<b>6,412</b>
<b>Allocations charged to</b>		
Extraordinary expenses	16,859	35,835
Financial expenses	50	50
Other operating expenses	1,701	1,764
	<b>18,610</b>	<b>37,649</b>
<b>Releases credited to</b>		
Payments made for employee terminations	(23,931)	-
Extraordinary revenues	(1,426)	-
Other	(74)	-
	<b>(25,431)</b>	<b>-</b>
Other variations	274	20
<b>Ending balance</b>	<b>37,534</b>	<b>44,081</b>

The 1995 allocations include provisions to cover the employee termination plan (see Note I), and the risks arising from the losses incurred by the Company's subsidiary Amadeus Group and from those which might arise when the final outcome of certain claims in progress becomes known.



The new allocations in 1996 were made to cover mainly the contingencies relating to the subsidiaries, tax assessments issued by the tax authorities and any losses which might arise when the final outcome of certain claims in progress becomes known.

#### **1) Corporate income tax**

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

The consolidated taxation system applicable to the Company as part of Sociedad Estatal de Participaciones Industriales is regulated by 1989 Budget Law (Law 37/1988) and Royal Decree Law 5/1995. Accordingly, the 1995 corporate income tax was settled, and the 1996 corporate income tax will be settled, on a consolidated return basis. Corporate income tax credits and debits were therefore recorded with contra items in the results for 1996, 1995 and prior years (see Note 15).

#### **m) Futures and other similar instruments**

The Company uses these instruments to hedge its net worth positions.

The Company 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).

If cash deposits are required to guarantee the obligations inherent to the aforementioned transactions, they are recorded under the “Short-Term financial investments - Deposits and guarantees” caption on the asset side of the balance sheet.

The expenses relating to transactions involving futures and similar instruments are expensed currently.

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

1. In the case of transactions arranged to hedge debts to credit entities, the balance of the asset positions are discounted to present value based on the related gains or losses.
2. For the other transactions, the pricing differences are recorded at the date of cancellation or final settlement of the futures or similar instruments.

## 5 Intangible Assets

The variations in 1996 and 1995 in intangible asset accounts and in the related accumulated amortization were as follows:

MILLIONS OF PESETAS					
1996	12-31-95	Additions and			12-31-96
		Provisions	Retirements	Transfers	
Rights on leased assets	34,224	415	-	(1)	34,638
EDP applications	4,124			712	4,836
Leasehold assignment					
and other rights	1,091	30	(6)	(712)	403
Amortization	(9,396)	(1,760)	6		(11,150)
<b>Net value</b>	<b>30,043</b>				<b>28,727</b>

MILLIONS OF PESETAS					
1995	01-01-95	Additions and			12-31-95
		Provisions	Retirements	Transfers	
Rights on leased assets	35,083	1	(854)	(6)	34,224
EDP applications	3,938			186	4,124
Leasehold assignment					
and other rights	707	594	(24)	(186)	1,091
Amortization	(7,520)	(1,878)	-	2	(9,396)
<b>Net value</b>	<b>32,208</b>				<b>30,043</b>

As of December 31, 1996 and 1995, the balance of the "Leasehold assignment and other rights" account included Ptas. 336 million and Ptas. 1,020 million, respectively, of research and development expenses.

The main features of the lease contracts (relating mainly to aircraft) in force as of December 31, 1996 and 1995, some of which have interest tied to LIBOR and lease payments denominated in foreign currencies, are as follows:



	MILLIONS OF PESETAS	
	1996	1995
Cash price of the aircraft acquired, according to contracts	34,476	40,961
Lease payments paid:		
In prior years	14,685	21,340
In the current year	3,941	5,020
Lease payments outstanding at December 31	26,354 (a)	31,916 (a)
Amount of purchase options	18,133 (a)	19,127 (a)

(a) As of December 31, 1996 and 1995, these amounts included Ptas. 8,644 million and Ptas. 12,117 million, respectively, of unincurred interest at those dates, the contra items for which are included under the "Deferred charges" caption in the accompanying balance sheets.

The due dates for the lease payments outstanding as of December 31, 1996, including the amount of the purchase options, are as follows:

Due in	Millions of Pesetas
1997	4,079
1998	4,174
1999	4,275
2000	4,316
2001	7,321
Remainder (through 2004)	20,322

In 1996 the Company exercised early the purchase option on two A-300 aircraft with a cash price according to the contract of Ptas. 6,728 million. The cost of these aircraft and their accumulated depreciation are included under the "Property, plant and equipment - Aircraft" caption in the accompanying balance sheets as of December 31, 1996 and 1995, since in prior years the Company had confirmed its intention to exercise the purchase option.

## 6 Property, Plant and Equipment

The variations in 1996 and 1995 in the property, plant and equipment accounts and in the related accumulated depreciation and provisions were as follows:

cost

MILLIONS OF PESETAS						
1996	12-31-95	Additions	Restatement Pursuant to R.D.L. 7/1996	Retirements	Transfers	12-31-96
Aircraft	305,434	844	8,849	(11,635)	-	303,492
<b>Other tangible fixed assets:</b>						
Land	404	-	147	-	-	551
Buildings and other structures	23,909	32	2,997	(293)	-	26,645
Machinery, installations and tools	50,302	1,556	3,529	(617)	30	54,800
Transport equipment	1,074	472	27	(42)	-	1,531
Furniture and fixtures	3,305	58	-	(67)	1	3,297
EDP equipment	21,782	325	-	(164)	1	21,944
Spare parts	26,943	2,114	-	(889)	-	28,168
Flight simulators	6,352	3	376	-	-	6,731
Construction in progress	13,822	2,941	-	(5,770)	(31)	10,962
	<b>147,893</b>	<b>7,501</b>	<b>7,076</b>	<b>(7,842)</b>	<b>1</b>	<b>154,629</b>

MILLIONS OF PESETAS						
1995	01-01-95	Additions	Retirements	Transfers	12-31-95	
Aircraft	309,626	115	(4,307)	-	305,434	
<b>Other tangible fixed assets:</b>						
Land	404	-	-	-	404	
Buildings and other structures	23,944	41	(76)	1	23,909	
Machinery installations and tools	49,091	1,526	(409)	94	50,302	
Transport equipment	1,112	23	(66)	5	1,074	
Furniture and fixtures	3,289	44	(39)	11	3,305	
EDP equipment	24,120	354	(2,699)	7	21,782	
Spare parts	24,698	4,696	(2,451)	-	26,943	
Flight simulators	6,401	124	(173)	-	6,352	
Construction in progress	13,308	1,490	(865)	(111)	13,822	
	<b>146,367</b>	<b>8,298</b>	<b>(6,778)</b>	<b>6</b>	<b>147,893</b>	



The balances of construction in progress as of December 31, 1996 and 1995, included Ptas. 8,771 million and Ptas. 10,619 million, respectively, of advances for aircraft purchase commitments to aircraft manufacturers. In 1996 the Company made advances of Ptas. 852 million in this connection and recovered Ptas. 3,422 million relating to the amount advanced for the four A-340's which have commenced operations under an operating lease contract.

As of December 31, 1996 and 1995, construction in progress also included Ptas. 1,141 million and Ptas. 1,577 million, respectively, of financial expenses capitalized in connection with these advances. In 1996 the Company canceled, with a charge to "Extraordinary expenses" in the accompanying 1996 statement of income (loss), Ptas. 436 million of interest expenses relating to the aforementioned four A-340 aircraft.

Additionally, as of December 31, 1996 and 1995, construction in progress included Ptas. 408 million and Ptas. 1,595 million, respectively, relating to the value of the auxiliary, equipment being installed in aircraft not yet received. In 1996 the Company, invested Ptas. 710 million in this equipment and recovered the Ptas. 1,891 million relating to the auxiliary equipment installed in the four A-340 aircraft acquired under operating lease contracts.

The additions in 1996 to the cost and to the provisions for depreciation of spare parts included Ptas. 3,907 million and Ptas. 2,783 million, respectively, relating to the value of certain aircraft spare parts which were added as a result of the dissolution of the Atlas Group.

On December 31, 1996, the Company restated its property, plant and equipment pursuant to Royal Decree-Law 7/1996, and paid the single 3% tax. The Company had previously availed itself of other restatement legislation. The restatement in 1996 was carried out by applying the maximum coefficients authorized by the Royal Decree-Law, with the 40% reduction for the effect of the Company's financing up to the limit of the estimated market value of each of the assets. The restatement surpluses were as follows:

	MILLIONS OF PESETAS
	<b>Surplus</b>
Aircraft	8,849
Land	147
Buildings and other structures	2,997
Machinery, installations and tools	3,529
Transport equipment	27
Flight simulators	376
	<b>15,925</b>

The restatement surplus, net of the single 3% tax, was credited to the "Restatement Reserve" caption, with a charge to the appropriate restated asset accounts, without altering the recorded accumulated depreciation amount.

The net increase in value resulting from this restatement will be depreciated over the tax periods in the remaining useful lives of the restated assets. It is estimated that the 1996 restatement will increase the 1997 depreciation charge by approximately Ptas. 7,072 million.

### Depreciation and provisions

MILLIONS OF PESETAS				
1996	12-31-95	Provisions	Retirements	12-31-96
<b>Aircraft</b>	163,166	13,010	(9,167)	167,009
<b>Other tangible fixed assets</b>				
Buildings and other structures	10,523	915	(41)	11,397
Machinery installations and tools	23,331	3,232	(574)	31,989
Transport equipment	876	89	(39)	926
Furniture and fixtures	2,393	229	(64)	2,558
EDP equipment	20,036	1,126	(164)	20,998
Spare parts	15,364	2,023	(70.4)	16,685
Flight simulators	3,800	381	-	4,181
	<b>82,323</b>	<b>7,995</b>	<b>(1,584)</b>	<b>88,734</b>

MILLIONS OF PESETAS					
1995	01-01-95	Provisions	Retirements	Transfers	12-31-95
<b>Aircraft</b>	152,831	12,615	(2,280)	-	163,166
<b>Other tangible fixed assets</b>					
Buildings and other structures	9,623	932	(32)	-	10,523
Machinery: installations and tools	26,343	3,338	(347)	(3)	29,331
Transport equipment	848	88	(64)	2	876
Furniture and fixtures	2,177	246	(33)	3	2,393
EDP equipment	20,636	2,099	(2,699)	-	20,036
Spare parts	12,680	4,296	(1,612)	-	15,364
Flight simulators	3,602	370	(172)	-	3,800
	<b>75,909</b>	<b>11,369</b>	<b>(4,957)</b>	<b>2</b>	<b>82,323</b>

## Transactions involving the aircraft

In 1994 the Company redesigned its fleet renewal plan and entered into various agreements with its suppliers. The main features of these agreements, which were partially amended in 1996, are described below.

### *Agreements relating to the Boeing aircraft*

In 1994 the Company entered into operating lease contracts with several leasing companies for seven B-757 aircraft. Two of these aircraft were on lease for a period of four years, extendible to a further 18 months, excluding the purchase option. The other five B-757 aircraft were on lease for an initial period of approximately five years, at the end of which the Company would have the following three options for each plane: to exercise the purchase option; to extend the lease for up to a further 12 years; or to return the plane to the lessor.

The Company's initial B-757 aircraft purchase contract with The Boeing Company ("Boeing") was still in force at December 31, 1996, and eight of the planes ordered under this contract had not been delivered at that date. In 1994 the Company entered into another purchase contract with Boeing for a further seven B-757 aircraft, which can be canceled if the Company exercises the purchase option on the five B-757 planes which are currently being operated under an operating lease. The Company's committed capital expenditure for the purchase of the 15 B-757 aircraft would, if completed, amount to approximately US\$ 735 million. Four of the 15 B-757's would be delivered in 1999, four in 2000 and seven in 2002. Any of these 15 aircraft may be replaced by other Boeing planes of equal purchase price. As of December 31, 1996, the Company had made advances totaling Ptas. 4,683 million in connection with these aircraft.

Also, in 1994 the Company sold to Boeing seven B-727 aircraft and one B-747 aircraft and subsequently entered into operating lease contracts for these planes for a period of one year and three years, respectively, including a purchase option. Ptas. 398 million of the capital gain arising from the sale of the B-747 aircraft were deferred and were recorded under the "Deferred revenues" caption in the balance sheet as of December 31, 1996. Ptas. 150 million of the foregoing capital gain were allocated to income in 1996 and 1995 and are included under the "Other operating revenues" caption in the statements of income (loss). In 1995 the Company exercised the purchase option on two of the seven leased B-727 aircraft for salvaging and use of replacement parts. An amendment to the initial contract on the other B-727 aircraft was agreed on in 1995, whereby the contract was extended to 1998 and may be renewed through July 2001.

### *Agreements relating to the Airbus aircraft*

In 1994 the Company agreed on a new delivery schedule with Airbus Industrie, G.I.E. ("Airbus") for eight A-340 aircraft, as follows: four in 1996, two in 1999 and two in 2000. In 1996 four A-340 aircraft came into service and a new agreement was entered into modifying the date of delivery of



the four remaining aircraft and establishing the delivery date of four additional aircraft which the Company has the option to purchase, the new schedule being as follows: two in 1997, one in 1998, one in 1999, two in 2000 and two in 2001.

The four A-340 aircraft that came into service in 1996 were acquired under an operating lease contract from Iberbus Concha Ltd., Iberbus Rosalia Ltd., Iberbus Chacel Ltd. and Iberbus Arenal Ltd. The Company has 40% holdings in the capital stock of all these companies (see Note 7). The term of the operating leases for the four A-340 aircraft is seven years, at the end of which the Company will have the following three options: to exercise the purchase option and pay a predetermined price for the aircraft; to extend the lease for five or eight years and mandatorily exercise the purchase option, paying the market value of the aircraft; or to return the planes to the lessor.

The Company also entered into agreements whereby it can lease under the terms described in the preceding paragraph the three A-340 aircraft deliverable in 1997 and 1998. The Company may enter into operating lease contracts with the companies owning each plane for an initial seven-year period. It must also contribute US\$ 73.5 million to finance the companies that will purchase these planes from the manufacturer. The cost of these three A-340 aircraft is approximately US\$ 324 million. The basic cost of the remaining five A-340 aircraft, scheduled for delivery in 1999, 2000 and 2001, is approximately US\$ 360 million.

As security for these transactions relating to the A-340 aircraft, the Company subscribed U.S. dollar promissory notes in favor of Airbus with an equivalent peseta value as of December 31, 1996, of Ptas. 1,487 million. The advances paid to Airbus for future aircraft totaled Ptas. 2,202 million as of December 31, 1996.

A previous purchase commitment for eight A-321 aircraft was canceled in 1994. The recovery of the US\$ 13 million advanced by the Company to Airbus for the purchase of the aforementioned A-321 aircraft was conditional upon the Company or other Iberia Group companies placing an order for aircraft or spare parts of approximately US\$ 400 million by December 13, 1996, for delivery by Airbus by December 15, 2000. This purchase commitment was canceled in 1996 following agreement with Airbus that the US\$ 13 million would be used to finance one of the companies that will acquire the next A-340 aircraft.

#### ***Agreements relating to other aircraft***

In 1995 the Company sold four DC-9 aircraft, one of them to Austral Líneas Aéreas - Cielos del Sur, S.A., for a total of Ptas. 683 million, giving rise to a net capital gain of Ptas. 430 million which is recorded under the "Gains on fixed asset disposals" caption in the accompanying 1995 statement of loss.

In 1996 the Company sold three DC-10 aircraft for a total of Ptas. 4,823 million, giving rise to a gain of Ptas. 2,352 million, which is recorded under the "Gains on fixed asset disposals" caption in the accompanying 1996 statement of income.



As of December 31, 1996, two A-300 aircraft that had been withdrawn from service at the end of 1992 as a result of the passenger ticket demand situation remained inactive. As of December 31, 1996, the net book value of the airframes of these aircraft, which was the same as their residual value, amounted to Ptas. 1,631 million. Various options are currently being analyzed for these two aircraft.

In 1993 the Company sold six A-320 aircraft and five MD-87 aircraft. Subsequent to this sale, it entered into operating lease contracts on these aircraft. The net capital gain of Ptas. 5,361 million on the sale of these aircraft was recorded under the "Deferred revenues" caption in the balance sheet. Ptas. 1,100 million of this gain were charged in both 1996 and 1995 to the "Other operating revenues" caption in the 1996 and 1995 statements of income (loss).

#### *Aircraft in service*

The Company's aircraft in service in 1996 are summarized as follows:

Type of Aircraft	Owned by the Company	Under Financial Lease	Under Operating Lease	Total
B-727	23	-	5	28
B-747	6	-	1	7
B-757	-	1	7	8
A-300	8 (a)	-	-	8 (a)
A-320	11	5	6	22
A-340	-	-	4	4
DC-8	-	-	3 (b)	3
DC-9	8 (c)	-	-	8
DC-10	8 (d)	-	-	8
MD-87	17	2	5	24
	81	8	31	120

(a) Including two inactive aircraft.

(b) Including two aircraft leased to the Company's subsidiary Cargosur, S.A., and another aircraft which this subsidiary had leased to third parties. The Company had subrogated to the subsidiary's position in this connection in 1995.

(c) Including four aircraft still leased to the subsidiary Binter Canarias, S.A.

(d) Including three aircraft sold in 1996 and one aircraft leased to the subsidiary Venezolana Internacional de Aviación, S.A. which was reincorporated into the Company's fleet in 1997.

12 aircraft and their engines had been mortgaged for a net book value of Ptas. 36,379 million as of December 31, 1996, as security for various loans which had been repaid in full at that date. One aircraft operated by the Company under a financial lease contract had been mortgaged for a net book value of Ptas. 4,793 million as of December 31, 1996. This guarantee was provided by the lessor and owner of the aircraft to third parties.

The operating lease payments paid in 1996 and 1995 for the aforementioned B-747, B-757, B-727, A-320, A-340 and MD-87 aircraft (28 in 1996 and 24 in 1995) amounted to Ptas. 11,818 million and Ptas. 10,396 million, respectively, and are included under the "Other operating expenses" caption in the accompanying statements of income (loss) (see Note 16). The detail of the approximate lease payments payable in this connection and of the expected due dates is as follows:

MILLIONS OF U.S. DOLLARS	
1997	108
1998	99
1999	55
2000 to 2003	131
	<b>393</b>

#### **Insurance coverage**

The Company has insurance policies for its property, plant and equipment and intangible assets which sufficiently covered their net book value as of December 31, 1996 and 1995. It also has insurance policies for the aircraft leased from third parties in accordance with the conditions stipulated in the related lease contracts. Most of these policies arc with Musini, Sociedad Mutua de Seguros y Reaseguros.

## **7 Long-term Financial Investments**

The variations in 1995 and 1996 in the balances of the "Holdings in Group and associated companies" caption and in the related provisions were as follows:

MILLIONS OF PESETAS		
Holdings in Group and Associated Companies	Cost	Provision
Balance at 01-01-95	141,140	(95,317)
Additions or provisions	67,541	(23,136)
Retirements or recoveries	(3,105)	80
Balance at 12-31-95	205,576	(118,373)
Additions or provisions	2,375	(2,752)
Retirements or allowances released	(130,789)	64,134
<b>Balance at 12-31-96</b>	<b>77,162</b>	<b>(56,991)</b>

The 1995 additions relate basically to the Company's share in the capital increase at Interinvest, S.A. The 1996 additions relate, on the one hand, to the acquisition for Ptas. 1,451 million of a 40% holding in the capital stock of the companies which purchased the four A-340 aircraft which came into service in 1996 (see Note 6) and, on the other, to the acquisition for Ptas. 924 million of the holding Amadeus Global Travel Distribution, S.A., that the Company had previously owned indirectly.

Group and Associated Companies	Address	December 31, 1996			
		Percentage of Direct and Indirect Ownership	Cost	Book Value Provision	Capital
		(a)			
Aviacion y Comercio, S.A	Mwdes,51; Madrid	32.93	3,880	-	7,400
Binter Canarias, S.A.	Aeropuerto de Las Palmas	99.99	5,127	(3,799)	1,387
Binter Mediterraneo S.A.	Aeropuerto de Las Palmas	99.99	6,157	(5,784)	1,608
Compania Auxiliar al Cargo Expres, S.A,	Juan de la Cierva, 9; Madrid	75.00	111		332
Campos Velazquez, S.A,	Velizqzw, 134; Madrid	99.99	3,785	(30)	150
Cargosur, S.A,	Avda. de la Hispanidad, 13; Madrid	100.00	1,445	(585)	1,008
Iber-Swiss Catering, S.A.	Ctra. de la Munoz, s/n Madrid	70.00	594	-	500
Vuelos Internacionales de Vacaciones, S.A. (VIVA)	Zurbano,41; Madrid	99.47	10,593	(7,242)	6,650
Amadeus Group	Salvador de Madariaga. 1; Madrid	29.20	2,481	(1,557)	6,527
Aerolineas Argentinas, S.A.	Boucharde 547 Buenos Aires	20.00	24,907	(21,860)	71,472
Lineas Aéreas del Cobre, S.A.	Avda. Libertador B. O Higgins, 107; Santiago de Chile	25.13	1,418	(1,418)	5,496
Venezolana Internacional de Aviacion, SA (VIASA)	Oscar M. Zuloaga, sin; Caracas	45.00	14,716	(14,716)	557
Sistemas Automatizados Agencias de Viajes, SA. (SAVIA)	Velaquez, 130; Madrid	99.90	200		2,000
Iberbus Concha Ltd.	George's Dock House, IFSC; Dublin	40.00	337		843
Iberbus Rosalia Ltd,	George's Dock House, IFSC; Dublin	40.00	342		855
Iberbus Chacel Ltd.	George's Dock House, IFSC; Dublin	40.00	379		950
Iberbus Arenal Ltd.	George's Dock House, IFSC; Dublin	40.00	393		932

(a) The Company's percentages of ownership in the capital stock of Group and associated companies remained unchanged in 1996 and 1995, except for those in Compañía Auxiliar al Cargo Expres, S. A., Aerolíneas Argentinas, S.A. and Líneas Aéreas del Cobre, S.A. The percentages of ownership of these companies were 60%, 83.35% (directly and indirectly) and 38.07%, respectively, as of December 31, 1995, and 75%, 20% and 25.13%, respectively, as of December 31, 1996.

(b) Including the following amounts relating to restatement reserves resulting from the assets restated pursuant to Royal Decree-Law 7/1996:

	MILLIONS OF PESETAS
Aviación y Comercio, S.A.	1,737
Binter Canarias, S. A.	593
Compañía Auxiliar al Cargo Expres, S.A.	1
Cargosur, S.A.	185
Iber-Swiss Catering, S.A.	232
Vuelos Internacionales de Vacaciones, S.A.	498 <sup>1</sup>

The retirements and allowances released in 1996 arose basically, as a result of the reduction in the Company's direct and indirect holdings in Aerolíneas Argentinas, S.A. and Líneas Aéreas del Cobre, S.A.

The information relating to the main Group and associated companies as of December 31, 1996 and 1995, drawn from their respective financial statements or from provisional financial statements in the case of Aerolíneas Argentinas, S.A., Venezolana Internacional de Aviación, S.A., Líneas Aéreas del Cobre and the Amadeus Group (the 1996 financial statements have not yet been approved by the respective Shareholders' Meetings), is as follows:

MILLIONS OF PSEFIAS

			December 31, 1995			
Income (Loss)			Income (Loss)			
Reserves	Ordinary	Extraordinary	Capital Stock	Reserves	Ordinary	Extraordinary
(b)						
14,165	18.3	159	7,400	7,450	(1,470)	1,439
134	(169)	66	2,000	(613)	(489)	30
(551)	(632)	(112)	2,000	(394)	(440)	(49)
187	27	-	40	189	52	(27)
3,352	253	-	150	3,346	376	-
(148)	(87)	87	1,445	1	141	(912)
345	65	7	500	49	47	17
(1,466)	(1,761)	(54)	6,650	(1,286)	(476)	(202)
(22,531)	7,181	(1,458)	6,516	(18,888)	(4,999)	(706)
(49,477) (e)	(16,347)	7,742	136,314 (c)	(68,957)	(14,563)	(8,323)
(6,546)	- (d)	- (d)	5,307	(2,456)	(673)	(132)
(1,388)	(920)	-	1,622	2,022	(1,495)	-
104	65	-	200	38	49	17
54	(85)	-	-	-	-	-
36	(68)	-	-	-	-	-
38	(68)	-	-	-	-	-
23	(33)	-	-	-	-	-

(c) Including the Company's direct and indirect holdings in the capital stock of Aerolíneas Argentinas, S.A. and Interinvest, S.A. as of December 31, 1995.

(d) At the date of preparation of these financial statements, it was not possible to obtain an estimate of this company's 1996 results.

(e) Including the irrevocable contribution made by Interinvest, S.A. for an equivalent amount of Ptas. 46,898 million.



In 1996 and 1995 the Shareholders' Meetings of the Group and associated companies listed below adopted the following resolutions:

MILLIONS OF PSEDIAS

	Contributions to Offset Losses		Distribution of Dividends		Capital Increase		Capital Reduction		Cancellation Reserves for Own Shares	
	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995
Hinter Canarias, S.A.		750	-	-	-	-	613	1,000	-	-
Binter Mediterraneo, S.A.							332	2,500	-	-
Campos Velazquez, S.A.	-	-	370	240	-	-	-	-	-	-
Interinvest, S.A.					-	66,704	-	-	-	-
Compania Auxiliar al Cargo-Expres, S.A.	-	-	-	-	-	-	8	-	28	-
Cargosur, S.A.	-	-	-	-	-	-	437	-	-	-

At the end of 1995, the Shareholders' Meeting of Interinvest, S.A. authorized a capital increase of Ptas. 66,704 million, which was subscribed in full by the Company through the direct contribution of Ptas. 22,679 million of loans to Aerolíneas Argentinas, S.A., the delivery of shares of this latter company with a value of Ptas. 3,105 million and the disbursement in cash of Ptas. 40,920 million.

Also, in 1995 Interinvest, S.A. made an irrevocable contribution of Ptas. 46,898 million on account of a future capital increase at Aerolíneas Argentinas, S.A. through the contribution in cash of Ptas. 40,920 million and by offsetting Ptas. 5,978 million of loans.

In 1996 the Company significantly reduced its holdings in Aerolíneas Argentinas, S.A. (selling its holding in Interinvest, S.A.) and Líneas Aéreas del Cobre, S.A. through the sale of 63.35% and 12.94%, respectively, of the capital stock of these companies to Andes Holding B.V., a Dutch company 42%-owned by Sociedad Estatal de Participaciones Industriales (SEPI). These holdings were sold for Ptas. 64,852 million, giving rise to a net loss of Ptas. 2,922 million, which is included under the "Losses on fixed assets" caption in the accompanying 1996 statement of income. Of the total sale price, Ptas. 17,740 million, deferred until Austral Líneas Aéreas - Cielos del Sur, S.A. a company 89.99% owned by Aerolíneas Argentinas, S.A.) is sold by Andes Holding B.V., had not been collected as of December 31, 1996. The deadline for the sale of Austral Líneas Aéreas - Cielos del Sur, S.A. expires in April 1999. If the sale has not been executed by that date, the shares of Austral Líneas Aéreas - Cielos del Sur, S.A., which are presently pledged to Iberia, Líneas Aéreas de España, S.A., will be transferred to the Company.

The contract under which these holdings were sold grants Iberia, Líneas Aéreas de España S.A. a two-year option to repurchase the shares sold, although it can only exercise this option if certain financial ratios relating to the Iberia Group's equity are met and if a private investor has a high degree of involvement in the transaction, as stipulated in the terms of the Company's Program of Measures approved by the European Commission (see Note 1 ).

Also, as a result of the undertaking made by Andes Holding B.V. to acquire 10% of the capital stock of Aerolíneas Argentinas, S.A. for US\$ 23,185,515 (Ptas. 3,047 million), the Company released Ptas. 174 million of the provisions recorded in prior years for this holding, thereby reducing the carrying value of the holding in Aerolíneas Argentinas, S.A. as of December 31, 1996, to its guaranteed recovery value.

In 1995 the Company recorded a provision of Ptas. 20,343 million in connection with its holdings in Aerolíneas Argentinas, S.A. and Venezolana Internacional de Aviación, S.A. (VIASA). This provision is included under the "Variations in control portfolio provisions" caption in the accompanying 1995 statement of loss, in view of the results of these companies and the financial position disclosed by their provisional balance sheets at that date. As of December 31, 1996, the allowance recorded in connection with VIASA fully covered the value of the Company's holdings in it.

As of December 31, 1996, the Company had provided U.S. dollar collateral guarantees for Aerolíneas Argentinas, S.A. to several entities totaling Ptas. 10,644 million. At that same date, the Company had provided a U.S. dollar collateral guarantee to a finance entity for Venezolana Internacional de Aviación, S.A. (VIASA) amounting to Ptas. 6,159 million. The terms of the aforementioned collateral guarantees ensure that they will not give rise to losses for the Company.

In November 1996 the Company submitted a Viability Plan for VIASA which was not accepted by the employees' representatives. VIASA's operations were discontinued in January 1997 and, following a resolution adopted by the shareholders, VIASA filed for temporary receivership in March and the company will now be liquidated.

The accompanying balance sheet as of December 31, 1996, includes balances with VIASA in connection with investments, loans, current accounts and deposits made on behalf of the latter, which, net of the provisions recorded, totaled Ptas. 10,036 million. Also, in February 1997 Iberia, Líneas Aéreas de España, S.A. undertook to contribute Ptas. 1,577 million to carry out the initial steps of VIASA's liquidation process. Iberia, Líneas Aéreas de España S.A. has guarantees securing the net balances recorded as of December 31, 1996, basically comprising mortgage guarantees on VIASA's real estate and aircraft.

The directors of Iberia, Líneas Aéreas de España S.A. consider that the provisions recorded as of December 31, 1996, for existing guarantees and for the adjustment to be made in connection with the overstated liability (see Note 5-1), cover the effect of the loss, if any, that might be incurred as a result of VIASA's liquidation.

The Amadeus Group comprises Amadeus Global Travel Distribution, S.A., Amadeus Data Processing GmbH (a German company) and their investees. In 1935 the Shareholders' Meetings of these two companies resolved to increase capital with paid-in surpluses totaling ECU 92.1 million. The capital increases were subscribed in full by a U.S. company through the contribution of its computer systems. As a result of this transaction, and following the acquisition by some of the former shareholders of the holding of one of the shareholders in the Amadeus Group, the Company's holding in the group is now 29.2%.

As of December 31, 1996, the Company had provided ECU collateral guarantees for the companies composing the Amadeus Group to several entities amounting to Ptas. 9,232 million.

The Amadeus Group, whose corporate purpose is the management and operation of a computerized reservation system, has incurred losses in recent years as a result of its operations being in the start-up phase. In 1996 the Amadeus Group reported income, and it is hoped that this situation will be consolidated in the coming years.

In 1996, as a result of the redemption of a block of shares of treasury stock owned by Compañía Auxiliar al Cargo Expres, S.A. (CACESA), the Company's holding in this company's capital stock increased to 75%.

The main data on the balances of the "Loans to Group and associated companies" caption and of the related provisions in the accompanying balance sheets as of December 31, 1996 and 1995, are as follows:

MILLIONS OF PSEFIAS			
	1996	1995	Due Date
Binter Canarias, S.A.	294	441	15-1-1999 (a)
Aerolineas Argentinas, S.A.	-	20	-
VIASA	13,357	11,292	&
SAVIA	-	200	1-7-1997 (a)
Amadeus Group	4,795	4,703	31-12-1998 (c)
Iberbus Concha Ltd.	2,583	-	29-2-2003
Iberbus Rosalia Ltd.	2,563	-	10-5-2003
Iberbus Chacel Ltd.	2,839	-	6-9-2003
Iberbus Arenal Ltd.	2,904	-	18-10-2003
<b>Total</b>	<b>29,335</b>	<b>16,656</b>	
<b>Provision</b>	<b>(4,589)</b>	<b>(1,744)</b>	

(a) The period variations relate to transfers of long-term debt to current liabilities.

(b) These credits are instrumented in several loans and promissory notes, secured, in part, by mortgage guarantees and denominated in U.S. dollars. The Ptas. 1,147 million of interest earned in 1996 were recorded with a credit to the "Deferred revenues" caption in the accompanying balance sheet as of December 31, 1996. Also, the "Long-term financial investments - Provisions" caption in the accompanying balance sheet as of December 31, 1996, includes a provision of Ptas. 4,589 million to cover the amount of this loan which, in the opinion of the Company's directors, is not sufficiently covered by mortgage guarantees.

(c) These loans are denominated in ECUs. Ptas. 119 million and Ptas. 905 million of these loans were repaid in 1996 and 1995, respectively.

The average annual interest rates on the foregoing loans in 1996, in some cases tied to MIBOR or LIBOR, ranged from 5% to 10%.

## 8 Short-term Financial Investments

The detail of the balances of this caption in the accompanying balance sheets is as follows:

	MILLIONS OF PSEIAS	
	1996	1995
Government debt securities	32,547	-
Short-term deposits	4,000	-
Investments made through SEPI	2,000	76
Short-term loans to Group and associated companies	347	600
Short-term deposits and guarantees	1,303	529
Unmatured interest receivable	1,285	95
Other short-term financial investments	2,637	2,463
	44,119	3,763

The government debt securities relate to government debentures and Treasury bills which earned average interest of 10.1% as of December 31, 1996.

## 9 Shareholders' Investment

### Capital stock

As of December 31, 1996 and 1995, the Company's capital stock consisted of 882,512,019 and 213,281,250, respectively, fully subscribed and paid registered shares of Ptas. 130 par value each.

As of December 31, 1996, Sociedad Estatal de Participaciones Industriales (see Note 1) was the Company's majority shareholder, with a holding of 99.98%.

On December 23, 1995, the Extraordinary Shareholders' Meeting resolved to increase capital by Ptas. 87,000 million. This capital increase was approved by the European Commission on January 31, 1996 (see Note 1) and was paid by Téneo, S.A. in two stages: one of Ptas. 36,685 million on April 26, 1996, and the other of Ptas. 50,315 million on June 24, 1996.

### Restatement reserve

From the date on which the tax authorities have reviewed and approved the balance of the "Restatement reserve" account (or the three-year period for review has expired), the aforementioned balance can be used, free of tax, to offset recorded losses (both prior years'

accumulated losses and current year losses) or losses which might arise in the future, and to increase capital stock. From January 1 2007, the balance of this account can be taken to unrestricted reserves, provided that the monetary surplus has been realized. The surplus will be deemed to have been realized in respect of the portion on which depreciation has been taken for accounting purposes or when the restated assets have been transferred or retired from the accounting records. If this balance were used in a manner other than that provided for in Royal Decree-Law 7/1996, it would be subject to tax.

### Other matters

On May 22, 1996, the Company's Shareholders' Meeting resolved to allocate the 1995 loss to the "Prior years' losses" account.

## 10 Provisions for Pensions and Similar Obligations

The variations in this account in 1995 and 1996 were as follows:

MILLIONS OF PESETAS

	Allowance for:		
	Retired Employees and Employees Placed on the Reserve	Serving Employees	Total Allowance
<b>Balance at January 1, 1995</b>	<b>14,375</b>	<b>31,378</b>	<b>45,753</b>
Provisions charged to			
Financial expenses	1,150	2,510	3,660
Personnel expenses	-	2,985	2,985
Transfer from the allowance for serving employees to that for retired employees and employees placed on the reserve	2,728	(2,928)	-
Amount used for payments	(3,044)	-	(3,044)
<b>Balance at December 31, 1995</b>	<b>15,409</b>	<b>33,945</b>	<b>49,354</b>
Provisions charged to			
Financial expenses	1,233	2,715	3,048
Personnel expenses	-	3,203	3,209
Transfer from the allowance for serving employees to that for retired employees and employees placed on the reserve	4,055	(4,055)	-
Amount used for payments	(3,336)	-	(3,331)
<b>Balance at December 31, 1996</b>	<b>17,361</b>	<b>35,814</b>	<b>53,175</b>

## 11 Commitments and Contingencies

As of December 31, 1996 and 1995, certain groups of employees had filed claims under several headings against the Company on which no decision had been handed down by the related courts at those dates. The Company's directors consider that the liabilities that might arise from these claims are sufficiently covered by the provisions recorded as of December 31, 1996.

In addition to the commitments to aircraft manufacturers (see Note 6) and the guarantees provided for various companies described in Note 7, as of December 31, 1996 and 1995, guarantees totaling Ptas. 15,936 million and Ptas. 8,032 million, respectively, had been provided for third parties.

## 12 Payable to Credit Entities and Promissory Notes

The detail of the Company's debt to credit entities and promissory notes as of December 31, 1996 and 1995, by maturity, is as follows:

December 31, 1996

Currency	Due in:					Subsequent Years
	1997	1998	1999	2000	2001	
MILLIONS OF PESETAS						
<b>Debts</b>						
Peseta loans	7,778	2,491	2,510	2,733	2,720	18,283
Foreign currency loans: Yen	146	242	340	423	3,203	2,927
ECU	1,969	1,169	1,169	1,169	1,168	8,179
Dutch guilder	798	521	521	521	521	3,650
Pound sterling	1,665	1,483	1,483	1,483	1,483	10,381
U.S. dollar	2,102	1,957	1,874	1,806	2,036	2,513
Deutsche mark	1,176	1,235	1,302	1,105	1,114	8,854
	<b>15,834</b>	<b>9,098</b>	<b>9,199</b>	<b>9,240</b>	<b>12,245</b>	<b>54,787</b>

The weighted average annual interest rates on the foregoing loans in 1996 were 9.52% for peseta loans and 7.67% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

**December 31, 1995**

MILLIONS OF PESTAS

Currency	Due in:					Subsequent Years
	1996	1997	1998	1999	2000	
<b>Debts</b>						
Peseta loans	71,789	13,846	6,083	5,466	6,545	33,015
Foreign currency loans: Yen	54	80	251	354	439	6,370
ECU	2,040	1,117	1,117	1,117	1,117	8,941
Dutch guilder	878	525	525	525	525	4,204
Pound sterling	2,374	1,239	1,239	1,239	1,239	9,915
U.S. dollar	2,274	2,211	2,077	2,000	1,804	4,209
Deutsche mark	1,254	1,296	1,349	1,407	1,202	10,278
	<b>80,663</b>	<b>20,314</b>	<b>12,641</b>	<b>12,108</b>	<b>12,871</b>	<b>76,932</b>
<b>Promissory notes</b>						
In pesetas	3,745	-	-	-	-	-
	<b>3,745</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

The weighted average annual interest rates on the foregoing loans in 1995 were 9.78% for peseta loans and 8.71% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

**13 Futures and Other Similar Instruments**

The breakdown, by derivative, of the notional values held by the Company as of December 31, 1996, is as follows:

MILLIONS OF PESTAS

<b>Interest rate risk hedging transactions:</b>	
Interest rate swaps	9,667
Interest rate options and futures	41,131
<b>Exchange risk hedging transactions:</b>	
Options on foreign currencies	58,894
Currency swaps	47,846

The foregoing transactions were arranged to fully or partially hedge the Company's asset positions or cash flow.

## 14 Balances and Transactions with Group and Associated Companies

The detail of the receivables from and payables to Group and associated companies as of December 31, 1996 and 1995, is as follows:

1996

	MILLIONS OF PESETAS			
	Receivable		Payable	
	Long Term	Short Term	Long Term	Short Term
SEPI (taxes - Note 15)	20,753	4,546	267	3,056
SEPI (other)	-	-	384	2,257
Vuelos Internacionales de Vacaciones, S.A.	-	498	-	-
Campos Velazquez, S.A.	-	-	-	202
Compania Auxiliar al Cargo-Expres, S.A.	-	283	-	126
Iber-Swiss Catering, S.A.	-	61	-	316
Iberia Tecnologia, S.A.	-	182	-	180
SAVIA	-	1,124	-	-
Aviation y Comercio, S.A.	-	186	-	-
Cargosur, S.A.	-	-	-	150
Aerolineas Argentinas, S.A.	-	4,878 (a)	-	-
Venezolana International de Aviation, S.A.	-	6,170	-	-
Amadeus Group	-	316	925	-
Binter Finance B.V.	-	546	-	-
Andes Holding B.V. (Note 7)	17,740	-	-	-
Binter Canarias, S.A.	-	-	-	473
Binter Mediterráneo, S.A.	-	-	-	101
Musini	-	-	1,684	242
Other	-	-	-	258
	<b>38,493</b>	<b>18,790</b>	<b>3,260</b>	<b>7,361</b>

(a) Includes Ptas. 468 million relating to Austral Líneas Aéreas - Cielos del Sur, S.A., a subsidiary of Aerolíneas Argentinas, S.A.

1995

MILLIONS OF PISES

	Receivable		Payable	
	Long Term	Short Term	Long Term	Short Term
TENEO, S.A. (taxes - Note 15)	17,527	15,034	67	-
TENEO, S.A. (other)	-	-	593	24
Vuelos Internacionales de Vacaciones, S.A.	-	-	-	288
Campos Velazquez, S.A.	-	-	-	874
Compania Auxiliar al Cargo Expres, S.A.	-	677	-	294
Iber-Swiss Catering, S.A.	-	30	-	255
Iberia Tecnologia, S.A.	-	120	-	180
SAVIA	-	794	-	-
Aviacion y Comercio, S.A.	-	-	-	379
Cargosur, S.A.	-	233	-	-
Aerolíneas Argentinas, S.A.	-	2,919 (a)	-	-
Venezolana International de Aviación, S.A.	-	3,906	-	-
Amadeus Group	-	476	-	-
Binter Finance	-	1,768	14,752	-
Binter Canarias, S.A.	-	-	-	1,566
Binter Mediterráneo, S.A.	-	-	-	58
Musini	-	-	1,684	239
Infoleasing, S.A.	-	-	1,263	798
Other	-	-	-	105
	<b>17,527</b>	<b>26,017</b>	<b>18,359</b>	<b>5,060</b>

(a) Including Ptas. 298 million relating to Austral Líneas Aéreas - Cielos del Sur, S.A., a subsidiary of Aerolíneas Argentinas, S.A.

The Company's main transactions with Group and associated companies in 1996 and 1995 were as follows:

1996

MILLIONS OF PESETAS

	Services Rendered	Financial Revenues	Services Received	Financial Expenses
Vuelos Internacionales de Vacaciones, S.A.	840		28	-
Campos Velazquez, S.A.	1		156	28
Compania Auxiliar al Cargo Expres, S.A.	1,320		399	-
Iber-Swiss Catering, S.A.	15	7	4,579	-
SAVIA	3,368	32		
Aviacion y Comercio, S.A.	14,657	13	401	340
Cargosur, S.A.			134	-
Aerolineas Argentinas, SA.	3,025	165	243	-
Venezolana Internacional de Aviacion, S.A.	4,357	422	-	-
Amadeus Group	3,031	299	6,319	-
Binter Canarias, S.A.	3,800	147	-	-
Binter Mediterraneo, S.A.	394		-	-

1995

MILLION OF PESETAS

	Services Rendered	Financial Revenues	Services Received	Financial Expenses
Vuelos Internacionales de Vacaciones, S.A.	2,519	-	223	-
Campos Velazquez, S.A.	1	-	147	39
Compania Auxiliar al Cargo Expres, S.A.	1,852	-	425	-
Iber-Swiss Catering, S.A.	85	19	4,356	-
SAVIA	2,429	56	433	-
Aviacion y Comercio, S.A.	14,644	-	434	780
Cargosur, S.A.	277	7	2,740	26
Aerolineas Argentina, S.A.	3,154	2,191	447	-
Venezolana Internacional de Aviacion, S.A.	2,000	977	-	-
Lineas Aéreas del Cobre, S.A.	226	-	-	-
Amadeus Group	1,984	306	6,382	-
Binter Canarias, S.A.	4,144	157	-	-
Binter Mediterraneo, S.A.	452	10	-	-

The balance of the services rendered to SAVIA include mainly a fee for use of the Company's ticket reservation systems. The services rendered to Aviación y Comercio, S.A., Aerolíneas Argentinas, S.A. Venezolana Internacional de Aviación, S.A. and Binter Canarias, S.A. consist basically of aircraft maintenance, passenger service, handling services for aircraft on stopovers and commissions on ticket sales.

The services rendered to the Company by Iber-Swiss Catering, S.A. relate to passenger service, handling services for aircraft and catering. The Amadeus Group bills the Company for ticket reservations made through its system and the Company receives a commission for each ticket issued through that system.

## 15 Tax Matters

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

The reconciliation of the results per books for 1996 and 1995 to the taxable bases for corporate income tax purposes is as follows:

### 1996

	MILLIONS OF PSEFIAS		
	Increase	Decrease	Amount
Income before taxes			2,823
Permanent differences	69	(2,665) (a)	(2,596)
Timing differences			
Current year	32,483 (b)	(864)	31,619
Prior years	150	(21,266) (c)	(21,116)
Taxable income (before consolidation adjustments)			10,730
Tax consolidation adjustments			
Permanent differences	1,313	-	1,313
Taxable income			12,043

(d) This amount relates mainly to the adjustment for the effect of inflation on the gains obtained by the Company on fixed asset disposals.

(b) This amount relates basically to the provisions recorded in 1996 for pension payments and to cover contingencies relating to the subsidiaries.

(c) This amount relates basically to the provisions recorded in prior years to the allowances for pensions, for the employee termination plan, for other commitments to employees and for loans to Group companies.

1995

MILLIONS OF PESETAS

	Increase	Decrease	Amount
Loss before taxes			(61,084)
Permanent differences	52	(1,390)	(1,338)
Timing differences			
Current year	30,573 (a)	-	30,573
Prior years	150	(7,905) (b)	(7,755)
Tax loss (before consolidation adjustments)			(39,604)
Tax consolidation adjustments			
Permanent differences	2,348	-	2,348
Tax loss			(37,256)

(a) This amount relates basically to the provisions recorded in 1995 to the allowances for pensions, for a portion of the employee termination plan and for other commitments to employees.

(b) This amount relates basically to the provisions recorded in prior years for pension payments and loans to Group companies.

Under the accounting method described in Note 4-1, in 1996 and 1995 the Company recorded tax credits and debits which led to a net charge of Ptas. 101 million and to a net credit of Ptas. 16,164 million in its 1996 and 1995 statements of income (loss), respectively. The expense for corporate income on recorded in 1996 is the result of applying a rate of 35% to book income adjusted for permanent differences, together with 7% of nonrecoverable timing differences. The result was reduced by double taxation and investment tax credits amounting to Pros. 1,173 million.

These tax credits and debits, which were recorded on the basis of their recovery date under the “Receivable from Group Companies “, “ Long-Term Receivables from Group Companies” and “Payable to Group and Associated Companies” captions in the accompanying balance sheets, arose from:

1996

	MILLIONS OF PESETAS					
	Receivable from Group Companies			Payable to Group and Associated Companies		
	Short Term	Long Term	Total	Short Term	Long Term	Total
Taxable income for the year	-	-	-	3,056	-	3,056
Timing differences arising in the year	760	8,335	9,095	-	242	242
Unallocated prior years timing differences	3,786	12,418	16,204	-	25	25
Total	4,546	20,753	25,299	3,056	267	3,323

1995

	MILLIONS OF PESETAS					
	Receivable from Group Companies			Payable to Group and Associated Companies		
	Short Term	Long Term	Total	Short Term	Long Term	Total
Tax loss for the year	10,431	-	10,431	-	-	-
Timing differences arising in the year	3,334	4,592	7,926	-	-	-
Unallocated prior years' timing differences	1,269	12,935	14,204	-	67	67
Total	15,034	17,527	32,561	-	67	67

Sociedad Estatal de Participaciones Industriales, as the controlling entity in the tax consolidation group, is responsible for the effective recovery by the Company of the tax credits recorded as of December 31, 1995, and in 1996 it paid all the short-term tax credits (Ptas. 10,431 million) as of December 31, 1995, relating to the tax loss for 1995.

The estimated years for use of the long-term tax credits as of December 31, 1996, are as follows:

MILLIONS OF PESETAS	
<b>Year of Recovery</b>	
1998	1,487
1999	1,548
2000 and subsequent years	17,718
	20,753

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

Current corporate income tax legislation provides various tax incentives to encourage new investments and, through April 1992, job creation. The Company availed itself of the tax benefits envisaged in this legislation and earned tax credits of Ptas. 294 million in 1996 and Ptas. 263 million in 1995 in this connection. The unused tax credits as of December 31, 1996 amounted to Ptas. 2,938 million, and the final years for using them are as follows:

<b>Year Earned</b>	<b>Millions of Pesetas</b>	<b>Last Year for Use</b>
1991	1,184	2000
1992	218	2000
1993	783	2000
1994	196	2000
1995	263	2000
1996	294	2001

On January 15, 1997, the tax authorities commenced an audit of the last five years for all the taxes applicable to the Company. No material additional liabilities are expected to arise for the Company as a result of this tax audit.

## 16 Revenues and Expenses

### a) Net sales

The breakdown of the Company's net sales, by business activity, is as follows:

MILLIONS OF PESETAS		
By Activity	1996	1995
Passenger ticket revenues	336,142	313,799
Freight revenues	33,083	32,199
Handling (aircraft dispatching and airport services)	54,117	55,632
Technical assistance to airlines	22,138	18,355
Other revenues	7,156	6,138
	<b>452,636</b>	<b>426,123</b>

### Passenger ticket revenues

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

MILLIONS OF PESETAS		
	1996	1995
Spain and Europe	221,181	207,137
Atlantic	94,120	86,896
Far East	14,454	13,664
Africa	6,387	6,102
	<b>336,142</b>	<b>313,799</b>

### Handling services

In 1992, after a public call for tenders, the Spanish Airports Autonomous Agency (AENA) awarded the Company a contract for the provision of handling services in Spain from April 1, 1993, to April 1, 2000, to act as first operator throughout Spain. Since 1993 AENA has been inviting tenders to act as second handling service operators at the main Spanish airports.

### Technical assistance to airlines

This caption includes revenues from aircraft maintenance services rendered to other air-lines, including the Group companies.

### 6) *Other operating revenues*

The breakdown of the balances of this caption in the accompanying, statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Commissions	11,094	11,661
Royalties	2,677	1,831
Rent	2,150	1,845
Recognition of deferred revenues	1,467	1,429
Other sundry revenues	7,233	7,029
	<b>24,621</b>	<b>23,795</b>

It is standard practice in the air transport industry to collect a commission on the tickets sold for other airlines.

### c) *Purchases*

The detail of the "Purchases" caption in the accompanying statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Aircraft fuel	44,165	34,362
Aircraft spare parts	11,407	8,601
Catering materials	4,164	3,969
Other purchases	2,617	1,980
	<b>62,353</b>	<b>48,912</b>

#### *d) Headcount and personnel expenses*

The average number of employees, by professional category, in 1996 and 1995 was as follows:

<b>Number of Employees</b>	<b>1996</b>	<b>1995</b>
<b>Ground personnel:</b>		
Class 1 technicians	770	820
Class 2 technicians	502	545
Clerical staff	5,874	6,187
Other	10,953	11,463
	<b>18,099</b>	<b>19,015</b>
<b>Flight personnel:</b>		
Pilots	1,139	1,165
Flight engineers	262	269
Cabin crew	2,955	2,796
	<b>4,356</b>	<b>4,230</b>
	<b>22,455</b>	<b>23,245</b>

As a result of the Company's Strategic Plan, which was drafted in 1991 and adapted in 1994 by the Program of Measures to meet the new competitive environment (see Note 1), 55 employees were laid off in 1996 and 618 employees in 1995, with a cost of Ptas. 217 million and Ptas. 3,190 million, respectively. These amounts were charged to the "Extraordinary expenses" caption in the accompanying 1996 and 1995 statements of income (loss).

Also, 1,989 employees were laid off in 1996 with a cost of approximately Ptas. 23,931 million, which was charged to the "Provision for third-party liability" caption in the accompanying balance sheet as of December 31, 1996.

As of December 31, 1996, it was planned to lay off a further approximately 400 employees. The Company's directors consider that the amounts recorded in this connection under the "Provision for third-party liability" caption in the accompanying balance sheet as of December 31, 1996, reasonably cover the expected cost of the planned terminations.

In compliance with the agreements entered into with the employees at the end of 1994, in January 1995 the Company paid them an extra payroll in January 1996 and January 1995, the amount of which is reflected under the "Agreements with employees" caption in the 1996 and 1995 statements of income (loss). Under these agreements, the Company recorded a provision of Ptas. 2,879 million with a charge to the "Agreements with employees" caption in the accompanying 1996 statement of income, for the estimated cost of the shares that the Company must transfer to its employees in early 1997.

Also, under the agreements entered into at the end of 1994, the Company undertook to pay its employees a percentage of the 1996 and 1995 results from ordinary activities exceeding those envisaged in the Company's viability plan. As of December 31, 1996 and 1995, the Company had recorded the related provision with a charge to the "Agreements with employees" caption.

#### e) Other operating expenses

The detail of the balances of this caption in the accompanying statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Commercial expenses	54,229	53,830
Air traffic levies and charges	35,121	32,618
Aircraft rentals (Note 6)	15,658	16,899
Maintenance (a)	16,629	13,648
Navigation aids	16,680	15,920
In-flight services	10,662	9,546
Reservation system expenses	8,914	8,153
Subdrv rent	8,909	8,057
Other'	33,373	34,055
	<b>200,175</b>	<b>192,726</b>

(a) Including maintenance expenses and provision for major repairs.

#### f) Extraordinary expenses

The detail of the balances of the "Extraordinary expenses" caption in the accompanying statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Indemnity payments and extraordinary expenses relating to employees	217	12,169
Provision for third-party liability	16,859	35,835
Provision for depreciation of nonoperating assets	1,132	988
Other extraordinary expenses	205	119
	<b>18,413</b>	<b>49,111</b>

### 17 Directors' Remuneration and Other Benefits

The remuneration earned by the directors in the form of per diems, wages and salaries and insurance premiums amounted to Ptas. 109 million in 1996 and Ptas. 62 million in 1995.

In 1996 and 1995 the Company had granted no advances or loans to its directors and had no pension commitments to them.

**18** 1996 and 1995 Statements of Changes in Financial Position

Following are the Company's 1996 and 1995 statements of changes in financial position:

<b>Application of funds</b>	<b>1996</b>	<b>1995</b>
Start-up expenses	900	12
Debt arrangement expenses and other deferred charges	59	545
Fixed asset additions		
Intangible assets	272	595
Property, plant and equipment	7,543	5,595
Long-term investments in Group and associated companies	11,886	54,499
Other long-term financial investments	235	351
Repayment or transfer to short-term of long-term debt		
Debt securities and other similar issues	47,109	45,895
Payable to Group and associated companies	16,201	2,068
Other accounts payable	3,167	4,375
Provisions for major repairs	1,954	2,114
Provisions for pensions and similar obligations	3,336	3,044
Provisions for third-party liability	24,005	-
Net effect of asset restatement pursuant to Royal Decree Law 7/1996	478	-
<b>Total Funds Applied</b>	<b>117,145</b>	<b>119,093</b>
<b>Funds Obtained in Excess of Funds Applied</b>		
<b>(Increase in Working Capital)</b>	<b>91,773</b>	<b>-</b>

MILLIONS OF PESETAS

Source of Funds	1996	1995
Funds obtained from operations	56,342	45,996
Capital increase	87,000	-
Long-term debt		
Group companies	218	15,479
Other companies	4,728	14,405
Disposal of property plant and equipment and intangible assets	11,237	2,045
Disposal of long-term financial investments	48,079	3,105
Early, writeoff or transfer to short-term of other long-term financial investments		
Group companies	487	1,920
Other long-term financial investments	324	385
Deferred revenues	503	-
Other funds obtained	-	60
<b>Total Funds Obtained</b>	<b>208,918</b>	<b>83,395</b>
<b>Funds Applied in Excess of Funds Obtained (Decrease in Working Capital)</b>	<b>-</b>	<b>35,698</b>

MILLIONS OF PISETAS

Variation in Working Capital	1996		1995	
	Increase	Decrease	Increase	Decrease
Inventories	-	46	66	-
Accounts receivable	-	5,222	-	8,302
Current liabilities	54,972	-	-	25,964
Short-term financial investments	40,356	-	-	1,829
Cash	812	-	-	89
Accrual accounts	901	-	420	-
Total	97,041	5,268	486	36,184
Variation in Working Capital	91,773	-	-	35,698

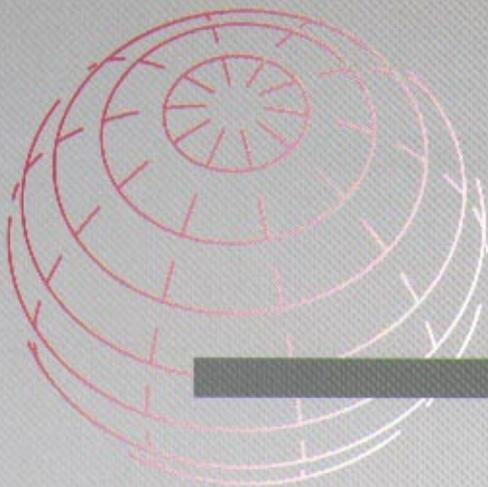
The reconciliation of the income (loss) per books to the funds obtained from operations is as follows:

MILLIONS OF PISETAS

	1996	1995
Income (loss) per books	2,722	(44,920)
Add/(Less)		
Period depreciation and amortization and fixed asset provisions	28,057	46,356
Provision for contingencies and expenses	29,682	48,289
Tax credit recoverable at long-term	(3,226)	(2,229)
Deferred interest expenses and deferred charges	2,701	3,172
Net exchange differences on long-term debt	731	(706)
Net exchange differences on fixed asset restatements	(238)	2,627
Deferred interest revenues	(1,467)	(1,430)
Net losses on fixed asset disposal	411	(799)
Recovery of overstated provisions and depreciation and amortization	(3,031)	(4,364)
	56,342	45,996

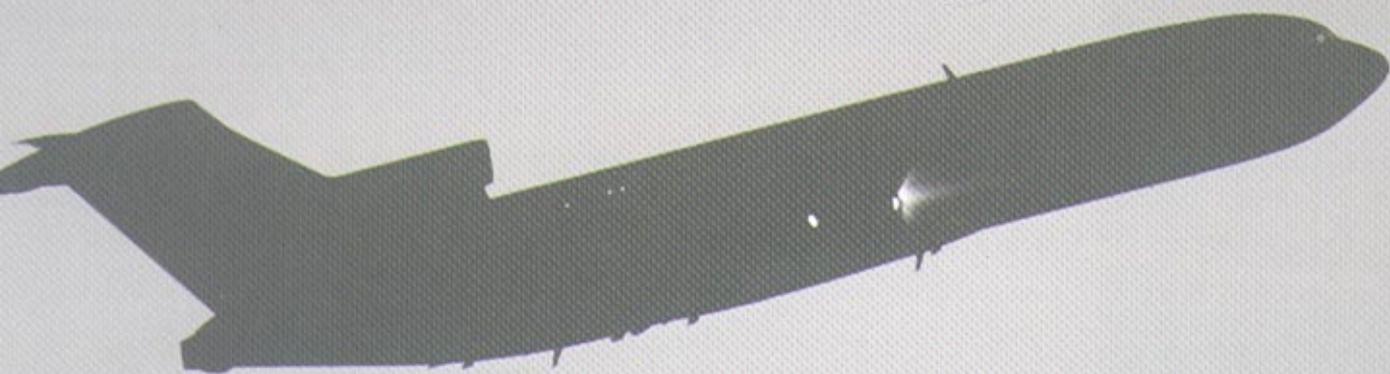
## 19 Explanation Added for Translation to English

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.



IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A.

**1996 MANAGEMENT REPORT**



Due to its length, this publication includes only a summary of the management report.  
The complete text has been deposited with the Madrid Mercantile Register.

## IBERIA, LINEAS AEREAS DE ESPANA. S.A.

### 1996 MANAGEMENT REPORT

#### 1 1996 Highlights

The most significant feature of 1996 was undoubtedly the fact that IBERIA, L.A.E. reported a profit for the first time since 1989.

This was possible mainly because of the effect of the implementation of the so-called "Program to Adapt IBERIA to the New Competitive Environment". The measures envisaged in this program enabled the capital contributed by the shareholder SEPI to be classified as an investment made under market conditions rather than as State aid, which would have forced the Company to adhere strictly to certain obligations that would have limited the freedom of its business management. Notification of the remaining capital increase of Ptas. 20,000 million was made conditional upon the Company meeting certain economic and productivity targets.

In this connection, in 1996, as in 1995, the Company met, and even exceeded, these targets. As regards the important points contained in the Plan, the first stage of the capital contribution was received in 1996, thus enabling the program of early retirements to commence and facilitating the reduction of interest-bearing debt: the planned sale of Aerolineas Argentinas and Ladeco to Andes Holding took place (although IBERIA continues to manage the former); and the transfer of scheduled VIVA routes to IBERIA was completed, leaving VIVA to operate exclusively in the charter flights market. As regards aircraft, the new Airbus A-340 (four of which were received in 1996, the first in March) came into service. The use of this new state-of-the-art aircraft represents a significant qualitative leap from the operational and passenger service viewpoints.

It should be noted that, except for the layoff plan and the aforementioned additional capital contribution, the adaptation program was completed in 1996 and the Company does not have to meet any more targets in this connection in the coming years. Under the adaptation program, the first capital contribution of Ptas. 37,000 million was made in March and was allocated to the allowance for the layoff plan (the early retirements did not commence until June for this reason). A second contribution of Ptas. 50,000 million was made in May, thus bringing the total contribution up to the Ptas. 87,000 million agreed on with the European Union for the year.

Another prominent event in 1996, which falls under the freedom of management concept referred to earlier, was the signature in March of productivity agreements with the labor union representatives of employees of all categories. As a result, using the same resources, a new flight schedule, broader than that initially envisaged, came into force at the end of the first quarter with the Summer schedule. Thanks to the new productivity measures, in addition to incorporating the direct Madrid-Bogota route using A-340 aircraft (formerly operating via Santo Domingo) and adding two direct Madrid-Sao Paulo flights a week



(also using A-340 aircraft) to the four flights with a stopover in Rio de Janeiro, the new schedule includes the following network changes (with the concomitant increase in production):

- The establishment of four new European routes, Madrid-Porte, Madrid-Stuttgart, Madrid-Hannover and Madrid-Venice, via Barcelona.
- An increase in the number of flights from Madrid to Miami, and from Miami to Cancún, Managua, San Pedro and San Salvador. The frequency of flights was also increased on the long-haul Mexico and Havana routes, and on the Brussels, Tel Aviv, Cairo and other medium-haul routes.
- The recovery of European routes, specifically:
  - Barcelona-Munich
  - Madrid-Barcelona-Manchester
  - Madrid-Barcelona-Dublin
  - Santiago-Bilbao-Paris
  - Bilbao-Frankfurt
  - Santiago-London
  - Sevilla-London

The greater than initially expected production had a notable impact on the Company's services areas, particularly handling and maintenance services, in which there was a significant increase in expenses coupled with a sharp rise in productivity.

The scheduling changes enabled the Company to respond to trends in the market, which grew significantly overall in 1% within the context of the general recovery of the air industry throughout the world. Against the backdrop of growing competition which characterized the market in 1996, notable achievements by IBERIA included the slight increase of 0.2% in the load factor and the 8.8% increase in production with respect to 1995.

As a result of the Plan, the productivity agreements and the positive market performance described above, the Company's earnings improved significantly, thus enabling it to face the future with clear prospects of ensuring its ongoing viability, provided that the measures to cut costs and increase productivity are stepped up with a view to the stiff competition which will foreseeably intensify in all the business areas in which IBERIA operates. In addition to the continual price and destination offers made by IBERIA's competitors, new threats emerged in 1996:



- Firstly, not only are European airlines intensifying “point-to-point” traffic competition, but they are now focusing their strategy on attracting traffic to their networks through their newly strengthened hubs, drawing traffic away from the networks themselves. In this regard, congestion at Barajas airport, IBERIA’s principal hub, increased notably in the second half of 1996, and the situation is set to worsen over the next two years, thus restricting the Company’s response capability:
- Secondly, the competition already existing was heightened by the appearance of new European operators in 1996 with the common feature of low operating costs, due to their innovative approach to the use and cost of resources, to the absence of in-flight service and to their distribution systems which are not based on the traditional travel agency channel, but rather on direct telephone sales and, in general, ticketless transport, thus significantly reducing operating costs. The three main companies operating under this system are EasyJet, Virgin Express and Debonair, which have commenced operations with a notable presence in the Spanish market.
- Thirdly, the Spanish scheduled flight companies, which stepped up supply in the last quarter of 1996, may now be in a position to cater for connecting traffic, and are indeed preparing the groundwork for this by developing sufficiently extensive domestic and international networks (proprietary or through agreements with other companies), thereby penetrating a market in which they presently do not have a significant presence. IBERIA’s response in 1996 consisted of launching the “ESTRELLA” fare, targeted at the lowest domestic flight price segment, in October.
- Lastly, 1996 witnessed the formation or forging of large-scale alliances, some of which achieved immunity from anti-trust regulations. While it is true that these alliances must overcome major obstacles, once they have been formed they will constitute a formidable source of competition for those that do not form part of these groups. In this respect, in 1996 IBERIA established close ties (now at an advanced stage) with several companies, which will enable it to play an important role in this process.

In connection with the theme of competition, the following aspects of 1996 must also be highlighted:

- Regional aviation, which has made notable headway in Spain and will continue to do so in the future, has experienced how the established national airlines have incurred significant losses which are forcing them to rethink their approach to operations. Such is the case of Air Track (LAN and LAG) and Air Nostrum. Prima Air, which commenced operations in February, went out of business six months later. However, certain new projects were successful, such as Air Europa Express, albeit behind schedule. IBERIA also responded to this situation in 1996 with

the establishment in December of a franchising agreement with Air Nostrum, the first of its kind in Spain, which will lead, at Air Nostrum's risk, to the coordination of the latter's flights with the IBERIA network and to its adoption of IBERIA's corporate image and distribution system. Due to the size of the aircraft used, it will also pave the way for operations on low-density European routes. None of the foregoing affects the plans being developed for the Group companies Binter Canarias and Binter Mediterráneo.

- In the handling area, in 1996 AENA awarded the second-operator licenses for the Madrid, Palma, Ibiza, Mahón and Alicante airports to Ineuropa Handling (Entrecanales, Cubiertas and Frankfurt airport), and for the Barcelona and Malaga airports to Iberhandling (FCC and Air Europa). It also awarded the second-operator freight handling license at Barajas airport to OGDEN CARGO and ALDEASA. These licenses concluded the process initiated in 1994 for airports with more than one million passengers per year.

Although IBERIA's market performance and revenues exceeded expectations in 1996, major efforts will undoubtedly be required to increase productivity, cut costs and selectively increase the level of investment in order to guarantee the required level of competitiveness in a highly attractive business in terms of profitability.

Competition forced the Company to take firm measures to defend its revenues and market shares. Efforts continued in 1996 to contain the general costs resulting from the Expense Reduction Program (PREGA), which had a particular impact in 1996 on the review of procedures and price negotiations. A salient feature of 1996 was the 19.3% increase in fuel prices with respect to 1995 year-end, which accounted for almost Ptas. 7,200 million of the total increase of Ptas. 9,803 million in fuel costs, the remainder being due to increased production. The increase forced the IATA airlines to agree on a rise in published fares to attempt to at least partly offset its effect.

In short, 1996 was a good year, in which the foundations were laid for an encouraging future that may place IBERIA in an attractive position with regard to its advantageous participation in one of the large international groups being formed that will open up new horizons in the air transport industry. Accordingly, in the face of the aforementioned threats, the productivity, cost containment and commercial management achievements of 1996, while significant, are clearly insufficient and must be continued and stepped up in the future.

In line with the foregoing, in late 1996 and early 1997 the Company defined its strategic action plan for 1997- 1999 which gave rise to a set of principles and measures embodied in the so-called "Master Plan". The Plan's objective is to make the Group fully competitive by the end of the period.



The measures contained in the Plan are open to fresh approaches that will help to attain the pursued objective and must be implemented by all the Company's employees, particularly its flight personnel. The strategy is based on three unalterable pillars:

- a) the definition of a series of measures that will substantially improve the net yield in an environment in which there is a clear trend towards the opposite.
- b) cost cutting and improved productivity of the labor force, particularly that of flight personnel (technicians and auxiliary staff) not primarily based on a reduction in the number of employees.
- c) the implementation of a new management model that will facilitate, on the one hand, better use of the Group's most expensive resources (aircraft and flight crews) through single network management and scheduling and, on the other, the segregation of the service areas into independent companies controlled and majority owned by the Group in order to make them more competitive and ensure their overall profitability.

Lastly, in November 1996 IBERIA submitted a viability plan for VIASA, which was unanimously accepted by the directors and shareholders and was presented to the employees' representatives for negotiation at the beginning of December.

Various circumstances, particularly the virtual refusal by the employees' representatives to negotiate the Plan and their categorical rejection of the set of measures essential for saving the company, without offering any serious and rigorous alternatives, led in the first instance to the halt of the company's operations and, subsequently, following contacts between the shareholders, to the filing at the beginning of March 1997 for temporary receivership and, finally, to the liquidation of the company by the mutual agreement procedure. This situation should enable IBERIA to recover the mortgage guarantees (Viasa's aircraft and buildings) on a portion of the loans that it granted to its investee in recent years.

The Group companies and their shareholder decided to restate their assets pursuant to Royal Decree-Law 7/1996 and Royal Decree 2607/1996 implementing it.

## 2 Group Production

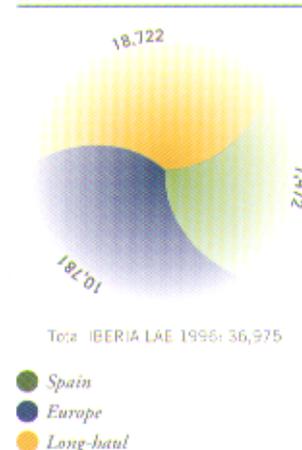
### 2.1 Supply

As a result of the favorable trends in the markets, the Air Transport Group taken as a whole reported a significant increase in supply in 1996 which, in the case of IBERIA, was made possible by the productivity agreements entered into with its employees.

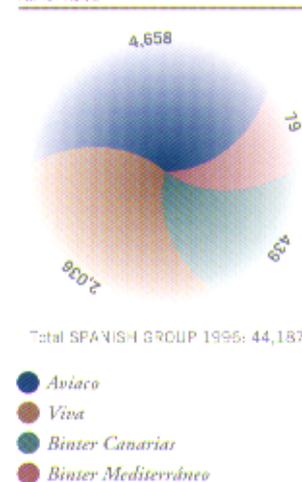
The other companies in the Spanish Group, with the exception of VIVA, which is fully integrated in the charter market, also saw increases in their supply.

	MILLION ASK's			
	1996	1995	Variation 96/95	% Variation
SPAIN	7,472	6,030	1,442	23.9
EUROPE	10,781	10,837	(56)	(0.5)
LONG-HAUL	18,722	17,105	1,617	9.4
IBERIA, L.A.E.	36,975	33,972	3,003	8.8
AVIACO	4,658	4,302	356	8.3
VIVA	2,036	2,310	(274)	(11.8)
BINTER CANARIAS	439	436	3	0.6
BINTER MEDITERRANEO	79	77	2	3.0
SPANISH GROUP	44,187	41,097	3,090	7.5
ARSA	15,302	14,623	679	4.6
VIASA	5,490	5,702	(212)	(3.7)
AUSTRAL	2,582	2,546	36	1.4

IBERIA LAE ASK's Supply  
(Million ASK's)



SPANISH GROUP ASK's Supply  
(Million ASK's)



### 2.2 Demand

The various Group areas and companies carried approximately 29.9 million passengers in 1996, 4.9% more than in 1995.

The breakdown by area/company is as follows:



	THOUSANDS OF PASSENGERS			
	1996	1995	Variation 96/95	% Variation
SPAIN	7,277	6,267	1,010	16.1
EUROPE	5,494	5,644	(150)	(2.6)
LONG-HAUL	1,852	1,754	98	5.6
IBERIA, L.A.E.	14,623	13,665	958	7.0
AVIACO	5,274	5,189	85	1.6
VIVA	988	962	26	2.7
BINTER CANARIAS	1,782	1,818	(36)	(2.0)
BINTER MEDITERANEO	186	238	(52)	(22.0)
SPANISH GROUP	22,853	21,872	981	4.5
ARSA	4,032	3,825	207	5.4
VIASA	937	950	(13)	(1.4)
AUSTRAL	2,084	1,855	229	12.4

The breakdown of RPK, by unit, is as follows:

	MILLION RPK'S			
	1996	1995	Variation 96/95	% Variation
S P A I N	5,059	3,920	1,139	29.1
EUROPE	6,999	7,003	(4)	(0.1)
LONG-HAUL	13,873	12,841	1,032	8.0
IBERIA, L.A.E.	25,931	23,764	2,167	9.1
AVIACO	2,819	2,603	216	8.3
VIVA	1,544	1,457	87	5.9
BINTER CANARIAS	317	322	(5)	(1.8)
BINTER MEDITERRANEO	44	54	(10)	(18.2)
SPANISH GROUP	30,655	28,200	2,455	a.7
ARSA	10,195	9,685	510	5.3
VIASA	3,567	3,791	(224)	(5.9)
AUSTRAL	1,768	1,648	120	7.3

The Group's RPK also improved with respect to 1995. However, whereas the Spanish Group's medium-haul routes increased by 4%, those of the three South American companies decreased.

### 2.3. Passenger load factor

The Spanish Group's load factor of 69.4% in 1996 was 0.8 percentage points higher than in 1995.

The breakdown of this figure, by unit, was as follows:

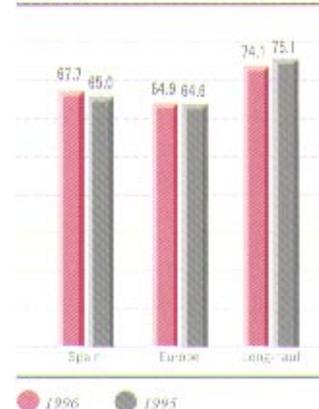
	(LOAD FACTOR)			
	1996	1995	Variation 96/95	% Variation
SPAIN	67.7	65.0	2.7	0.8
EUROPE	64.9	64.6	0.3	0.4
LONG-HAUL	74.1	75.1	(1.0)	(1.3)
IBERIA, LAE.	70.1	70.0	0.1	0.3
AVIACO	60.5	60.5	-	-
VI VA	75.8	63.1	12.7	20.2
BINTER CANARIAS	72.2	73.9	(1.7)	(2.4)
BINTER MEDITERRANEO	54.8	69.1	(14.3)	(20.6)
SPANISH GROUP	69.4	68.6	0.8	1.1
ARSA	66.6	66.2	0.4	0.6
VIASA	65.0	66.5	(1.5)	(2.3)
AUSTRAL	68.5	64.7	3.7	5.8

The improved load factor for the Spanish Group as a whole reflects the efforts made to tailor supply to demand.

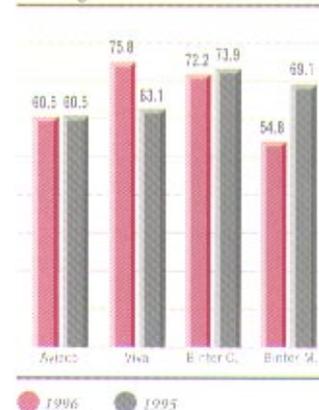
### 2.4. Average yield (Ptas./RPK)

The detail of the variations in the average yield, by area/company, in 1996, and of the comparable figures for 1995 is as follows:

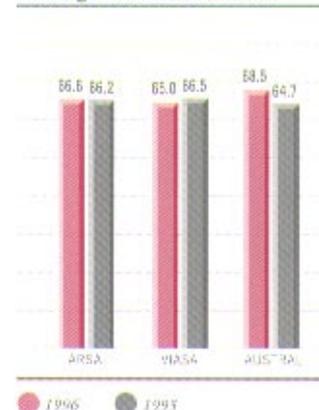
IBERIA LAE Passenger load factor (LOAD FACTOR)



SPANISH GROUP Passenger load factor (LOAD FACTOR)

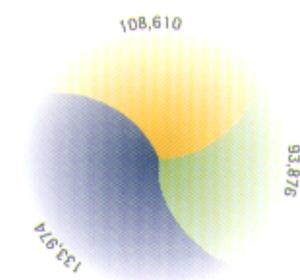


South American investees Passenger load factor (LOAD FACTOR)





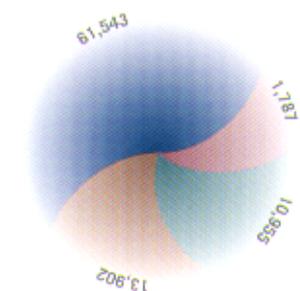
IBERIA LAE Passenger revenues  
(Millions of Pesetas)



Total IBERIA LAE 1996: 336,460

- Spain
- Europe
- Long-haul

SPANISH GROUP  
Passenger revenues (Millions of Pesetas)



Total SPANISH GROUP 1996: 424,647

- Aviaco
- Viva
- Binter Canarias
- Binter Mediterraneo

(Ptas./RPK)

	1996	1995	Variation 96/95	% Variation
SPAIN	18.6	20.1	(1.5)	(7.6)
EUROPE	19.1	19.1	0.1	0.4
LONG-HAUL	7.8	7.8		0.1
<b>IBERIA, L.A.E.</b>	<b>13.0</b>	<b>13.2</b>	<b>(0.2)</b>	<b>(1.5)</b>
AVIACO	21.8	22.4	(0.6)	(2.6)
VIVA	9.0	12.8	(3.8)	(29.6)
BINTER CANARIAS	34.6	33.7	0.9	2.8
BINTER MEDITERRANEO	40.6	41.8	(1.4)	(3.2)
<b>SPANISH GROUP</b>	<b>13.9</b>	<b>14.3</b>	<b>(0.4)</b>	<b>(3.1)</b>
(U.S. Cents/RPK)				
ARSA	7.8	7.9	(0.1)	(1.5)
VIASA	6.4	6.4	-	(0.2)
AUSTRAL	12.1	13.4	(1.13)	(9.7)

## 2.5. Passenger revenues

The breakdown of the Spanish Group's passenger revenues in 1996, which amounted to Ptas. 424,647 million (up 5.3% on 1995) is as follows:

(AMOUNTS IN MILLIONS OF PSEFETAS AND THOUSANDS OF U.S. DOLLARS)

	1996	1995	Variation 96/95	% Variation
SPAIN	93,876	78,737	15,139	19.2
EUROPE	133,974	133,745	229	0.2
LONG-HAUL	108,610	100,494	8,116	8.1
<b>IBERIA, L.A.E.</b>	<b>336,460</b>	<b>312,976</b>	<b>23,484</b>	<b>7.5</b>
AVIACO	61,543	58,329	3,214	5.5
VIVA	13,902	18,673	(4,771)	(25.6)
BINTER CANARIAS	10,955	10,844	111	1.0
BINTER MEDITERRANEO	1,787	2,257	(470)	(20.8)
<b>SPANISH GROUP</b>	<b>424,647</b>	<b>403,079</b>	<b>21,568</b>	<b>5.4</b>
(THOUSANDS OF U.S. DOLLARS)				
ARSA	794,892	765,472	28,104	3.8
VIASA	229,370	244,250	(14,880)	(6.1)
AUSTRAL	214,520	221,346	(6,826)	(3.1)

The variations in 1996 in passenger revenues were as follows:

	Variation 96/95	Cause of the Variation		
		Price	Volume	Parity
DOMESTIC	15,139	(7,647)	23,044	(257)
EUROPE	229	1,258	(158)	(871)
LONG-HAUL	8,116	1,370	8,142	(1,396)
<b>IBERIA, L.A.E.</b>	<b>23,484</b>	<b>(5,019)</b>	<b>31,027</b>	<b>(2,524)</b>
AVIACO	3,214	(1,571)	4,785	n/a
VIVA	(4,772)	(5,415)	797	(154)
BINTER CANARIAS	111	295	(184)	n/a
BINTER MEDITERRANEO	(470)	(53)	(417)	n/a
<b>SPANISH GROUP</b>	<b>21,568</b>	<b>(11,763)</b>	<b>36,008</b>	<b>(2,678)</b>

The improvement in revenues was generally due to a notable increase in demand, which had a positive impact on the load factor, although it was partially offset by a reduction in the average yield, partly due to the decline in the peseta exchange rate.



### 3 Activities of the Air Transport Group

#### 3.1. Iberia: Passenger traffic (by area)

	1996	1995	Variation 96/95	% Variation
Million ASK's	36,975	33,972	3,003	8.8
Million RPK's	25,931	23,764	2,167	9.1
Load Factor (%)	70,1	70,0	0.1	0.3
Yield (Ptas./RPK)	13,0	13,2	(0.2)	(1.5)
Passenger revenues (Millions of Ptas.)	336,460	312,976	23,484	7.5

Production rose as a result of the productivity agreement reached with the pilots, enabling better use to be made of resources from April/May onwards.

The most noteworthy events in this area were the inauguration of routes to four new European destinations (Hannover, Stuttgart, Venice and Porto), the increase in the frequency of flights to Havana, Mexico City and Miami and the increased supply with second product ("Estrella" fare) reservations in the Madrid/Barcelona segment.

Yield was down by 1.3% (Ptas. 0.2) with respect to 1995, due partly to price wars, particularly in the short-/medium-haul areas, but due also to a new traffic structure, since the average haul increased by 2% over 1995 (the domestic market's RPK increased by only 2.4%, as compared with 8.8% for IBERIA as a whole). In addition, all VIVA's lower-yield tourist routes were incorporated in 1996.

Since ASK's grew by 8.8% and revenues by 7.5%, revenues per ASK fell by 1%.

Because of its impact on this analysis of the 1996 figures, it should be noted that in November 1996 ASK's were 47% higher and short- and medium-haul revenues were 46% higher than in November 1995, due to the well-supported pilots' strike in 1995. Accordingly the 1996 figures reflect disproportionately high increases.

Salient measures taken in 1996 to strengthen Iberia's competitive position were:

- The introduction of the new Business II class on European routes to contribute to the recovery of business market share.
- A more aggressive policy for defending domestic market share through new fares ("Estrella" fare) and increased supply (growth in the Madrid/Barcelona segment through the second product -"Estrella" fare).
- Preliminary agreement with Air Nostrum for its inclusion as a franchisee in the IBERIA network so as to feed the network in Madrid and Barcelona and to increase domestic market share.
- Introduction in the Spanish market of "Monthly Offers" covering specific offers to various destinations in the international network. The offers gained increasing notoriety in the media and boosted the image that IBERIA is trying to improve in the Spanish market of having competitive Fares.
- In the latter part of 1996, coinciding with the delays caused by oversaturation at Barajas, for the first time a large-scale personalized communication policy was introduced under the Iberia Plus program to offer apologies and Iberia Plus points to all customers who experienced delays.

Lastly, the situation of Barajas airport should be mentioned for its negative impact on the company. The negative punctuality indexes at this airport, which is the IBERIA network's hub, are deteriorating Iberia's image and the levels of saturation are preventing production growth.

### **3.2. Freight**

1996 saw the consolidation of the operation of the three DC-8 freight aircraft initiated on July 1, 1995, following the absorption of CARGOSUR by IBERIA, L.A.E's Cargo Unit, with the implications that this has on comparison of the 1996 and 1995 results (reclassification of results by nature, higher fuel, aircraft maintenance and aircraft traffic service expenses and lower freight aircraft lease costs).

To supplement the freight aircraft fleet and in order to cater for demand in the South Atlantic network, one-half of the hold of a weekly B-747 round-trip flight on the RUE-MAD-MST route was rented from Aerolineas Argentinas. This route commenced in mid-April and is so far yielding satisfactory results.

As in prior years, the policy applied throughout 1996 was based on the optimization of cargo holds in passenger planes, supplemented by freight aircraft and the rental of holds from other companies, in order to meet the demand of certain markets and to act in general as a freight market stabilizing and regulatory factor.

The freight aircraft used in 1996 were once again three DC-8 aircraft, with a capacity of around 35 tonnes, depending on the length of the legs flown and the density of the cargo. The markets served are as follows:

- Canary Islands market. The Company covers the needs of the Postal Service and of the cargo market in general, which is mostly made up of couriers and warehouse owners/distributors.
- European market. The scarcity of pallet transporters in Europe makes it necessary to operate freight aircraft flights to MST (Maastricht) as network flights (centralization of European freight services).
- American market. Freight aircraft are operated to supplement the fluctuating supply of passenger flights on which there is high cargo demand which cannot be met by the passenger aircraft.

The composition of freight supply in 1996 was as follows: 75.6% in passenger aircraft cargo holds and 24.4% in freight aircraft (either with our DC-8 plants or in holds rented from third parties).

The increase in demand in terms of RTK's related mainly to the long-haul network, demand in which grew by 15% and represented 81.9% of the total RTK's in 1996.

Various factors contributed to the reduction in yield (6.8%):

- On the one hand, the 15%0 rise in demand in the intercontinental network (offsetting the low yield), as compared with the increase of only 2% in demand in the short- and medium-haul networks (offsetting the high yield).
- The fall of the yen in the Far East market.
- The growth in the lowest fare traffic under the policy of improving the load factor on routes (for example, the average yield on Europe/Argentina routes is at least three times higher than that on the Argentina /Europe routes).

Another noteworthy event in the freight area was the entry of a second operator for handling services at the Madrid and Barcelona terminals in April 1996, although the effects were not as marked in the first year as had been feared. In fact, the number of kilograms handled in Madrid fell by only 1.7%, and the number increased by 17.1% in Barcelona (basically, due to outgoing traffic).

### **3.3. Handling**

The process of deregulating handling services at Spanish airports commenced in 1994. By the end of 1995 the Las Palmas, Tenerife, Arrecife and Fuerteventura airports had been deregulated.

Handling services at the Bilbao, Santiago, Sevilla, Valencia, Palma, Ibiza and Alicante airports were deregulated in 1996, the latter three in November.

The tenders for Madrid, Barcelona and Malaga were called by AENA (Spanish public airports and aviation agency) in 1996, but the second operators will not commence operations at these airports until April 1997.

The activity of third-party companies at the airports mentioned in the first two paragraphs fell by 5.2% with respect to 1995, although in the network as a whole third-party activity increased by 2% in 1996.

The total headcount in decreased by 4.8% from 1995, although activity increased by 3%.

The average yield of third-party, companies in 1996 increased by 1.2% over the second half of 1995 (in the first half the fares included the handling fee). However, taking into account the 4.4% rise in fares in January 1996, the yield fell by 3 % in real terms. Fares can be considered to be remaining steady.

Expenses per weighted plane handled were reduced significantly. However, if the 1995 and 1996 expenses are made comparable, subtracting in both years the target-based remuneration and in 1995 the handling fee (which was eliminated in July 1995, the expenses per weighted plane handled were 5.8% lower in 1996 than in 1995.

The reasons for this reduction were twofold:

- Improved productivity.
- A proportional reduction in personnel expenses as a result of the Viability Plan.

### **3.4. Maintenance**

#### ***Marketing area***

Marketing efforts again focused on products with the best technological prospects, such as airframe, engine and component maintenance for the A-320, MD-87 and B-757 fleets, and on the products in which, thanks to our experience and facilities, we are most competitive (e.g. "D" overhauls of H-747 and JT8D-7Q engines).

The main clients in 1996 were:

Lufthansa:	"D" overhauls of B-747 and A-320 aircraft
Alitalia:	"D" overhauls of B-747 aircraft
Air France:	"D" overhauls of B-74? aircraft and CFM56 (A-320) engines
Aerolineas Arg.:	JT9D7Q engines
Olympic Airways:	JT9D7Q and JT8D engines
Air Europa:	RR211 (B-757) engines
Viasa:	JT8D engines and B-727/DC-10 parts
Fawcett:	JT8D engines
Greenwich:	JT9D7Q engines

#### *New products*

- Consolidation of the "D" overhauls of Iberia and Lufthansa A-320 aircraft.
- Commencement of maintenance of the A-340 aircraft incorporated in the fleet during the year.

#### *Technological capacity*

- Completion of the wheel shop automation research and development project.
- Commencement of implementation of the aircraft brake shop automation research and development project.
- Implementation of the purchasing module of the OMMIS (aeronautical material planning and control) system.

#### *Productivity*

- The direct labor force decreased by 239 employees at the Madrid hub and by 33 at the detachments. However, since the direct labor annual production time remained the same as in 1995, productivity increased.
- A 4% decrease in plane immobilization time for "C" and "D" overhauls was achieved.
- The number of "C" overhauls (around 40) carried out by the Maintenance Department was maintained with respect to 1995.

#### *Variation in parameters*

Billings of work performed for third parties increased by 31% in 1996 with respect to 1995, leading to a rise in the number of man-hours billed to non-Group companies and in materials used and outsourcing relating to the activity of third parties.

Billings to Iberia and the IBERIA Group increased with respect to 1995 and to POA, leading to a rise in the number of "D" overhauls required.

As regards expenses, both the amount of materials used and outsourcing expenses increased as a result of greater production, mainly for non-Group companies; however, this increase was more than offset by the greater billing to third parties.

### **3.5. Systems management**

Expenses in this area were Ptas. 225 million lower than in 1995, mainly due to the reductions in software license contracting, equipment maintenance, installations, technical assistance and

period depreciation as a result of delays in installing equipment and the conclusion of computer equipment depreciation periods.

55 employees were laid off in 1996, thus meeting the targets included in the A-3500 Plan, leaving a total labor force of 534 employees. In addition to the aforementioned terminations, another 25 employees from the Management Control, Administration and Supplies areas were transferred to Central Services, reducing personnel expenses by Ptas. 427 million. This reduction was partially offset by the increase in internal billings in this connection.

The higher communications expenses in 1996, which were offset by a simultaneous increase in external revenues from AMADEUS, were due to the agreement between IBERIA, AMADEUS and SITA, whereby, the latter took over management of communications between South American travel agencies and AMADEUS, providing IBERIA with a sales margin of 7% on SITA's billings for this service. 1,382 travel agencies joined the system in 1996.

External revenues increased by Ptas. 4 14 million in 1996, due, on the one hand, to the aforementioned agreement between IBERIA, AMADEUS and SITA and, on the other, to the signature of new computer service contracts with FJY AIR and HELICOPTEROS DEL SUR. LADECO ceased to be a customer of the Systems Department in mid-1996, and revenues decreased accordingly.

A new Flight Document Capture system was installed that will significantly reduce data transcription costs, although its effect will be more notable in the coming years.

### **3.6. Operations management**

#### **3.6.1. Flight operations**

The plans, programs, committees, etc., in which the Flight Departments were involved included:

- Meetings with Maintenance, Handling and In-Flight Services to address the implementation of the ECATAR Service.
- Quality plan. Modification of planes for the Business II class.
- Punctuality and Regularity Committee (C.P.R.).
- Creation of and involvement in a specific C.P.R. for Barcelona airport.
- Meetings with AENA, Air-Traffic Control and Airport Security to discuss matters affecting fleet operations.

### **3.6.2. Mining**

The main programs organized by the Training Department in 1996 were as follows:

- Of the more than 800 candidates who took the pilot recruitment tests in 1996, the Company selected 64, 44 of whom are now taking training courses at the Company.
- Installation of the B-747 flight simulator was completed and it has been in use since January for all the B-747 Training and Refresher courses, thus cutting costs since flight crews no longer have to take these courses outside the Company.
- 1,686 Training, Refresher, Situation, Rescue, Instructor, Load and Load Distribution courses were attended by 9,515 students in 1996, and flight simulators were used for a total of 19,252 hours.
- 7,837 flight simulator hours were sold to non-Group companies in 1996. The services sold by the Training Department to third parties included most notably two B-727 Training courses for Líneas Aéreas Canarienses and one A-320 course for BCM Airlines.

### **3.6.3. Flight safety**

The main projects carried out in this area in 1996 were as follows:

- Overall Safety Plan
- Aircraft Accident Response Plan
- Flight Safety Committee

### **3.6.4. Technical area and flight support**

The projects performed in 1996 by the Technical and Flight Support Department included most notably the following:

- As a result of negotiations with AENA and the Directorate-General of Civil Aviation, the former anti-noise procedure at Barajas airport was eliminated and replaced by the ATA system, producing an estimated annual fuel saving of Ptas. 273 million.

- A program was implemented for the selective reduction of MTOW for A-300, A-320, B-727, B-757 and MD-87 aircraft, with decreased landing, flyover and parking charges, giving rise to an annual saving of Ptas. 602 million.

### **3.6.5. Network control**

Services were once again provided to the Company's Operating Units in their Flight Dispatch Planning, Load and Load Distribution Logs, Flight Tracking and Monitoring, Slot Management and other activities.

To enhance the aforementioned services, the following systems were installed:

- INFOVOX, automatic telephone information service for flight crew programming.
- AUTOMATIC MADRID SIGN-IN for flight crew presenting itself for duty.
- WEEKLY FORECAST and automatic calculation of travel allowance.
- New INTAM information system.
- ATFM Slot Management - Phase One.

### **3.7. In-flight service department**

Of maximum importance, and serving as a starting point for highlighting the measures taken by the In-Flight Service Department in 1996, was the grouping together of all the Company's in-flight services under one department as part of the organizational change.

The actions taken in 1996 can be divided into the two areas in which the Department is structured:

#### ***Ground services***

The actions taken in this area in 1996 included most notably the following:

- Quality management
  - Implementation of the "Las cocinas del aire" project, consisting of serving dishes designed by prestigious head chefs of Spanish restaurants on long-haul routes.
  - Modification and redesign of menus for European flights in response to the needs of the new Business II product.

- **Service planning**

- Review and full editing of new equipment and crew manuals for all aircraft with a significant reduction of articles carried on board.
- Participation in the ALTAIR integral automation project.
- Participation in the design and implementation of the new Business II class, defining the equipment and crew based on the services offered.

- **Warehouses**

- Significant reductions in stocks.
- Improved stock rotation

*In-flight services*

The most noteworthy actions in 1996 can be summarized as follows:

- **Training**

Awareness campaign for and implementation of an ONGOING TRAINING system using the following types of course:

- Transition from one type of aircraft to another.
- Technical service meetings.
- Instructor training.
- Training of new chief flight attendants.
- New cabin crew training.

- **Cabin crew programming and management**

Cabin crew productivity was enhanced through cabin crew service programming.

Maternity leave was reduced by 0.92 percentage points and general absenteeism by 0.44 percentage points.

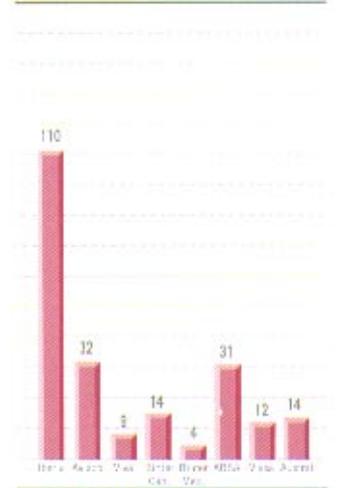
## 4 Resources

### 4.1. Fleet

The detail of the passenger aircraft fleet operated by the Group as of December 31, 1996, is as follows:

Aircraft Type	Iberia	Aviaco	Viva	Binter Canar.	Binter Medit.	ARSA	Viasa	Austral	Total
B-727	28					5	7		40
B-737			9			11			20
B-747	7					6			13
B-757	8								8
A-300	6								6
A-310						3			3
A-320	22								22
A-340	4								4
DC-8	3								3
DC-9	4	19		4				7	34
DC-10	4						5		9
MD-81								2	2
MD-83								3	3
MD-87	24								24
MD-88		13				6			19
CN-235				4	4			2	10
ATR-72				6					6
<b>Total</b>	<b>110</b>	<b>32</b>	<b>9</b>	<b>14</b>	<b>4</b>	<b>31</b>	<b>12</b>	<b>14</b>	<b>226</b>

Fleet (Number of aircraft as of December 31, 1996)



The additions and retirements in 1996 are summarized as follows:

Aircraft Type	Iberia	ARSA	Viasa	Total
B-727		(2)	1	(1)
A-340	4			4
DC-10	(3)			(3)
<b>Total</b>	<b>1</b>	<b>(2)</b>	<b>1</b>	<b>0</b>

The daily usage of the Domestic Air Transport Group's aircraft, in terms of total block hours per aircraft per day, was as follows:

	1996	1995
B-727	5.1	4.5
B-737	7.0	8.6
B-747	13.5	12.8
B-747M	11.1	13.2
B-757	7.3	7.0
DC-8 (freight)	8.4	6.4
DC-9 Iberia	4.9	4.8
DC-9 Aviaco	6.4	6.2
DC-9 Binter Canarias	3.4	3.7
DC-10	11.8	11.3
MD-87	7.6	7.2
MD-88	6.3	5.8
A-300	6.8	6.1
A-320	7.9	7.6
A-340	12.3	
CN-235	3.1	3.3
ATR-72	5.7	5.7

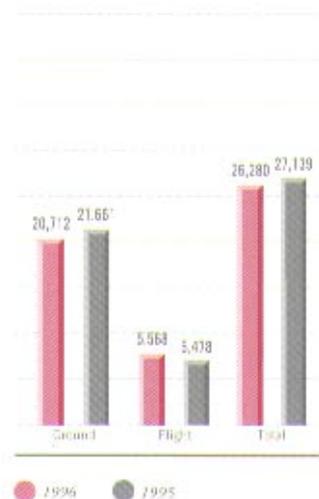
## 4.2. Personnel

The detail of the average and year-end headcount in 1996 and 1995 is as follows:

### Average Headcount

	Ground		Flight		Total	
	1996	1995	1996	1995	1996	1995
PASSENGER	3,045	5,298	42	2,796	3,087	8,094
FREIGHT	1,096	1,157			1,096	1,167
HANDLING	7,571	7,960			7,571	7,960
MAINTENANCE	4,125	3,104			4,125	3,104
SYSTEMS	562	617			562	617
OPERATIONS	436	506	1,401	1,434	1,837	1,940
IN-FLIGHT SERVICES	167	-	2,912	-	3,079	-
CENTRAL SERVICES	1,137	406			1,137	406
<b>IBERIA, L.A.E,</b>	<b>18,139</b>	<b>19,048</b>	<b>4,355</b>	<b>4,230</b>	<b>22,494</b>	<b>23,278</b>
AVIACO	1,091	1,117	828	847	1,919	1,964
VIVA	256	300	194	200	450	500
BINTER CANARIAS	153	153	154	145	307	298
BINTER MEDITERRANEO	35	35	37	38	72	73
CARGOSUR		29	-	18	-	47
CAMPOS VELAZQUEZ	10	11			10	11
CACESA	127	124			127	124
IBER-SWISS	872	817			872	817
SAVIA	29	27			29	27
<b>SPANISH GROUP</b>	<b>20,712</b>	<b>21,661</b>	<b>5,568</b>	<b>5,478</b>	<b>26,280</b>	<b>27,139</b>
ARSA	3,763	4,196	1,575	1,601	5,338	5,797
AUSTRAL	1,123	1,298	357	381	1,480	1,679
VIASA	1,496	1,732	805	838	2,301	2,570

SPANISH GROUP Personnel



#### NOTES:

- In 1996 the central minor repair functions that in 1995 had been the responsibility of the Traffic Department were transferred to Maintenance. Also, the personnel, administration, economic control and supplies areas were grouped together at corporate level (Central Services).
- Except for the Miami crews, in 1996 the technical and auxiliary flight personnel were included in the Operations and In-Flight Services areas, respectively.
- The Cargosur personnel were transferred to the Iberia Freight Division in 1996.

### Year-end headcount

	Ground		Flight		Total	
	1996	1995	1996	1995	1996	1995
PASSENGER	3,068	5,305	42	2,863	3,110	8,168
FREIGHT	1,059	1,156			1,059	1,156
HANDLING	7,961	8,310			7,961	8,310
MAINTENANCE	3,747	3,051			3,747	3,051
SYSTEMS	535	611			535	611
OPERATIONS	427	498	1,376	1,424	1,803	1,922
IN-FLIGHT SERVICES	161	-	3,012	-	3,173	-
CENTRAL SERVICES	1,039	399			1,039	399
<b>IBERIA, L.A.E.</b>	<b>17,997</b>	<b>19,330</b>	<b>4,430</b>	<b>4,287</b>	<b>22,427</b>	<b>23,617</b>
AVIACO	1,001	1,041	826	850	1,827	1,891
VIVA	233	269	181	189	414	458
BINTER CANARIAS	152	155	149	157	301	312
BINTER MEDITERRANEO	33	36	37	37	70	73
CARGOSUR	-	-		-	-	-
CAMPOS VELAZQUEZ	9	10			9	10
CACESA	128	124			128	124
IBER-SWISS	895	806			895	806
SAVIA	30	27			30	27
<b>SPANISH GROUP</b>	<b>20,478</b>	<b>21,798</b>	<b>5,623</b>	<b>5,520</b>	<b>26,101</b>	<b>27,318</b>
ARSA	3,691	3,814	1,493	1,674	5,184	5,488
AUSTRAL	-	1,213	-	372	-	1,585
VIASA	1,451	1,668	794	822	2,245	2,490

*NOTES:*

- See notes to the preceding table.

### *Productivity*

The variations in the productivity of the Air Transport Group companies, measured in terms of ASK/employee, were as follows:

	Ground Staff % Variation 96/95	Flight Technicians % Variation 96/95	Flight Auxiliaries % Variation 96/95	Total % Variation 96/95
IBERIA, L.A.E.	14.30	13.43	3.00	12.63
AVIACO	10.80	10.43	10.99	10.78
VIVA	3.58	(9.30)	(9.20)	(1.96)
BINTER CANARIAS	0.78	6.41	(14.48)	(2.25)
BINTER MEDITERRANEO	3.21	7.02	3.00	4.55
<b>SPANISH GROUP</b>	<b>12.45</b>	<b>11.12</b>	<b>2.92</b>	<b>11.03</b>
ARSA	16.61	8.69	5.06	13.56
AUSTRAL	17.14	6.96	8.84	14.99
VIASA	11.49	(0.01)	0.31	7.54

The Group's improved productivity, except at Viva and Binter Canarias, was significant, particularly at IBERIA. In addition to the agreements reached with the employees, enabling a broader traffic schedule to be designed, the early retirement plan envisaged in the A-3500 Plan commenced in 1995.

## 5 Operating Results

### 5.1. Operating income at Iberia

Total operating income for 1996 amounted to Ptas. 34,188 million.

The detail by unit is as follows (in millions of pesetas):

	MILLIONS OF PESETAS	
	1996	1995
PASSENGER	8,910	3,056
FREIGHT	4,636	4,830
HANDLING	20,987	16,877
MAINTENANCE	4,678	6,023
SYSTEMS	1,714	2,002
OPERATIONS	246	649
IN-FLIGHT SERVICES	858	-
CENTRAL SERVICES	(7,841)	(8,320)
<b>IBERIA, L.A.E.</b>	<b>34,188</b>	<b>25,117</b>

The summarized detail of IBERIA's operating account for 1996 and 1995 is as follows (amounts in millions of pesetas):

Operating revenues	MILLIONS OF PESETAS		
	1996	1995	% Var.
Passenger	336,142	313,387	7.3
Freight and excess baggage	33,083	32,199	2.7
Handling	54,117	55,632	(2.7)
Maintenance	22,138	18,355	20.6
Sales commissions	11,094	11,661	(4.9)
Other operating revenues	21,032	19,441	8.2
	<b>477,606</b>	<b>450,675</b>	<b>6.0</b>

Operating expenses	MILLIONS OF PESETAS		
	1996	1995	% Var.
Fuel	44,165	34,362	28.5
Airport taxes and other levies	9,250	11,297	(18.1)
Personnel expenses	157,840	159,617	(1.1)
Traffic services	36,822	33,365	10.4
Commissions	38,997	38,548	1.2
Over-commissions	15,232	15,282	(0.3)
Navigation aids	16,680	15,920	4.8
Aircraft maintenance and provisions	25,234	19,452	29.7
Aircraft lease expenses	16,814	17,184	(2.2)
Period depreciation and amortization	21,873	22,266	(1.8)
Other operating expenses	60,501	58,265	3.8
	443,408	425,558	4.2
<b>Operating income</b>	<b>34,198</b>	<b>25,117</b>	<b>36.1</b>



The main comments on the operating account are as follows:

**A) Operating revenues**

Operating revenues increased by 6% in 1996. The main variations were as follows:

**- Passenger revenues**

The difference between the passenger revenue figure shown above and that shown in the activity tables is due to the fact that the latter relates directly to the actual production for each year and does not reflect accounting adjustments and restatements. The breakdown of the Ptas. 22,755 million increase in freight revenues is as follows:

	Variation 96/95	Reason for Variation		
		Price	Volume	Parity
Short- and medium- haul revenues	14,891	(6,389)	22,408	(1,128)
Long-haul revenues	7,864	1,370	7,890	(1,396)
<b>Total</b>	<b>22,755</b>	<b>(5,019)</b>	<b>30,298</b>	<b>(2,524)</b>

The difference in volume is due to the sharp increase in demand of 9.1% in terms of RPK. The price variation was the result of several factors, the most important being the competitive environment, which continues to drive prices down. However, the variation was also influenced by the relative fall in the fare mix, with a greater proportion of economy-class fares, and a slight (2%) increase in medium-haul fares, as well as a greater fares use of net market prices.

Lastly, the variation in parity effect was due mainly to the fall of the Japanese yen by approximately 12.8% with respect to its average 1995 price. The fluctuations in the price of the other major currencies were much less marked and, overall, had a near zero effect on the Company's revenues.

**- Freight revenues**

The breakdown of the 2.8% increase in freight revenues is as follows:

Variation 96/95	Reason for Variation			
	Price	Volume	Parity	Other
884	(2,287)	3,558	(210)	(177)

The rise in volume was due to the notable increase in demand (12.7%), particularly in freight aircraft, although cargo holds also increased as a result of the increase in passenger supply.

The fall in prices was the consequence of market competition and the 4.7% increase in the average flight length, with the resulting drop in RTK's.

As with passenger revenues, the fall in parity arose mainly on the Japanese routes, the revenues from which account for 10% of the total.

The "Other" heading relates to the reduction in mail and excess baggage revenues.

**- Handling**

The Ptas. 1,515 million drop in handling revenues is not a fair reflection of the actual situation, since the elimination in July 1995 of the exclusive handling fee paid to AENA, which logically affected revenues, significantly distorts any comparison of the 1996 and 1995 figures. Disregarding the effect of this factor, 1996 revenues were Ptas. 793 million higher than in 1995. The breakdown is as follows:

Price increase	377
Increase in volume	416
<b>Total</b>	<b>793</b>

These increases were due, on the one hand, to the fact that despite growing competition, the sharp rise in demand resulting from the increase in air traffic in Spain and the measures taken to protect market share enabled handling activities to even slightly exceed (by 0.8%) those of third parties, and, on the other, prices did not fall by as much in 1996 as was initially feared. The fact that part of the increase in revenues was achieved through prices reflects a different demand structure, where scheduled flights increased to the detriment of charter flights (whose prices are lower in view of the service offered). The Company's competitors achieved the most notable gains in market share in the charter market.

It should also be noted that the increase in the Company's handling activities had a notable influence on productivity, in this area.

**- Maintenance**

The 1996 aircraft (airframe, engines and parts) maintenance revenues were significantly better (P'tas. 3,783 million) than those of 1995, mainly because of work performed for non-Air Transport Group customers (Ptas. 3,735 million) and for other Group companies. This increase in IBERIA's production made it necessary to restrict maintenance work for non-Group third parties to high-technology products with greater added value, since the size of the maintenance area basically only covers the Company's needs. Accordingly, work with lower margins and for which there is very stiff international competition was outsourced. In 1996 IBERIA continued to build upon its large customer roster, relating principally to general overhauls of R-747 aircraft and of JT9, CFM56 and RB211 engines.

**- Sales commissions**

As in 1995, despite an increase in revenues from sales by non-Group companies of tickets printed on IBERIA paper, and in Mundicolor travel packages and car rentals, total revenues fell by Ptas. 567 million due to the effect of the definitive transfer of VIVA from the scheduled to the charter market, giving rise to a drop of Ptas. 1,500 million in billings to this company:

**- Other operating revenues**

The main reasons for the Ptas. 1,591 million rise in other operating revenues were the increases in revenues from the use of communications services and in-flight sales, which were partially offset by higher capitalized expenses of in-house work on fixed assets and the recovery of the overprovision for major repairs.

### **B) Operating Expenses**

The 4.2% (Ptas. 17,860 million) increase in operating expenses was lower than the increase in operating revenues and considerably lower than the rise in production. This figure is even more notable if the sharp rise in fuel prices is taken into account, without which operating expenses would have only increased by around 2.5%.

The variations in the main expense items were as follows:

#### **- Fuel**

As mentioned above, the sudden increase (17.6%) in fuel prices from the first quarter and the steady climb during the rest of the year to put the average price for the year at 19.3% higher than in 1995 had a profound impact on expenses.

Total fuel expenses were 28.5% (Ptas. 9,803 million) higher than in 1995, mainly due to the price increase, which was further aggravated by the slight rise in the U.S. dollar. Another factor was the cost of increased production, which was partially offset by more efficient consumption as a result of using more modern aircraft (namely the A-340).

The summarized detail of these effects is as follows:

Price	(7,193)
Volume	(3,466)
Parity	(264)
Consumption per ASK	1,120
Total	(9,803)

#### **- Airport taxes and other levies**

This expense fell sharply in 1996. The main reason for this decrease is detailed in the section on handling revenues. On July 1, 1995, AENA discontinued the exclusive handling fee which, until then, had represented an annual cost of Ptas. 2,308 million. Disregarding the effect of this factor, this expense increased by 2.9% in 1996 as a result of the airport taxes, the increase being lower, however, than the increase in the number of passengers carried.

**- Personnel expenses**

Personnel expenses fell by Ptas. 1,777 million (1.1%) in 1996, due mainly to the application of the measures contained in the Adaptation Program. However, the following points should be noted in this connection:

In 1996, as in 1995, there was a cost of Ptas. 11,301 million under this caption as a result of the compensation arising from the agreements with employees (both the Adaptation Program and the subsequent productivity agreements). This cost is nonrecurring, i.e. it is not included in salary tables with effect in future years. Ptas. 2,927 million of this figure related to compensation for having exceeded the results envisaged in the Adaptation Program, Ptas. 2,879 million related to the 20% outstanding from the CPI revisions for 1993 and 1994, to be paid in the form of IBERIA shares; Ptas. 5,182 million were compensation for the productivity increases; and the remaining Ptas. 313 million related to the forfeiture of rest days by permanent employees, also to cater for the increased production.

The saving achieved through the reduction of the labor force amounted to Ptas. 4,355 million, which was partly offset by the Ptas. 1,800 million increase in payments for seniority and promotions and the Ptas. 1,150 million rise in employee welfare benefits.

**- Traffic service expenses**

Traffic services expenses increased substantially (10.4%) in 1996, albeit in line with the increase in activity and the effect of inflation. However, mention should be made of the reduction in expenses controllable by the Company, such as aircraft cleaning and handling equipment on international stopovers. This, however, contrasts with the increases in such important expense items as landing rights or aircraft dispatching, which are difficult to negotiate because they depend on the local airport authorities in the case of the former, and, in the latter case, on handling operators who have exclusive arrangements at numerous stopover destinations. Significant pressure was, however, brought to bear on these operators in 1994 and 1995.

**- Commercial expenses (commissions and over-commissions)**

In 1996 as in 1995, net commissions as a percentage of passenger revenues decreased by 3.1%, mainly due to greater use of the TNM (net market price) method. The use of this method also affected the price structure, limiting the use of over-commissions, the amount of which even fell slightly despite the considerable increase in sales.

**- Navigation aids**

Air traffic control expenses increased by only 4.8%, less than the increase in activity, largely due to the price adjustments within the structure of the European air traffic control agency (Eurocontrol).

**- Aircraft maintenance expenses**

In 1996 aircraft maintenance expenses rose by Ptas. 5,782 million (20.7%) with respect to 1995. However, in addition to the considerable increase in aircraft activity mention must be made of the significant amount of work performed for non-Group companies, which contributed Ptas. 3,783 million to the increase in revenues. Disregarding the effect of this factor, maintenance costs remained in line with the volume of production, and even absorbed the increase due to inflation and the moderate effect of the U.S. dollar exchange rate.

**- Aircraft lease expenses**

There was a slight drop (Ptas. 370 million) in 1996 in aircraft lease expenses as compared with 1995, although the following should be noted in this connection:

Passenger aircraft lease expenses rose by Ptas. 1,288 million in 1996, due mainly to the effect of the progressive incorporation during the year of the four A-340 planes.

However, the cost of leasing freight aircraft fell by Ptas. 1,994 million because, for the second half of 1995 the aircraft operated by Cargosur were transferred to IBERIA (although not title thereto). Consequently, freight aircraft lease expenses were reduced, since only the depreciation of the aircraft was taken into account, the other expenses relating to the former wet-lease being eliminated.

**- Period depreciation**

The decrease of Ptas. 393 million in period depreciation was due mainly to the retirement of three DC-10 aircraft sold in 1996, although this was partially offset by the increase in inventories of rotatable and repairable parts as a result of the incorporation of the new A-340 aircraft and greater Group and third-party activity.

**- Other operating expenses**

The increase of Ptas. 2,236 million (3.8%) in this caption was the result of the significant cost containment efforts made. The variations in other operating expenses are summarised as follows:

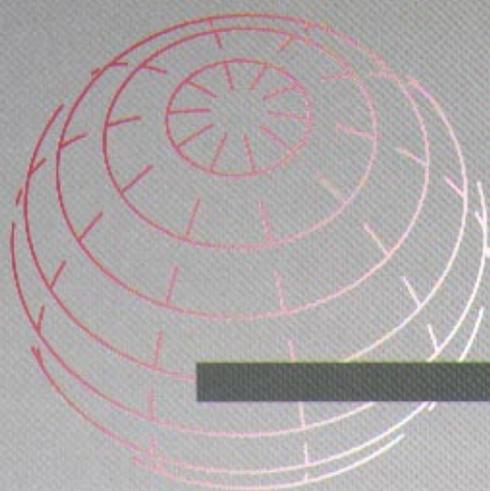
- Aircraft supply materials consumed, in-flight sales articles, advertising materials and sundry expenses increased by Ptas. 734 million as a result of the greater activity and advertising campaigns.

- Media advertising expenses increased by Ptas. 518 million as a result of the need to relaunch IBERIA's image and to publicize the Company's offers in the face of stiffer competition.
- Reservation system distribution expenses rose by Ptas. 751 million, which is lower than the increase relating to the effect of the increased activity.
- Communications (mainly SITA) expenses increased by Ptas. 430 million.
- The increases in the aforementioned expenses were partially offset by the notable reductions in, inter alia, operating provisions, independent professional services and flight insurance expenses.

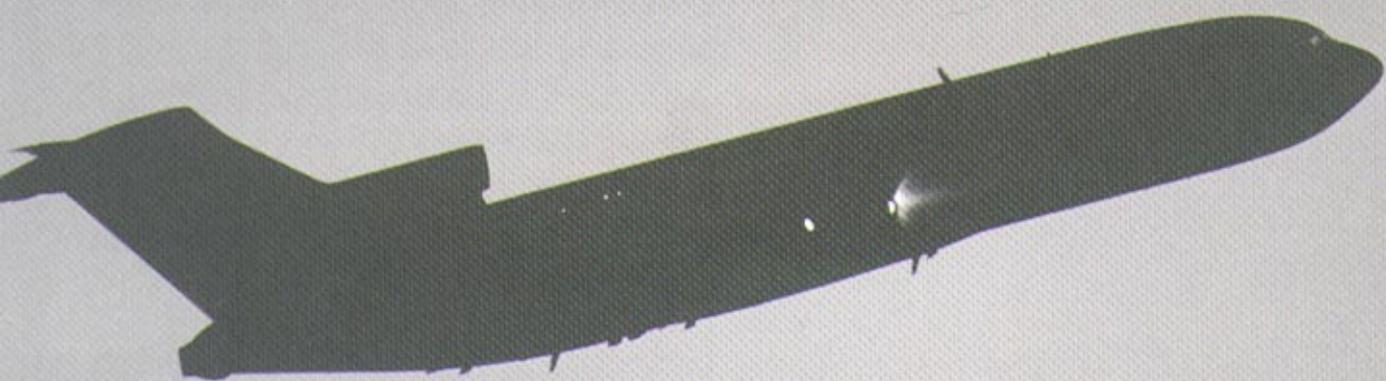
The overall comparison of the 1996 and 1995 statements of income is as follows:

	1996	1995
<b>Operating income</b>	<b>34,198</b>	<b>25,117</b>
Financial revenues	4,380	5,082
Financial expenses	(13,412)	<b>(20,105)</b>
Provision to pension allowance	(3,948)	(3,660)
Exchange gains	5,947	5,258
Exchange losses	(6168)	<b>(8,245)</b>
<b>Financial loss</b>	<b>(13,201)</b>	<b>(21,670)</b>
Aerolineas Argentinas	(2,154)	(19,076)
Viasa	-	(674)
Ladeco	(464)	(312)
<b>Amadeus</b>	-	619
Iberswiss	165	45
Binter Canarias	400	(459)
Binter Mediterraneo	(744)	(488)
Viva	(1,320)	<b>(675)</b>
Other	156	(737)
<b>Loss on securities portfolio</b>	<b>(3,961)</b>	<b>(21,755)</b>
<b>Extraordinary loss</b>	<b>(14,213)</b>	<b>(42,776)</b>
<b>Net income (loss) before taxes</b>	<b>2,823</b>	<b>(61,084)</b>
Taxes	(101)	16,164
<b>Net income (loss) after taxes</b>	<b>2,722</b>	<b>(44,920)</b>





**GOVERNING BODIES**



## GOVERNING BODIES

### BOARD OF DIRECTORS

---

#### CHAIRMAN

Sabier de Irala Estévez

#### DIRECTORS

Juan Carlos Aparicio Pérez

Joaquin Clotet Garriga

José de Carvajal Salido

Fermin López Covarrubias

José Manuel Fernandez Normiella

Maria Angeles Monjas Revilla

Cristobal Montoro Romero

Miguel Nadal Segala

Bernardo Obrador Vidal

Cecilia Pérez Velasco

Javier Salas Collantes

José Manuel Serra Peris

#### NONDIRECTOR SECRETARY

José Maldonado Ramos

### EXECUTIVE COMMITTEE

---

#### CHAIRMAN

Xabier de Irala Esthez

#### MEMBERS

Joaquin Clotet Garriga

José Manuel Fernandez Normiella

Miguel Nadal Segall

Fermin Lopez Covarrubias

Cecilio Pérez Velasco

## MANAGEMENT TEAM

---

### CEO

Mr. Xabier de Irala Estévez

### MEMBERS

Angel Mullor Parrondo  
GENERAL MANAGER

Guillermo Serrano Entrambasaguas  
DEPUTY GENERAL MANAGER

Martin Cuesta Vivar  
ORGANIZATION AND HUMAN RESOURCES MANAGER

José Maria Fariza Batanero  
CONTROL AND ADMINISTRATION MANAGER

Enrique Dupuy de Lôme Chávarri  
FINANCIAL MANAGER

Sergio Turrión Barbado  
INDUSTRIAL RELATIONS MANAGER

Enrique Donaire Rodriguez  
COMMERCIAL MANAGER

Manuel López Colmenarejo  
NETWORK DEVELOPMENT AND PROGRAMMING MANAGER

Javier Arraiza Martinez-Marina  
OPERATIONS MANAGER

Cados Medrano Rodriguez  
IN-FLIGHT SERVICES MANAGER

Salvador Magallo Martinenez  
BUSINESS MANAGER

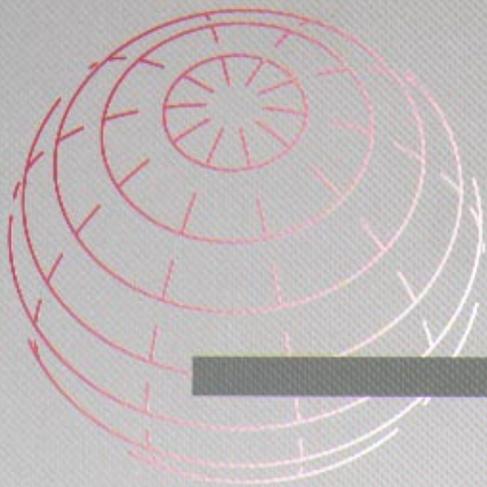
## AGENDA

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1. Examination and approval, if appropriate, of the 1996 individual and consolidated financial statements (balance sheets, statements of income (loss) and notes to financial statements) and management report.
2. Resolution, if appropriate, on the distribution of the Company's 1996 income.
3. Approval, if appropriate, of the conduct of business by the Company's Board of Directors in 1996.
4. Reelection, if appropriate, of the Company's Board members.
5. Approval, if appropriate, of the Minutes of the Meeting.

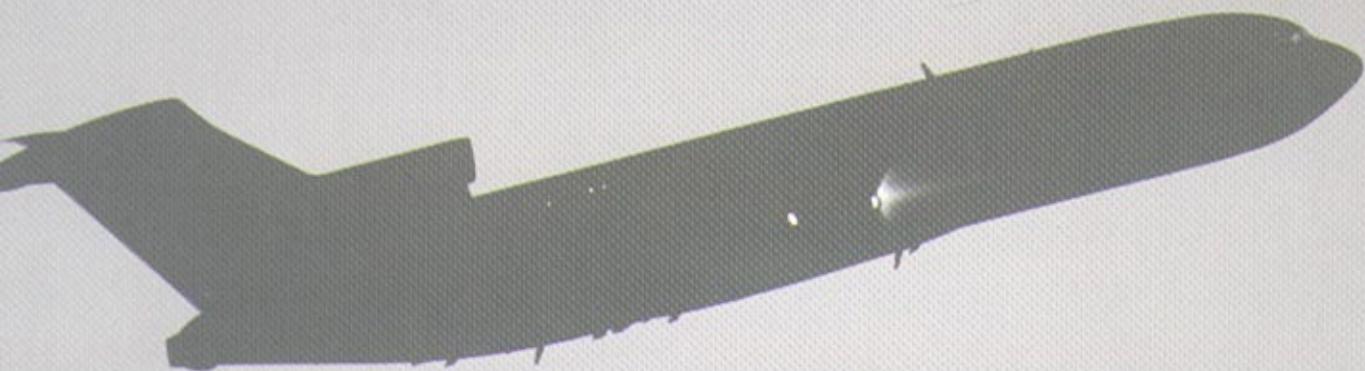




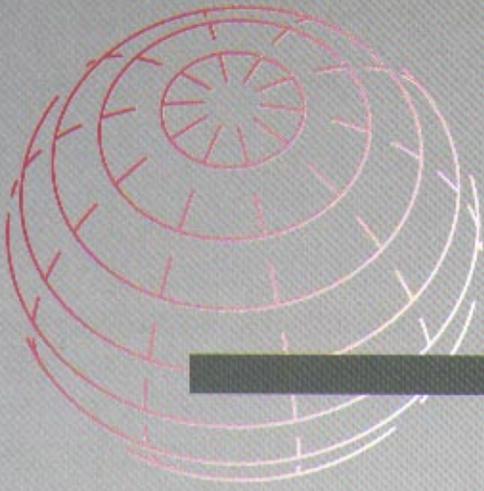


IBERIA GROUP

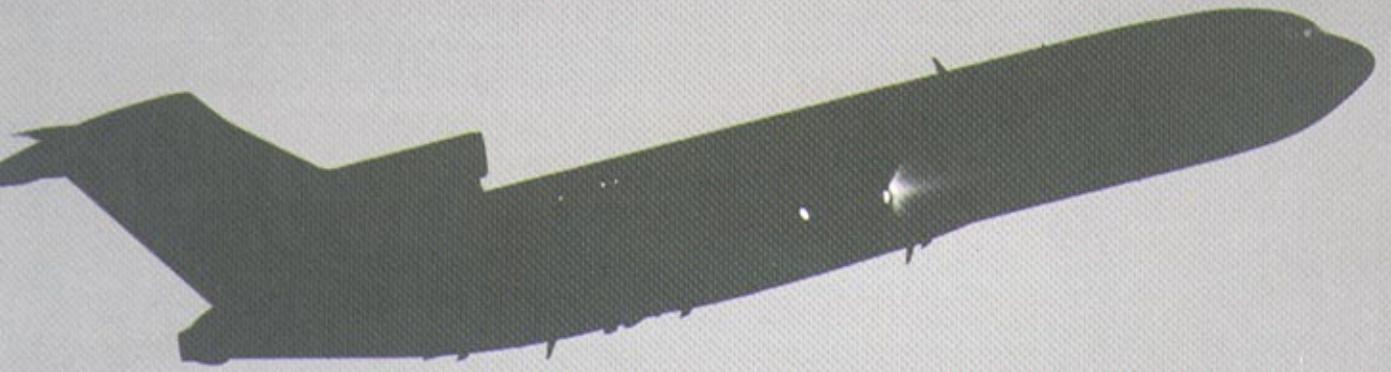
**CONSOLIDATED ANNUAL REPORT**







**LEGAL INFORMATION**





Translation of a report and consolidated financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 21).

In the event of a discrepancy, the Spanish-language version prevails.

## 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 CONSOLIDATED COMPANIES comprising the consolidated balance sheet as of December 31, 1996, and the related consolidated statement of income and notes to consolidated financial statements for the year then ended. The preparation of these consolidated financial statements is the responsibility of the controlling company's directors. Our responsibility is to express an opinion on the consolidated financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the documentation supporting the consolidated financial statements and evaluation of their presentation, of the accounting principles applied and of the estimates made. In connection with the dependent and associated companies, in which Iberia, Líneas Aéreas de España, S.A. has ownership interests of the percentages disclosed in Notes 2 and 3 to the consolidated financial statements, our work included examination of the financial statements of Aviation y Comercio, S.A. The financial statements of the other companies, whose assets and net results represent approximately 8% and 53%, respectively, of the related consolidated figures for 1996, were examined by other auditors and our professional opinion is based, with respect to these companies, only on the reports of the other auditors.

For comparison purposes the controlling company's directors present, in addition to the 1996 figures for each item in the 1996 consolidated financial statements referred to above, the figures for 1995. Also, as permitted by current regulations on the preparation of consolidated financial statements, the notes to consolidated financial statements do not include the statement of changes in financial position. Our opinion refers only to the 1996 consolidated financial statements. Our auditors' report dated May 6, 1996, on the 1995 consolidated financial statements contained an opinion with one qualification.

As indicated in Notes 5-f, 7 and 11 to the consolidated financial statements, certain of the consolidated companies restated their assets pursuant to Royal Decree-Law 7/1996, which gave rise to a surplus, net of the single tax, of Ptas. 18,443 million, which is included under the "Restatement Reserve" and "Reserves at Companies Consolidated by the Global Integration Method" captions in the consolidated balance sheet as of December 31, 1996.

In our opinion, based on our audit and on the reports of other auditors, the 1996 consolidated financial statements referred to above present, in all material respects, a true and fair view of the net worth and financial position of Iberia, Líneas Aéreas de España, S.A. and Consolidated Companies as of December 31, 1996, and of the results of their operations in the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with generally accepted accounting principles and standards applied on a basis consistent with that of the preceding year.

The accompanying consolidated management report for 1996 contains the explanations which the controlling company'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 management report is consistent with that contained in the consolidated financial statements for 1996. Our work as auditors was confined to checking the consolidated management report with the aforementioned scope, and did not include a review of any information other than that drawn from the accounting records of the consolidated companies.

May 30, 1997

Arthur Andersen y Cia., S. Com.  
Reg. Mere. Madrid, Tomo 3190, Libro 0, Folio 1,  
Sec. 8, Hoja M-54414, Inscrip. 1.a

Inscrita en el Registro Oficial de Auditores de  
Cuentas (ROAC)  
Inscrita en el Registro de Economistas Auditores (REA)

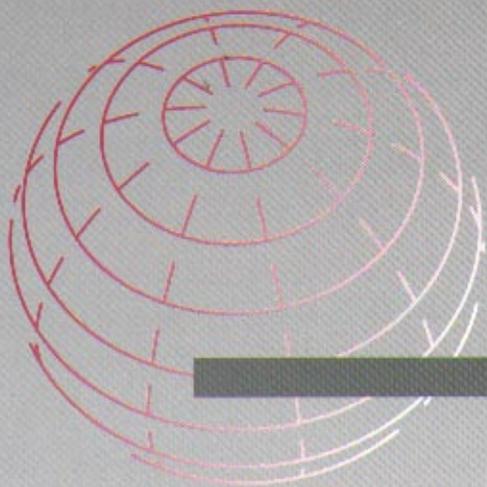
Domicilio Social:  
Raimundo Fdez. Villaverde, 65. 28003 Madrid  
Código de Identificación Fiscal D-79104469

ARTHUR ANDERSEN

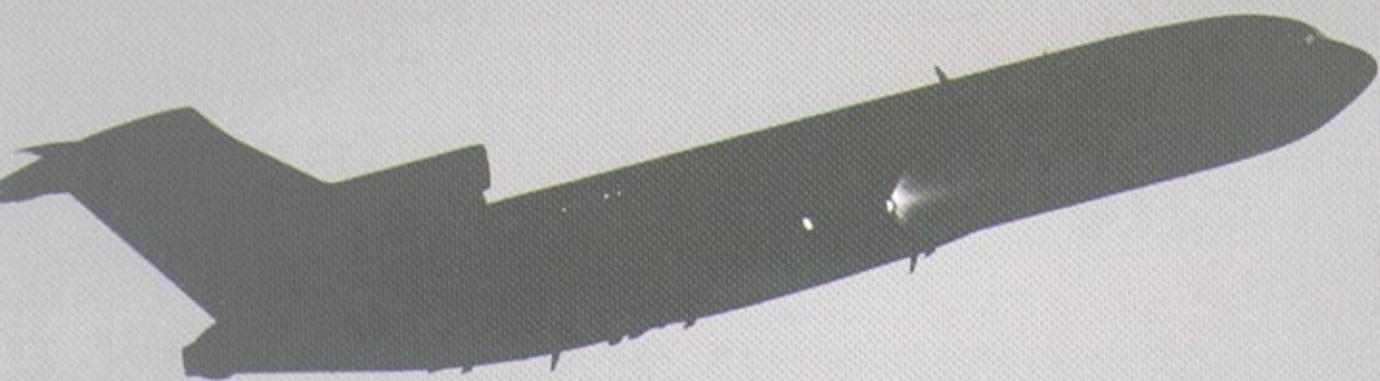


José Manuel Rodríguez





## CONSOLIDATED FINANCIAL STATEMENTS



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

IBERIA GROUP

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

ASSETS	1996	1995
<b>FIXED AND OTHER NONCURRENT ASSETS:</b>		
Start-up expenses	903	1,451
Intangible assets (Note 6)	34,913	78,797
Intangible assets and rights	48,188	102,962
Amortization	(13,275)	(24,165)
<b>Property, plant and equipment (Note 7)</b>	<b>262,955</b>	<b>329,153</b>
Aircraft		
Cost	395,120	439,223
Depreciation and provisions	(203,400)	(222,796)
	191,720	216,427
Other tangible fixed assets		
Cost	170,423	223,232
Depreciation and provisions	(99,188)	(110,506)
	71,235	112,726
<b>Long-term financial investments (Note 8)</b>	<b>81,112</b>	<b>47,319</b>
Holdings in companies carried by the equity method		1,122
Loans to companies carried by the equity method	29,041	15,995
Long-term investment securities	32,248	5,800
Other long-term receivables	47,575	26,673
Provisions	(27,752)	(2,271)
<b>Shares of the controlling company</b>	<b>7</b>	<b>7</b>
<b>Total fixed and other noncurrent assets</b>	<b>379,890</b>	<b>456,727</b>
<b>GOODWILL IN CONSOLIDATION (Note 9)</b>	<b>-</b>	<b>22,138</b>
<b>DEFERRED CHARGES (Note 6)</b>	<b>11,703</b>	<b>22,203</b>
<b>CURRENT ASSETS:</b>		
Inventories	9,038	14,708
Accounts receivable	84,127	102,731
Short-term financial investments (Note 10)	63,122	22,758
Cash	2,359	3,257
Accrual accounts	4,423	6,459
<b>Total current assets</b>	<b>163,069</b>	<b>149,913</b>
<b>TOTAL ASSETS</b>	<b>554,662</b>	<b>650,981</b>

The accompanying Notes 1 to 21 are an integral part of these consolidated balance sheets.

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

<b>SHAREHOLDER'S INVESTMENT AND LIABILITIES</b>	<b>1996</b>	<b>1995</b>
<b>SHAREHOLDER'S INVESTMENT (Note 11):</b>		
Subscribed capital stock	114,727	27,727
Reserves of the controlling company	(29,559)	(86)
Prior years' losses	(45,006)	(86)
Restatement reserve	15,447	
<b>Reserves at companies consolidated by the global integration method</b>	<b>4,886</b>	<b>(942)</b>
<b>Reserves at companies carried by the equity method</b>	<b>(3,470)</b>	<b>(938)</b>
<b>Translation loss</b>	<b>(689)</b>	<b>(1,254)</b>
<b>Income (loss) attributable to the controlling company (Note 19)</b>	<b>3,520</b>	<b>(44,620)</b>
Consolidated income (loss) for the year	3,768	(48,426)
Income (loss) attributed to minority interests (Note 19)	(248)	3,806
<b>Total shareholder's investment</b>	<b>89,415</b>	<b>(20,113)</b>
<b>MINORITY INTERESTS (Note 12)</b>	<b>15,045</b>	<b>8,228</b>
<b>DEFERRED REVENUES (Notes 5-i, 7 and 8)</b>	<b>6,472</b>	<b>7,394</b>
<b>PROVISIONS FOR CONTINGENCIES AND EXPENSES (Note 13)</b>	<b>123,537</b>	<b>131,820</b>
<b>LONG-TERM DEBT:</b>		
Payable to credit entities (Note 15)	122,527	197,063
Other accounts payable	3,431	24,157
	125,928	221,220
<b>CURRENT LIABILITIES:</b>		
Promissory notes issued (Note 15)	-	3,745
Payable to credit entities (Note 15)	23,209	108,930
Payable to companies carried by the equity method	183	
Customer advances	51,878	44,620
Payables for purchases and services	71,024	84,680
Other nontrade payables (Note 4-d)	47,874	60,402
Accrual accounts	67	55
<b>Total current liabilities</b>	<b>194,235</b>	<b>302,432</b>
<b>TOTAL SHAREHOLDERS' INVESTMENT AND LIABILITIES</b>	<b>554,662</b>	<b>650,981</b>

The accompanying Notes 1 to 21 are an integral part of these consolidated balance sheets.

IBERIA GROUP

**CONSOLIDATED STATEMENTS OF INCOME (LOSS) FOR 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESTETAS

DEBIT	1996	1995
<b>EXPENSES:</b>		
Purchases (Note 18)	76,707	90,891
Personnel expenses		
Wages, salaries and similar expenses	140,458	164,701
Agreements with the controlling company's employees	5,806	11,738
Employee welfare expenses	41,494	46,779
Period depreciation and amortization	28,676	38,101
Variation in operating provisions	1,529	2,266
Other operating expenses (Note 18)	227,174	301,439
	521,844	655,915
<b>Operating income</b>	<b>33,514</b>	<b>19,290</b>
Financial and similar expenses	20,784	35,111
Variation in financial investment provisions	4,589	(2,304)
Exchange losses	6,573	8,438
	31,946	41,245
Share in losses of companies carried by the equity method	414	3,266
Amortization of goodwill in consolidation (Note 9)	29	124
<b>Income from ordinary activities</b>	<b>14,120</b>	
Losses on fixed assets	2,626	1,743
Variation in fixed asset provisions	46	64
Extraordinary expenses (Note 18)	19,468	55,579
Prior years' expenses and losses	780	1,229
	22,920	58,615
<b>Consolidated income before taxes</b>	<b>2,948</b>	<b>-</b>
Corporate income tax (Note 17)	(820)	(17,312)
<b>Consolidated income for the year</b>	<b>3,768</b>	<b>-</b>
Income attributed to minority interests	248	-
<b>Income for the year attributed to the controlling company</b>	<b>3,520</b>	<b>-</b>

The accompanying Notes 1 to 21 are an integral part of these consolidated statements of income loss.

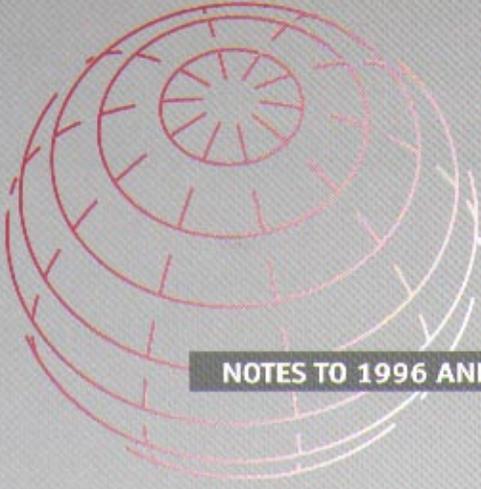
**CONSOLIDATED STATEMENTS OF INCOME (LOSS) FOR 1996 AND 1995**

CURRENCY - MILLIONS OF SPANISH PESETAS

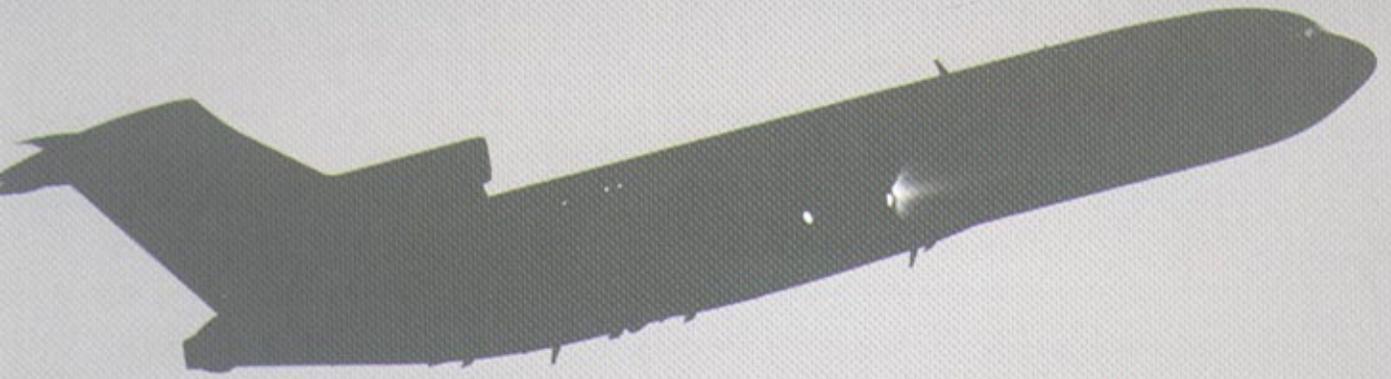
CREDIT	1996	1995
<b>REVENUES:</b>		
Net sales (Note 18)	539,198	655,108
Inventory variation	66	(390)
Capitalized expenses of Group work on fixed assets	343	776
Other operating revenues	15,751	19,711
	555,358	675,205
Revenues from shareholdings	208	116
Other interest and similar revenues	5,012	3,996
Exchange gains	6,104	7,512
	11,324	11,624
<b>Financial loss</b>	<b>20,622</b>	<b>29,621</b>
Equity in income of companies carried by the equity method	1,671	-
<b>Loss on ordinary activities</b>	<b>-</b>	<b>13,721</b>
Gains on fixed asset disposals (Note 7)	3,533	1,012
Extraordinary revenues	5,164	1,044
Prior years' revenues and income	3,051	4,542
	11,748	6,598
Extraordinary loss	11,172	52,017
<b>Consolidated loss before taxes</b>	<b>-</b>	<b>65,738</b>
<b>Consolidated loss for the year</b>	<b>-</b>	<b>48,426</b>
Loss attributed to minority interests	-	3,806
<b>Loss for the year attributed to the controlling company</b>	<b>-</b>	<b>44,620</b>

The accompanying Notes 1 to 21 are an integral part of these consolidated statements of income loss.





**NOTES TO 1996 AND 1995 CONSOLIDATED FINANCIAL STATEMENTS**



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

## **1** Controlling Company Description and Plans

Iberia, Líneas Aéreas de España, S.A. was incorporated on June 28, 1927, to engage mainly in the air transport of passengers and cargo. Under a Law of June 1940, the Company was authorized to operate scheduled passenger transport services throughout Spain, as Spain's flag airline.

Téneo, S.A. was the majority shareholder of Iberia, Líneas Aéreas de España, S.A. until September 16, 1996, when it transferred all its shares in Iberia, Líneas Aéreas de España, S.A. to Sociedad Estatal de Participaciones Industriales (SEPI).

In 1994 Iberia, Líneas Aéreas de España, S.A. drafted a Propm of Measures and agreed on various actions for 1994, 1995 and 1996 with its employees.

### *Program of measures*

The Program of Measures included a capital increase at Iberia, Líneas Aéreas de España, S.A., which was submitted for approval by the European Commission.

On January 31, 1996, the European Commission authorized a capital increase by Ptas. 87,000 million, to be carried out in two stages: a first increase of Ptas. 37,000 million for the cost of reducing the labor force, and a second increase of Ptas. 50,000 million relating to the repayment of debt. These capital increases were disbursed on April 26 and May 24, 1996, respectively. Iberia, Líneas Aéreas de España, S.A. considers the operational and financial objectives to have been met and has requested authorization for notification of the additional capital increase of Ptas. 20,000 million in the first quarter of 1997.

The Program of Measures also envisaged a significant divestment in the capital stock of Aerolíneas Argentinas, S.A. and Líneas Aéreas del Cobre, S.A. The main features of the divestments in 1996 are detailed in Note 3.

### *Actions agreed on with the employees*

The actions agreed on with the employees, relating basically to wage cuts, increased productivity, and an employee termination plan, were implemented in 1994, 1995 and 1996.

Among the measures agreed on with the employees was the reduction of the Company's headcount by 3,500 employees by the end of 1997 by means of early retirements and voluntary redundancy. The headcount had been reduced by 3,158 as of December 31, 1996.

In 1995 Iberia, Líneas Aéreas de España, S.A. recorded a provision of Ptas. 31,556 million for the estimated cost of the outstanding employee terminations. The "Provisions for contingencies and expenses" caption in the accompanying consolidated balance sheets as of December 31, 1995 and 1996, included Ptas. 31,556 million and Ptas. 7,625 million, respectively, in this connection.

The agreements entered into with the employees also included certain employee compensation

payments (some of which were performance-related), which were recorded in 1995 and 1996 (see "Headcount and personnel expenses" in Note 18).

### **1997-1999 Master Plan**

In recent months, management of Iberia, Líneas Aéreas de España, S.A. has prepared a Master Plan defining the strategic actions to be taken in 1997, 1998 and 1999. The Plan's goal is to make the Iberia Group fully competitive. The specific actions to be taken are presently being defined and will require acceptance by all the worker's groups in the Iberia Group.

## **2 Dependent Companies**

The data on the dependent companies as of December 31, 1996 and 1995, were as follows:

Company	Registered Office	Line of Business	Percentage of Ownership by Iberia, Líneas Aéreas de España, S.A.	
			1996	1995
Vuelos Internacionales de Vacaciones, S.A. (VIVA)	Zurbano, 41 - Madrid	Air transport of passengers and cargo	99.47	99.47
Campos Velazquez, S.A.	Velaquez, 134 - Madrid	Acquisition and holding of urban properties	99.99	99.99
Binter Canarias S.A.	Las Palmas Airport	Air transport of passengers and cargo in the Canary Islands	99.99	99.99
Binter Mediterraneo S.A.	Las Palmas Airport	Air transport of passengers and cargo	99.99	99.99
Cargosur, S.A.	Avda. de la Hispanidad, 13 Madrid	Air transport of cargo	100.00	100.00
Iber-Swiss Catering, S.A.	Ctra. de la Munozza, s/n Madrid	Preparation and marketing of food and other services for aircraft	70.00	70.00
Sistenias Automatizados Agencias de Viaje, S.A. (SAVIA)	Velaquez, 130 Madrid	EDP services applicable to the travel and tourism industries	99.90	99.90
Compañía Auxiliar al Cargo Expres, S.A. (CACESA) (a)	Juan de la Cierva, 7-9 Coslada (Madrid)	Transport of cargo	75.00	60.00
Aviacion y Comercio, S.A. (AVIACO)	Maudes, 51 Madrid	Air transport of passengers and cargo	32.93	32.93

(a) See Note 4-b

All the foregoing dependent companies were consolidated by the global integration method and their fiscal years end on December 31.

### 3 Associated Companies

The fiscal years of the associated companies consolidated in 1996 and 1995 end on December 31.

The associated companies included in the Iberia Group's consolidation process in 1996 and 1995, and data thereon, are as follows:

Company	Registered Office	Line of Business	Percentage of Ownership by Iberia, Líneas Aéreas de España, S.A.		Consolidation Method	
			1996	1995	1996	1995
Venzolana Internacional de Aviacion, S.A. (VIASA)	Oscar M. Zuloaga, s/n Caracas, Venezuela	Air transport of passengers and cargo	45.00	45.00	Equity method	Equity method
Línea Aéreas del Cobre, S.A. (LADECO)	Avda. Libertador B. O'Higgins. 107 Santiago de Chile	Air transport of passengers and cargo	25.13	38.07	Equity method	Equity method
Amadeus Group	Salvador de Madariaga, 1 Madrid	Management and operation of a computerized reservation system	29.20	25.00	Equity method	Equity method
Aerolíneas Argentinas Group (a)	Bouchar, 547 Buenos Aires, Argentina	Air transport of passengers and cargo and ancillary services for aircraft	20.00	83.35		Global integration

(a) This group was consolidated by the global integration method in 1995 (see Note 4-b).

The net worth data of Venzolana Internacional de Aviacion, S.A., the Aerolíneas Argentinas Group and the Amadeus Group used in consolidation were drawn from their respective provisional financial statements and their provisional consolidated financial statements as of December 31, 1996 and 1995, before receipt of the related auditors' reports.

The net worth data of Líneas Aéreas del Cobre, S.A. used in consolidation in 1995 were obtained from its provisional financial statements as of December 31, 1995. The information in this company's definitive financial statements as of December 31, 1995, was used for 1996 consolidation purposes, although its 1996 income statement was not available.

At the end of 1935, the Shareholders' Meeting of Interinvest, S.A. authorized a capital increase of Ptas. 66,704 million, which was subscribed in full by Iberia, Líneas Aéreas de España, S.A. through the direct contribution of Ptas. 22,679 million of loans to Aerolíneas Argentinas, S.A., the delivery of shares of this latter company with a value of Ptas. 3,105 million and the disbursement in cash of Ptas. 40,920 million.

Also, at the end of 1995 Interinvest, S.A. made an irrevocable contribution of Ptas. 46,898 million on account of a future capital increase at Aerolíneas Argentinas, S.A. through the contribution in cash of Ptas. 40,920 million and by offsetting Ptas. 5,978 million of loans.

In accordance with the conditions imposed by the European Union for the capital increase authorized at Iberia, Líneas Aéreas de España, S.A., in 1996 Iberia, Líneas Aéreas de España, S.A. sold most of its holding in Aerolíneas Argentinas, S.A. and part of its holding in Líneas Aéreas del Cobre, S.A. to Andes Holding B.V., a Dutch company 42% owned by Sociedad Estatal de Participaciones Industriales (SEPI) and 58% owned by the merchant banks Merrill Lynch and Bankers Trust. The holdings were sold for US\$ 520,020,854 (Ptas. 64,852 million). Of the total sale price, Ptas. 17,740 million, deferred until Austral Líneas Aéreas - Cielos del Sur, S.A. (a company 89.99% owned by Aerolíneas Argentinas, S.A.) is sold by Andes Holding B.V., had not been collected as of December 31, 1996. These amounts are recorded under the "Accounts receivable" and "Other long-term receivables" captions, respectively, in the accompanying consolidated balance sheet as of December 31, 1996. The deadline for the sale of Austral Líneas Aéreas - Cielos del Sur, S.A. expires in April 1999. If the sale has not been executed by that date, the shares of Austral Líneas Aéreas - Cielos del Sur, S.A., which are presently pledged to Iberia, Líneas Aéreas de España, S.A., will be transferred to the Company.

The contract under which these holdings were sold grants Iberia, Líneas Aéreas de España, S.A. a two-year option to repurchase the shares sold, although it can only exercise this option if certain financial ratios relating to the Iberia Group's equity are met and if a private investor has a high degree of involvement in the transaction, as stipulated in the terms of the Program of Measures of Iberia, Líneas Aéreas de España, S.A. approved by the European Commission (see Note 1).

Also, as a result of the undertaking made by Andes Holding B.V. to acquire 10% of the capital stock of Aerolíneas Argentinas, S.A. for US\$ 23,185,515 (Ptas. 3,047 million), Iberia, Líneas Aéreas de España, S.A. released Ptas. 174 million of the provisions recorded in prior years for this holding, thereby reducing the carrying value of the holding in Aerolíneas Argentinas, S.A. as of December 31, 1996, to its guaranteed recovery value.

## 4 Basis of Presentation of the Consolidated Financial Statements

### a) True and fair view

The accompanying consolidated financial statements were prepared from the accounting records of Iberia, Líneas Aéreas de España, S.A. and of its subsidiaries (as detailed in Notes 2 and 3) which were adjusted in the case of certain companies by the effects of the restatement made pursuant to Royal Decree-Law 7/1996.

The financial statements of the Spanish subsidiaries were prepared by each company's directors in accordance with the Spanish National Chart of Accounts and subsequent implementing regulations (see Note 5-h). The Venezuelan subsidiary Venezolana Internacional de Aviacion, S.A., the Aerolíneas Argentinas Group (for consolidation as of December 31, 1995) and the Amadeus Group were consolidated on the basis of their provisional financial statements as of December 31, 1996 and 1995, which in the case of the Aerolíneas Argentinas Group included adjustments for inflation, before receipt of the related auditors' reports.

As of December 31, 1996, the Aerolíneas Argentinas Group was excluded from consolidation as a result of the sale of most of the holding therein and of the purchase commitment made by Andes Holding B.V.

The subsidiary Líneas Aéreas del Cobre, S.A. was consolidated in 1995 on the basis of its provisional financial statements as of December 31, 1995, before receipt of the related auditors' reports. In 1996 it was consolidated on the basis of its definitive financial statements as of December 31, 1996, although its 1996 income statement was not available. Both sets of financial statements include adjustments for inflation.

The 1996 consolidated financial statements, which were prepared by the controlling company's directors, will be submitted for approval by the controlling company's Shareholders' Meeting, and it is considered that they will be approved without any changes. The 1995 consolidated financial statements were approved by the Shareholders' Meeting of the controlling company on May 22, 1996.

### b) Comparative information

As a result of the sale of most of the controlling company's holding in Aerolíneas Argentinas, S.A. (see Note 3), Iberia, Líneas Aéreas de España, S.A.'s holding in the Aerolíneas Argentinas Group was reduced to 20%. Also, as indicated in Note 3, the holding in Aerolíneas Argentinas, S.A. was reduced to Ptas. 3,047 million. Accordingly, as permitted by current regulations on the preparation of consolidated financial statements, the controlling company's directors decided not to consolidate the provisional financial statements of the Aerolíneas Argentinas Group as of December 31, 1996. The provisional financial statements of the Aerolíneas Argentinas Group as of December 31, 1995, which were consolidated by the global integration method, reflected assets representing approximately Ptas. 148,339 million of the related consolidated figures.

As a result of the aforementioned change in the consolidable Group in 1996, certain explanatory tables of 1996 variations included in these notes to consolidated financial statements reflect in the “Nonconsolidated Companies” column the effect of eliminating the Aerolíneas Argentinas Group’s balances included in consolidation in 1995.

In 1996, as a result of the redemption of a block of shares of treasury stock owned by Compañía Auxiliar al Cargo Expres, S.A., Iberia, Líneas Aéreas de España, S.A.’s holding in this company’s capital stock increased by 15%.

Also, certain reclassifications were made under the “Shareholders’ investment” caption in the consolidated balance sheet as of December 31, 1995, to improve the presentation thereof. The reclassifications consisted basically of the allocation of consolidation adjustments (see Note 11) to each Group or associated company.

The balances of the “Property, plant and equipment” and “Shareholders’ investment” captions in the consolidated balance sheet as of December 31, 1996, are not comparable with those of 1995 because the controlling company and its dependent companies restated their tangible fixed assets pursuant to Royal Decree-Law 7/1996.

Also, certain explanatory tables of 1995 variations reflect in the “New Companies” and “Nonconsolidated Companies” columns in these notes to financial statements the changes in the consolidated Group and consolidation methods arising from the consolidation of Aviación y Comercio, S.A., and Compañía Auxiliar al Cargo Expres, S.A. by the global integration method and of carrying the Amadeus Group by, the equity method.

### **c) Consolidation principles**

The companies over which there is effective control were consolidated by the global integration method. The controlling company and the companies consolidated by the global integration method constitute the “consolidable Group”. The associated companies in which the controlling company has a significant influence on management but does not have majority, voting rights and does not manage them jointly with third parties are carried by the equity method. The companies comprising the consolidable Group and those carried by the equity method constitute the Iberia Group. The equity of minority shareholders in the net worth and results of the consolidated subsidiaries is reflected under the “Minority interests” caption on the liability side of the consolidated balance sheets and their equity in the results of the aforementioned subsidiaries is reflected under the “Income attributed to minority interests” and “Loss attributed to minority interests” captions, as appropriate, in the consolidated statements of income (loss).

All material accounts and transactions between companies consolidated by the global integration method were eliminated in consolidation.

The consolidated financial statements do not include the tax effect of transferring the reserves of the consolidated subsidiaries to the accounts of the controlling company, since no transfers of reserves not taxed at source are anticipated, since such reserves are expected to be used as self-financing resources by each consolidated subsidiary.

#### **d) Grouping of items**

The balances of the “Other nontrade payables” caption in the accompanying consolidated balance sheets consist of the following items:

	MILLIONS OF PSEFAS	
	1996	1995
Nontrade accounts payable	8,843	15,044
Accrued taxes payable	18,750	16,943
Compensation payable	20,281	28,415
	47,874	60,402

### **5 Valuation Standards**

The main valuation methods applied in preparing the consolidated financial statements were as follows:

#### **a) Goodwill in consolidation**

Goodwill was calculated as the positive difference between the cost of the investment in each consolidated company and its respective underlying book value per the available balance sheet closest to the acquisition date.

This goodwill was allocated to asset items of the related subsidiary whose independently appraised market value differed from their net book value in the balance sheet of reference.

The goodwill recorded in the accompanying consolidated balance sheet as of December 31, 1995, represented the residual balance not allocable to asset items which is being amortized by the straight-line method over five and ten years (see Note 9). These amortization periods were established by the Group’s directors because they are the periods during which the goodwill will foreseeably contribute to the obtaining of income at the Group.

In 1996 the goodwill in consolidation was written off as a result of the sale of most of Iberia, Líneas Aéreas de España, S.A.’s holding in the subsidiary Aerolíneas Argentinas, S.A. (see Note 3), and of the amortization of the remaining goodwill relating to Líneas Aéreas del Cobre, S.A.

#### **b) Uniformity of presentation**

The main valuation principles and standards used by the controlling company were applied to all the companies consolidated and to the associated companies so as to ensure uniform presentation of the items composing the consolidated financial statements.

#### **c) Translation methods**

The 1996 and 1995 financial statements of the Latin American companies and of the Amadeus Group, which are denominated in U.S. dollars and ECUs, respectively, were translated to pesetas at the 1996 and 1995 year-end exchange rates, except for:

1. Capital and reserves, which were translated at historical exchange rates.
2. Income statement accounts, which were translated at the average exchange rates in each year.

The exchange differences arising from application of these translation methods are included under the "Shareholders investment - Translation loss" caption in the accompanying 1996 and 1995 consolidated balance sheets.

#### **d) Start-up expenses**

These expenses consist basically of public deed execution and registration expenses relating to capital increases, and are amortized at an annual rate of 20%.

An addition of Ptas. 900 million was recorded under this caption in 1996 in connection with the public deed execution and registration expenses relating to the capital increase of Ptas. 87,000 million at Iberia, Líneas Aéreas de España, S.A. (see Note 11).

Ptas. 585 million and Ptas. 8 15 million of amortization of start-up expenses were charged to the consolidated statements of income (loss) in 1996 and 1995, respectively.

#### **e) Intangible assets**

Leased assets are recorded as intangible assets at the cost of the related item, excluding interest cost, and are amortized by the same methods as those used to depreciate similar items of property, plant and equipment. The total debt for lease payments plus the amount of the purchase option is recorded as a liability. The difference between the two amounts, which represents the interest expenses of the transaction, is recorded under the "Deferred charges" caption in the accompanying consolidated balance sheets and is allocated to income each year by the interest method.

As of December 31, 1996 and 1995, Iberia, Líneas Aéreas de España, S.A., and Vuelos Internacionales de Vacaciones, S.A. restated the net book value of certain of their leased aircraft pursuant to a Ministry of Economy and Finance Order (see Note 5-j).

The balances of the “EDP applications” account relate basically to the start-up expenses of the Amadeus project, which are being amortized in a maximum period of five years.

Ptas. 2,302 million and Ptas. 5,036 million of amortization of intangible assets were charged to the 1996 and 1995 consolidated statements of income (loss), respectively.

#### **f) Property, plant and equipment**

The valuation methods applied by the consolidable Group are basically as follows:

##### **1. Aircraft:**

Spanish companies’ aircraft acquired prior to October 31, 1983, are carried at cost restated pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1996. Aircraft acquired after that date are carried at cost restated pursuant to Royal Decree-Law 7/1996, except for certain aircraft, the value of which was modified pursuant to the provisions of a Ministry of Economy and Finance Order (see Note 5-j).

Through 1993, the financial expenses relating to the period in which advances were made to suppliers of aircraft, determined by applying to the amount of such advances the average interest rate on the loans obtained to finance the purchase, were capitalized.

##### **2. Other tangible fixed assets:**

The Spanish companies’ land, buildings and specialized installations acquired prior to October 31, 1983, are carried at cost restated pursuant to the applicable enabling legislation, including Royal Decree-Law 7/1996. Those acquired after that date and the other tangible fixed assets recorded under the “Other Tangible Fixed Assets” caption in the accompanying consolidated balance sheets are carried at cost restated pursuant to Royal Decree-Law 7/1996.

##### **3. Aerolíneas Argentinas Group:**

Pursuant to current Argentinean regulations, the tangible fixed and intangible assets of the Aerolíneas Argentinas Group included in the consolidation of the Iberia Group in 1995 include certain technical restatements made as of June 30, 1991, adjusted for inflation and based on studies conducted by independent experts in this field.

#### 4. Repairs, upkeep and maintenance:

The companies in the consolidable Group, except for Aerolíneas Argentinas, S.A. (see Note 5-b), record a provision for the periodic major repairs of their aircraft (basically B-737, B-747, B-757, DC-10, DC-8, A-300, A-320, MD-87 and A-340 aircraft) based on the total estimated cost to be incurred, and allocate this cost to income on a straight-line basis during the period elapsing between two successive major repairs. As of December 31, 1996 and 1995, the balances of this provision were reflected under the "Provisions for contingencies and expenses" caption in the accompanying consolidated balance sheets.

The costs of minor repairs to the aforementioned types of aircraft and of all repairs to the B-727 and DC-9 aircraft of the controlling company Iberia, Líneas Aéreas de España, S.A. are expensed currently, since the annual expenses tend to be uniform.

Upkeep and maintenance expenses are expensed currently.

#### **g) Depreciation of property, plant and equipment**

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

The methods applied to calculate depreciation of the main items of property, plant and equipment are as follows:

##### 1. Aircraft:

The depreciable cost of the aircraft is equal to their book value less the estimated residual value at the end of their useful lives. The residual value ranges from 10% to 20%, depending on the aircraft.

##### 2. Aircraft spare parts:

Spare parts for aircraft maintenance are depreciated, depending on the type of part, as follows:

###### a. Rotatable parts

These are depreciated in a period ranging from 10 to 18 years from the date of purchase, assuming a residual value of between 10% and 20%, depending on the type of aircraft.

###### b. Repairable parts

These are depreciated in a period ranging from 8 to 10 years, depending on the aircraft, from the date of purchase, assuming a residual value of 10% in all cases.

The Companies also record provisions for depreciation of spare parts based on obsolescence.

### 3. Years of estimated useful life

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

Aircraft	18 (a)
Buildings and other structures	20 - 50
Machinery, installations and tools	10 - 16.5
Transport equipment	7 - 10
Furniture and fixtures	10
EDP equipment	4 - 7
Spare parts	8 - 18
Flight simulators	10 - 14

(a) The used aircraft acquired by the Group are depreciated over a period shorter than their estimated useful life for accounting purposes.

The buildings and facilities of Iberia, Líneas Aéreas de España, S.A. and of Aviación y Comercio, S.A. on land owned by the Spanish State, mostly at Spanish airports, with an aggregate net book value of P'tas. 1,587 million and Ptas. 1,811 million per the two companies' balance sheets as of December 31, 1996 and 1995, respectively, are depreciated over the respective concession periods.

Depreciation is taken on the net amount of tangible fixed asset restatements from the date they are recorded, using the same useful life periods as for the cost values.

### 4. Aerolíneas Argentinas Group

The property, plant and equipment of the Aerolíneas Argentinas Group are depreciated by the straight-line method at rates based on their useful life, as estimated by the independent experts mentioned earlier.

As of December 31, 1995, the net book value of the restated assets did not exceed their market value, and the useful lives and residual values of the related assets did not differ materially from those estimated by the controlling company for similar assets.

The detail of depreciation of and provisions for property, plant and equipment charged to the consolidated statements of income (loss) for 1996 and 1995 is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Aircraft	17,412	21,745
Other tangible fixed assets	9,890	12,468
	27,302	34,213

#### **h) Marketable securities and other similar financial investments**

Investments in nonconsolidated companies are carried at cost net, where appropriate, of the required provisions for diminution in value (cost higher than fair value at year-end).

Investments in government debt securities are carried at cost. The interest on these securities is credited to income when earned and is charged through maturity to the "Short-term financial investments" caption.

#### **i) Translation of foreign currency balances**

The balances of accounts denominated in foreign currencies are translated to pesetas at the exchange rates ruling at December 31 of each year. However, following customary airline practice, the balance of the liability for unused traffic documents is reflected in the accompanying consolidated balance sheets at the exchange rate for the month of the sale, as set by the International Air Transport Association (I.A.T.A.). The I.A.T.A. exchange rate for each month is the average exchange rate for the last five days of the preceding month.

Translation differences arising from translation at official year-end exchange rates and from variations in exchange rates from December 31 of the preceding year to the date of effective collection or payment are recorded under the "Exchange gains/losses" captions in the consolidated statements of income (loss), except for the net gains or losses arising from translating the financing obtained for the acquisition of certain aircraft and, exceptionally in 1996, the gains of Ptas. 9 18 million arising from the restatement of the balances receivable from the associated company Venezolana Internacional de Aviación, S.A., which were recorded under the "Deferred revenues" caption in the 1996 consolidated balance sheet.

#### **j) Exchange differences arising from aircraft financing**

Pursuant to Valuation Rule 14 in Section 5 of the Spanish National Chart of Accounts, on March 23, 1994, the Ministry of Economy and Finance issued, at the proposal of the Accounting and Audit Institute (ICAC), a Ministerial Order on the accounting treatment of certain foreign currency exchange differences.

Under this accounting regulation, from January 1, 1993, the net amount of foreign currency exchange differences arising in each year on debts for financing for the acquisition by Iberia, Líneas Aéreas de España, S.A., Aviación y Comercio, S.A. and Vuelos Internacionales de Vacaciones, S.A. of aircraft added to the fleet in the same year and in the four immediately preceding years has to be recorded as an increase or decrease in the value of such aircraft.

In accordance with the above-mentioned Ministerial Order, in 1996 and 1995 the adjustments made to the cost and period depreciation of certain of the aircraft were as follows:

	MILLIONS OF PISETAS	
	Increase/(Decrease)	
	1996	1995
<b>Intangible assets (a)</b>		
cost	694	(1,505)
Period amortization/provisions	136	(217)
<b>Property, plant and equipment (b)</b>		
cost	406	(2,155)
Period depreciation	70	(364)

(a) As of December 31, 1996, these amounts included increases of Ptas. 521 million in cost and of Ptas. 102 million in period amortization at Vuelos Internacionales de Vacaciones, S.A. (VIVA).

(b) As of December 31, 1996, the amounts included increases of Ptas. 341 million in cost and of Ptas. 59 million in period depreciation at Avacion y Comercio S.A

#### **k) Inventories**

Inventories, basically aeronautical supplies, are valued at average purchase cost, and the related provisions for depreciation are recorded.

#### **1) Recognition of revenues and expenses**

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

Ticket sales and the traffic documents for freight and other services are initially credited to "Customer advances" in the consolidated balance sheets. The balances of this caption in the accompanying consolidated balance sheets reflect the liability for tickets and traffic documents sold prior to December 31, 1996 and 1995, but not used at those dates.

The revenues relating to these items are recognized when the transport or service is performed.

196 was the first full year of use of the new system introduced by management of the controlling company for controlling sales and the utilization of international flight tickets and for determining the balance of the "Customer advances" caption. The initial analyses performed by management of the controlling company in 197 of the balance of the "Customer advances" caption in the consolidated balance sheet as of December 31, 1996, in connection with the unused international flight tickets at that date disclosed an unquantified overstatement of the liability recorded for the possibility of tickets not being used in the future. When the analyses of

the balance recorded as of December 31, 1996, has concluded, management of Iberia, Líneas Aéreas de España, S.A. will adjust the excess liability recorded at that date and will implement the additional control measures required to accurately determine the year-end balance in future years.

Iberia, Líneas Aéreas de España, S.A. and its commercial air subsidiaries have introduced the "Iberia Plus" card as an ongoing promotional tool whereby the holder of the card accumulates "points" for taking certain flights, using certain hotels, renting cars or making credit card purchases with credit cards covered by the program. The points can be exchanged for free tickets or other services offered by the companies included in the program. The accompanying consolidated balance sheets as of December 31, 1996 and 1995, include provisions of Ptas. 4,083 million and Ptas. 3,123 million, respectively, in this connection, based on estimates of the value of the points accumulated at those dates.

#### **m) Supplementary pension payments to employees**

Under the collective labor agreements currently in force, Iberia, Líneas Aéreas de España, S.A. and Aviación y Comercio, S.A. are required to pay full compensation to, or to supplement the social security benefits of, flight personnel who take early retirement or are placed on the reserve and to land personnel taking early retirement, in accordance with the conditions specified for each case.

The accompanying consolidated balance sheets as of December 31, 1996 and 1995, reflect the total liability incurred by Iberia, Líneas Aéreas de España, S.A. and Aviación y Comercio, S.A. in this connection at those dates. The provisions recorded by Iberia, Líneas Aéreas de España, S.A. and Aviación y Comercio, S.A. to cover the estimated liability incurred in 1996 and 1995 and the interest allocable to the recorded allowance are included under the "Personnel expenses" and "Financial expenses" captions, respectively, in the accompanying consolidated statements of income (loss) (see Note 13).

The actuarial studies used in 1996 and 1995 were prepared under the "unit credit" method and their main features were assumed interest rates of 6% and 8%, respectively, expected consumer price index increases of 3% and 4% per year, respectively, and annual provisions payable in arrears. The changes in the main assumptions used in the study in 1996 were made to bring the study more into line with the current trend in interest rates.

#### **n) 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 controlling company and of its subsidiaries Aviación y Comercio, S.A., Vuelos Internacionales de Vacaciones, S.A. and Sistemas Automatizados Agencias de Viajes, S.A.) and other welfare benefits in certain circumstances (death of spouse, transitory and permanent disability, etc.).

Under the current collective labor agreements, the controlling company, the above-mentioned subsidiaries and their employees make the regulatory contributions to the Montepio, as established in these labor agreements. The Montepio's bylaws limit these companies to the payment by them of the regulatory established contributions.

The consolidable Group's contribution of Ptas. 2,907 million in 1996 and Ptas. 2,978 million in 1995 were recorded under the "Personnel expenses" caption in the accompanying consolidated statements of income (loss).

#### **o) Provision for third-party liability**

This provision reflects basically the estimated amount of potential payment obligations whose exact amount cannot yet be determined or whose date of payment is uncertain, depending on the fulfillment of certain conditions. The allocations to and releases from this provision are recorded on the basis of the best estimates available at any given time.

The variations in these accounts in 1996 and 1995 were as follows:

	MILLIONS OF PESETAS	
	1996	1995
<b>Beginning balance</b>	<b>52,525</b>	<b>11,417</b>
Nonconsolidated companies (a)	(4,084)	-
Allocations charged to		
Extraordinary expenses	17,454	34,540
Financial expenses	50	50
Operating expenses	292	2,079
Prior years' expenses and losses	351	685
	18,147	37,354
Releases credited to		
Operating revenues	-	(2)
Payments	(24,040)	
Extraordinary loss	(1,521)	(1,141)
Other	(74)	-
	(25,635)	(1,151)
Other variations		
Transfers	-	2,976
New companies	-	1,909
Other	536	20
	536	4,905
<b>Ending balance (Note 13)</b>	<b>41,489</b>	<b>52,525</b>

(a) See Note 4-b.

The 1995 allocations include provisions recorded by Iberia, Líneas Aéreas de España, S.A. to cover the employee termination plan (see Note 1).

The new allocations in 1936 were made to cover mainly tax assessments issued by the tax authorities and any losses which might arise when the final outcome of certain claims in progress becomes known.

#### **p) Corporate income tax**

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

The consolidated taxation system applicable to the controlling company and its dependent companies (except the Aerolíneas Argentinas Group) as part of Sociedad Estatal de Participaciones Industriales was regulated by the 1989 Budget Law (Law 37/1988) and Royal Decree Law 5/1395. Accordingly, the 1995 corporate income tax was settled, and the 1996 corporate income tax will be settled, on a consolidated return basis. Corporate income tax credits and debits were therefore recorded with contra items in the consolidated results for 1996, 1995 and prior years (see Note 17).

#### **q) Futures and other similar instruments**

Iberia, Líneas Aéreas de España, S.A. uses these instruments to hedge its net worth positions.

The Company 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).

If cash deposits are required to guarantee the obligations inherent to the aforementioned transactions, they are recorded under the “Short-term financial investments - Deposits and guarantees” caption on the asset side of the consolidated balance sheet.

The expenses relating to transactions involving futures and similar instruments are expensed currently.

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

1. In the case of transactions arranged to hedge debts to credit entities, the balance of the asset positions are discounted to present value based on the related gains or losses.
2. For the other transactions, the pricing differences are recorded at the date of cancellation or final settlement of the futures or similar instruments.

## 6 Intangible Assets

The variations in 1996 and 1995 in intangible asset accounts and in the related accumulated amortization were as follows:

MILLIONS OF PESETAS						
<b>1996</b>	12-31-95	Nonconsolidate Companies (a)	Additions and Provisions	Retirements	Transfers	12-31-96
Rights on leased assets	88,569	(47,256)	978	-	(1)	42,290
EDP applications	4,692	-	73	-	712	5,477
Research and development expenses Intellectual property and leasehold	1,613	-	29	-	(1,306)	336
assignment rights	8,088	(7,999)	1	(5)	-	85
Amortization	(24,165)	13,187	(2,302)	5	-	(13,275)
<b>Net value</b>	<b>78,797</b>					<b>34,913</b>

(a) See Note 4-b.

MILLIONS OF PESETAS								
<b>1995</b>	01-01-95	New Companies	Nonconsolidated Companies	Additions and Provisions	Retirements	Transfers	Other	12-31-95
Rights on leased assets	90,843	70	-	725	-	1,789	(4,858)	88,569
EDP applications	17,498	-	(13,018)	76	(61)	197	-	4,692
Research and development expenses Intellectual property and Leasehold	1,096	-		727	(24)	(186)	-	1,613
assignment rights	9,655	12	(1,260)	1	-	(226)	(94)	8,088
Amortization	(22,681)	(41)	5,476	(5,036)	44	(1,516)	(411)	(24,165)
<b>Net value</b>	<b>96,411</b>							<b>78,797</b>

The main features of the lease contracts (relating mainly to aircraft) in force as of December 31, 1996 and 1995, some of which have floating interest rates and lease payments denominated in foreign currencies, are as follows:

MILLIONS OF PESETAS		
	1996	1995(b)
Cash price of the assets acquired, according to Contracts	41,089	88,695
Lease payments paid:		
In prior years	19,578	33,701
In the current year	4,869	9,081
Leasepayments outstanding at December 31	34,49 <sup>(a)</sup>	73,60 <sup>(a)</sup>
Amount of purchase options	18,468 (a)	19,437 (a)

(a) As of December 31, 1996 and 1995, these amounts included Ptas. 10,808 million and Ptas. 20,873 million, respectively, of unincurred interest at those dates, the contra items for which are included under the "Deferred charges" caption in the accompanying consolidated balance sheets.

(b) These figures include amounts relating to the Aerolíneas Argentinas Group. The cash price includes Ptas. 40.638 million in connection with this Group.

The due dates for the lease payments outstanding as of December 31, 1996, including the amount of the purchase options, are as follows:

Due in	Millions of Pesetas
1997	5,015
1998	5,111
1999	5,207
2000	5,243
Remainder (through 2004)	32,387

In 1996 Iberia, Líneas Aéreas de España, S.A. exercised early the purchase option on two A-300 aircraft with a cash price according to the contract of Ptas. 6,728 million. The cost of these aircraft and their accumulated depreciation are included under the "Property, plant and equipment - aircraft" caption in the accompanying consolidated balance sheets as of December 31, 1996 and 1995, since in prior years Iberia, Líneas Aéreas de España, S.A. had confirmed its intention to exercise the purchase option.

## 7 Property, Plant and Equipment

The variations in 1996 and 1995 in the property, plant and equipment accounts and in the related accumulated depreciation and provisions were as follows:

### Cost

MILLIONS OF PISEFIAS							
1996	12-31-95	Nonconsolidated Companies	Additions	Retirements	Transfers	Restatement Pursuant to R.D.L. 7/1996	12-31-96
<b>Aircraft</b>	<b>439,223</b>	<b>(48,803)</b>	<b>1,234</b>	<b>(11,635)</b>	<b>218</b>	<b>14,883</b>	<b>395,120</b>
Other tangible fixed assets:							
Land	928	(524)	-	-	-	150	554
Buildings and other structures	34,775	(9,268)	36	(293)	-	3,273	28,523
Machinery installations and tools	53,613	(1,138)	1,723	(638)	406	3,571	57,537
Transport equipment	2,591	(725)	539	(58)	-	45	2,392
Furniture and fixtures	5,012	(1,140)	97	(76)	1	-	3,894
EDP equipment	26,180	(1,830)	979	(182)	1	-	25,148
Spare parts	75,729	(43,536)	2,366	(1,180)	-	-	33,379
Flight simulators	6,352	-	3	-	-	376	6,731
Other	4,116	(3,243)	80	(1)	-	66	1,018
Construction in progress	13,936	(77)	3,189	(5,770)	(31)	-	11,247
	<b>223,232</b>	<b>(61,481)</b>	<b>9,012</b>	<b>(8,198)</b>	<b>377</b>	<b>7,481</b>	<b>170,423</b>

MILLIONS OF PISEFIAS								
1995	01-01-95	New Companies	Nonconsolidated Companies	Additions	Retirements	Transfers	Other	12-31-95
<b>Aircraft</b>	<b>392,201</b>	<b>51,803</b>	<b>-</b>	<b>718</b>	<b>(4,709)</b>	<b>3,375</b>	<b>(4,165)</b>	<b>439,223</b>
Other tangible fixed assets:								
Land	947	-	-	-	-	-	(19)	928
Buildings and other structures	35,022	676	(1,237)	734	(155)	-	(265)	34,775
Machinery, installations and tools	51,823	1,135	-	1,891	(567)	(596)	(73)	53,613
Transport equipment	2,328	92	-	125	(148)	215	(21)	2,591
Furniture and fixtures	4,157	266	-	425	(73)	182	55	5,012
EDP equipment	39,940	675	(13,079)	1,070	(2,827)	441	(40)	26,180
Spare parts	72,905	9,556	-	7,105	(5,732)	(5,802)	(2,303)	75,729
Flight simulators	6,627	-	-	124	(391)	-	(8)	6,352
Other	4,908	137	(949)	51	(12)	191	(210)	4,116
Construction in progress	13,547	3	-	1,542	(944)	(167)	(45)	13,936
	<b>232,204</b>	<b>12,540</b>	<b>(15,265)</b>	<b>13,067</b>	<b>(10,849)</b>	<b>(5,536)</b>	<b>(2,929)</b>	<b>223,232</b>

The balances of construction in progress as of December 31, 1996 and 1995, included Ptas. 8,771 million and Ptas. 10,619 million, respectively, of advances for Iberia, Líneas Aéreas de España, S.A.'s aircraft purchase commitments to aircraft manufacturers. In 1996 Iberia, Líneas Aéreas de España, S.A. made advances of Ptas. 852 million in this connection and recovered Ptas. 3,422 million relating to the amount advanced for the four A-340's which have commenced operations under an operating lease contract.

As of December 31, 1996 and 1995, construction in progress also included Ptas. 1,141 million and Ptas. 1,577 million, respectively, of financial expenses capitalized in connection with these advances. In 1996 Iberia, Líneas Aéreas de España, S.A. canceled, with a charge to "Extraordinary expenses" in the accompanying 1996 consolidated statement of income (loss), Ptas. 436 million of interest expenses relating to the aforementioned four A-340 aircraft.

Additionally, as of December 31, 1996 and 1995, construction in progress included Ptas. 408 million and Ptas. 1,595 million, respectively, relating to the value of the auxiliary equipment being installed in aircraft not yet received by Iberia, Líneas Aéreas de España, S.A. In 1996 Iberia, Líneas Aéreas de España, S.A. invested Ptas. 710 million in this equipment and recovered the Ptas. 1,891 million relating to the auxiliary equipment installed in the four A-340 aircraft acquired under operating lease contracts.

The additions in 1995 to the cost and to the provisions for depreciation of spare parts included Ptas. 3,907 million and Ptas. 2,783 million, respectively, relating to the value of certain aircraft spare parts which were transferred to Iberia, Líneas Aéreas de España, S.A. as a result of the dissolution of the Atlas Group.

On December 31, 1996, Iberia, Líneas Aéreas de España, S.A. and certain of its dependent companies restated their property, plant and equipment pursuant to Royal Decree-Law 7/1996, and paid the single 3% tax. These companies had previously availed themselves of other restatement legislation. The restatement in 1996 was carried out by applying the maximum coefficients authorized by the Royal Decree-Law, with the 40% reduction for the effect of the financing of these companies (except for Aviación y Comercio, S.A.) up to the limit of the estimated market value of each of the assets. The restatement surpluses were as follows:

MILLIONS OF PESETAS

<b>Surplus</b>	
Aircraft	14,883
Land	150
Buildings and other structures	3,273
Machinery, installations and tools	3,571
Transport equipment	45
Flight simulators	376
Other	66
	<b>22,364</b>

The restatement surplus, net of the single 3% tax, was credited to the "Restatement reserve" caption at each company, with a charge to the appropriate restated asset accounts, without altering the recorded accumulated depreciation amount.

The net increase in value resulting from this restatement will be depreciated over the tax periods in the remaining useful lives of the restated assets. It is estimated that the 1996 restatement will increase the 1997 depreciation charge by approximately Ptas. 7,743 million.

### Depreciations and provisions

MILLIONS OF PESETAS

1996	12-31-95	Nonconsolidate Companies	Additions	Retirements	Transfers	12-31-96
<b>Aircraft</b>	<b>222,796</b>	<b>(27,698)</b>	<b>17,412</b>	<b>(9,167)</b>	<b>57</b>	<b>203,400</b>
Other tangible fixed assets						
Buildings and other structures	13,112	(1,968)	994	(41)	-	12,097
Machinery, installations and tools	30,890	(404)	3,478	(585)	(57)	33,322
Transport equipment	1,952	(512)	159	(51)	-	1,548
Furniture and fixtures	3,373	(641)	276	(71)	1	2,937
EDP equipment	22,726	(1,264)	1,687	(180)	-	22,969
Spare parts	32,138	(12,622)	2,835	(795)	-	21,556
Flight simulators	3,801	-	381	-	-	4,182
Other	2,514	(2,017)	80	-	-	577
	<b>110,506</b>	<b>(19,428)</b>	<b>9,890</b>	<b>(1,723)</b>	<b>(57)</b>	<b>99,188</b>

1995	01-01-95	New Companies	Nonconsolidate Companies	Additions	Retirements	Transfers	Other	12-31-95
<b>Aircraft</b>	<b>186,671</b>	<b>19,336</b>	<b>-</b>	<b>21,745</b>	<b>(2,364)</b>	<b>(1,437)</b>	<b>(1,155)</b>	<b>222,796</b>
Other tangible fixed assets								
Buildings and other structures	11,523	291	(91)	1,554	(95)	(6)	(64)	13,112
Machinery, installations and tools	27,202	553	-	3,627	(437)	(52)	(3)	30,890
Transport equipment	1,573	52	-	210	(122)	17	222	1,952
Furniture and fixtures	2,707	171	-	544	(55)	23	(17)	3,373
EDP equipment	30,351	435	(8,056)	2,779	(2,779)	66	(70)	22,726
Spare parts	30,541	2,253	-	5,756	(4,093)	(790)	(1,529)	32,138
Flight simulators	3,672	-	-	370	(323)	81	1	3,801
Other	2,584	72	(372)	446	(37)	(5)	(174)	2,514
	<b>110,153</b>	<b>3,827</b>	<b>(8,519)</b>	<b>15,286</b>	<b>(7,941)</b>	<b>(666)</b>	<b>(1,634)</b>	<b>110,506</b>

### Transactions involving the aircraft

In 1994 Iberia, Líneas Aéreas de España, S.A. redesigned its fleet renewal plan and entered into various agreements with its suppliers. The main features of these agreements, which were partially amended in 1996, are described below.

#### *Agreements relating to the Boeing aircraft*

In 1994 Iberia, Líneas Aéreas de España, S.A. entered into operating lease contracts with several leasing companies for seven B-757 aircraft. Two of these aircraft were on lease for a period of four years, extendible to a further 18 months, excluding the purchase option. The other five B-757 aircraft were on lease for an initial period of approximately five years, at the end of which Iberia, Líneas Aéreas de España, S.A. would have the following three options for each plane: to exercise the purchase option; to extend the lease for up to a further 12 years; or to return the plane to the lessor.

Iberia, Líneas Aéreas de España, S.A.'s initial B-757 aircraft purchase contract with The Boeing Company ("Boeing") was still in force at December 31, 1996, and eight of the planes ordered under this contract had not been delivered at that date. In 1994 Iberia, Líneas Aéreas de España, S.A. entered into another purchase contract with Boeing for a further seven B-757 aircraft, which can be canceled if Iberia, Líneas Aéreas de España, S.A. exercises the purchase option on the five B-757 planes which are currently being operated under an operating lease. The capital expenditure committed by Iberia, Líneas Aéreas de España, S.A. for the purchase of the 15 B-757 aircraft would, if completed, amount to approximately US\$ 735 million. Four of the 15 B-757's would be delivered in 1999, four in 2000 and seven in 2002. Any of these 15 aircraft may be replaced by other Boeing planes of equal purchase price. As of December 31, 1996, Iberia, Líneas Aéreas de España, S.A. had made advances totaling Ptas. 4,683 million in connection with these aircraft.

Also, in 1994 Iberia, Líneas Aéreas de España, S.A. sold to Boeing seven B-727 aircraft and one B-747 aircraft and subsequently entered into operating lease contracts for these planes for a period of one year and three years, respectively, including a purchase option. Ptas. 398 million of the capital gain arising from the sale of the B-747 aircraft were deferred and were recorded under the "Deferred revenues" caption in the consolidated balance sheet as of December 31, 1994. Ptas. 150 million of the foregoing capital gain were allocated to consolidated income in 1996 and 1995 and are included under the "Other operating revenues" caption in the consolidated statements of income (loss). In 1995 Iberia, Líneas Aéreas de España, S.A. exercised the purchase option on two of the seven leased B-727 aircraft for salvaging and use of spare parts. An amendment to the initial contract on the other B-727 aircraft was agreed on in 1995, whereby the contract was extended to 1998 and may be renewed through July 2001.

#### *Agreements redating to the Airbus aircraft*

In 1994 Iberia, Líneas Aéreas de España, S.A. agreed on a new delivery schedule with Airbus Industrie, G.I.E. ("Airbus") for eight A-340 aircraft, as follows: four in 1996, two in 1999 and two in 2000. In 1996 four A-340 aircraft came into service and a new agreement was entered into modifying the date of delivery of the four remaining aircraft and establishing the delivery date of four additional aircraft which the controlling company has the option to purchase, the new schedule being as follows: two in 1997, one in 1998, one in 1999, two in 2000 and two in 2001.

The four A-340 aircraft that came into service in 1996 were acquired under an operating lease contract from Iberbus Concha Ltd., Iberbus Rosalia Ltd., Iberbus Chacel Ltd. and Iberbus Arenal Ltd. Iberia, Líneas Aéreas de España, S.A. has 40% holdings in the capital stock of all these companies (see Note 8). The term of the operating leases for the four A-340 aircraft is seven years, at the end of which Iberia, Líneas Aéreas de España, S.A. will have the following three options: to exercise the purchase option and pay a predetermined price for the aircraft; to extend the lease for five or eight years and mandatorily exercise the purchase option, paying the market value of the aircraft; or to return the planes to the lessor.

The controlling company also entered into agreements whereby it can lease under the terms described in the preceding paragraph the three A-340 aircraft deliverable in 1997 and 1998. Iberia, Líneas Areas de España, S.A. may enter into operating lease contracts with the companies owning each plane for an initial seven-year period. It must also contribute US\$ 73.5 million to

finance the companies that will purchase these planes from the manufacturer. The cost of these three A-340 aircraft is approximately US\$ 324 million. The basic cost of the remaining five A-340 aircraft, scheduled for delivery in 1999, 2000 and 2001, is approximately US\$ 360 million.

As security for these transactions relating to the A-340 aircraft, Iberia, Líneas Aéreas de España, S.A. subscribed U.S. dollar promissory notes in favor of Airbus with an equivalent peseta value as of December 31, 1996, of Ptas. 1,487 million. The advances paid to Airbus for future aircraft totaled Ptas. 2,292 million as of December 31, 1996.

A previous purchase commitment for eight A-321 aircraft was canceled in 1994. The recovery of the US\$ 13 million advanced by Iberia, Líneas Aéreas de España, S.A. to Airbus for the purchase of the aforementioned A-321 aircraft was conditional upon Iberia, Líneas Aéreas de España, S.A. or other Iberia Group companies placing an order for aircraft or spare parts of approximately US\$ 400 million by December 13, 1996, for delivery by Airbus by December 15, 2000. This purchase commitment was canceled in 1996 following agreement with Airbus that the US\$ 13 million would be used to finance one of the companies that will acquire the next A-340 aircraft.

#### ***Agreements relating to other aircraft***

In 1995 Iberia, Líneas Aéreas de España, S.A. sold four DC-9 aircraft, one of them to Austral Líneas Aéreas - Cielos del Sur, S.A., for a total of Ptas. 683 million, giving rise to a net capital gain of Ptas. 430 million which is recorded under the "Gains on fixed asset disposals" caption in the accompanying consolidated 1995 statement of loss.

In 1996 Iberia, Líneas Aéreas de España, S.A. sold three DC-10 aircraft for a total of Ptas. 4,823 million, giving rise to a gain of Ptas. 2,352 million, which is recorded under the "Gains on fixed asset disposals" caption in the accompanying 1996 consolidated statement of income.

As of December 31, 1996, two A-300 aircraft that had been withdrawn from service at the end of 1992 as a result of the passenger ticket demand situation remained inactive. As of December 31, 1996, the net book value of the airframes of these aircraft, which was the same as their residual value, amounted to Ptas. 1,631 million. Various options are currently being analyzed for these two aircraft.

In 1993 Iberia, Líneas Aéreas de España, S.A. sold six A-320 aircraft and five MD-87 aircraft. Subsequent to this sale, it entered into operating lease contracts on these aircraft. The net capital gain of Ptas. 5,361 million on the sale of these aircraft was recorded under the "Deferred revenues" caption in the consolidated balance sheet. Ptas. 1,100 million of this gain were charged in both 1996 and 1995 to the "Other operating revenues" caption in the accompanying 1996 and 1995 consolidated statements of income (loss).

### Aircraft in service

The aircraft in service of the companies consolidated by the global integration method in 1996 are summarized as follows:

Type of Aircraft	Owned by the Companies	Under Financial Lease	Under Operating Lease	Total
B-727	23	-	5	28
B-737	2	2	5	9
B-747	6	-	1	7
B-757	-	1	7	8
A - 300	8 (a)	-	-	8
A-320	11	5	6	22
A-340	-	-	4	4
DC-8	2 (b)	-	1	3
DC-7	27 (c)	-	-	27
DC-10	8 (d)	-	-	8
MD-87	17	2	5	24
MD-88	13	-	-	13
ATR	6	-	-	6
CN-235	7 (e)	-	1	8
	<b>130</b>	<b>10</b>	<b>35</b>	<b>175</b>

(a) Including two inactive aircraft of Iberia, Líneas Aéreas de España, S.A.

(b) Including two aircraft of Cargosur, S.A. leased by Iberia, Líneas Aéreas de España, S.A.

(c) Including four aircraft leased by Iberia, Líneas Aéreas de España, S.A. to its subsidiary Binter Canarias, S.A.

(d) Including three aircraft sold in 1996 and one aircraft leased by Iberia, Líneas Aéreas de España, S.A. to its subsidiary Venezolana Internacional de Aviación, S.A. which was reincorporated into Iberia, Líneas Aéreas de España, S.A.'s fleet in 1997.

(e) Including two Binter Mediterráneo, S.A. aircraft leased to Austral Líneas Aéreas - Cielos del Sur, S.A. (Aerolíneas Argentinas Group) under an operating lease contract.

12 aircraft and their engines had been mortgaged by Iberia, Líneas Aéreas de España, S.A. for a net book value of Ptas. 36,379 million as of December 31, 1996, as security for various loans which had been repaid in full at that date. One aircraft operated by Iberia, Líneas Aéreas de España, S.A. under a financial lease contract had been mortgaged for a net book value of Ptas. 4,793 million as of December 31, 1996. This guarantee was provided by the lessor and owner of the aircraft to third parties.

The operating lease payments paid in 1996 and 1995 by Iberia, Líneas Aéreas de España, S.A. for the aforementioned R-747, R-757, R-727, A-320, A-340 and MD-87 aircraft (28 in 1996 and 24 in 1995) amounted to Ptas. 11,818 million and Ptas. 10,396 million, respectively, and are included under the "Other operating expenses" caption in the accompanying consolidated statements of income (loss) (see Note 18). The detail of the approximate lease payments payable in this connection and of the expected due dates is as follows:

MILLIONS OF U.S.A. DOLLARS	
1997	108
1998	99
1999	55
2000 to 2003	131
	393

***Insurance coverage***

The controlling company and its dependent companies have insurance policies for their property plant and equipment and intangible assets which sufficiently covered their net book value as of December 31, 1996 and 1995. They also have insurance policies for the aircraft leased from third parties in accordance with the conditions stipulated in the related lease contracts. Most of these policies are with Musini, Sociedad Mutua de Seguros y Reaseguros.

## 8 Long-term Financial Investments

The variations in 1996 and 1995 in the balances of the "Holdings in companies carried by, the equity method" caption in the accompanying consolidated balance sheets relate to the effect of recording the controlling company's share in the losses of the Latin American airlines Venezolana Internacional de Aviacion, S.A. and Lineas Aéreas de1 Cobre, S.A.

The Aerolíneas Argentinas Group was excluded from consolidation as of December 31, 1996 (see Notes 3, 4-a and 4-b). The net book value of the 20% holding in the capital stock of Aerolíneas Argentinas, S.A. amounts to Ptas. 3,047 million. This holding is recorded at a cost of Ptas. 24,907 million under the "Long-term investment securities" caption with a provision of Ptas. 21,860 million recorded under the "Provisions" caption in the accompanying consolidated balance sheet as of December 31, 1996.

The controlling company's share (approximately Ptas. 3,090 million in 1996 and Ptas. 5,278 million in 1995) in the Amadeus Group's net worth deficiency is recorded in the "Provisions for third-party liability" account under the "Provisions for contingencies and expenses" caption in the accompanying consolidated balance sheets as of December 31, 1996 and 1995, respectively. Also, the controlling company's share (approximately Ptas. 832 million) in the Latin American company Venezolana Internacional de Aviacion, S.A.'s net worth deficiency is recorded in the "Provisions for third-party liability" account under the "Provisions for contingencies and expenses" caption in the consolidated balance sheet as of December 31, 1996.

As of December 31, 1996, the controlling company's directors assumed the risks for the losses of Líneas Aéreas de1 Cobre, S.A. corresponding to Iberia, Líneas Aéreas de Espana, S.A.'s percentage of ownership of that company up to the limit of the book values of the holding, since the controlling company is not the majority shareholder of that company.

As of December 31, 1996, the controlling company had provided U.S. dollar collateral guarantees for Aerolíneas Argentinas, S.A. to several entities totaling Ptas. 10,644 million. Also, at that same date, the controlling company had provided a U.S. dollar collateral guarantee to a finance entity for Venezolana Internacional de Aviacion, S.A. (VIASA) amounting to Ptas. 6,159 million. The terms of the aforementioned collateral guarantees ensure that they, will not give rise to losses for the Group.

In November 1996 the controlling company submitted a Viability Plan for VIASA which was not accepted by the employees representatives. VIASA's operations were discontinued in January 1997 and, following a resolution adopted by the shareholders, VIASA filed for temporary receivership in March and the company' will now be liquidated.

The accompanying consolidated balance sheet as of December 31, 1996, includes balances with VIASA in connection with investments, loans, current accounts and deposits made on behalf of the latter, which, net of the provisions recorded, totaled Ptas. 10,036 million. Also, in February 1997 Iberia, Líneas Aéreas de España, S.A. undertook to contribute Ptas. 1,577 million to carry out the initial steps of VIASA's liquidation process. Iberia, Líneas Aéreas de España, S.A. has guarantees securing the net balances recorded as of December 31, 1996, basically comprising mortgage guarantees on VIASA's real estate and aircraft.

The directors of Iberia, Líneas Aéreas de España, S.A. consider that the provisions recorded as of December 31, 1996, for existing guarantees and for the adjustment to be made in connection with the overstated liability (see Note 4-h), cover the effect of the loss, if any, that might be incurred as a result of VIASA's liquidation. The Amadeus Group comprises Amadeus Global Travel Distribution, S.A., Amadeus Data Processing GmbH (a German company) and their investees. In 1995 the Shareholders Meetings of these two companies resolved to increase capital with paid-in surpluses totaling ECU 92.1 million. The capital increases were subscribed in full by a U.S. company through the contribution of its computer systems. As a result of this transaction, and following the acquisition by some of the former shareholders of the holding of one of the shareholders in the Amadeus Group, Iberia, Líneas Aéreas de España, S.A.'s holding in the group was 29.2% as of December 31, 1996 and 1995.

As of December 31, 1996 and 1995, the controlling company had provided ECU collateral guarantees for the companies composing the Amadeus Group to several entities amounting to Ptas. 9,232 million and Ptas. 11,563 million, respectively.

The Amadeus Group, whose corporate purpose is the management and operation of a computerized reservation system, has incurred losses in recent years as a result of its operations being in the start-up phase. In 1996 the Amadeus Group reported income, and it is hoped that this situation will be consolidated in the coming years.

The main data on the loans granted by the controlling company included under the "Loans to companies carried by the equity method" caption in the accompanying consolidated balance sheets as of December 31, 1996 and 1995, are as follows:

MILLIONS OF PISEFAS			
	1996	1995	Due Date
Amadeus Group	4,795	4,703	31-12-1998 (a)
VIASA	13,357	11,292	(b)
Iberbus Concha Ltd.	2,583		29-02-2003
Iberbus Rosalia Ltd.	2,563		10-05-2003
Iberbus Chacel Ltd.	2,839		06-09-2003
Iberbus Arenal Ltd.	2,904		18-10-2003
<b>Total</b>	<b>29,041</b>	<b>15,995</b>	
<b>Provision</b>	<b>(4,589)</b>	<b>(442)</b>	

(a) These loans are denominated in ECUs. Ptas. 199 million and Ptas. 905 million of these loans were repaid in 1996 and 1995, respectively.

(b) These credits are instrumented in several loans and promissory notes, secured, in part, by mortgage guarantees and denominated in U.S. dollars. The Ptas. 1,147 million of interest earned in 1996 were recorded with a credit to the "Deferred revenues" caption in the accompanying consolidated balance sheet as of December 31, 1996. Also, the "Long-term financial investments - Provisions" caption in the accompanying consolidated balance sheet as of December 31, 1996, includes a provision of Ptas. 4,589 million to cover the amount of this loan which, in the opinion of the directors, is not sufficiently covered by mortgage guarantees.

The average annual interest rates on the foregoing loans in 1996, in some cases tied to MIBOR or LIBOR, ranged from 5% to 10%.

## 9 Goodwill in Consolidation

The variations in this caption of the accompanying consolidated balance sheets in 1996 and 1995 were as follows:

MILLIONS OF PISEFAS	
Balance at January 1, 1995	22,262
Amortization	(124)
Balance at December 31, 1995	22,138
Amortization	(29)
Retirements	(22,109)
Balance at December 31, 1996	

As of December 31, 1995, the goodwill in consolidation related mainly to the remaining balance of the goodwill arising from the controlling company's acquisition of a majority holding in the capital stock of Aerolíneas Argentinas, S.A. in April 1994.

As a result of the sale of the majority holding in Aerolíneas Argentinas, S.A. (see Note 3), this goodwill was recovered in 1996.

## 10 Short-term Financial Investments

The detail of the balances of this caption in the accompanying consolidated balance sheets is as follows:

	MILLIONS OF PÉSEIAS	
	1996	1995
Government debt securities	35,017	8,272
Short-term deposits	9,000	-
Investments made through SEPI	13,782	3,176
Short-term deposits and guarantees	1,366	2,136 (a)
Unmatured interest receivable	1,319	78
Other short-term financial investments	2,638	9,096 (a)
	<b>63,122</b>	<b>22,758</b>

(a) Including Ptas. 1,552 million and Ptas. 6,386 million relating to the Aerolíneas Argentinas Group.

The government debt securities relate to government debentures and Treasury bills which earned average interest of 9.9% as of December 31, 1996.

## 11 Shareholder's Investment

As of December 31, 1996 and 1995, the capital stock of Iberia, Líneas Aéreas de España, S.A. consisted of 882,512,019 and 213,281,250, respectively, fully subscribed and paid registered shares of Ptas. 130 par value each.

As of December 31, 1996, Sociedad Estatal de Participaciones Industriales (see Note 1) was the majority shareholder Iberia, Líneas Aéreas de España, S.A., with a holding of 39.38%.

On December 23, 1995, the Extraordinary Shareholders' Meeting of Iberia, Líneas Aéreas de España, S.A. resolved to increase capital by Ptas. 87,000 million. This capital increase was approved by the European Commission on January 31, 1996 (see Note 1) and was paid by Téneo, S.A. in two stages: one of Ptas. 36,685 million on April 26, 1996, and the other of Ptas. 50,315 million on June 24, 1996.

On May 22, 1996, the Shareholders' Meeting of Iberia, Líneas Aéreas de España, S.A. resolved to allocate the 1995 loss to the "Prior years' losses" account.

The variations in consolidated equity accounts in 1996 and 1995 were as follows:

	Subscribed Capital Stock	Legal Reserve	Restate Re
Balances at January 1, 1995	69,103	33	
Allocation of 1994 consolidated loss			
Capital reduction and application of reserves to offset the controlling company's loss	(41,376)	(33)	
Reclassification of reserves as a result of the change in the consolidation method applied to Aviacicon y Comercio, S.A. and the Amadeus Group	-	-	
1995 loss, per accompanying consolidated statement of loss			
Other variations	-	-	
Reclassification of reserves (see Note 4-b)	-	-	
Balances at December 31, 1995	27,727	-	
Allocation of 1995 consolidated loss			
Capital increase at the controlling company	87,000	-	
Reclassification of reserves as a result of the change in the consolidation method applied to the Aerolineas Argentinas Group	-	-	
Restatement pursuant to Royal Decree-Law 7/1996	-	-	15,447
1996 income, per accompanying consolidated statement of income	-	-	
Other variations	-	-	
Balances at December 31, 1996	114,727	-	15,447

(a) Including shares of the controlling company amounting to Ptas. 7 million which constitute restricted reserves.

Other services	Prior Years' Losses	Reserves at Companies Consolidated by the Global Integration Method	Reserves at Companies Carried by the Equity Method	Translation Differences	(Loss) Income for the Year Attributable to the Controlling Company	Total
7,240	-	(69,584)	(6,967)	(706)	(44,142)	24,977
(27,726)	-	(10,544)	(5,872)		44,142	
1,409	-	-	-	-	-	-
-	-	5,534 (a)	(5,534) (a)			
-	-	-	-	-	(44,620)	(44,620)
321	-	78	(321)	(548)	-	(470)
(9,244)	(80)	73,574	17,756	-	-	-
	(86)	(942)	(938)	(1,254)	(44,620)	(20,113)
	(44,920)	1,963	(1,663)	-	44,620	-
	-	-	-	-	-	87,000
		869	(869)	-	-	
		2,996	-	-	-	18,443
	-	-	-		3,520	3,520
	-	-	-	565	-	565
	(45,006)	4,886 (a)	(3,470)	(689)	3,520	89,415

### **Restatement Reserve**

From the date on which the tax authorities have reviewed and approved the balance of the "Restatement reserve" account (or the three-year period for review has expired), the aforementioned balance can be used, free of tax, to offset recorded losses (both prior years' accumulated losses and current year losses at each subsidiary) or losses which might arise in the future, and to increase capital stock. From January 1, 2007, the balance of this account can be taken to unrestricted reserves, provided that the monetary surplus has been realized. The surplus will be deemed to have been realized in respect of the portion on which depreciation has been taken for accounting purposes or when the restated assets have been transferred or retired from the accounting records. If this balance were used in a manner other than that provided for in Royal Decree-Law 7/1996, it would be subject to tax.

### **Reserves at companies consolidated by the global integration method and carried by the equity method**

The detail of the balances of the "Reserves at companies consolidated by the global integration method" caption in the accompanying consolidated balance sheets as of December 31, 1996 and 1995 is as follows:

	MILLIONS OF PESETAS			
		1996		1995
	Restatement Reserve	Other Reserves	Total	
Aviacion y Comercio, S.A.	1,560	1,666	3,226	1,673
Binter Canarias, S.A.	593	(4,199)	(3,606)	(3,740)
Binter Mediterraneo, S.A.	-	(5,038)	(5,038)	(4,550)
Compania Auxiliar al Cargo Expres, S.A. (a)	1	41	42	26
Campos Velazquez, S.A.	-	327	327	(49)
Cargosur, S.A.	185	(770)	(585)	1
Iber-Swiss Catering, S.A.	163	(165)	(2)	(210)
Vuelos Internacionales de Vacaciones, S.A.	494	(5,930)	(5,436)	(5,257)
Aerolineas Argentinas Group (a)				(62,448)
Sistemas Automatizados Agencias de Viajes, S.A.	-	102	102	38
Total	2,996	(13,966)	(10,970)	(74,516)
Consolidation adjustments	-	15,856	15,856	73,574
Total	2,996	1,890	4,886	(942)

(a) See Note 4-b

The detail of the consolidation adjustments is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Period amortization taken on goodwill		
in prior years (a)	-	(3,770)
Release of provisions for long-term financial		
investments in the controlling company made by		
dependent companies in prior years (a)	16,096	78,871
Cancellation of dividends received in prior Years	(240)	-
Elimination of gains on fixed asset sales between		
consolidable Group companies (a)	-	(1,789)
Other adjustments (a)	-	262
<b>Total</b>	<b>15,856</b>	<b>73,574</b>

(a) See Note 4-b.

The detail of the balances of the "Reserves at companies carried by the equity method" caption in the accompanying consolidated balance sheets as of December 31, 1996 and 1995, is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Líneas Aéreas del Cobre, S.A.	(1,376)	(1,063)
Venezolana Internacional de Aviación, S.A.	(13,748)	(13,076)
Amadeus Group	(6,836)	(4,555)
<b>Total</b>	<b>(21,960)</b>	<b>(18,694)</b>
Consolidation adjustments	18,490	17,756
<b>Total</b>	<b>(3,470)</b>	<b>(938)</b>

The detail of the consolidation adjustments is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Period amortization taken on goodwill		
in prior years (a)	(589)	(465)
Release of provisions for long-term financial		
investments in the controlling company made by		
dependent companies in prior years (a)	21,489	18,221
Elimination of gains on sales (a)	(1,592)	-
Other adjustments (a)	(818)	-
<b>Total</b>	<b>18,490</b>	<b>17,756</b>

(A) See Note 4-b.

*Other matters*

The restricted reserves at the consolidable Group companies amounted to Ptas. 1,575 million and Ptas. 2,257 million as of December 31, 1996 and 1995, respectively.

Also, as of December 31, 1995, the accumulated losses of Binter Canarias, S.A., Cargosur, S.A., the Amadeus Group, Aerolineas Argentinas, S.A., Lineas Aéreas del Cobre, S.A. and Venezolana Internacional de Aviacion, S.A. had reduced their net worth to less than one-half of their respective capital stock amounts. At that same date, the accumulated loss of Binter Mediterraneo, S.A. had reduced its net worth to less than two-thirds of capital stock. In 1996 the Shareholders' Meetings of the Spanish companies referred to above restored their net worth position through capital reductions.

As of December 31, 1996, the accumulated losses of Binter Mediterraneo, S.A. the Amadeus Group, Aerolineas Argentinas, S.A., Líneas Aéreas del Cobre, S.A. and Venezolana Internacional de Aviacion, S.A. had reduced their net worth to less than one-half of their respective capital stock amounts. At that same date, the accumulated losses of Vuelos Internacionales de Vacaciones, S.A. had reduced its net worth to less than two-thirds of capital stock. Except for Venezolana internacional de Aviación, S.A., these companies are presently evaluating various measures to restore their net worth equilibrium within the periods stipulated in the relevant legislation.

The companies with holdings of 10% or more in the capital stock of the dependent companies as of December 31, 1996, were as follows:

	Percentage of Ownership	Investee
SEPI	67.07	Aviación v Comercio. S.A.
Marítimas Reunidas, S.A.	25.00	Compainia Auxiliar al Cargo Expres, S.A.
Grupo Swiss-Air	30.00	Iber-Swiss Catering, S.A.
Air France	29.20	Amadeus Group
Lufthansa	29.20	Amadeus Group
System One	12.40	Amadeus Group
Fondo de Inversión Venezolano	40.00	Venezolana Internacional de Aviación, S.A.
Banco Provincial	15.00	Venezolana Internacional de Aviación, S.A.
Lan Chile	56.91	Líneas Aéreas del Cobre, S.A.
Andes Holding B.V	12.94	Líneas Aéreas del Cobre, S.A.

## 12 Minority Interests

The variations, by dependent company, in the balances of the "Minority interests" caption in the accompanying consolidated balance sheets as of December 31, 1995 and 1996, were as follows:

	MILLIONS OF PSEFIAS						
	Vuelos Internacionales de Vacaciones, S.A.	Aviación y Comercio, S.A.	Iber- Swiss Catering, S.A.	Compañía Auxiliar al Cargo Expres, S.A.	Aerolíneas Argentinas Group	Amadeus Group	Total
Balance at January 1, 1995	29	-	165	-	443	416	1,053
Share in 1995 income (loss)	(4)	(21)	13	10	(3,810)	-	(3,806)
New companies	-	11,306	-	31	-	-	11,337
Nonconsolidated companies	-	-	-	-	-	(416)	(416)
Balance at December 31, 1995	25	11,285	184	101	(3,367)	-	8,128
Share in 1996 income (loss)	(9)	229	22	6	-	-	248
Nonconsolidated companies	-	-	-	-	3,367	-	3,367
Restatement pursuant to Royal Decree- Law 7/1996	3	3,177	69	-	-	-	3,249
Other	(1)	-	-	(46)	-	-	(47)
Balance at December 31, 1996	18	14,691	275	61	-	-	15,045

The breakdown of the balances of the "Minority interests" caption as of December 31, 1996, is as follows:

	MILLIONS OF PSEFIAS				
	Capital Stock	Reserves	Restatement Reserve	Share in Income (Loss)	Total
Vuelos Internacionales de Vacaciones, S.A.	35	(11)	3	(9)	18
Aviación y Comercio, S.A.	4,962	6,323	3,177	229	14,691
Iber-Swiss Catering, S.A.	150	34	69	22	275
Compañía Auxiliar al Cargo-Expres, S.A.	8	47	-	6	61
	5,155	6,393	3,249	248	15,045

### 13 Provisions for Contingencies and Expenses

The detail of the balances of this caption in the accompanying consolidated balance sheets is as follows:

	MILLIONS OF PESETAS	
	12-31-96	12-31-95
Provisions for pensions and similar obligations	62,472	57,639
Provision for major repairs	19,576	21,656
Other contingencies (Note 5-o)	41,489	52,525
<b>Total</b>	<b>123,537</b>	<b>131,820</b>

The variations in 1995 and 1996 in the provisions for pensions and similar obligations were as follows:

	MILLIONS OF PESETAS		
	Allowance for:		
	Retired Employees and Employees Placed on the reserve	Serving Employees	Total Provision
Balance at January 1, 1995	14,375	31,378	45,753
New company	301	6,983	7,284
Provisions charged to			
Financial expenses	1,172	3,030	4,202
Personnel expenses	-	3,580	3,580
Transfer from the allowance for serving employees to that for retired employees and employees placed on the reserve	2,928	(2,928)	-
Amount used for payments	(3,180)		(3,180)
Balance at December 31, 1995	15,596	42,043	57,639
Provisions charged to			
Financial expenses	1,385	3,177	4,562
Personnel expenses	-	3,766	3,766
Transfer from the allowance for serving employees to that for retired employees and employees placed on the reserve	4,245	(4,245)	-
Amount used for payments	(3,495)	-	(3,495)
<b>Balance at December 31, 1996</b>	<b>17,731</b>	<b>44,741</b>	<b>62,472</b>

## 14 Commitments and Contingencies

As of December 31, 1996 and 1995, certain groups of employees had filed claims under several headings against Iberia, Líneas Aéreas de España, S.A. on which no decision had been handed down by the related courts at those dates. The directors of Iberia, Líneas Aéreas de España, S.A. consider that the liabilities that might arise from these claims are sufficiently covered by the provisions recorded as of December 31, 1996.

In addition to the commitments to aircraft manufacturers (see Note 7) and the guarantees provided for various companies described in Note 8, as of December 31, 1996 and 1995, guarantees totaling Ptas. 15,936 million and Ptas. 9,059 million, respectively, had been provided for third parties.

## 15 Payable to Credit Entities and Promissory Notes

The detail of the debts to credit entities and promissory notes as of December 31, 1996 and 1995, by maturity, is as follows:

December 31, 1996

MILLIONS OF PESETAS							
Currency	Due in:					Subsequent Years	
	1997	1998	1999	2000	2001		
<b>Debts:</b>							
Peseta loans	13,465	3,808	3,772	3,845	3,888	24,463	
Foreign currency loans: Yen	146	242	340	423	3,203	2,927	
ECU	2,920	1,967	1,967	1,967	1,966	14,367	
Dutch guilder	798	521	521	521	521	3,650	
Pound sterling	1,665	1,483	1,483	1,483	1,483	10,381	
U.S. dollar	3,039	2,893	2,806	2,733	2,959	6,334	
Deutsche mark	1,176	1,235	1,302	1,105	1,114	8,854	
	<b>23,209</b>	<b>12,149</b>	<b>12,191</b>	<b>12,077</b>	<b>15,134</b>	<b>70,976</b>	

The weighted average annual interest rates on the foregoing loans in 1996 were 9.5% for peseta loans and 7.5% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

December 31, 1996

MILLIONS OF PESETAS

Currency	Due in:					Subsequent Years
	1996	1997	1998	1999	2000	
Debts:						
Peseta loans	77,400	14,800	7,100	6,528	7,657	40,363
Foreign currency loans: Yen	54	80	251	354	439	6,370
ECU	2,417	1,880	1,880	1,880	1,880	15,624
Dutch guilder	878	525	525	525	525	4,204
Pound sterling	2,374	1,239	1,239	1,239	1,239	9,915
U.S. dollar	23,287	7,524	7,383	7,130	7,702	23,531
Deutsche mark	1,269	1,296	1,349	1,407	1,202	10,278
Other	1,251					
	<b>108,930</b>	<b>27,344</b>	<b>19,727</b>	<b>19,063</b>	<b>20,644</b>	<b>110,285</b>
Promissory notes:						
In pesetas	3,745	-	-	-	-	-
	3,745	-	-	-	-	-

The weighted average annual interest rates on the foregoing loans in 1995 were 10% for peseta loans and 8.5% for foreign currency loans, and some of the rates were tied to MIBOR or LIBOR, respectively.

## 16 Futures and Other Similar Instruments

The breakdown, by derivative, of the notional values held by the controlling company as of December 31, 1996, is as follows:

MILLIONS OF PESETAS

Interest rate risk hedging transactions:	
Interest rate swaps	9,676
Interest rate options and futures	41,172
Exchange risk hedging transactions:	
Options on foreign currencies	81,078
Currency swaps	47,846

NOTE: The foregoing transactions were arranged to fully or partially hedge the controlling company's asset position or cash flow.

## 17 Tax Matters

The corporate income tax of each of the companies consolidated by the global integration method is calculated on the basis of the result per books, which does not necessarily coincide with the taxable base for corporate income tax purposes.

The reconciliation of the consolidated results per books for 1996 and 1995 of the companies composing the tax consolidation group to the taxable bases for corporate income tax purposes is as follows:

### 1996

	MILLIONS OF PSEETAS		
	Increase	Decrease	Amount
Income for the year per books (before taxes)			2,700
Permanent differences	72	(2,824) (a)	(2,752)
Timing differences			
Current year	37,407 (b)	(916)	36,491
Prior years	150	(23,475) (a)	(23,325)
Taxable income (before consolidation adjustments)			13,114
Consolidation adjustments			
Permanent differences	248	(1,639)	(1,391)
<b>Taxable income</b>			<b>11,723</b>

(a) This amount relates mainly to the adjustment for the effect of inflation on the gains obtained by the controlling company on fixed asset disposals.

(b) This amount relates basically to the provisions recorded in 1996 for pension payments and to cover contingencies relating to the subsidiaries.

(c) This amount relates basically to the provisions recorded in prior years to the allowances for pensions, for the employee termination plan, for other commitments to employees and for loans to associated Group companies.

## 1995

MILLIONS OF PSEIAS

	Increase	Decrease	Amount
Loss before taxes per books			(61,932)
Permanent differences	58	(1,599)	(1,541)
Timing differences			
Current year	33,333 (a)	(52)	<b>33,281</b>
Prior years	150	(9,140) (b)	(8,990)
Tax loss (before consolidation adjustments)			<b>(39,182)</b>
Consolidation adjustments			
Permanent differences	74	(299)	(225)
Tax loss			<b>(39,407)</b>

(a) This amount relates basically to the provisions recorded by the controlling company in 1995 to the allowances for pensions, for a portion of the employee termination plan and for other commitments to employees.

(b) This amount relates basically to the provisions recorded in prior years for pension payments and loans to Group companies.

Under the accounting method described in Note 5-p in 1996 and 1995 the companies consolidated by the global integration method composing the tax consolidation group recorded tax credits and debits which led to net credits of Ptas. 820 million and Ptas. 17,312 million in the 1996 and 1995 consolidated statements of income (loss), respectively. The tax credits and debits, which were recorded on the basis of their recovery date under the "Accounts receivable", "Other long-term receivables", "Other nontrade payables" and "Long-term debt - Other accounts payable" captions in the accompanying consolidated balance sheets, arose from:

1996

MILLIONS OF PESETAS

	Short-Term Receivables	Other Long-Term Receivables	Total Receivables	Other Nontrade Payables	Other Long- Term Payables	Total Payables
Taxable income for the year	981	-	981	3,819	-	3,819
Prior years' tax losses available for						
Carryforward	-	140	140	-	-	-
Timing differences arising in the year	760	10,042	10,802	-	260	260
Unallocated prior years' timing						
Differences	5,107	13,838	18,945	-	49	49
<b>Total</b>	<b>6,848</b>	<b>24,020</b>	<b>30,868</b>	<b>3,819</b>	<b>309</b>	<b>4,128</b>

1995

MILLIONS OF PESETAS

	Short- Term Receivables	Other Long- Term Receivables	Total Receivables	Other Long-Term Payables
Tax loss for the year	11,416		11,416	
Prior years' tax losses available				
for carry forward		140	140	-
Timing differences arising in the year	3,334	5,530	8,864	18
Unallocated prior years' timing				
differences	2,020	15,116	17,136	72
<b>Total</b>	<b>16,770</b>	<b>20,786</b>	<b>37,556</b>	<b>90</b>

Sociedad Estatal de Participaciones Industriales, as the controlling entity in the tax consolidation group, is responsible for the effective recovery by the Group of the tax credits recorded as of December 31, 1995, and in 1996 it paid all the short-term tax credits (Ptas. 11,416 million) as of December 31, 1995, relating to the tax loss for 1995.

The estimated years for use of the long-term tax credits as of December 31, 1996, are as follows:

MILLIONS OF PESETAS

Year of Recovery	
1998	2,086
1999	2,148
2000 and subsequent years	19,786
	24,020

The directors of the companies in the consolidated tax group consider that all these credits will be recovered in not more than ten years.

Current Spanish corporate income tax legislation provides various tax incentives to encourage new investments and, through April 1992, job creation. The Spanish consolidated companies availed themselves of the tax benefits envisaged in this legislation and earned tax credits of Ptas. 425 million in 1996 and Ptas. 333 million in 1995 in this connection. The unused tax credits as of December 31, 1996, amounted to Ptas. 4,891 million, and the final years for using them are as follows:

Year Earned	Millions of Pesetas	Last Year of Use
1991	1,184	2000
1992	1,860	2000
1993	980	2000
1994	233	2000
1995	296	2000
1996	338	2001

On January 15, 1997, the tax authorities commenced an audit of the last five years for all the taxes applicable to the controlling company. No material additional liabilities are expected to arise for the controlling company as a result of this tax audit.

## 18 Revenues and Expenses

### a) Net sales

The breakdown of the consolidable Group companies' net sales, by type of activity, is as follows:

	MILLIONS OF PESETAS		
	1996	Nonconsolidated Companies Aerolíneas Argentinas Group 1995	1995
Passenger ticket revenues	418,775	123,545	527,450
Freight revenues	34,315	15,331	48,869
Handling (aircraft dispatching and airport services)	45,469	440	47,442
Technical assistance to airlines	18,054		12,585
Other revenues	22,585	3,157	18,762
Total	539,198	142,473	655,108

### **Passenger ticket revenues**

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

	MILLIONS OF PESETAS	
	1996	1995
Spain and Europe	306,086	296,781
Atlantic	89,316	210,406 (a)
Far East	15,241	13,660
Africa and Middle East	8,132	6,603
<b>Total</b>	<b>418,775</b>	<b>527,450</b>

(a) This amount includes Ptas. 123,545 million of passenger revenues from the Aerolíneas Argentinas Group.

### **Handling services**

In 1992, after a public call for tenders, the Spanish Airports Autonomous Agency (AENA) awarded Iberia, Líneas Aéreas de España, S.A. a contract for the provision of handling services in Spain from April 1, 1993, to April 1, 2000, to act as first operator throughout Spain. Since 1993 AENA has been inviting tenders to act as second handling service operators at the main Spanish airports.

### **Technical assistance to airlines**

This caption includes revenues from aircraft maintenance services rendered to other airlines.

### **b) Purchases**

The detail of the "Purchases" caption in the consolidated statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Aircraft fuel	53,125	61,778
Aircraft spare parts	12,397	12,484
Catering materials	4,597	4,520
Other purchases	6,588	12,109
	<b>76,707</b>	<b>90,891 (a)</b>

(a) This amount includes Ptas. 27,533 million relating to purchases of the Aerolíneas Argentinas Group.

### c) Headcount and personnel expenses

The average number of employees at the companies consolidable by the global integration method, by professional category, in 1996 and 1995 was as follows:

Employees	1996	Nonconsolidated Companies Aerolíneas Argentinas Group 1995	1995
<b>Ground personnel:</b>			
Class 1 technicians	702	721	1,738
Class 2 technicians	612	1,001	1,674
Clerical staff	6,511	2,145	8,845
Other	12,636	2,252	15,486
	<b>20,661</b>	<b>6,119</b>	<b>27,743</b>
<b>Flight personnel:</b>			
Pilots	1,658	562	2,270
Flight engineers	264	117	375
Cabin crew	3,637	1,278	4,775
	5,559	1,977	7,460
	<b>26,220</b>	<b>8,096</b>	<b>35,203</b>

As a result of the Strategic Plan of Iberia, Líneas Aéreas de España, S.A., which was drafted in 1991 and adapted in 1994 by the Program of Measures to meet the new competitive environment (see Note 1), 55 employees were laid off in 1996 and 618 employees in 1995, with a cost of Ptas. 2 17 million and Ptas. 3,190 million, respectively. These amounts were charged to the "Extraordinary expenses" caption in the accompanying 1996 and 1995 consolidated statements of income (loss).

Also, 1,389 employees were laid off at Iberia, Líneas Aéreas de España, S.A. in 1996 with a cost of approximately Ptas. 23,931 million, which was charged to the "Provision for third-party liability" caption in the accompanying consolidated balance sheet as of December 31, 1996.

As of December 31, 1996, it was planned to lay off a further approximately 400 employees. The directors of Iberia, Líneas Aéreas de España, S.A. consider that the amounts recorded in this connection under the "Provision for third-party liability" caption in the accompanying consolidated balance sheet as of December 31, 1996, reasonably cover the expected cost of the planned terminations.

Also in 1995, and under its operational restructuring and downsizing plans, the Aerolíneas Argentinas Group continued the program to reduce headcount implemented in prior years. 1,457 employees were terminated under this program in 1995 at a cost of Ptas. 2,261 million and Ptas. 257 million, which is recorded under the "Extraordinary expenses" and "Personnel expenses"

captions, respectively, in the accompanying 1995 consolidated statement of loss. These captions also include costs of Ptas. 647 million and Ptas. 25 million, respectively, relating to the provisions for future employee termination indemnities.

Under the controlling company's Strategic Plan, most of the operations of Cargosur, S.A. were absorbed in 1995 and, accordingly, 97 of this company's employees were laid off in 1995, with a cost of approximately Ptas. 780 million, which was recorded under the "Extraordinary expenses" caption in the accompanying 1995 consolidated statement of loss.

In compliance with the agreements entered into with its employees at the end of 1994, in January 1995 the controlling company paid them an extra payroll in January 1996 and January 1995, the amount of which is reflected under the "Agreements with the controlling company's employees" caption in the 1996 and 1995 consolidated statements of income (loss). Under these agreements, the controlling company recorded a provision of Ptas. 2,879 million with a charge to the "Agreements with the controlling company's employees" caption in the accompanying 1996 consolidated statement of income, for the estimated cost of the shares that the controlling company must transfer to its employees in early 1997.

Also, under the agreements entered into at the end of 1994, the controlling company undertook to pay its employees a percentage of the 1996 and 1995 results from ordinary activities exceeding those envisaged in the viability plan. As of December 31, 1996 and 1995, the controlling company had recorded the related provision with a charge to the "Agreements with the controlling company's employees" caption.

#### **d) Other operating expenses**

The detail of the balances of this caption in the accompanying statements of income (loss) is as follows:

MILLIONS OF PESETAS			
	1996	Nonconsolidated Companies Aerolíneas Argentinas Group 1995	1995
Commercial expenses	54,597	27,671	85,803
Air traffic levies and charges	44,132	15,240	62,780
Maintenance (a)	21,065	5,532	21,773
Navigation aids	18,302		20,475
Aircraft rentals (Note 7)	15,886	6,774	22,759
Other	73,192	28,875	87,627
	<b>227,174</b>	<b>86,092</b>	<b>301,439</b>

(a) Including maintenance expenses and provision for major repairs.

### e) Extraordinary expenses

The detail of the balances of the "Extraordinary expenses" caption in the accompanying 1996 and 1995 consolidated statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	1996	1995
Indemnity payments and extraordinary expenses relating to employees	217	15,857 (a)
Provision for third-party liability	17,454	34,540 (a)
Provision for depreciation of nonoperating assets	1,132	988
Reversal of the provision for the technical revaluation of Aerolíneas Argentinas, S.A.	-	4,191
Other extraordinary expenses	665	3
	<b>19,468</b>	<b>55,579</b>

(a) These amounts include Ptas. 1,015 million and Ptas. 2,378 million of indemnity payments and extraordinary expenses relating to employees and provision for third-party liability, respectively, at the Aerolíneas Argentinas Group.

### 19 Contribution of Group and Associated Companies to the Consolidated Results --

The contribution of Group and associated companies to the 1996 and 1995 consolidated results was as follows:

	MILLIONS OF PESETAS	
	Income/(Loss)	
	1996	1995
Iberia, Líneas Aéreas de España, S.A.	4,415	(20,959)
Aviación y Comercio, S.A.	113	(6)
Binter Canarias, S.A.	(103)	(459)
Binter Mediterraneo, S.A.	(744)	(488)
Compañía Auxiliar al Cargo Expres, S.A.	21	14
Campos Velázquez, S.A.	253	376
Cargosur, S.A.		(771)
Iber-Swiss Catering, S.A.	50	45
Vuelos Internacionales de Vacaciones, S.A.	(1,807)	(674)
Aerolíneas Argentinas Group (a)		(18,499)
Sistemas Automatizados Agencias de Viajes, S.A.	65	66
Amadeus Group	1,671	(2,281)
Venezolana Internacional de Aviación, S.A.	(414)	(672)
Líneas Aéreas del Cobre, S.A. (a)		(312)
<b>Income (loss) attributed to the controlling company</b>	<b>3,520</b>	<b>(44,620)</b>

(a) As explained in Notes 3, 4-a, 4-b and 8, the Aerolíneas Argentinas Group was excluded from consolidation as of December 31, 1996. Also, as indicated in Note 8, it was not possible to obtain any information on the 1996 results of Líneas Aéreas del Cobre, S.A., and Iberia, Líneas Aéreas de España, S.A. recorded a provision for the full net book value of its holding in this company.

The detail of the balances of the "Income (loss) attributed to minority interests" caption in the accompanying 1996 and 1995 consolidated statements of income (loss) is as follows:

	MILLIONS OF PESETAS	
	<b>Income/(Loss)</b>	
	<b>1996</b>	<b>1995</b>
Aviacion y Comercio, S.A.	229	(21)
Compania Auxiliar al Cargo Expres, S.A.	6	10
Iber-Swiss Catering, S.A.	22	19
Vuelos Internacionales de Vacaciones, S.A.	(9)	(4)
Aerolineas Argentines Group (a)		(3,810)
Income (loss) attributed to minority interests	248	(3,806)

(a) see Note 4-b

## **20** Directors' Remuneration and Other Benefits

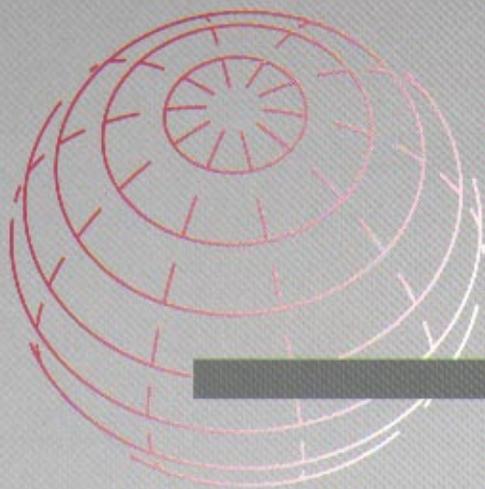
The remuneration earned by the directors of Iberia, Líneas Aéreas de Espana, S.A. in the form of per diem, wages and salaries and insurance premiums amounted to Ptas. 109 million in 1996 and Ptas. 62 million in 1995.

In 1996 and 1995 no advances or loans were granted to the controlling company's directors and there were no pension commitments to them.

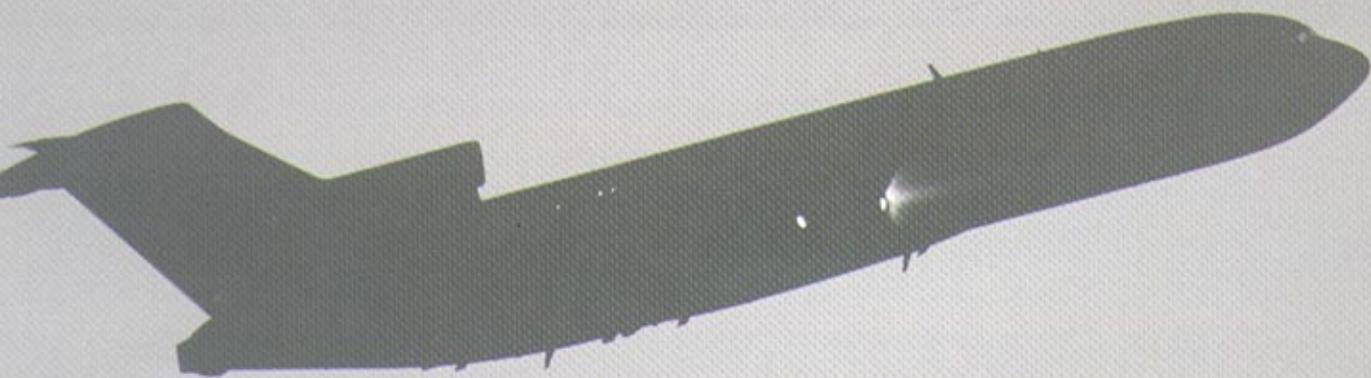
## **21** Explanation Added for Translation to English

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





## 1996 CONSOLIDATED MANAGEMENT REPORT



Due to its length, this publication includes only a summary of the management report.  
The complete text has been deposited with the Madrid Mercantile Register.

## 1 1996 Highlights

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The most significant feature of 1996 was undoubtedly the fact that IBERIA, L.A.E. reported a profit for the first time since 1989.

This was possible mainly because of the effect of the implementation of the so-called "Program to Adapt IBERIA to the New Competitive Environment". The measures envisaged in this program enabled the capital contributed by the shareholder SEPI to be classified as an investment made under market conditions rather than as State aid, which would have forced the Company to adhere strictly to certain obligations that would have limited the freedom of its business management. Notification of the remaining capital increase of Ptas. 20,000 million was made conditional upon the Company meeting certain economic and productivity targets.

In this connection, in 1996, as in 1995, the Company met, and even exceeded, these targets. As regards the important points contained in the Plan, the first stage of the capital contribution was received in 1996, thus enabling the program of early retirements to commence and facilitating the reduction of interest-bearing debt; the planned sale of Aerolineas Argentinas and Ladeco to Andes Holding took place (although IBERIA continues to manage the former); and the transfer of scheduled VIVA routes to IBERIA was completed, leaving VIVA to operate exclusively in the charter flights market. As regards aircraft, the new Airbus A-340 (four of which were received in 1996, the first in March) came into service. The use of this new state-of-the-art aircraft represents a significant qualitative leap from the operational and passenger service viewpoints.

It should be noted that, except for the layoff plan and the aforementioned additional capital contribution, the adaptation program was completed in 1996 and the Company does not have to meet any more targets in this connection in the coming years. Under the adaptation program, the first capital contribution of Ptas. 37,000 million was made in March and was allocated to the allowance for the layoff plan (the early retirements did not commence until June for this reason). A second contribution of Ptas. 50,000 million was made in May, thus bringing the total contribution up to the Ptas. 87,000 million agreed on with the European Union for the year.

Another prominent event in 1996, which falls under the freedom of management concept referred to earlier, was the signature in March of productivity agreements with the labor union representatives of employees of all categories. As a result, using the same resources, a new flight schedule, broader than that initially envisaged, came into force at the end of the first quarter with the Summer schedule. Thanks to the new productivity measures, in addition to incorporating the direct Madrid-Bogota route using A-340 aircraft (formerly operating via Santo Domingo) and adding two direct

Madrid-Sao Paulo flights a week (also using A-340 aircraft) to the four flights with a stopover in Rio de Janeiro, the new schedule includes the following network changes (with the concomitant increase in production):

- The establishment of four new European routes, Madrid-Porto, Madrid-Stuttgart, Madrid-Hannover and Madrid-Venice, via Barcelona.
- An increase in the number of flights from Madrid to Miami, and from Miami to Cancun, Managua, San Pedro and San Salvador. The frequency of flights was also increased on the long-haul Mexico and Havana routes, and on the Brussels, Tel Aviv, Cairo and other medium-haul routes.
- The recovery of European routes, specifically:
  - Barcelona-Munich
  - Madrid-Barcelona-Manchester
  - Madrid-Barcelona-Dublin
  - Santiago-Bilbao-Paris
  - Bilbao-Frankfurt
  - Santiago-London
  - Sevilla-London

The greater than initially expected production had a notable impact on the Company's services areas, particularly handling and maintenance services, in which there was a significant increase in expenses coupled with a sharp rise in productivity.

The scheduling changes enabled the Company to respond to trends in the market, which grew significantly overall in 1996 within the context of the general recovery of the air industry throughout the world. Against the backdrop of growing competition which characterized the market in 1996, notable achievements by IBERIA included the slight increase of 0.2% in the load factor and the 8.8% increase in production with respect to 1995.

As a result of the Plan, the productivity agreements and the positive market performance described above, the Company's earnings improved significantly, thus enabling it to face the future with clear prospects of ensuring its ongoing viability, provided that the measures to cut costs and increase productivity are stepped up with a view to the stiff competition which will foreseeably intensify in all the business areas in which IBERIA operates. In addition to the continual price and destination offers made by IBERIA's competitors, new threats emerged in 1996:

- Firstly, not only are European airlines intensifying “point-to-point” traffic competition, but they are now focusing their strategy on attracting traffic to their networks through their newly strengthened hubs, drawing traffic away from the networks themselves. In this regard, congestion at Barajas airport, IBERIA’s principal hub, increased notably in the second half of 1996, and the situation is set to worsen over the next two years, thus restricting the Company’s response capability.
- Secondly, the competition already existing was heightened by the appearance of new European operators in 1996 with the common feature of low operating costs, due to their innovative approach to the use and cost of resources, to the absence of in-flight service and to their distribution systems which are not based on the traditional travel agency channel, but rather on direct telephone sales and, in general, ticketless transport, thus significantly reducing operating costs. The three main companies operating under this system are EasyJet, Virgin Express and Debonair, which have commenced operations with a notable presence in the Spanish market.
- Thirdly, the Spanish scheduled flight companies, which stepped up supply in the last quarter of 1996, may now be in a position to cater for connecting traffic, and are indeed preparing the groundwork for this by developing sufficiently extensive domestic and international networks (proprietary or through agreements with other companies), thereby penetrating a market in which they presently do not have a significant presence. IBERIA’s response in 1996 consisted of launching the “ESTRELLA” fare, targeted at the lowest domestic flight price segment, in October.
- Lastly, 1996 witnessed the formation or forging of large-scale alliances, some of which achieved immunity from anti-trust regulations. While it is true that these alliances must overcome major obstacles, once they have been formed they will constitute a formidable source of competition for those that do not form part of these groups. In this respect, in 1996 IBERIA established close ties (now at an advanced stage) with several companies, which will enable it to play an important role in this process.

In connection with the theme of competition, the following aspects of 1996 must also be highlighted:

- Regional aviation, which has made notable headway in Spain and will continue to do so in the future, has experienced how the established national airlines have incurred significant

losses which are forcing them to rethink their approach to operations. Such is the case of Air Track (LAN and LAG) and Air Nostrum. Prima Air, which commenced operations in February, went out of business six months later. However, certain new projects were successful, such as Air Europa Express, albeit behind schedule. IBERIA also responded to this situation in 1996 with the establishment in December of a franchising agreement with Air Nostrum, the first of its kind in Spain, which will lead, at Air Nostrum's risk, to the coordination of the latter's flights with the IBERIA network and to its adoption of IBERIA's corporate image and distribution system. Due to the size of the aircraft used, it will also pave the way for operations on low-density European routes. None of the foregoing affects the plans being developed for the Group companies Binter Canarias and Binter Mediterraneo.

- In the handling area, in 1996 AENA awarded the second-operator licenses for the Madrid, Palma, Ibiza, Mahbn and Alicante airports to Ineuropa Handling (Entrecanales, Cubiertas and Frankfurt airport), and for the Barcelona and Malaga airports to Iberhandling (FCC and Air Europa). It also awarded the second-operator freight handling license at Barajas airport to OGDEN CARGO and ALLIEASA. These licenses concluded the process initiated in 1994 for airports with more than one million passengers per year.

Although IBERIA's market performance and revenues exceeded expectations in 1996, major efforts will undoubtedly be required to increase productivity, cut costs and selectively increase the level of investment in order to guarantee the required level of competitiveness in a highly attractive business in terms of profitability.

Competition forced the Company to take firm measures to defend its revenues and market shares. Efforts continued in 1996 to contain the general costs resulting from the Expense Reduction Program (PREGA), which had a particular impact in 1996 on the review of procedures and price negotiations. A salient feature of 1996 was the 19.3% increase in fuel prices with respect to 1995 year-end, which accounted for almost Ptas. 7,200 million of the total increase of Ptas. 9,803 million in fuel costs, the remainder being due to increased production. The increase forced the IATA airlines to agree on a rise in published fares to attempt to at least partly offset its effect.

In short, 1996 was a good year, in which the foundations were laid for an encouraging future that may place IBERIA in an attractive position with regard to its advantageous participation in one of the large international groups being formed that will open up new horizons in the air transport industry. Accordingly, in the face of the aforementioned threats,

the productivity, cost containment and commercial management achievements of 1996, while significant, are clearly insufficient and must be continued and stepped up in the future.

In line with the foregoing, in late 1996 and early 1997 the Company defined its strategic action plan for 1997-1999 which gave rise to a set of principles and measures embodied in the so-called "Master Plan". The Plan's objective is to make the Group fully competitive by the end of the period.

The measures contained in the Plan are open to fresh approaches that will help to attain the pursued objective and must be implemented by all the Company's employees, particularly its flight personnel. The strategy is based on three unalterable pillars:

- a) the definition of a series of measures that will substantially improve the net yield in an environment in which there is a clear trend towards the opposite.
- b) cost cutting and improved productivity of the labor force, particularly that of flight personnel (technicians and auxiliary staff) not primarily based on a reduction in the number of employees.
- c) the implementation of a new management model that will facilitate, on the one hand, better use of the Group's most expensive resources (aircraft and flight crews) through single network management and scheduling and, on the other, the segregation of the service areas into independent companies controlled and majority owned by the Group in order to make them more competitive and ensure their overall profitability.

Lastly, in November 1996 IBERIA submitted a viability plan for VIASA, which was unanimously accepted by the directors and shareholders and was presented to the employees' representatives for negotiation at the beginning of December.

Various circumstances, particularly the virtual refusal by the employees' representatives to negotiate the Plan and their categorical rejection of the set of measures essential for saving the company, without offering any serious and rigorous alternatives, led in the first instance to the halt of the company's operations and, subsequently, following contacts between the shareholders, to the filing at the beginning of March 1997 for temporary receivership and, finally, to the liquidation of the company by the mutual agreement procedure. This situation should enable IBERIA to recover the mortgage guarantees (Viasa's aircraft and buildings) on a portion of the loans that it granted to its investee in recent years.

The Group companies and their shareholder decided to restate their assets pursuant to Royal Decree-Law 7/1996 and Royal Decree 2607/1996 implementing it.

## 2 Group Production

### 2.1 Supply

As a result of the favorable trends in the markets, the Air Transport Group taken as a whole reported a significant increase in supply in 1996 which, in the case of IBERIA, was made possible by the productivity agreements entered into with its employees.

The other companies in the Spanish Group, with the exception of VIVA, which is fully integrated in the charter market, also saw increases in their supply.

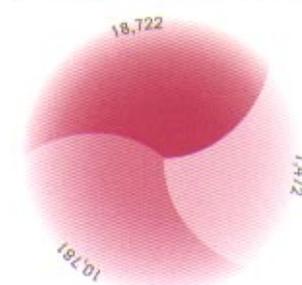
	MILLION ASK'S			
	1996	1995	Variation 96/95	% Variation
SPAIN	7,472	6,030	1,442	23.7
EUROPE	10,781	10,837	(56)	(0.5)
LONG-HAUL	18,722	17,105	1,617	9.4
<b>IBERIA, L.A.E.</b>	<b>36,975</b>	<b>33,972</b>	<b>3,003</b>	<b>8.8</b>
AVIACO	4,658	4,302	356	8.3
VIVA	2,036	2,310	(274)	(11.8)
BINTECANARIAS	439	436	3	0.6
BINTEMEDITERANEO	79	77	2	3.0
<b>SPANISH GROUP</b>	<b>44,187</b>	<b>41,097</b>	<b>3,090</b>	<b>7.5</b>
ARSA	15,302	14,623	679	4.6
VIASA	5,490	5,702	(212)	(3.7)
AUSTRAL	2,582	2,546	36	1.4

As regards the South American investees, the sustained growth in supply of Aerolineas Argentinas was maintained in the long-haul market in 1996, whereas it grew more slowly in the short-haul market, as evidenced by Austral's supply. The reduction in the supply of Viasa was due to the labor disputes in the summer.

### 2.2 Demand

The various Group areas and companies carried approximately 29.9 million passengers in 1996, 4.9% more than in 1995.

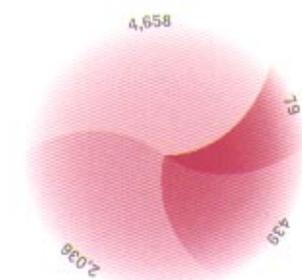
IBERIA LAE ASK's Supply  
(MILLION ASK'S)



Total IBERIA LAE 1996: 36,975



SPANISH GROUP ASK's Supply  
(MILLION ASK'S)



Total SPANISH GROUP 1996: 44,187



The breakdown by area/company is as follows:



	THOUSANDS OF PASSENGERS			
	1996	1995	Variation 96/95	% Variation
SPAIN	7,277	6,267	1,010	16.1
EUROPE	5,494	5,644	(150)	(2.6)
LONG-HAUL	1,852	1,754	98	5.6
<b>IBERIA, L.A.E.</b>	<b>14,623</b>	<b>13,665</b>	<b>958</b>	<b>7.0</b>
AVIACO	5,274	5,189	85	1.6
VIVA	988	962	26	2.7
BINTER CANARIAS	1,782	1,818	(36)	(2.0)
BINTER MEDITERRANEO	186	238	(52)	(22.0)
<b>SPANISH GROUP</b>	<b>22,853</b>	<b>21,872</b>	<b>981</b>	<b>4.5</b>
ARSA	4,032	3,825	207	5.4
VIASA	937	950	(13)	(1.4)
AUSTRAL	2,084	1,855	229	12.4

The breakdown of RPK, by unit, is as follows:

	MILLIONS RPK'S			
	1996	1995	Dif. s/a.a.	% s/a.a.
SPAIN	5,059	3,920	1,139	29.1
EUROPE	6,999	7,003	(4)	(0.1)
LONG-HAUL	13,873	12,841	1,032	8.0
<b>IBERIA, L.A.E.</b>	<b>25,931</b>	<b>23,764</b>	<b>2,167</b>	<b>9.1</b>
AVIACO	2,819	2,603	216	8.3
VIVA	1,544	1,457	87	5.9
BINTER CANARIAS	317	322	(5)	(1.8)
BINTER MEDITERRANEO	44	54	(10)	(18.2)
<b>SPANISH GROUP</b>	<b>30,655</b>	<b>28,200</b>	<b>2,455</b>	<b>8.7</b>
ARSA	10,195	9,685	510	5.3
VIASA	3,567	3,791	(224)	(5.9)
AUSTRAL	1,768	1,648	120	7.3

The Group's RPK also improved with respect to 1995. However, whereas the Spanish Group's medium-haul routes increased by 4%, those of the three South American companies decreased

Noteworthy with respect to the South American investees was the fall in Viasa's traffic due to this company's poor performance between June and September, which led the market to reject its supply.

### 2.3. Passenger load factor

The Spanish Group's load factor of 69.4% in 1996 was 0.8 percentage points higher than in 1995.

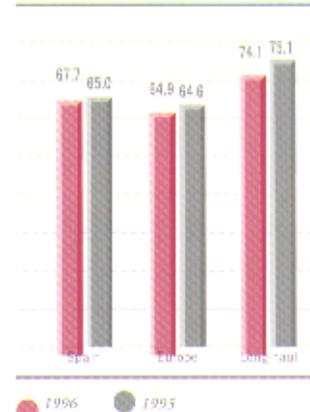
The breakdown of this figure, by unit, was as follows:

SPAIN	67.7	65.0	2.7	0.8
EUROPE	64.9	64.6	0.3	0.4
LONG-HAUL	74.1	75.1	(1.0)	(1.3)
IBERIA, L.A.E.	70.1	70.0	0.1	0.3
AVIACO	60.5	60.5		
VIVA	75.8	63.1	12.7	20.2
BINTER CANARIAS	72.2	73.9	(1.7)	(2.4)
BINTER MEDITERANEO	54.8	69.1	(14.3)	(20.6)
SPANISH GROUP	69.4	68.6	0.8	1.1
ARSA	66.6	66.2	0.4	0.6
VIASA	65.0	66.5	(1.5)	(2.3)
AUSTRAL	68.5	64.7	3.7	5.8

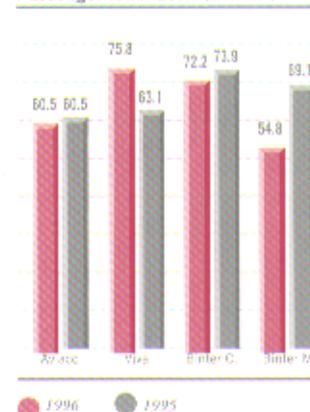
The improved load factor for the Spanish Group as a whole reflects the efforts made to tailor supply to demand,

The load factor of Aerolineas Argentina and Austral also improved, unlike that of Viasa, which fell by 1.5 percentage points.

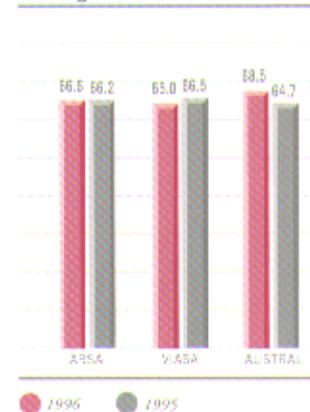
IBERIA LAE Passenger load factor  
(Load factor)



SPANISH GROUP  
Passenger load factor (Load factor)



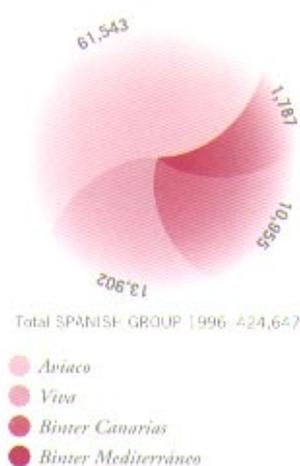
South American investees  
Passenger load factor (Load factor)



IBERIA LAE Passenger revenues  
(Millions of Pesetas)



SPANISH GROUP  
Passenger revenues (Millions of Pesetas)



## 2.4. Average yield (Ptas./RPK)

The detail of the variations in the average yield, by area/company, in 1996, and of comparable figures for 1995 is as follows:

	(Ptas./RPK)			
	1996	1995	Variation 96/95	% Variation
SPAIN	18.6	20.1	(1.5)	(7.6)
EUROPE	19.1	19.1	0.1	0.4
LONG-HAUL	7.8	7.8	-	0.1
<b>IBERIA, L.A.E.</b>	<b>13.0</b>	<b>13.2</b>	<b>(0.2)</b>	<b>(1.5)</b>
AVIACO	21.8	22.4	(0.6)	(2.6)
VIVA	9.0	12.8	(3.8)	(29.6)
BINTER CANARIAS	34.6	33.7	0.9	2.8
BINTER MEDITERRANEO	40.6	41.8	(1.4)	(3.2)
<b>SPANISH GROUP</b>	<b>13.9</b>	<b>14.3</b>	<b>(0.4)</b>	<b>(3.1)</b>
(U.S. Cents)				
ARSA	7.8	7.9	(0.1)	(1.5)
VIASA	6.4	6.4	-	(0.2)
AUSTRAL	12.1	13.4	(1.13)	(9.7)

## 2.5. Passenger revenues

The breakdown of the Spanish Group's passenger revenues in 1996, which amount to Ptas. 424,647million (up 5.3% on 1995) is as follows:

	(AMOUNTS IN MILLIONS OF PESETAS AND THOUSANDS OF U.S. DOLLARS)			
	1996	1995	Variation 96/95	% Variation
SPAIN	93,876	78,737	15,139	19.2
EUROPE	133,974	133,745	229	0.2
LONG-HAUL	108,610	100,494	8,116	8.1
<b>IBERIA, L.A.E.</b>	<b>336,460</b>	<b>312,976</b>	<b>23,484</b>	<b>7.5</b>
AVIACO	61,543	58,329	3,214	5.5
VIVA	13,902	18,673	(4,771)	(25.6)
BINTER CANARIAS	10,955	10,844	111	1.0
BINTER MEDITERRANEO	1,787	2,257	(470)	(20.8)
<b>SPANISH GROUP</b>	<b>424,647</b>	<b>403,079</b>	<b>21,568</b>	<b>5.4</b>
(THOUSANDS OF U.S. DOLLARS)				
ARSA	794,892	765,472	28,104	3.8
VIASA	229,370	244,250	(14,880)	(6.1)
AUSTRAL	214,520	221,346	(6,826)	(3.1)

the variations in 1996 in passenger revenues were as follows:

	Variation	Cause of the Variation		
	96/95	Price	Volume	Parity
DOMESTIC	15,139	(7,647)	23,044	(257)
EUROPE	229	1,258	(158)	(871)
LONG-HAUL	8,116	1,370	8,142	(1,396)
<b>IBERIA, L.A.E.</b>	<b>23,484</b>	<b>(5,019)</b>	<b>31,027</b>	<b>(2,524)</b>
AVIACO	3,214	(1,571)	4,785	n/a
VIVA	(4,772)	(5,415)	797	(154)
BINTER CANARIAS	111	295	(184)	n/a
BINTER MEDITERRANEO	(470)	(53)	(417)	n/a
<b>SPANISH GROUP</b>	<b>21,568</b>	<b>(11,763)</b>	<b>36,008</b>	<b>(2,678)</b>

The improvement in revenues was generally due to a notable increase in demand, which had a positive impact on the load factor, although it was partially offset by a reduction in the average yield, partly due to the decline in the peseta exchange rate.

### 3 Activities of the Air Transport Group

#### 3.1. Iberia: Passenger traffic (by area)

	1996	1995	Variation 96/95	% Variation
Million ASK's	36,975	33,972	3,003	8.8
Million RPK's	25,931	23,764	2,167	9.1
Load Factor (%)	70,1	70,0	0,1	0.3
Yield (Ptas./RPK:)	13,0	13,2	(0,2)	(1.5)
Passenger Revenues (millions of pesetas)	336,460	312,976	23,484	7.5

Production rose as a result of the productivity agreement reached with the pilots, enabling better use to be made of resources from April/May onwards.

The most noteworthy events in this area were the inauguration of routes to four new European destinations (Hannover, Stuttgart, Venice and Porto), the increase in the frequency of flights to Havana, Mexico City and Miami and the increased supply with second product ("Estrella" fare) reservations in the Madrid/Barcelona segment.

Yield was down by 1.3% (Ptas. 0.2) with respect to 1995, due partly to price wars, particularly in the short-medium-haul areas, but due also to a new traffic structure, since the average haul increased by 2%, over 1995 (the domestic market's RPK increased by only 2.4%, as compared with 8.8% for IBERIA as a whole). In addition, all VIVA's lower-yield tourist routes were incorporated in 1996.

Since ASK's grew by 8.8% and revenues 7.5%, revenues per ASK fell by, 1%.

Because of its impact on this analysis of the 1996 figures, it should be noted that in November 1996 ASK's were 47% higher and short- and medium-haul revenues were 46% higher than in November 1995, due to the well-supported pilots' strike in 1995. Accordingly, the 1996 figures reflect disproportionately high increases.

Salient measures taken in 1996 to strengthen Iberia's competitive position were:

- The introduction of the new Business II Class European routes to contribute to the recovery of business market share.
- A more aggressive policy for defending domestic market share through new fares ("Estrella" fare) and increased supply (growth in the Madrid/Barcelona segment through the second product -"Estrella" fare).
- Preliminary agreement with Air Nostrum for its inclusion as a franchise in the IBERIA network so as to feed the network in Madrid and Barcelona and to increase domestic market share.
- Introduction in the Spanish market of "Monthly Offers" covering specific offers to various destinations in the international network. The offers gained increasing notoriety in the media and boosted the image that IBERIA is trying to improve in the Spanish market of having competitive fares.
- In the latter part of 1996, coinciding with the delays caused by oversaturation at Barajas, for the first time a large-scale personalized communication policy was introduced under the Iberia Plus program to offer apologies and Iberia Plus points to all customers who experienced delays.

Lastly, the situation of Barajas airport should be mentioned for its negative impact on the company. The negative punctuality, indexes at this Airport, which is the IBERIA network's hub, are deteriorating Iberia's image and the levels of saturation are preventing production growth.

### 3.2. Freight

1996 saw the consolidation of the operation of the three DC-8 freight aircraft initiated on July 1, 1995, following the absorption of CARGOSUR by IBERIA, L.A.E's Cargo Unit, with the implications that this has on comparison of the 1996 and 1995 results (reclassification of results by, nature, higher fuel, aircraft maintenance and aircraft traffic service expenses and lower freight aircraft lease costs).

To supplement the freighter aircraft fleet and in order to cater for demand in the South Atlantic network, one-half of the hold of a weekly B-747 round-trip flight on the BUE-MAD-MST route was rented from Aerolineas Argentinas. This route commenced in mid-April and is so far yielding satisfactory results.

As in prior years, the policy applied throughout 1996 was based on the optimization of cargo holds in passenger planes, supplemented by freight aircraft and the rental of holds from other companies in order to meet the demand of certain markets and to act in general as a freight market stabilizing and regulatory factor.

The freight aircraft used in 1996 was once again three DC-8 aircraft, with a capacity of around 35 tonnes, depending on the length of the legs flown and the density of the cargo. The markets served are as follows:

- Canary Islands market. The Company covers the needs of the Postal Service and of the cargo market in general, which is mostly made up of couriers and warehouse distributors.
- European market. The scarcity, of pallet transporters in Europe makes it necessary to operate freight aircraft flights to MST (Maastricht) as network flights (centralization of European freight services).
- American market. Freight aircraft are operated to supplement the fluctuating supply of passenger flights on which there is high cargo demand which cannot be met by the passenger aircraft.

The composition of freight supply in 1996 was as follows: 75.6% in passenger aircraft cargo holds and 24.4% in freight aircraft (either with our DC-8 planes or in holds rented from third parties).

The increase in demand in terms of RTK's related mainly to the long-haul network, demand in which grew by 15% and represented 81.9% of the total RTK's in 1996.

Various factors contributed to the reduction in yield (6.8%):

- On the one hand, the 15% rise in demand in the intercontinental network (offsetting the low yield), as compared with the increase of only 2% in demand in the short- and medium-haul networks (offsetting the high yield).
- The fall of the yen in the Far East market.
- The growth in the lowest fare traffic under the policy of improving the load factor on routes (for example, the average yield on Europe/Argentina routes is at least three times higher than that on the Argentina /Europe routes).

Another noteworthy event in the freight area was the entry of a second operator for handling services at the Madrid and Barcelona terminals in April 1996, although the effects were not as marked in the first year as had been feared. In fact, the number of kilograms handled in Madrid fell by only 1.7% , and the number increased by 17.1% in Barcelona (basically due to outgoing traffic).

### **3.3. Handling**

The process of deregulating handling services at Spanish airports commenced in 1994. By the end of 1995 the Las Palmas, Tenerife, Arrecife and Fuerteventura airports had been deregulated.

Handling services at the Bilbao, Santiago, Sevilla, Valencia, Palma, Ibiza and Alicante airports were deregulated in 1996, the latter three in November.

The tenders for Madrid, Barcelona and Malaga were called by AENA (Spanish public airports and aviation agency) in 1996, but the second operators will not commence operations at these airports until April 1997.

The activity of third-party companies at the airports mentioned in the first two paragraphs fell by, 5.2% with respect to 1995, although in the network as a whole third-party activity increased by 2% in 1996.

The total headcount in decreased by 4.8% from 1995, although activity increased by 3%..

The average yield of third-party companies in 1996 increased by 1.2% over the second half of 1995 (in the first half the fares included the handling fee). However, taking into account the 4.4% rise in fares in January 1996, the yield fell by 3% in real terms. Fares can be considered to be remaining steady.

Expenses per weighted plane handled were reduced significantly. However, if the 1995 and 1996 expenses are made comparable, subtracting in both years the target-based remuneration and in 1995 the handling fee (which was eliminated in July 1995), the expenses per weighted plane handled were 5.8% lower in 1996 than in 1995.

The reasons for this reduction were twofold:

- Improved productivity.
- A proportional reduction in personnel expenses as a result of the Viability Plan.

### **3.4. Maintenance**

#### ***Marketing area***

Marketing efforts again focused on products with the best technological prospects, such as airframe, engine and component maintenance for the A-320, MD-87 and B-757 fleets, and on the products in which, thanks to our experience and facilities, we are most competitive (e.g. "D" overhauls of B-747 and JT8D-7Q engines).

The main clients in 1996 were:

Lufthansa	"D" overhauls B-747 y A-320 aircraft
Alitalia:	"D" overhauls B-747 aircraft
Air France:	"D" overhauls B-747 aircraft and CFM56 (A-320) engines
Aerolineas Arg.:	JT9D7Q engines
Olympic Airways:	JT9D7Q y JT8D engines
Air Europa:	RR211 (B-757) engines
Viasa:	JT8D engines and B-727/DC-10 parts
Fawcett:	JT8D engines
Greenwich:	JT9D7Q engines

#### ***New products***

- Consolidation of the "D" overhauls of Iberia and Lufthansa A-320 aircraft.
- Commencement of maintenance of the A-340 aircraft incorporated in the fleet during the year.

#### ***Technological capacity***

- Completion of the wheel shop automation research and development project.
- Commencement of implementation of the aircraft brake shop automation research and development project.
- Implementation of the purchasing module of the OMMIS (aeronautical material planning and control) system.

### *Productivity*

The direct labor force decreased by 239 employees at the Madrid hub and by 33 at the detachments. However, since the direct labor annual production time remained the same as in 1995, productivity increased.

- . A 4% decrease in plane immobilization time for "C" and "D" overhauls was achieved.
- The number of "C" overhauls (around 40) carried out by the Maintenance Department was maintained with respect to 1995.

### *Variation in parameters*

Billings of work performed for third parties increased by 31% in 1996 with respect to 1995, leading to a rise in the number of man-hours billed to non-Group companies and in materials used and outsourcing relating to the activity of third parties.

Billings in Iberia and the IBERIA Group increased with respect to 1995 and to POA, leading to a rise in the number of "D" overhauls required.

As regards expenses, both the amount of materials used and outsourcing expenses increased as a result of greater production, mainly for non-Group companies; however, this increase was more than offset by the greater billing in third parties.

### 3.5. Systems management

Expenses in this area were Ptas. 225 million lower than in 1995, mainly due to the reductions in software license contracting, equipment maintenance, installations, technical assistance and period depreciation as a result of delays in installing equipment and the conclusion of computer equipment depreciation periods.

55 employees were laid off in 1996, thus meeting the targets included in the A-3500 Plan, leaving a total labor force of 534 employees. In addition to the aforementioned terminations, another 25 employees from the Management Control, Administration and Supplies areas were transferred to Central Services, reducing personnel expenses by Ptas. 427 million. This reduction was partially offset by the increase in internal billings in this connection.

The higher communications expenses in 1996, which were offset by a simultaneous increase in external revenues from AMADEUS, were due to the agreement between IBERIA, AMADEUS and SITA, whereby the latter took over management of communications between South American travel agencies and AMADEUS, providing IBERIA with a sales margin of 7% on SITA's billings for this service. 1,382 travel agencies joined the system in 1996,

External revenues increased by Ptas. 414 million in 1996, due, on the one hand, to the aforementioned agreement between IBERIA, AMADEUS and SITA and, on the other, to the signature of new computer service contracts with FJY AIR and HELICÓPTEROS DEL SUR. LADECO ceased to be a customer of the Systems Department in mid-1996, and revenues decreased accordingly.

A new Flight Document Capture system was installed that will significantly reduce data transcription costs, although its effect will be more notable in the coming years.

### **3.6. Operations Management**

#### ***3.6.1. Flight operations***

The plans, programs, committees, etc., in which the Flight Departments were involved included:

- Meetings with Maintenance, Handling and In-Flight Services to address the implementation of the ECATAR Service.
- Quality plan. Modification of planes for the Business II class.
- Punctuality and Regularity Committee (C.P.R.).
- Creation of and involvement in a specific C.P.R. for Barcelona airport.
- Meetings with AENA, Air-Traffic Control and Airport Security to discuss matters affecting fleet operations.

#### ***3.6.2. Training***

The main programs organized by the Training Department in 1996 were as follows:

- Of the more than 800 candidates who took the pilot recruitment tests in 1996, the Company selected 64, 44 of whom are now taking training courses at the Company.
- Installation of the B-747 flight simulator was completed and it has been in use since January for all the B-747 Training and Refresher courses, thus cutting costs since flight crews no longer have to take these courses outside the Company.
- 1,686 Training, Refresher, Situation, Rescue, Instructor, Load and Load Distribution courses were attended by 9,515 students in 1996, and flight simulators were used for a total of 19,252 hours.

- 7,837 flight simulator hours were sold to non-Group companies in 1996. The services sold by the Training Department to third parties included most notably two B-727 Training courses for Líneas Aéreas Canarienses and one A-320 course for BCM Airlines.

### **3.6.3. Flight Safety**

The main projects carried out in this area in 1996 were as follows:

- Overall Safety Plan
- Aircraft Accident Response Plan
- Flight Safety Committee

### **3.6.4. Technical Area and Flight Support**

The projects performed in 1996 by the Technical and Flight Support Department included most notable the following:

- As a result of negotiations with AENA and the Directorate-General of Civil Aviation, the former anti-noise procedure at Barajas airport was eliminated and replaced by the ATA system, producing an estimated annual fuel saving of Ptas. 273 million.
- A program was implemented for the selective reduction of MTOW for A-300, A-320, B-727, B-757 and MD-87 aircraft, with decreased landing, flyover and parking charges, giving rise to an annual saving of Ptas. 602 million.
- Cooperation with AENA to improve operating methods in Madrid and Madrid and Barcelona in order to increase the capacity of both airports.

### **3.6.5. Network Control**

Services were once again provided to the Company's Operating Units in their Flight Dispatch Planning, Load and Load Distribution Logs, Flight Tracking and Monitoring, Slot Management and other activities.

To enhance the aforementioned services, the following systems were installed:

- INFOVOX, automatic telephone information service for flight crew programming.

- AUTOMATIC MADRID SIGN-IN for flight crew presenting itself for duty:
- WEEKLY FORECAST and automatic calculation of travel allowance.
- New INTAM information system.
- ATFM Slot Management - Phase One.

### **3.7. In-flight Service Department**

Of maximum importance, and serving as a starting point for highlighting the measures taken by the In-Flight Service Department in 1996, was the grouping together of all the Company's in-flight services under one department as part of the organizational change.

The actions taken in 1996 can be divided into the two areas in which the Department is structured:

#### ***Ground Services***

The actions taken in this area in 1996 included most notably the following:

##### **- Quality management**

- Implementation of the "Las cocinas del aire" project, consisting of serving dishes designed by prestigious head chefs of Spanish restaurants on long-haul routes.
- Modification and redesign of menus for European flights in response to the needs of the new Business II product.

##### **- Service planning**

- Review and full editing of new equipment and crew manuals for all aircraft with a significant reduction of articles carried on board.
- Participation in the ALTAIR integral automation project.
- Participation in the design and implementation of the new Business II class, defining the equipment and crew based on the services offered.

##### **- Warehouses**

- Significant reductions in stocks
- Improved stock rotation

### ***In-Flight Services***

The most noteworthy actions in 1996 can be summarized as follows:

#### **- Training**

Awareness campaign for and implementation of an ONGOING TRAINING system using the following types of course:

- Transition from one type of aircraft to another.
- Technical service meetings.
- Instructor training.
- Training of new chief flight attendants.
- New cabin crew training.

#### **- Cabin crew programming and management**

Cabin crew productivity was enhanced through cabin crew service programming.

Maternity leave was reduced by 0.92 percentage points and general absenteeism by 0.44 percentage points.

### **3.8. Aviaco**

Trends in 1996 continued along the same lines as in 1995. The economy grew and the resulting economic recovery led to increased demand. The deregulation of the air transport industry, which now encompasses all the Spanish companies, is making the industry more mature. The significant rise in the supply of the new operators is forcing the more established operators to face growing competition.

Demand also followed the same trends as in 1995. Business traffic, boosted by the economic recovery, experienced sustained growth, albeit combined with a lower usage of higher-class services. Leisure traffic remained somewhat lackluster, undoubtedly due to restrained consumption and a lingering tendency to save as a result of the past economic situation.

Competition from the new operators had a particularly strong impact in 1996 on the routes served by AVIACO. On the one hand, the companies established at national level with jet aircraft, which commenced their penetration of scheduled traffic on high-density routes served in the Spanish market by IBERIA, continued their growth by turning to the medium- and low-density routes constituting the market assigned to AVIACO. On the other hand, the regional airlines continued to expand, although the main regional company, Air Nostrum, became linked to the Group under a franchising agreement, while the others were experiencing general difficulties, which eventually led to the closure of certain companies such as Prima Air.

The increase in supply caused by new companies is concentrated at peak hours, i.e. early morning and late evening, which compounds the loss of passengers. The competitors also base their strategies to attract demand on significantly lower fares which, because of the Company's logical reaction, has given rise to a continuous drop in average revenues (in constant terms) since 1994.

Accordingly, in March 1995 AVIACO completed a Strategic Plan proposing measures required to adapt to the profound change in its market. In 1995 and 1996 it fully implemented all the management measures proposed in the Plan, except for those affecting the salary- and productivity-related aspects of the collective labor agreements. By rationalizing the flight network and implementing labor force and cost containment measures, AVIACO was able to report operating income in 1996. However, the failure of the negotiations with the labor unions prolonged the situation of structural imbalance at the company.

AVIACO's production, measured in terms of seat-kilometers offered, was 8.3% higher in 1996 than in 1995, representing a significant rise in productivity, since material resources remained at the same levels and human resources, as explained below, were reduced. The charter traffic initiated in 1995 was further strengthened in 1996. Production in this market remains marginal and aims to cover scheduling gaps at weekends when demand for scheduled traffic drops. The seasonability of charter traffic is complementary to that of scheduled flights, since demand increases at the weekend.

Average passenger haul continued to grow in 1996 (6.6%), and the use of the MD-88 aircraft also intensified.

As part of the Company's multiprovincial advertising strategy, in 1996 AVIACO became the Official Airline for the Cycling Tour of Spain by virtue of an agreement with Unipublic, as a result of which AVIACO was present in all 22 stages of the 1996 race. Among other commitments linked with the agreement, AVIACO appeared as a sponsor during the daily report on the race on Spanish national television.

The labor conflict in 1995, coupled with the major disruption suffered by Spanish air traffic as a result of the implementation of a new control system in its initial phase of adaptation and development and, basically, the problems caused by the expansion work at Barajas airport, put back scheduled flight punctuality to levels existing five years ago. Although the external difficulties affect to a greater degree airlines with hubs in Madrid, AVIACO remained among Europe's elite in terms of punctuality.

The operating income of Ptas. 1,428 million in 1996 represented 2.29% of operating revenues and was 7.8% higher than in 1995. The financial loss of Ptas. 1,333 million in 1996 was down 15.1% from 1995. Financial revenues amounted to Ptas. 1,301 million, as compared with the Ptas. 1,057 million obtained in 1995, an increase of 23.1%. The Ptas. 2,634 million of financial expenses were virtually the same as the Ptas. 2,627 million in 1995. Income from ordinary

activities amounted to Ptas. 95 million. Although there were fewer labor disputes in 1996 than in 1995, they had a considerable impact on the company's earnings. The SEPLA labor union in AVIACO called strikes for February 16, 17, 18, 19, 28 and 29, and for March 1 seven days in total- which were effectively supported by the company's pilots. The loss directly attributable to the strike exceeded Ptas. 200 million.

In addition to the aforementioned variations in passenger revenues, freight, mail and excess baggage revenues amounted to Ptas. 1,139 million, down 5.5% from the Ptas. 1,205 million obtained in 1995. The other air traffic revenues (charter and positional revenues and revenues from services rendered to the Group) amounted to Ptas. 1,365 million in 1996, up Ptas. 932 million on 1995. Revenues from handling services rendered to third parties fell by 4.2% from Ptas. 1,480 million in 1995 to Ptas. 1,418 million in 1996.

Operating expenses amounted to Ptas. 63,111 million in 1996, Ptas. 2,222 million (3.6%) higher than in 1995. This increase arose from the rise in the price of fuel, which led to an increase of around Ptas. 1,200 million in billings, and from the increase in charter production, which led to a rise of around Ptas. 550 million in variable costs. Disregarding these factors, variable costs grew by a very moderate 0.8% with respect to 1995. However, as discussed below, the difference between our costs and those of our competitors compels us to redouble our efforts and sacrifices in this area.

It should be noted that the required level of competitiveness in the new environment should be secured by optimizing differential costs (basically salaries and overheads), since the costs typically associated with the air transport industry (fuel, airport and flight handling services and levies and aircraft costs) and the commercial costs are similar for all comparable networks. Notable in this regard was the increase of only 0.5% in wages and salaries as a result of the wage freeze and a 2.2% decrease in average headcount, offsetting the effect of promotions. In a monopoly or a situation of stable competition this figure would be acceptable: however, in a climate of ever-increasing competition and for a company with significantly higher unit costs than its competitors, it signifies the postponement for yet another year of the recovery of the difference, putting AVIACO's capacity to compete, and even survive, in grave danger.

Fuel costs, which have been falling steadily in recent years, rose sharply in 1996. Fuel costs totaled Ptas. 6,339 million, up 27.6% on the Ptas. 4,968 million in 1995.

Handling service costs dropped by 0.4% to Ptas. 7,466 million in 1996, due to the elimination of the fee charged by AENA for each handling service, be it for the Group or for third parties. The unit prices billed by IBERIA were the same as in 1994.

Aircraft maintenance costs amounted to Ptas. 4,907 million in 1996, up 7.1% on 1995, due in part to the increase in production (which, in terms of block hours, was 5.1%), to the fact that the unit costs associated with the contract with IBERIA remained at 1995 levels and, lastly to the decrease of Ptas. 300 million in expenses incurred in the special work involved in removing MD-88 engines to correct defects and to comply with DC-9 guidelines.

Public aeronautical services (landings, navigational aids and airport taxes) amounted to Ptas. 6,280 million in 1996, Ptas. 426 million higher than in 1995. Ptas. 200 million of the rise related to the increase in charter production.

Commercial costs increased by 4.3% with respect to 1995. Commissions paid on ticket sales rose in line with scheduled traffic passenger revenues. Reservation system costs increased by 5.9% in 1996 to Ptas. 2,631 million.

Passenger service costs decreased by 4.4% from Ptas. 2,274 million in 1995 to Ptas. 2,173 million in 1996. Implementation of the cost containment program in the contracting and consumption monitoring areas continued in 1996.

Equipment and rental costs and period depreciation and amortization amounted to Ptas. 3,345 million, as compared with Ptas. 3,331 million in 1995.

The Company's permanent labor force closed the year at 1,744 employees, 52 (2.9%) fewer than the headcount at December 31, 1995. The average number of employees in 1996 was 1,919, as compared with 1,963 in 1995, a drop of 2.3%.

The Unit's main parameters are as follows:

	1996	1995	Variation 96/95	% Variation
Million ASK's	4,658	4,302	356	8.3
Million RPK's	2,819	2,603	216	8.3
Load factor (%)	60.5	60.5	0	0.0
Yield (Ptas./RPK)	21.8	22.4	(0.6)	(2.5)
Passenger revenues (millions of pesetas)	61,543	58,329	3,214	5.5
Operating income (millions of pesetas)	1,428	1,325	103	7.8
Net income (loss) after taxes (millions of pesetas)	341	(31)	373	119.5
Equivalent employees	1,919.3	1,963.7	(44.4)	(2.3)

### 3.9. Viva

Under the agreement between IBERIA and its employees, on February 1, 1995, the process of transferring all the scheduled routes formerly operated by VIVA commenced. Consequently, VIVA only operated ten scheduled routes (with 182 million ASK's) in the first quarter of 1996. From April 1996 it operated only charter flights, which represented 91% of the company's activity in terms of ASK's in 1996.

The high monthly and weekly seasonability of the charter market, combined with the growing competition in the tourism industry, the high number of flight cancellations, the difficulties involved in reentering a market that VIVA had abandoned years before and the commercial advantages of other companies (market of origin, support from large tour operators, etc.) compose the unfavorable arena in which the company operates. RPK's, ASK's load factor and yield become irrelevant in this market, where the important yardsticks are block hours and the price of a block hour.

Noteworthy regarding the target of adapting VIVA to the new market were the high aircraft maintenance costs, arising mainly from the switch to the Boeing Maintenance Plan (authorized by the civil aviation authorities) and the use of company employees to carry out the annual overhauls. The labor force was reduced by 9.61% to 414 employees, and all aircraft stopovers were eliminated, as was the maintenance detachment in Alicante.

In 1996 VIVA's operating fleet comprised nine B-737 aircraft, two of which were replaced during the year. 23,096 block hours were flown and there were 10,968 flights. The fleet's productivity declined to 6.98 block hours (including 717 nonproductive flights). The aircraft had a regularity rate of 99.07% and a punctuality rate (with a 15-minute leeway) of 66,659 down from the 76.6% achieved in 1935.

The main reasons for the Ptas. 4,832 million drop in revenues was that average revenues per block hour and block hours in the charter market were 6.4% and 21.6%, respectively, lower than expected.

The main parameters of the charter flight activity are as follows:

	1996	1995	% Variation
Block hours	20,154	5,337	277.7
ASK's	1,854,170	455,300	307.2
Load factor (%)	77.93	74.39	4.8
RPK's	1,444,998	338,701	326.6
Number of passengers	918,910	224,325	309.6

### **3.10. Binter Canarias**

In 1996 the Canary Islands market attracted the attention of new competitors, whose plans were to start up operations in that year. However, problems of various kinds, particularly relating to aircraft authorization, have delayed the commencement of their operations until 1997. Such is the case of Canarias Regional, a subsidiary, of the Air Europa Group, which will operate 64-seater BaE Advanced Turbo Prop (ATP) planes, and of Líneas Aereas Canarias (LAC) which, following various changes of strategy and fleet plans, seems to be targeting the charter market, in principle using a B-727 aircraft.

Although the competitive scenario did not change in the air transport industry in 1996, there were changes in competition in the shipping business. The Fred Olsen shipping company commenced services on the Santa Cruz de la Palma-Tenerife line, and the ARMAS shipping company commenced operations on the Las Palmas-Fuerteventura line. Binter Canarias' load factor was affected on both routes, falling by 6.4 and 4.2 percentage points, respectively with respect to 1995.

The company's activity remained at 1995 levels, with a slight increase in supply due to the rise in the average size of the aircraft, brought about by the 22.7% reduction in CN-235 seats and the 6.1% increase in DC-9 seats.

The 2% decrease in demand for scheduled flights in 1996 was offset slightly by the increase in charter demand. The decrease arose because of the aforementioned stiffening of competition from shipping although the stagnation of part of the market was also felt, as evidenced by the 2.2% drop in demand from the island of Gran Canaria.

The load factor therefore fell by 1.7 percentage points. The company compensated for this decrease by reducing its supply in the last quarter of 1996 on the routes where the loss of passengers to competitors was most significant. However, supply, on the most important route, Las Palmas-Tenerife Norte was increased by 4.1%, albeit below the growth in demand (7.1%).

Average revenues were 2.8% higher in 1996 than in 1995 and were also higher than budgeted, since the budgets did not include the 3% increase in fixes.

Costs in 1996 were in line with the budgeted figures, except, obviously, for personnel expenses and fuel costs. The cost per ASK was 27.5% higher, partly due to the sharp rise in prices and the greater relative use of DC-9 aircraft.

Maintenance expenses were kept at 1995 levels, despite including the full cost of the annual overhaul of the DC-9 fleet, since these aircraft were operated under a wet lease in the first quarter of 1995. This also explains the drop in lease expenses. Distribution expenses decreased by 21.8% due to the implementation (as envisaged in the Plan) of a billings without reservation system.

The cash flow generated and the fall in interest rates contributed to improving financial results. In connection with extraordinary results, the annual amortization of Ptas. 240 million of the FEDER capital subsidy (for the ATR aircraft) was offset by the provisions recorded for tax contingencies relating to personal income tax withholdings and tax prepayments on compensation in kind.

The company's main parameters are as follows:

	1996	1995	Variation 96/95	% Variation
Million ASK's	439	436	3	0.6
Million RPK's	316	322	(6)	(1.8)
Load Factor (%)	72.2	73.4	(1.7)	(2.4)
Yield (Ptas./RPK)	34.6	33.7	0.9	2.8
Passenger revenues (millions of pesetas)	10,955	10,844	111	1.0
Operating revenues (millions of pesetas)	11,425	11,335	90	0.8
Operating income (loss) (millions of pesetas)	382	(76)	458	602.6
Net loss after taxes (millions of pesetas)	(103)	(459)	356	77.5
Equivalent employees	306.9	298.2	8.7	2.9

### 3.11. Binter Mediterraneo

The load factor fell from 69.1% in 1995 to 54.9% in 1996, due to competition from Melilla Jet from October 1995. Supply increased by 3%, whereas demand dropped by 22.01%. Consequently, the year-on-year reduction in load factor, in percentage terms, was 20.59%.

Operations on the Granada-Melilla route were consolidated and a new route between Malaga and Alicante was opened in 1996.

In cumulative terms, the yield in 1996 was 3.24% lower than in 1995, due to a lengthening of the average haul and the fall in fares as a result of the promotional campaigns aimed at offsetting the increasing market share of competitors, all despite having increased fares in the second half of the year.

A Strategic Plan was drawn up in October (although it has not yet been implemented) and additional measures were designed, pending the negotiations on the new Viability Plan that was drafted in late 1996.

In cumulative terms, financial expenses decreased with respect to 1995 due to interest rate cuts, although the cash flow generated is insufficient to remedy the company's unfavorable financial structure.

The courts have not yet handed down their decision on the flight technicians' claims regarding the CPI for 1995 and the reflection of the CPI for 1994 in the salary tables.

The company's main aggregates in 1996 and 1995 were as follows:

	1996	1995	Variation 96/95	% Variation
Block hours	6,383	6,277	106	1.69
Millions of ASK's	80	77	3	3.1
Millions of RPK's	44	53	(9)	(18.2)
Load factor (%)	54.85	69.10	(14.25)	(20.6)
Yield (Ptas./RPK)	41.0	42.3	(1.3)	0.2)
Number of passengers	185,647	238,048	(52,401)	(22.0)
Operating revenues (millions of pesetas)	2,117	2,573	(456)	(17.7)
Operating loss (millions of pesetas)	(618)	(271)	(347)	(128.0)
Net loss after taxes (millions of pesetas)	(745)	(488)	(257)	(52.6)
Equivalent employees	71.90	72.96	1.06	(1.5)

### 3.12. Savia

1996 was this company's second full year of operations. SAVIA's commercial operations are completely separate from those of IBERIA, which ensures the neutrality required by the European Code of Conduct. As regards the network, SAVIA entered into numerous technical service contracts with IBERIA (Systems Management), permitting a high degree of synergy between the two companies to be maintained.

The company continued its policy of investing in computer equipment in order to cater for the increase in demand at agencies which wish to connect with the service provided by SAVIA. The number of agencies connected to the system rose by 18.9% from 3,061 in 1995 to 3,640 in 1996. The number of terminals increased from 5,956 in 1995 to 7,150 in 1996.

Flight reservations increased by 18.8%, from 15.4 million in 1995 to 18.3 million in 1996; hotel reservations rose by 250%, from 3,123 to 31,690; and car rentals were up by 376%, from 10,199 to 48,559.

The company's main aggregates in 1996 and 1995 were as follows:

	1996	1995	Variation 96/95	% Variation
Operating revenues (millions of pesetas)	5,971.4	5,037.8	933.6	18.53
Operating income (millions of pesetas)	123.5	108.8	14.8	13.60
Equivalent employees	29.5	27.0	2.5	9.26
Net income after taxes (millions of pesetas)	64.8	65.6	(0.8)	(1.22)

### 3.13. Iber-Swiss Catering

1996 for IBER-SWISS was characterized by the increase in its two main business aggregates: the number of food-trays served and the number of planes handled. The salient features of 1996 for this company were as follows:

- The 9% increase in trays served to IBERIA was due to the increase in demand from IBERIA.
- Noteworthy with regard to the number of trays served to non-Group companies was the fall in demand from SWISSAIR as a result of the drop in this company's activity and the sharp increase in demand from other customers due to sales to the new customers US Air and Singapore Airlines.
- The average unit price per tray fell slightly with respect to 1995 due to the fact that the royalty was not included in the price in 1996. However, expectations were exceeded due to a different form of catering service remuneration. The average unit price of handling services was 5% lower than that budgeted for in the Annual Operating Plan, basically because the rise in the CPI was not passed on to the major companies.
- This company had 895 employees in December 1996, 52 more than budgeted. Noteworthy was the increase in hirings of casual workers, which led to a significant decrease in wages per contract, enabling the company's unit labor cost to be under the targeted amount.
- Tray-King, the automatic tray preparation and filling facility, only serves part of the IBERIA tourist class passengers and did not achieve the expected increase in productivity.

The company's main aggregates in 1996 and 1995 were as follows:

	1996	1995	Variation 96/95	% Variation
Production of food-trays (units)	6,301,395	5,898,600	402,795	6.8
Planes served (units)	67,966	63,412	4,554	7.2
Average price per food-tray (pesetas)	582	586	(4)	(0.8)
Average headcount	872	817	55	6.7
Food-trays per employee (units)	7,226	7,219	7	0.1
Operating revenues (millions of pesetas)	5,987	5,668	319	5.6
Operating income (millions of pesetas)	170	150	20	-
Net income after taxes (millions of pesetas)	72	64	8	-

### 3.14. Cacesa

Excluding sales of the Ibertras Maritimo product, which have been falling ever since the company decided to abandon marginal and risky operations, total sales in 1996 increased by 6.4%. Including the Ibertras Maritimo product, sales decreased by 14.4% from 1995.

The Ibexpress product was redefined in 1996 and measures were taken to attract end customers to the door-to-door service, which achieved 40% more deliveries in 1996 than in 1995. A new approach was defined in the second half of 1996 for the international product and the new product is expected to be launched in the first quarter of 1997.

A restrictive policy was followed with the Ibertras Maritimo product due to the risk inherent thereto, and the customer roster for the Ibertras Aéreo product was diversified, thus offsetting the decreases in production by the other, more seasonal, market segments.

Work also continued in 1996 on the automation process, the results of which were as follows:

- Installation of the hardware required for all in-house and licensee markets.
- Full installation of the IBX application.
- Initial installation, pending tests, of the IBT application.

This company's main aggregates in 1996 and 1995 were as follows:

	1996	1995	Variation 96/95	% Variation
Ibexpress revenues (millions of pesetas)	1,093	963	130	13.48
Ibertras Aéreo revenues (millions of pesetas)	1,906	1,884	22	1.13
Ibertas Marítimo revenues (millions of pesetas)	120	884	(764)	(86.42)
Supplier costs (millions of pesetas)	2,610	3,196	(586)	(18.33)
Equivalent employees	127.40	123.98	3.42	2.76
Operating income (millions of pesetas)	53.59	56.00	(2.41)	(4.21)
Net income after taxes (millions of pesetas)	27.22	24.50	2.72	11.10

### 3.15. Campos Velazquez

Since 1993, in which the Campos Velaquez Complex was sold to Infoinvest S.A., the company's activity has focused on the management and maintenance of the Complex. The salient features of 1996 were as follows:

- The fixed percentages established in the related contracts were billed directly to the tenants of the blocks in 1996 unlike 1995, in which billings were nmte to IBERIA, which then passed on the costs to the various companies concerned. This led to an increase in operating revenues, because under the former system Campos Velazquez absorbed these costs.
- The company had nine employees in December, one fewer than in December 1995 due to the retirement of an employee in 1995. In accordance with the collective labor agreement, the salary increase was 3.5%, plus the 0.8% relating to the CPI adjustment.
- The company has forfeited its consolidated taxation status and, accordingly, it must pay Ptas. 136 million of corporate income tax for 1996.

	1996	1995	Variation 96/95	% Variation
Equivalent employees	9	10	(1)	(7.7)
Operating revenues (millions of pesetas)	238	210	19	8.7
Operating loss (millions of pesetas)	(3)	(21)	18	-
Net income after taxes (millions of pesetas)	253	376	13	-

### 3.16. Aerolíneas Argentinas

The final operating loss for the year amounted to US\$ 59.9 million, an improvement of US\$ 4.5 million with respect to 1995.

This improvement was due to the increases in operating expenses of US\$ 18.9 million and of US\$ 23.4 million in operating revenues.

The 1.84% rise in expenses in 1996 was mainly due to fuel costs, which increased by a significant US\$ 23.6 million, and to the increase in prices and maintenance expenses due to the greater supply and use of the B-727 aircraft (28.2% HB/plane/day) with respect to 1995. The other expense items were reduced, particularly overheads excluding personnel expenses (16%), personnel expenses (10.87%) and in-flight supplies per RPK (7%).

In 1996 passenger revenues increased by US\$ 32 million and RPK's by 5.3%, whereas the yield fell by 1.4%. The downward trend in the yield was reversed in the last quarter of the year and is now performing very favorably in the Latin American network and acceptably in the regional and short-haul networks. The European network is showing the poorest results, essentially due to the use of net market prices. A very encouraging feature of 1996 was that higher-class revenues doubled with respect to 1995.

The increase in the operating loss (US\$ 77.4 million) with respect to that budgeted for in the Annual Operating Plan was mainly due to three factors: passenger revenues net of variable marketing expenses (US\$ 57.5 million), net freight revenues (US\$ 21 million) and fuel (US\$ 19.5 million), whereas the other operating expenses fell.

The decrease in net passenger revenues was due to the 3.9% drop in RPK's and the 5% fall in net fares. The US\$ 8.3 million decrease in net freight revenues was due in the short-haul market to increased competition and the decrease of US\$ 13.3 million in the international market to the fact that the targets were not met with respect to cargo to be transported by scheduled flights. The variation in fuel expenses was due exclusively to the increase in fuel prices.

It should be noted that the replacement of the B-727 aircraft with B-737 aircraft envisaged in the Annual Operating Plan, the impact of which was estimated at US\$ 10-15 million, and the increase in supply in the Latin American network through the addition of one A-310 aircraft did not ultimately take place.

The sale of Austral gave rise to a higher extraordinary gain (US\$ 6.2 million) than that envisaged in the Annual Operating Plan, and there was no loss on the disposal of the B-727 aircraft, since the sale did not take place during the year and a lower book value was recorded in 1995. Indemnity payments to employees increased by US\$ 7 million in 1996.

The financial loss was US\$ 17.4 million higher than budgeted as a result of exchange losses (US\$ 8.9 million), the higher financial expenses (US\$ 13.5 million) brought about mainly by the five-month delay in settling the liabilities incurred on the sale of Austral and the lower cash flow arising from decreased earnings.

The main parameters are as follows:

	1996	1995	Variation 96/95	% Variation
Block hours	108,250.4	100,688.7	7,561.7	7.51
Million ASK's	15,301.6	14,622.5	679.1	4.64
Load factor	66.6	66.2	0.4	0.60
Million RPK's	10,195.4	9,684.6	510.8	5.27
Number of passengers	4,031.9	3,824.8	207.1	5.42
Operating revenues (millions of pesetas)	988,822.7	965,408.5	23,414.2	2.43
Operating loss (millions of pesetas)	(59,877.5)	(64,347.7)	4,470.2	6.95
Equivalent employees	5,338.0	5,797.1	(459.1)	(7.92)
Net loss after taxes (millions of pesetas)	(67,936.7)	(182,406.8)	114,470.1	62.76

### 3.17. Austral

Austral's total annual supply increased by 1.41% in 1996 and its load factor rose by 5.78% to 68.5%; however, the yield fell by 9.6% due to a price war with competitors. Austral's commercial strategy in 1996 envisaged the redistribution of routes with ARSA, the incorporation of the Business Class in all its aircraft and the prioritization of marketing activities targeted at business passengers. New intermediate fares were introduced in the second half of the year, which enabled the lowest fares to be gradually increased, thereby improving yield and revenues per ASK ratios, all without losing load factor.

Noteworthy with regard to the redistribution of routes with ARSA was the withdrawal from the Cordoba hub and the transfer of the CN-235's to Buenos Aires in order to operate the Buenos Aires-Rosario routes. The Austral personnel at Cordoba airport were transferred for operating purposes to ARSA.

It should be noted that the addition of the two DC-9's to operate in the regional network and to increase supply in the domestic network, as envisaged in the Annual Operating Plan, did not take place.

Operating income increased by US\$4.9 million with respect to 1995 as a result of the significant 15.8% reduction in costs, which more than absorbed the US\$ 11 million fall in revenues triggered by the lowering of fares due to increased competition.

The fall in operating expenses was mainly due to the decreases in personnel expenses (US\$5.5 million), as a result of the lower headcount (11.8%); in handling expenses (US\$ 1.7 million), since self-handling activities commenced at various airports; and in in-flight service (US\$ 4.8 million), due to the redefinition of in-flight service and cost-cutting measures.

The main parameters are as follows:

	1996	1995	Variation 96/95	%Variation
Block hours	39,053	37,186	1,867	5.02
Million ASK's	2,582	2,546	36	1.41
Load factor (%)	68.5	64.7	3.8	5.87
Million RPK's	1,768	1,648	120	7.28
Number of passengers	2,084	1,855	229	12.39
Operating revenues (millions of pesetas)	222,017	232,997	(10,980)	(4.71)
Operating income (millions of pesetas)	14,629	9,734	4,895	(50.29)
Equivalent employees	1,480.1	1,678.12	(198)	(11.8)
Net loss after taxes (millions of pesetas)	9,812	3,995	5,817	(145.61)

### 3.18. Viasa

1996 was marked in Venezuela by the continuing economic tension and social unrest. Official control over foreign currency availability and exchange control measures persisted for a good part of the year. Dollar exchange transactions were subsequently liberalized and the bolivar/U.S. dollar exchange rate rose from 290 bolivars/US\$ 1 at the end of 1995 to 477 bolivars/US\$ 1 at 1996 year-end. Inflation was 103%.

The company's performance in the first quarter of the year exceeded expectations until negotiation of the collective labor agreements for maintenance personnel and air hostesses commenced. Whereas the air hostesses continued to work, but to the detriment of the company's image, the maintenance personnel forced flight cancellations and delays of five hours and more. An agreement was reached as a result of the negotiations, which lasted from May to August, with the drawback that the company's image among customers deteriorated as a result of the cancellations. It has not been possible to recover the passengers lost, despite having increased commissions and lowered prices.

The company had 2,245 employees as of December 31, 1996, 244 fewer than at the beginning of the year. The reduction related mainly to ground staff.

By network, supply fell in the North American and European markets, which bore the decrease in demand served. The reduction in supply and demand was unfortunately accompanied by a decrease of 0.19% fall in yield, which would be greater in real terms due to the 4.58%, reduction in the average haul.

The company incurred all estimated loss of US\$ 30.2 million, givingt a net worth deficiency which, combined with the failure to generate cash flow, places VIASA in a difficult situation light of Venezuelan legislation.

The very high loss for the year arose mainly as a result of the strikes, which reduced revenue and increased expenses because of flight cancellations, obliging the company to pay for accommodation, board and lodging, indemnities, etc. thereby reducing the funds generated because, in addition to the cuts in revenues and increases in expenses, VIASA tickets were at other companies, leading to increased billings to VIASA by them.

The main parameters of this company's activity are as follows:

	1996	1995	Variation 96/95	%Variation
Block hours	33,192	35,277	(2,085)	(5.91)
Million ASK's	5,490	5,702	(212)	(3.7)
Load factor (%)	64.97	66.49	(1.52)	(2.3)
Million RPK	3,567	3,791	(224)	(5.9)
Number of passengers	80,983	75,621	5,362	7.09
Operating revenues (thousands of U.S. dollars)	267,931	292,598	(24,667)	(8.4)
Operating loss (thousands of U.S. dollars)	(12,042)	7,955	(19,997)	(251.4)
Equivalent employees	2,301.00	2,569.80	(268.8)	(10.46)
Net loss after taxes (millions of U.S. dollars)	(30,161)	1,322	(31,483)	(2,381.6)

Since Iberia is Viasa's majority shareholder and is responsible for its management, it submitted a viability plan for 1997 that was approved by the shareholders. However, following intense negotiations, it was not possible to implement the plan, leading to the halt of the company's operations and its forthcoming liquidation.

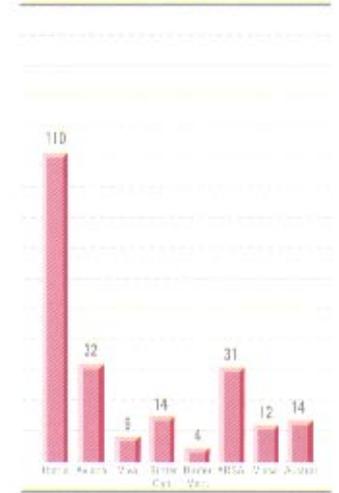
## 4 Resources

### 4.1. Fleet

The detail of the passenger aircraft fleet operated by the Group as of December 31, 1996, is as follows:

Aircraft Type	Iberia	Aviaco	Viva	Binter Canar.	Binter Medit.	ARSA	Viasa	Austral	Total
B-727	28					5	7		40
B-737			9			11			20
B-747	7					6			13
B-757	8								8
A-300	6								6
A-310						3			3
A-320	22								22
A-340	4								4
DC-8	3								3
DC-9	4	19						7	34
DC-10	4						5		9
MD-81								2	2
MD-83								3	3
MD-87	24								24
MD-88		13				6			19
CN-235				4	4			2	10
ATR-72				6					6
<b>Total</b>	<b>110</b>	<b>32</b>	<b>9</b>	<b>14</b>	<b>4</b>	<b>31</b>	<b>12</b>	<b>14</b>	<b>226</b>

Fleet (Amount of Aircraft as of December 31, 1996)



The additions and retirements in 1996 are summarized as follows:

Aircraft Type	Iberia	ARSA	Viasa	Total
B-727		(2)	1	(1)
A-340	4			4
DC-10	(3)			(3)
Total	1	(2)	1	0

The daily usage of the Domestic Air Transport Group's aircraft, in terms of total block per aircraft per day, was as follows:

B-727	5.1	4.5
B-737	7.0	8.6
B-747	13.5	12.8
B-747M	11.1	13.2
B-757	7.3	7.0
DC-8 (freight)	8.4	6.4
DC-9 Iberia	4.9	4.8
DC-9 Aviaco	6.4	6.2
DC-9 Binter Canarias	3.4	3.7
DC-10	11.8	11.3
MD-87	7.6	7.2
MD-88	6.3	5.8
A-300	6.8	6.1
A-320	7.9	7.6
A-340	12.3	
CN-235	3.1	3.3
ATR-72	5.7	5.7

## 4.2. Personnel

The detail of the average and year-end headcount in 1996 and 1995 is as follows:

Average headcount

	Ground		Flight		Total	
	1996	1995	1996	1995	1996	1995
PASSENGER	3,045	5,298	42	2,796	3,087	8,094
FREIGHT	1,096	1,157			1,096	1,167
HANDLING	7,571	7,960			7,571	7,960
MAINTENANCE	4,125	3,104			4,125	3,104
SYSTEMS	562	617			562	617
OPERATIONS	436	506	1,401	1,434	1,837	1,940
IN-FLIGHT SERVICES	167	-	2,912	-	3,079	-
CENTRAL SERVICES	1,137	406			1,137	406
<b>IBERIA, L.A.E.</b>	<b>18,139</b>	<b>19,048</b>	<b>4,355</b>	<b>4,230</b>	<b>22,494</b>	<b>23,278</b>
AVIACO	1,091	1,117	828	847	1,919	1,964
VIVA	256	300	194	200	450	500
BINTER CANARIAS	153	153	154	145	307	298
BINTER MEDITERRANEO	35	35	37	38	72	73
CARGOSUR	-	29	-	18	-	47
CAMPOS VELAZQUEZ	10	11			10	11
CACESA	127	124			127	124
IBER-SWISS	872	817			872	817
SAVIA	29	27			29	27
<b>SPANISH GROUP</b>	<b>20,712</b>	<b>21,661</b>	<b>5,568</b>	<b>5,478</b>	<b>26,280</b>	<b>27,139</b>
ARSA	3,763	4,196	1,575	1,601	5,338	5,797
AUSTRAL	1,123	1,298	357	381	1,480	1,679
VIASA	1,496	1,732	805	838	2,301	2,570

SPANISH GROUP Personnel



### NOTES:

- In 1996 the central minor repair functions that in 1995 had been the responsibility of the Traffic Department were transferred to Maintenance. Also, the personnel, administration, economic control and supplies areas were grouped together at corporate level (Central Services).
- Except for the Miami crews, in 1996 the technical and auxiliary flight personnel were included in the Operations and In-Flight Services areas, respectively.
- The Cargosur personnel were transferred to the Iberia Freight Division in 1996.

Year-end headcount

	Ground		Flight		Total	
	1996	1995	1996	1995	1996	1995
PASSENGER	3,068	5,305	42	2,863	3,110	8,168
FREIGHT	1,059	1,156			1,059	1,156
HANDLING	7,961	8,310			7,961	8,310
MAINTENANCE	3,747	3,051			3,747	3,051
SYSTEMS	535	611			535	611
OPERATIONS	427	498	1,376	1,424	1,803	1,922
IN-FLIGHT SERVICES	161		3,012		3,173	
CENTRAL SERVICES	1,039	399			1,039	399
<b>IBERIA, LAE.</b>	<b>17,997</b>	<b>19,330</b>	<b>4,430</b>	<b>4,287</b>	<b>22,427</b>	<b>23,617</b>
AVIACO	1,001	1,041	826	850	1,827	1,891
VIVA	233	269	181	189	414	458
BINTER CANARIAS	152	155	149	157	301	312
BINTER MEDITERRANEO	33	36	37	37	70	73
CARGOSUR						
CAMPOS VELAZQUEZ	9	10			9	10
CACESA	128	124			128	124
IBER-SWISS	895	806			895	806
SAVIA	30	27			30	27
<b>SPANISH GROUP</b>	<b>20,478</b>	<b>21,798</b>	<b>5,623</b>	<b>5,520</b>	<b>26,101</b>	<b>27,318</b>
ARSA	3,691	3,814	1,493	1,674	5,184	5,488
AUSTRAL		1,213		372		1,585
VIASA	1,451	1,668	794	822	2,245	2,490

NOTES:

- See notes to the preceding table

### **Productivity**

The variations in the productivity of the Air Transport Group companies, measured in terms of ASK/employee were as follows:

	Ground Staff % Variation 96/95	Flight Technicians % Variation 96/95	Flight Auxiliaries % Variation 96/95	Total % Variation 96/95
IBERIA LAE	14.30	13.43	3.00	12.63
AVIACO	10.80	10.43	10.99	10.78
VIVA	3.58	(9.30)	(9.20)	(1.96)
BINTER CANARIAS	0.78	6.41	(14.48)	(2.25)
BINTER MEDITERRANEO	3.21	7.02	3.00	4.55
SPANISH GROUP	12.45	11.12	2.92	11.03
ARSA	16.61	8.69	5.06	13.56
AUSTRAL	17.14	6.96	8.84	14.99
VIASA	11.49	(0.01)	0.31	7.54

The Group's improved productivity except at Viva and Binter Canarias, was significant, particularly at IBERIA. In addition to the agreements reached with the employees, enabling a broader traffic schedule to be designed, the early retirement plan envisaged in the A-3500 Plan commenced in 1995

## 5 Operating Results

### 5.1. Operating income at Iberia

Total operating income for 1996 amounted to Ptas. 34,188 million.

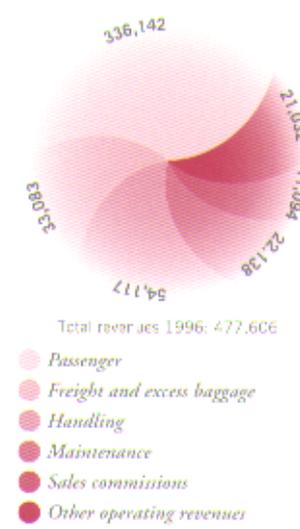
The detail by unit is as follows (in millions of pesetas):

	MILLIONS OF PESTAS	
	1996	1995
PASSENGER	8,910	3,056
FREIGHT	4,636	4,830
HANDLING	20,987	16,877
MAINTENANCE	4,678	6,023
SYSTEMS	1,714	2,002
OPERATIONS	246	649
IN-FLIGHT SERVICES	858	
CENTRAL SERVICES	(7,841)	(8,320)
IBERIA, L.A.E.	34,188	25,117

The summarized detail of IBERIA's operating account for 1996 and 1995 is as follows (amounts in millions of pesetas):

	MILLIONS OF PESETAS		
	1996	1995	% Variation
<b>Operating revenues</b>			
Passenger	336,142	313,387	7.3
Freight and excess baggage	33,083	32,199	2.7
Handling	54,117	55,632	(2.7)
Maintenance	22,138	18,355	20.6
Sales commissions	11,094	11,661	(4.9)
Other operating revenues	21,032	19,441	8.2
	<b>477,606</b>	<b>450,675</b>	<b>6.0</b>
<b>Operating expenses</b>			
Fuel	44,165	34,362	28.5
Airport taxes and other levies	9,250	11,297	(18.1)
Personnel expenses	157,840	159,617	(1.1)
Traffic services	36,822	33,365	10.4
Commissions	38,997	38,548	1.2
Over-commissions	15,232	15,282	(0.3)
Navigation aids	16,680	15,920	4.8
Aircraft maintenance and provisions	25,234	19,452	29.7
Aircraft lease expenses	16,814	17,184	(2.2)
Period depreciation and amortization	21,873	22,266	(1.8)
Other operating expenses	60,501	58,265	3.8
	<b>443,408</b>	<b>425,558</b>	<b>4.2</b>
<b>Operating income</b>	<b>34,198</b>	<b>25,117</b>	<b>36.1</b>

**Operating revenues**  
(Millions of Pesetas)



The main comments on the operating account are as follows:

**A) Operating revenues**

Operating revenues increased by 6% in 1996. The main variations were as follows:

**- Passenger revenues**

The difference between the passenger revenue figure shown above and that shown in the activity tables is due to the fact that the latter relates directly to the actual production for each year and does not reflect accounting adjustments and restatements. The breakdown of the Ptas. 22,755 million increase in freight revenues is as follows:

	Var. 96/95	Reason for Variation		
		Price	Volume	Parity
Short -and medium- haul revenues	14,891	(6,389)	22,408	(1,128)
Long-haul revenues	7,864	1,370	7,890	(1,396)
<b>Total</b>	<b>22,755</b>	<b>(5,019)</b>	<b>30,298</b>	<b>(2,524)</b>

The difference in volume is due to the sharp increase in demand of 9.1 % in terms of RPK. The price variation was the result of several factors, the most important being the competitive environment, which continues to drive prices down. However, the variation was also influenced by the relative fall in the fare mix, with a greater proportion of economy-class fares, and a slight (2%) increase in medium-haul fares, as well as a greater use of net market prices.

Lastly, the variation in parity, effect was due mainly to the fall of the Japanese yen to approximately 12.8% with respect to its average 1995 price. The fluctuations in the price of the other major currencies were much less marked and, overall, had a near zero effect on the Company's revenues.



These increases were due, on the one hand, to the fact that despite growing competition, the sharp rise in demand resulting from the increase in air traffic in Spain and the measures taken to protect market share enabled handling activities to even slightly exceed (by 0.8%) those of third parties, and, on the other, prices did not fall by as much in 1996 as was initially feared. The fact that part of the increase in revenues was achieved through prices reflects a different demand structure, where scheduled flights increased to the detriment of charter flights (whose prices are lower in view of the service offered). The Company's competitors achieved the most notable gains in market share in the charter market.

It should also be noted that the increase in the Company's handling activities had a notable influence on productivity in this area.

#### **- Maintenance**

The 1996 aircraft (airframe, engines and parts) maintenance revenues were significantly better (Ptas. 3,783 million) than those of 1995, mainly because of work performed for non-Air Transport Group customers (Ptas. 3,735 million) and for other Group companies. This increase in IBERIA's production made it necessary to restrict maintenance work for non-Group third parties to high-technology, products with greater added value, since the size of the maintenance area basically only covers the Company's needs. Accordingly, work with lower margins and for which there is very stiff international competition was outsourced. In 1996 IBERIA continued to build upon its large customer roster, relating principally to general overhauls of B-747 aircraft and of JT9, CFM56 and RB211 engines.

#### **- Sales commissions**

As in 1995, despite an increase in revenues from sales by non-Group companies of tickets printed on IBERIA paper, and in Mundicolor travel packages and car rentals, total revenues fell by Ptas. 567 million due to the effect of the definitive transfer of VIVA from the scheduled to the charter market, giving rise to a drop of Ptas. 1,500 million in billings to this company.

#### **- Other operating revenues**

The main reasons for the Ptas. 1,591 million rise in other operating revenues were the increases in revenues from the use of communications services and in-flight sales, which were partially offset by higher capitalized expenses of in-house work on fixed assets and the recovery of the overprovision for major repairs.

### **B) Operating expenses**

The 4.2% (Ptas. 17,860 million) increase in operating expenses was lower than the increase in operating revenues and considerably lower than the rise in production. This figure is even more notable if the sharp rise in fuel prices is taken into account, without which operating expenses would have only increased by around 2.5%.

The variations in the main expense items were as follows:

#### **- Fuel**

As mentioned above, the sudden increase (17.6%) in fuel prices from the first quarter and the steady climb during the rest of the year to put the average price for the year at 19.3% higher than in 1995 had a profound impact on expenses.

Total fuel expenses were 28.5% (Ptas. 9,803 million) higher than in 1995, mainly due to the price increase, which was further aggravated by the slight rise in the U.S. dollar. Another factor was the cost of increased production, which was partially offset by more efficient consumption as a result of using more modern aircraft (namely the A-340).

The summarized detail of these effects is as follows:

[REDACTED]	
Price	(7,193)
Volume	(3,466)
Parity	(264)
Consumption per ASK	1,120
Total	<b>(9,803)</b>

### **- Airport taxes and other levies**

This expense fell sharply in 1996. The main reason for this decrease is detailed in the section on handling revenues. On July 1, 1995, AENA discontinued the exclusive handling fee which, until then, had represented an annual cost of Ptas. 2,308 million. Disregarding the effect of this factor, this expense increased by 2.9% in 1996 as a result of the airport taxes, the increase being lower, however, than the increase in the number of passengers carried.

### **- Personnel expenses**

Personnel expenses fell by Ptas. 1,777 million (1.1%) in 1996, due mainly to the duplication of the measures contained in the Adaptation Program. However, the following points should be noted in this connection:

In 1996, as in 1995, there was a cost of Ptas. 1 1,301 million under this caption as a result of the compensation arising from the agreements with employees (both the Adaption Program and the subsequent productivity agreements). This cost is nonrecurring, i.e. it is not included in salary tables with effect in future years. Ptas. 2,927 million of this figure related to compensation for having exceeded the results envisaged in the Adaptation Program; Ptas. 2,879 million related to the 20% outstanding from the CPI revisions for 1993 and 1994, to be paid in the form of IBERIA shares; Ptas. 5,182 million were compensation for the productivity increases; and the remaining Ptas. 3 13 million related to the forfeiture of rest days by permanent employees, also to cater for the increased production.

The saving achieved through the reduction of the labor force amounted to Ptas. 4,355 million, which was partly offset by the Ptas. 1,800 million increase in payments for seniority, and promotions and the Ptas. 1,150 million rise in employee welfare benefits.

**- Traffic service expenses**

Traffic service expenses increased substantially (10.4%) in 1996, albeit in line with the increase in activity and the effect of inflation. However, mention should be made of the reduction in expenses controllable by the Company, such as aircraft cleaning and handling equipment on international stopovers. This, however, contrasts with the increases in such important expense items as landing rights or aircraft dispatching, which are difficult to negotiate because they depend on the local airport authorities in the case of the former, and, in the latter case, on handling operators who have exclusive arrangements at numerous stopover destinations. Significant pressure was, however, brought to bear on these operators in 1994 and 1995.

**- Commercial expenses (commissions and over-commissions)**

In 1996 as in 1995, net commissions as a percentage of passenger revenues decreased by, 3.1%, mainly due to greater use of the TNM (net market price) method. The use of this method also affected the price structure, limiting the use of over-commissions, the amount of which even fell slightly, despite the considerable increase in sales.

**- Navigation aids**

Air traffic control expenses increased by only 4.8%, less than the increase in activity, largely due to the price adjustments within the structure of the European air traffic control agency (Eurocontrol).

**- Aircraft maintenance expenses**

In 1996 aircraft maintenance expenses rose by Ptas. 5,782 million (29.7%) with respect to 1995. However, in addition to the considerable increase in aircraft activity mention must be made of the significant amount of work performed for non-Group companies, which contributed Ptas. 3,783 million to the increase in revenues. Disregarding the effect of this factor, maintenance costs remained in line with the volume of production, and even absorbed the increase due to inflation and the moderate effect of the U.S. dollar exchange rate.

#### **- Aircraft lease expenses**

There was a slight drop (Ptas. 370 million) in 1996 in aircraft lease expenses as compared with 1995, although the following should be noted in this connection:

Passenger aircraft lease expenses rose by Ptas. 1,288 million in 1996, due mainly to the effect of the progressive incorporation during the year of the four A-340 planes.

However, the cost of leasing freight aircraft fell by Ptas. 1,994 million because, from the second half of 1995 the aircraft operated by Cargosur were transferred to IBERIA (although not title thereto). Consequently freight aircraft lease expenses were reduced, since only the depreciation of the aircraft was taken into account, the other expenses relating to the former wet-lease being eliminated.

#### **- Period depreciation**

The decrease of Ptas. 393 million in period depreciation was due mainly to the retirement of three DC-10 aircraft sold in 1996, although this was partially offset by the increase in inventories of rotatable and repairable parts as a result of the incorporation of the new A-340 aircraft and greater Group and third-party activity.

#### **Other operating expenses**

The increase of Ptas. 2,236 million (3.8%) in this caption was the result of the significant cost containment efforts made. The variations in other operating expenses are summarized as follows:

- Aircraft supply materials consumed, in-flight sales articles, advertising materials and sundry expenses increased by Ptas. 734 million as a result of the greater activity and advertising campaigns.
- Media advertising expenses increased by Ptas. 518 million as a result of the need to relaunch IBERIA's image and to publicize the Company's offers in the face of stiffer competition.
- Reservation system distribution expenses rose by Ptas. 751 million, which is lower than the increase relating to the effect of the increased activity.
- Communications (mainly SITA) expenses increased by Ptas. 430 million.
- The increases in the aforementioned expenses were partially offset by the notable reductions in, inter alia, operating provisions, independent professional services and flight insurance expenses

The overall comparison of the 1996 and 1995 statements of income is as follows:

	1996	1995
<b>Operating Income</b>	<b>34,198</b>	<b>25,117</b>
Financial revenues	4,380	5,082
Financial expenses	(13,412)	(20,105)
Provision to pension allowance	(3,948)	(3,660)
Exchange gains	5,947	5,258
Exchange losses	(6,168)	(8,245)
<b>Financial Loss</b>	<b>(13,201)</b>	<b>(21,670)</b>
Aerolineas Argentinas	(2,154)	(19,076)
Viasa	-	(672)
Ladeco	(464)	(312)
Amadeus	-	619
Iberswiss	165	45
Binter Canarias	400	(457)
Binter Mediterraneo	(744)	(488)
Viva	(1,320)	(675)
Other	156	(737)
<b>Loss on Securities Portfolio</b>	<b>(3,961)</b>	<b>(21,755)</b>
<b>Extraordinary Loss</b>	<b>(14,213)</b>	<b>(42,776)</b>
Net Income (Loss) Before Taxes	2,823	(61,084)
Taxes	(101)	16,164
<b>Net Income (Loss) After Taxes</b>	<b>2,722</b>	<b>(44,920)</b>

### **5.2. Operating results of the Spanish Air Transport Group**

The Iberia Group reported income of Ptas. 3,520 million in 1996, as compared with the loss of Ptas. 44,620 million in 1995, the detail being as follows:

	<b>1996</b>	<b>1995</b>
<b>Operating Income</b>	<b>33,514</b>	<b>19,290</b>
Financial loss	(20,456)	(29,621)
Financial expenses net	(20,153)	(28,635)
Exchange losses, net	(303)	(926)
Amortization of goodwill in consolidation	(29)	(124)
Results of companies carried by the equity method	(897)	(3,266)
Extraordinary loss	(9,184)	(52,017)
Net income (loss) before taxes	2,748	(65,738)
Income (loss) attributed to minority interests	(248)	3,806
Taxes	820	17,312
<b>Net Income (Loss) After Taxes</b>	<b>3,520</b>	<b>(44,620)</b>

The 1996 earnings figure was made possible by the Companies capacity to respond to market trends, which were characterized by, significant overall growth in 1996 within the context of the general recovery of the air transport industry worldwide. The Companies achieved this through the continued implementation of cost-cutting measures, the commencement of Iberia's early retirement plan and the increase in employee productivity.

The reduction of Iberia's holding in the Aerolineas Argentina Group and, therefore, the carrying of the reduced holding by the equity method, improved the Group's operating results.

The financial loss was also notably reduced, mainly due to the repayment of long-term interest-bearing debt. This was made possible by the capital increase at IBERIA subscribed by its majority, shareholder.

The fall in extraordinary losses was mainly due to the recognition in 1995 of the full amount of the estimated cost of IBERIA's layoff plan, despite the recording of extraordinary provisions in 1996 to cover contingencies relating to the Latin American subsidiaries.

*Design and Production:*

**Departament Gràfic, S.L.**

## Errata - Annual Report 1996

### **Iberia LAE**

- (1) Page 18. Paragraph next to last, third line.
  - 3,158 should be 3,360.

### **Iberia Group**

- (a) Page 114. Paragraph last but two, last line.
  - 3,158 should be 3,360.

**IBERIA** 



SOCIEDAD ESTATAL  
DE PARTICIPACIONES INDUSTRIALES