



Dear shareholder,

This year the financial statements of IBERIA summarize the most significant events and information of a complex year, in which airline companies, and Iberia among them, have seen air traffic suffer the after-effects of 11-S, but in which we have also had the opportunity to demonstrate our ability to react and overcome the difficulties.

2002 was a special year for many reasons. We celebrated the company's 75th anniversary, Iberia joined the IBEX 35 and other selective stock market indices, and we completed the renewal of our short- and medium-haul fleet; we sold some affiliates, such as Binter Canarias, and created others, such as Iberia Cards or the Airport Multiservice company in Madrid; we signed extended commercial agreements with British Airways and implemented major improvements in the Madrid - Barcelona shuttle. Yet if I had to highlight an event, that unquestionably ranks as one of the most outstanding achievements of this company, this is to have reported the second best operating income in its history in one of the worst years on record of commercial aviation. The Iberia Group operating profit of more than 249 million euros is far more than just a figure: it shows that once more we have managed to confront the worst possible environment and come out of it even stronger.

In 2001 and 2002, specially since the attacks of September 11, IATA airlines have lost 32,000 million dollars, more than they had earned since the Second World War. More than 400,000 jobs were lost throughout the industry, half of them in airline companies; but as I have said so often, if one cannot avoid a crisis, then we must seize the opportunity to restructure and put companies back on their feet, correcting defects that sometimes have dragged on for decades.

As one might expect, in 2002 our priority was to tackle and overcome a situation that was tremendously difficult for the industry. The result is undeniable: 249 million euros of operating profit; almost 805 million euros of earnings before interest, tax, depreciation, amortization and aircraft rentals (EBITDAR), 23 per cent up from the previous year; an EBITDAR margin of 17.1 per cent, 3.3 points higher than in 2001; net profit of 159.8 million euros, three times the previous year's figure; and a return on equity (ROE) of 12 per cent. For the second year in a row, Iberia was again the most profitable airline in Europe.

These earnings are the direct consequence of the anticrisis plan launched at the end of 2001, which we have continued throughout 2002, and some parts of which, such as the cost-saving plan, remain in force. The plan revolved around a basic principle that is easy to understand (whenever demand and revenues fall, we must reduce supply and costs) but very difficult to apply in the air transport industry, which has always been characterized by rigid and costly means of production. In recent years, Iberia had prepared itself with flexibility mechanisms, through wet lease contracts and new aircraft agreements that were also flexible both regarding the aircraft models and sizes as well as the terms of delivery and financing mechanisms; all of which enabled us to immediately cut production and costs by returning leased aircraft, postponing the delivery of new ones and withdrawing the oldest aircraft earlier than scheduled.

The anticrisis plan also included downsizing the work force by more than 2,500, a measure that fortunately we managed to achieve through non-traumatic means, and a strict cost optimisation plan that went far beyond its goals, saving Iberia 60 million euros, as compared to our initial goal of 54 million euros.

The outcome of all these measures has been that, while annual ASK was cut by 5.2 per cent, demand only declined 2.2 per cent, so that the load factor improved by 2.3 points, a significant achievement at a time of recession and falling demand. We also gained market share in our strategic markets.

Furthermore, revenue was very similar to the previous year -only 0.8 per cent lower. In homogeneous terms, that is, without considering Binter Canarias in 2001, revenues would have been one per cent higher, expenses dropped six per cent, as a result of the company's successful cost cutting measures. Cash assets increased 257 million euros to 1,217 million euros, while bank debt fell 103 million euros to 613 million euros.

I mentioned earlier that sometimes a crisis gives us the opportunity to speed up necessary changes. A good example of this, in the case of Iberia, has been the renewal of the fleet. In the past, Iberia has always had too many different models, which makes it more expensive to operate, slows down flight scheduling and reduces crew productivity. By withdrawing aircraft from service ahead of schedule, since the end of 2001, we have halved the number of models of aircraft used on long haul flights from four to two, and on short and medium-haul flights, from six to three. Standardising the fleet plays a key role in boosting cockpit crew productivity, which last year improved by 4.2 per cent, and the aircraft utilisation rate, which increased 5.3 per cent in 2002, in spite of reduced capacity.

2002 was also a year to look ahead to the future, a future in which air transport will remain essential -IATA estimates that the number of passengers will double over the next 10 years- but competition will be stiffer and customer expectations will differ.

During the second half of the year we designed the master plan for the period 2003-2005, and the main objectives are the consolidation of profitability, growth with flexibility, increased productivity and enhanced service.

The strategies as defined in the plan must allow us to meet the challenges and opportunities of the next three years, mainly the gradual opening of the new runways at the Madrid and Barcelona airports, the New Terminal at Barajas, the arrival of new competitors due to the capacity increase of the airports and the commissioning of the high-speed train between Madrid and Barcelona.

Iberia will grow over the next three years, provided that no exceptional circumstances emerge, and in any case with flexibility measures for reducing production if necessary. In fact, we have already had to apply these flexibility measures in 2003, as air traffic and airline revenues are once again being hit hard by the economic crisis and global instability. The biggest increase in flights is scheduled for 2005, coinciding with the enlargement of the company's two operating hubs.

The master plan also calls for cost-saving measures and improved fleet utilisation, in order to also compete with the new types of airlines that are emerging, such as low cost carriers.

One of our core priorities is to enhance our service. We are working on a Customer Relationship Management (CRM) project that will allow us to know customers and satisfy their expectations better. We are already focusing in this area, with significant results, for example, in punctuality.

Finally, and in fulfilment of our commitment last year, you will find enclosed with this annual report a Social Responsibility Report, together with a Corporate Governance Report. As Chairman of Iberia, I also speak on behalf of our employees and customers, who believe that solid business earnings must go hand in hand with transparent information and a commitment to the society in which we live. A commitment to create new wealth while protecting the environment, and to return to society part of the profit that it has helped to generate by contributing, among others, to the integration of the disabled and to the enhancement of the living conditions of the most disadvantaged.

Thank you,



Xabier de Irala
CHAIRMAN OF IBERIA