ANNUAL REPORT 2008

IBERIA

Customer language

eficacia

calidad

sabilidad

transparencia

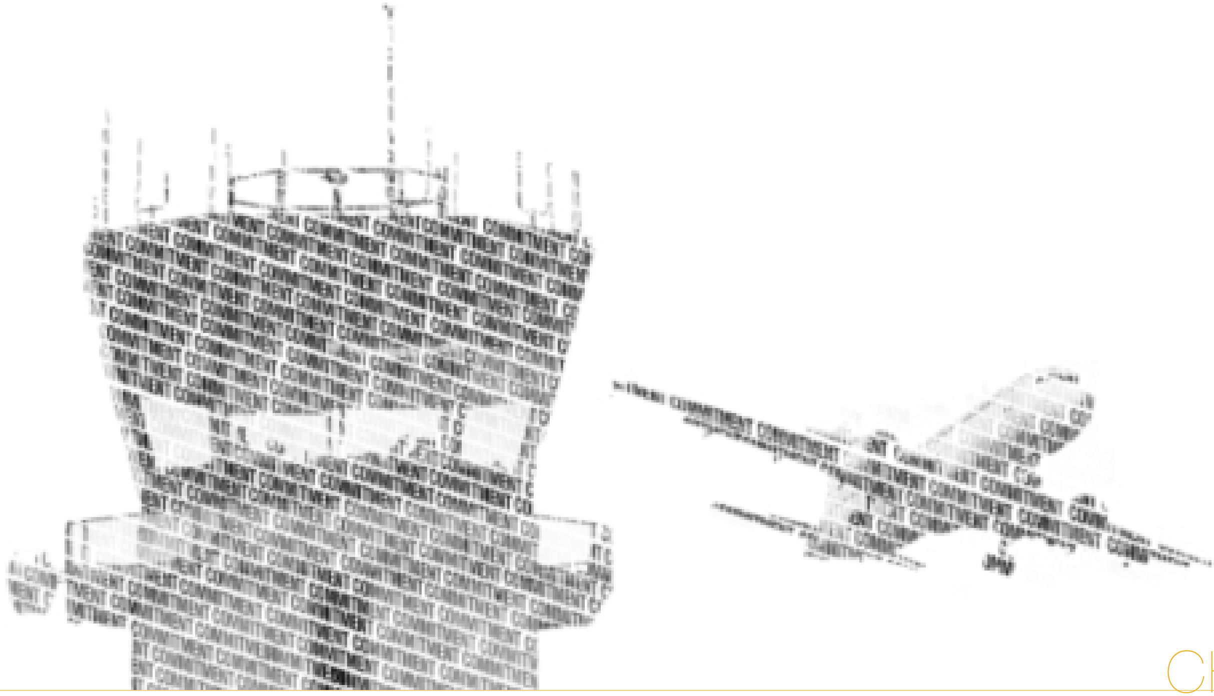
servicio

confianza

atención

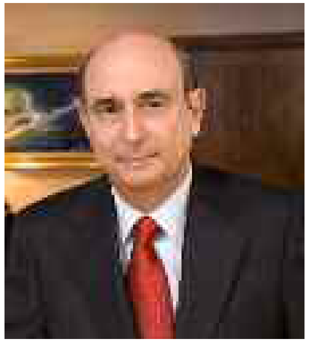
satisfacción

oneworld 10 years



CHAIRMAN'S STATEMENT

CHAIRMAN'S STATEMENT



The year of this Annual Report, 2008, will be remembered for two circumstances that have dented the results not only of Iberia, but of the entire air transport sector in general. The first of these circumstances was the fuel price, which was extremely volatile throughout the year, reaching an all-time high of 150 dollars/barrel in the summer, to subsequently come down to around 50 dollars. The second circumstance is the worldwide economic and financial crisis, which was more severe in the second half of the year and is continuing, equally harsh, in 2009, causing the Gross Domestic Product to plummet in several countries and an unprecedented drop in air traffic.

In Spain, to complicate things even further, the expansion of the high-speed train has also hit air traffic on certain domestic routes with traditionally very high traffic.

In spite of this rather depressing scenario, Iberia has managed to close the year with a consolidated profit of 32 million euro, thus posting positive results for the thirteenth year in succession, quite amazing in this sector.

Yet although positive, they are clearly nowhere near the results posted in 2007, which was an outstanding year. This evolution is due to the tremendous increase in fuel costs, up 45.5% on 2007, no less than 521 million extra on a cost item that had already been growing for several years. The 1,666 million paid by Iberia for aviation fuel represents more than 30% of the Group's operating expenses and 33.6% of the Transport business.

On the other hand, the cost-cutting and network restructuring policies have been successful again, achieving a 5.6% reduction in the other operating expenses items.

Operating revenues slid by 1.3%, although the difference can be put down to the depreciation of the dollar against the euro. Had the exchange rate remained constant, revenues would have increased slightly.

Traffic was weaker than capacity, mainly as a result of the current economic situation, hence the load factor was 1.6 points down on 2007. Even so, the 80% average load factor achieved is still one of the highest among European network carriers and four points above the AEA (Association of European Airlines) average.

Once again, the maintenance (MRO) business was positive, increasing its invoicing to third parties by 8.7%, consolidating and expanding its products and clients, individually or in collaboration with partners such as Singapore Technologies Aerospace. Also in 2008 we started to build a new MRO hangar in Barcelona, the only one in the whole of Catalonia that will have sufficient capacity to house aircraft with more than 100 seats. When it is completed, in 2010, this will be the most modern and technologically most advanced hangar in the south of Europe and will be able to provide services, among others, for the airlines operating at El Prat airport.

I should also like to point out that in these times of financial crisis and shortage of liquidity on the markets, our company closed the year with a healthy financial balance, equity of 1,564 million and liquidity of 2,351 million.

Productivity, another of the elements that contributed towards reducing unit costs, also performed well during the year. Employee productivity (measured in ASK/employee) increased by 3.9% respect to 2007 and fleet utilisation (measured in block hours/aircraft) rose 4.3% to 10 hours/day/aircraft, a record level for the company and probably the best in the sector among comparable airlines.

Apart from the figures per se, some of the most important developments during 2008 were seen in corporate transactions or improvement of Iberia's position on the world markets. We highlight the commencement of negotiations to explore the possibility of a merger with British Airways. We also reached an agreement with British and American Airlines to jointly operate the routes between Europe and North America, for which we need anti-trust immunity, currently being negotiated. Finally, the clickair-Vueling merger process aiming to create the largest new generation carrier in Spain and one of the largest in Europe is progressing according to schedule and is due to be completed in the second half of 2009.

2008 also marked the end of our 2006-2008 Director Plan, which set out, among other objectives, to review and optimise the network, enhance quality and revenues, improve resource productivity and cut costs.

Review of the flight schedule was completed, exceeding even the expectations of the Plan. Long haul routes are increasingly gaining weight in our company and now represent almost 50% of the passenger revenues, whereas in 2005 they barely accounted for 35%.

We have also strengthened our leadership on routes between Europe and Latin America, where our market share has risen from 17.6% in 2005 to 19.2% in 2008. That leadership is even greater on the business market, thanks to our Business Plus class and the extensive network of flights, destinations, frequencies and connections offered by our company and increasing from 19.2% before the plan to 21.9% in 2008.

If one of the company's strongest commitments was to increase revenue and quality, the best reflection that this has been achieved is seen in the Business Plus results: the number of passengers has grown by 45% since the beginning of the Plan. Precisely as a result of the greater share of business traffic, the unit revenues on long haul routes have increased by 23%.

Maintenance also showed strong growth, with an 83% increase in revenues from third parties since 2005.

We have also concluded the modernisation and homogenisation of the fleet and now have just two models of aircraft. This allows greater operating efficiency and a huge saving in operating costs. The average age of our aircraft is now 7 years, one of the lowest among network carriers. This has enabled us to increase our fleet utilisation to 10 hours/day, 10% more than before the Plan. This modernisation also benefits the environment, since the newer aircraft are far more silent and efficient in fuel consumption, so emit significantly less gas into the atmosphere.

The headcount has been reduced by 12.8% respect to 2005, almost four points more than we had budgeted, by applying non-traumatic measures. Meanwhile, over the three years of this Director Plan, staff productivity increased by 19.2%.

Last of all we come to the economic balance. Operating profit was more or less as expected in the Director Plan, while consolidated revenues and profits were better than forecast.

During 2008 we also worked on our Strategic Plan for 2009-2011, which takes very much into account the world macroeconomic situation at present and despite this, or precisely because of it, it is clearly geared towards improving revenues and the quality of customer service in all areas and businesses of the company.

The main pillar is, without doubt, the Integral Customer Service Improvement Plan. This Plan contemplates the investment of 150 million over the coming three years for the different improvements, including a complete renovation of the long haul Tourist class and commencement of the designing of a new long-haul Business class, redesigning of the VIP lounges at key airports, speeding-up of processes for Business clients and a clear focus on improving the customer service attitude.

We will continue to increase our leadership with Latin America and Europe, while maintaining our presence on the domestic market.

In economic terms, the aim is to recover our former profitability levels with an EBITDAR margin of 14% on average in the last three years, underpinning the Group's current financial standing.

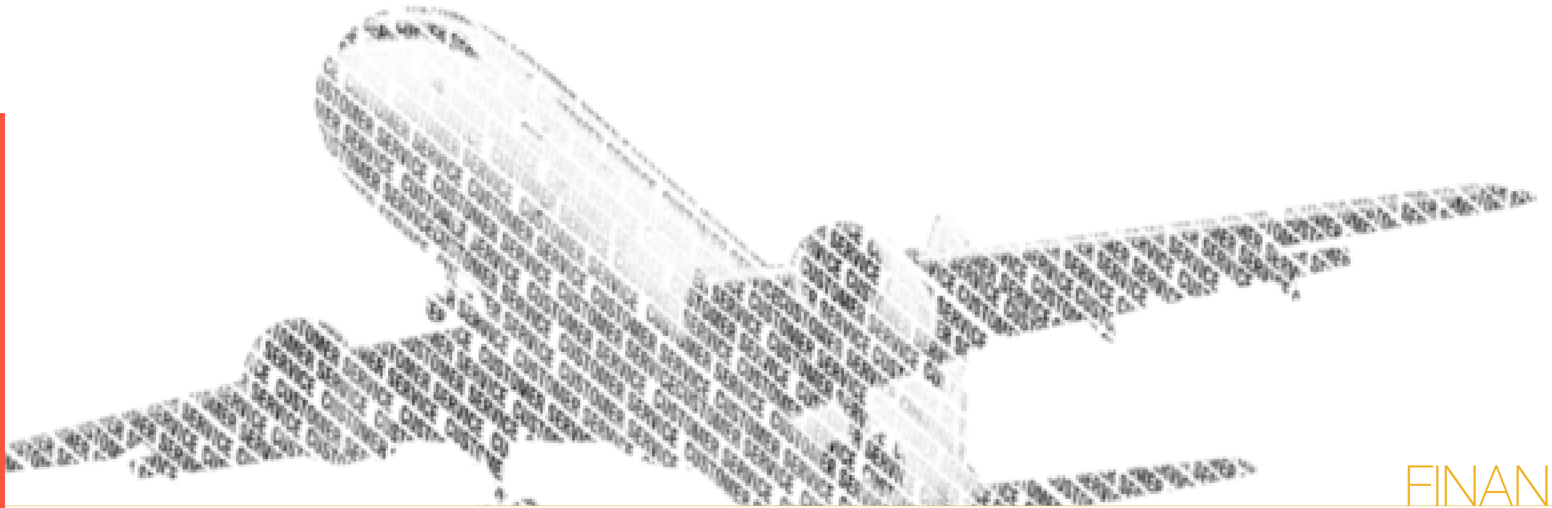
Finally, our overall goal is to make Iberia a strategic benchmark on a market which, as you all know, is constantly changing.

In any case, following the company's normal practice of adapting rapidly to changing circumstances on the market, which has been so successful in the past, Iberia has devised a contingency plan to cope with the current international economic crisis and fall in demand, contemplating measures such as reducing capacity by more than 4% in 2009, postponing the delivery of new aircraft, temporarily cancelling the wet lease and checking all expenses and investments. The aim is, as on other occasions, to take advantage of the company's flexibility to adjust supply to demand, or capacity to traffic, and grow again when the circumstances improve. This has been one of the mainstays of Iberia's success in the past and it will be again in the future.

As regards the initiatives we have taken as a socially responsible company, the Corporate Responsibility framework has been reviewed to adapt it to the new directives of the 2009-2011 Strategic Plan and prevailing best practices on the market. The framework establishes the guidelines for action in aspects such as environmental and social performance and the company's stakeholder engagement.

Iberia's efforts in this regard have led to its simultaneous inclusion in the selective Dow Jones World and European Sustainability Indexes and, for the first time, in the FTSE4Good IBEX. All these indexes recognise the best practices in Corporate Social Responsibility and are a value added for us and motivation to continue improving every day.

Fernando Conte
President of Iberia



FINANCIAL STATEMENTS AND MANAGEMENT REPORTS

IBERIA GROUP

Deloitte.

Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

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AUDITORS' REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

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

We have audited the consolidated financial statements of IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A. AND SUBSIDIARIES comprising the consolidated balance sheet at 31 December 2008 and the related consolidated income statement, consolidated cash flow statement, consolidated statement of changes in equity and notes to the consolidated financial statements for the year then ended. The preparation of these consolidated financial statements is the responsibility of the Parent's directors. Our responsibility is to express an opinion on the consolidated financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards in Spain, which require examination, by means of selective tests, of the evidence supporting the consolidated financial statements and evaluation of their presentation, of the accounting policies applied and of the estimates made.

As required by Spanish corporate and commercial law, for comparison purposes the Parent's directors present, in addition to the figures for 2008 for each item in the consolidated balance sheet, consolidated income statement, consolidated cash flow statement and consolidated statement of changes in equity, the figures for 2007. Our opinion refers only to the consolidated financial statements for 2008. On 31 March 2008, we issued our auditors' report on the 2007 consolidated financial statements, in which we expressed an unqualified opinion.

In our opinion, the accompanying consolidated financial statements for 2008 present fairly, in all material respects, the consolidated equity and consolidated financial position of Iberia, Líneas Aéreas de España, S.A. and Subsidiaries at 31 December 2008 and the consolidated results of their operations, the changes in consolidated equity and their consolidated cash flows for the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with International Financial Reporting Standards as adopted by the European Union applied on a basis consistent with that of the preceding year.

The accompanying consolidated management report for 2008 contains the explanations which the Parent's directors consider appropriate about the Group's situation, the evolution of its business and other matters, but is not an integral part of the consolidated financial statements. We have checked that the accounting information in the consolidated management report is consistent with that contained in the consolidated financial statements for 2008. 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 Iberia, Líneas Aéreas de España, S.A. and Subsidiaries.

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

Rodríguez

José Manuel Rodríguez
27 February 2009

Deloitte, S.L. Inscrita en el Registro Mercantil de Madrid, Tomo 13.650, folio 188, sección 8, hoja M-54414, inscripción 96, C.I.F.: B-79104469. Domicilio Social: Plaza Pablo Ruiz Picasso, 1 - Torre Picasso, 28020 Madrid.

Member of
Deloitte Touche Tohmatsu

CONSOLIDATED FINANCIAL STATEMENTS

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs, as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA GROUP **Consolidated balance sheets at December 31, 2008 and 2007**

Millions of euros

ASSETS	Notes	2008	2007
NON-CURRENT ASSETS:			
Intangible assets	5.1	**52**	**51**
Property, plant and equipment:	6	**1,118**	**1,133**
Aircraft		779	791
Other items of property, plant and equipment		339	342
Investments in associates		**17**	**16**
Non-current financial assets:	7	**672**	**404**
Equity instruments		247	42
Loans and receivables		123	116
Derivatives		70	26
Other financial assets		232	220
Deferred tax assets	13	**591**	**481**
Other non-current assets		-	**1**
Total non-current assets		**2,450**	**2,086**
CURRENT ASSETS:			
Non-current assets classified as held for sale	6	**11**	**-**
Inventories:	5.5	**224**	**197**
Aircraft spare parts		176	151
Other inventories		48	46
Accounts receivable	8	**586**	**720**
Current financial assets:	7.2	**1,751**	**860**
Loans and receivables		34	60
Derivatives		79	35
Other financial assets		1,638	765
Current prepayments and accrued income		**12**	**11**
Cash and cash equivalents:	5.7	**600**	**2,143**
Cash		74	77
Other cash equivalents		526	2,066
Total current assets		**3,184**	**3,931**
TOTAL ASSETS		**5,634**	**6,017**

EQUITY AND LIABILITIES	Notes	2008	2007
EQUITY:	9		
Share capital		**743**	**743**
Share premium		**120**	**120**
Reserves of the Parent		**694**	**817**
Reserves at fully consolidated companies		**(5)**	**(12)**
Reserves at companies accounted for using the equity method		**(21)**	**10**
Profit attributable to the Parent:		**32**	**327**
Consolidated profit for the year		32	328
Profit attributable to minority interests		-	(1)
Equity attributable to shareholders of the Parent		**1,563**	**2,005**
Minority interests		**1**	**1**
Total equity		**1,564**	**2,006**
NON-CURRENT LIABILITIES:			
Long-term provisions	11	**1,283**	**1,377**
Non-current payables	10	**403**	**421**
Deferred tax liabilities	13	**1**	**1**
Non-current accrued expenses and deferred income	5.16	**78**	**97**
Total non-current liabilities		**1,765**	**1,896**
CURRENT LIABILITIES:			
Current payables	10	**640**	**269**
Customer advances	5.16	**394**	**455**
Trade and other payables:		**1,254**	**1,384**
Suppliers and sundry accounts payable		970	1,020
Remuneration payable		159	202
Tax payables	13	125	162
Current accrued expenses and deferred income		**17**	**7**
Total current liabilities		**2,305**	**2,115**
TOTAL EQUITY AND LIABILITIES		**5,634**	**6,017**

The accompanying Notes 1 to 23 are an integral part of the consolidated balance sheets at December 31, 2008 and 2007.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs, as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA GROUP **Consolidated income statements for 2008 and 2007**

Millions of euros

	Notes	Income (Expenses)	
		2008	2007
Revenue	14.1	**5,223**	**5,304**
Other operating income:	14.2	**292**	**231**
Recurring		227	217
Non recurring		65	14
Procurements	15.1	**(1,864)**	**(1,354)**
Staff costs:	15.2	**(1,321)**	**(1,444)**
Recurring		(1,320)	(1,380)
Non recurring		(1)	(64)
Depreciation and amortisation charge		**(193)**	**(215)**
Other operating expenses:	15.3	**(2,157)**	**(2,305)**
Recurring		(2,152)	(2,288)
Non recurring		(5)	(17)
Net gains on disposal of non-current assets	14.3	**25**	**196**
Profit from operations		**5**	**413**
Finance income	14.4	137	126
Finance costs	15.4	(52)	(60)
Exchange differences (gains and losses)		(2)	(3)
Share of results for the year of associates	16	(18)	(29)
Other income and expenses		(34)	-
Profit before tax		**36**	**447**
Income tax	13	(4)	(119)
Profit for the year from continuing operations		**32**	**328**
Attributable to:			
Shareholders of the Parent		32	327
Minority interests		-	(1)
Basic earnings per share (in euros)	9.3	**0.034**	**0.346**

The accompanying Notes 1 to 23 are an integral part of the consolidated income statements for 2008 and 2007.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs, as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA GROUP Consolidated statement of changes in equity

A) Consolidated statements of recognised income and expense for 2008 and 2007

Millions of euros

	Income / (Expenses)	
	31-12-2008	31-12-2007
Consolidated profit for the year	32	327
Income and expenses recognised directly in equity		
Measurement of financial instruments:	(114)	-
Available-for-sale financial assets	(114)	-
Cash flow hedges	(335)	(84)
Tax effect	135	25
	(314)	(59)
Transfers to the consolidated income statement:		
Cash flow hedges	66	40
Tax effect	(20)	(12)
	46	28
Total recognised income / (expenses)	(236)	296

The accompanying Notes 1 to 23 are an integral part of the consolidated statement of changes in equity for the years ended December 31, 2008 and 2007.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs, as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA GROUP **Consolidated statements of changes in equity**

B) Consolidated statements of total changes in equity for the years ended December 31, 2008 and 2007 (Note 9)

Millions of euros

			Reserves of the Parent						Reserves at					
	Share capital	Share premium	Adjustment of share capital to euros	Legal reserve	Treasury shares	Voluntary reserves	Reserves arising from application of IFRSs	Valuation adjustments	Fully consolidated companies	Companies accounted for using the equity method	Profit	Total	Minority interests	Total equity
Balances at December 31, 2006	**739**	**116**	**1**	**147**	**(14)**	**596**	**165**	**(58)**	**(17)**	**6**	**57**	**1,738**	**1**	**1,739**
Total recognised income and expenses	-	-	-	-	-	-	-	**(31)**	-	-	327	**296**	-	**296**
Transactions with owners														
Distribution of profit:														
To reserves	-	-	-	1	-	51	(37)	-	5	4	(24)	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	(33)	(33)	-	(33)
Capital increase	4	4	-	-	-	-	-	-	-	-	-	8	-	8
Changes in treasury shares	-	-	-	-	(5)	-	-	-	-	-	-	(5)	-	(5)
Other changes	-	-	-	-	-	-	1	-	-	-	-	1	-	1
Balances at December 31, 2007	**743**	**120**	**1**	**148**	**(19)**	**647**	**129**	**(89)**	**(12)**	**10**	**327**	**2,005**	**1**	**2,006**
Total recognised income and expenses	-	-	-	-	-	-	-	**(268)**	-	-	**32**	**(236)**	-	**(236)**
Transactions with owners														
Distribution of profit:														
To reserves	-	-	-	1	-	195	(3)	-	7	(31)	(169)	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	(158)	(158)	-	(158)
Changes in treasury shares	-	-	-	-	(45)	-	-	-	-	-	-	(45)	-	(45)
Other changes	-	-	-	-	-	-	(3)	-	-	-	-	(3)	-	(3)
Balances at December 31, 2008	**743**	**120**	**1**	**149**	**(64)**	**842**	**123**	**(357)**	**(5)**	**(21)**	**32**	**1,563**	**1**	**1,564**

The accompanying Notes 1 to 23 are an integral part of the consolidated statements of changes in equity for the years ended December 31, 2008 and 2007.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRSs, as adopted by the European Union (see Notes 3 and 23). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA GROUP Consolidated cash flow statements for 2008 and 2007 (Note 22)

Millions of euros

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES (I)	**38**	**381**
Profit before tax	**36**	**447**
Adjustments for:	**113**	**142**
Depreciation and amortisation charge	193	215
Impairment losses	6	-
Changes in provisions	52	163
Gains/Losses on derecognition and disposal of non-current assets	(25)	(102)
Gains/Losses on derecognition and disposal of financial instruments	-	(94)
Finance income	(137)	(126)
Finance costs	52	60
Exchange differences	-	(4)
Change in fair value of financial instruments	5	7
Other income and expenses	(33)	23
Changes in working capital:	**(56)**	**(8)**
Inventories	(26)	(15)
Trade and other receivables	126	(113)
Other current assets	(26)	1
Trade and other payables	(153)	125
Other current liabilities	11	(35)
Other non-current assets and liabilities	12	29
Other cash flows from operating activities:	**(55)**	**(200)**
Interest paid	(26)	(34)
Dividends received	1	14
Interest received	137	88
Income tax recovered (paid)	(31)	(121)
Other amounts received (paid)	(136)	(147)
CASH FLOWS FROM INVESTING ACTIVITIES (II)	**(390)**	**351**
Payments due to investment:	**(633)**	**(328)**
Group companies and associates	(57)	(9)
Intangible assets	(20)	(20)
Property, plant and equipment	(127)	(163)
Other financial assets	(429)	(136)
Proceeds from disposal:	**243**	**679**
Intangible assets	-	6
Property, plant and equipment	106	360
Other financial assets	47	265
Other assets	90	48
CASH FLOWS FROM FINANCING ACTIVITIES (III)	**(301)**	**(239)**
Proceeds and payments relating to equity instruments:	**(45)**	**3**
Proceeds from issue of equity instruments	-	8
Purchase of treasury shares	(46)	(8)
Disposal of treasury shares	1	3
Proceeds and payments relating to financial liability instruments:	**(98)**	**(209)**
Proceeds from issue of bank borrowings	56	29
Repayment of bank borrowings	(154)	(238)
Dividends and returns on other equity instruments paid:	**(158)**	**(33)**
Dividends	(158)	(33)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES (IV)		
NET INCREASE / DECREASE IN CASH AND CASH EQUIVALENTS (I+II+III+IV)	**(653)**	**493**
Cash and cash equivalents at beginning of year	2,835	2,342
Cash and cash equivalents at end of year	2,182	2,835

The accompanying Notes 1 to 23 are an integral part of the consolidated cash flow statement.

IBERIA GROUP
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR 2008 AND 2007 PREPARED IN ACCORDANCE WITH IFRSS

1. ACTIVITY OF THE PARENT AND THE GROUP

Iberia, Líneas Aéreas de España, S.A. engages mainly in the air transport of passengers and freight and also performs other complementary activities, the most noteworthy of which include assistance for passengers and aircraft at airports and aircraft maintenance.

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

Iberia, Líneas Aéreas de España, S.A. is a fully-fledged member of the **one**world alliance, one of the world's largest airline groups, which facilitates the globalisation of its air transport business.

In addition to the activities carried out directly by Iberia, Líneas Aéreas de España, S.A. and for the purpose of complementing them or developing transport-related business activities, the Company has been incorporating or investing in various companies which compose the Iberia Group of which Iberia, Líneas Aéreas de España, S.A. is the Parent.

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

2. GROUP COMPANIES

2.1. Subsidiaries

Subsidiaries are defined as companies in which Iberia, Líneas Aéreas de España, S.A., as the Parent, owns directly or indirectly more than 50% of the share capital and, accordingly, has the capacity to exercise effective control thereon.

The fully consolidated companies composing the Iberia Group, their main business activity and the ownership interests held by the Parent therein are as follows:

- Cargosur, S.A. (corporate holdings), VIVA Vuelos Internacionales de Vacaciones, S.A. (corporate holdings), Campos Velázquez, S.A. (acquisition of urban property), Iberia Tecnología, S.A. (corporate holdings), Consultores Hansa, S.A. (inactive), Binter Finance B.V. (financing and cash) and Iberia México (cargo handling at Mexico airport). Iberia, Líneas Aéreas de España, S.A. has a 100% direct or indirect ownership interest in these companies.
- Compañía Auxiliar al Cargo Exprés, S.A. (cargo transport), Auxiliar Logística Aeroportuaria, S.A. (cargo transport) and Iberia Desarrollo Barcelona, S.R.L. (aircraft maintenance infrastructures), which are directly or indirectly 75% owned.

Notes 9.6 and 16 to the consolidated financial statements show the contributions made by these companies to Group reserves and profit. The assets contributed by these companies are not material.

2.2. Associates

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

Exceptionally, the Iberbus companies (see Note 7), in which the Group owns more than 20% of the voting rights, are not considered to be associates and, accordingly, are not consolidated, since the majority shareholder, Airbus, guarantees that Iberia, Líneas Aéreas de España, S.A., a minority shareholder of and lender to these companies, will recover its investment in full.

The associates, their main business activity and the ownership interests held by the Parent therein are as follows: 43.5 % of Iberia Cards (issue and management of payment instruments), 49% of Multiservicios Aeroportuarios, S.A. (airport-related ancillary services), 65% of Iber-América Aerospace, LLC (purchase and sale of aircraft parts and engines), 50% de Empresa Logística de Carga Aérea, S.A. (operation of a freight terminal at Havana airport), 50% of Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A. (aircraft maintenance), 51% of Handling Guinea Ecuatorial, S.A. (handling services operator at Malabo airport), 25% of the Air Miles Group (multi-industry customer loyalty), 39% of Serpista, S.A. (airport equipment maintenance), 49% of International Supply Management, S.L. (marketing of chemical products), 40% of Noamar Air Handling Holdco N.V. (handling services operator at Tel Aviv airport), 50% of Madrid Aerospace Service (landing-gear maintenance) and 20% of Clickair, S.A. (passenger transport). The interest in the dividend rights of Clickair, S.A. amounts to 80%.

Notes 9.7 and 16 to the accompanying consolidated financial statements show the contributions made by these companies to Group reserves and profit.

Changes in the scope of consolidation

In 2007 Iberia Tecnología, S.A., which is wholly-owned by Iberia, Línea Aéreas de España, S.A. incorporated Iberia Desarrollo Barcelona, S.R.L., which commenced operations in 2008.

In 2008 Iberia México was newly and fully consolidated and Madrid Aerospace Services, S.L. began to be accounted for using the equity method.

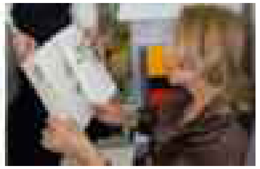
3. BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS AND BASIS OF CONSOLIDATION

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

The consolidated financial statements for 2008 were obtained from the accounting records and financial statements of the Parent and the Group companies.

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the



European Union, in conformity with Regulation (EC) no. 1606/2002 of the European Parliament and with Law 62/2003, of December 30, on Tax, Administrative, Labour and Social Security Measures, so that they present fairly the Group's consolidated equity and financial position at December 31, 2008 and the results of its operations, the changes in consolidated equity and the consolidated cash flows in the Group in the year then ended.

The 2008 consolidated financial statements of the Group and the 2008 individual financial statements of the Group companies, which were prepared by the respective directors, have not yet been approved by the shareholders at their respective Annual General Meetings. However, the Parent's directors consider that the aforementioned financial statements will be approved without any material changes.

3.2. Main decisions relating to IFRSs

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

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

Consolidated Financial Statements

The Group took the following decisions in relation to the adoption of new standards and interpretations issued:

1. **Standards and interpretations applicable in 2007**

   IFRIC 11 IFRS 2 Group and Treasury Share Transactions and the amendment to IAS 39/IFRS 7 Reclassification of Financial Assets became effective for the first time in 2008. The adoption of these new interpretations and amendments had no impact on the Group's consolidated financial statements.

2. **Standards and interpretations issued but not yet in force**

   At the date of preparation of these consolidated financial statements, the following standards and interpretations had been published by the IASB but had not yet come into force, either because their effective date is subsequent to the date of the consolidated financial statements or because they had not yet been adopted by the European Union.

		Obligatory application in the years beginning on or after
Standards and amendments to standards:		
IFRS 8	Operating segments	January 1, 2009
Revised IAS 23	Borrowing costs	January 1, 2009
Revised IAS 1	Presentation of financial statements	January 1, 2009
Revised IFRS 3 (1)	Business combinations	July 1, 2009
Amended IAS 27 (1)	Consolidated and separate financial statements	July 1, 2009
Amended IFRS 2	Share-based payment - vesting conditions and cancellations	January 1, 2009
Amended IAS 32 and IAS 1	Financial instruments puttable at fair value and obligations arising on liquidation	January 1, 2009
Amended IFRS 1 and IAS 27	Cost of an investment in an entity's separate financial statements	January 1, 2009
Amended IAS 39 (1)	Eligible hedged items	July 1, 2009
Interpretations:		
IFRIC 12 (1)	Service concession arrangements	(3)
IFRIC 13	Customer loyalty programmes	January 1, 2009 (2)
IFRIC 14	IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction	January 1, 2009 (2)
IFRIC 15 (1)	Agreements for the construction of real estate	January 1, 2009
IFRIC 16 (1)	Hedges of a net investment in a foreign operation	October 1, 2008
IFRIC 17 (1)	Distributions of non-cash assets to owners	July 1, 2009

(1) Standards and interpretations not yet adopted by the European Union at the date of preparation of these consolidated financial statements.
(2) Date of obligatory application as approved in the Official Journal of the European Union.
(3) This interpretation is awaiting endorsement. As announced by the EU's Accounting Regulatory Committee (ARC) it will foreseeably be approved for use in the EU with a new effective date which would postpone its obligatory application until 2010 (in theory the IASB had initially established January 1, 2008 as the effective date).

The Directors consider that the application of these standards and interpretations will not have a significant effect on the consolidated financial statements, except for IFRIC 13, the potential impact of which has not yet been assessed.

3.3. Responsibility for the information and use of estimates

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

In the Group's consolidated financial statements for 2008 estimates were made by the directors of the Parent in order to quantify or measure and, where appropriate, recognise certain of the assets, liabilities, income, expenses or obligations. These estimates relate basically to the following:

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

These estimates were made on the basis of the best information available at December 31, 2008 on the events analysed.

In any case, events that take place in the future might make it necessary to change these estimates in the coming years, which, if any, would be applied prospectively.

3.4. Basis of consolidation

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

The share of third parties of the Group's equity and profit for the year are presented under “Minority Interests” in the consolidated balance sheet and the consolidated income statement, respectively.

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

In the consolidated financial statements, investments in associates are accounted for using the equity method, i.e. at the Group's share of net assets of the investee, after taking into account the dividends received therefrom and other equity eliminations. The Group's share of the profits obtained by the investee in the year are presented under “Share of Results for the Year of Associates” in the accompanying income statement.

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

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

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

4. DISTRIBUTION OF THE PARENT’S PROFIT

The directors of Iberia, Líneas Aéreas de España, S.A. propose that the profit for 2008 be taken in full to voluntary reserves.

5. ACCOUNTING POLICIES AND MEASUREMENT BASES

The principal accounting policies and measurement bases used in preparing the Group’s consolidated financial statements for 2008 were as follows:

5.1. Intangible assets

Intangible assets include computer software which was acquired mainly from third parties. The Group recognises under this heading the computer software acquisition and development costs incurred. Computer software maintenance costs are recognised in the consolidated income statement for the year in which they are incurred. Computer software is amortised on a straight-line basis over five years.

5.2. Property, plant and equipment

Property, plant and equipment are carried at historical cost, net of the related accumulated depreciation and the impairment losses, if any.

The improvements to items of property, plant and equipment leading to increased capacity, efficiency, or to a lengthening of the useful lives of the assets are capitalised.

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

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

	Years of estimated useful life
Aircraft	18 - 22
Buildings and other structures	20 - 50
Machinery, fixtures and tools	10 - 15
Transport equipment	7 - 10
Furniture	10
Computer hardware	4 - 7
Spare parts for property, plant and equipment	8 - 18
Flight simulators	12 - 14

The estimated residual value of rotatable fuselage parts (those assigned to specific types or families of aircraft), which is recognised under "Spare Parts for Property, Plant and Equipment", ranges from 10% to 20% of acquisition cost, depending on the type of aircraft to which the parts are assigned. The estimated residual value of repairable fuselage parts is 10% of acquisition cost.

The Group depreciates in full the acquisition cost of other items of property, plant and equipment.

When including owned aircraft and aircraft operated under a finance lease, the Group separates from the cost of the aircraft the cost relating to the components that will be replaced during the scheduled overhauls that take place every four to seven years. This cost is depreciated on a straight-line basis over the period from the acquisition of the aircraft to the first scheduled overhaul. The cost of the repairs made during these overhauls is capitalised to property, plant and equipment and depreciated over the period elapsing until the next scheduled overhaul takes place.

The cost of maintenance of items of property, plant and equipment and the cost of minor repairs to aircraft operated by the Group are recognised in the income statement as incurred.

For each aircraft operating under an operating lease, based on the terms of the related leases, the Group recognises an allowance for the total cost to be incurred in scheduled overhauls and allocates this cost to the income statement on a straight-line basis over the period between two consecutive overhauls (see Note 11).

5.3. Impairment of property, plant and equipment and intangible assets

When there is any indication of decline in value, the Group performs an impairment test to estimate the possible loss of value that reduces the recoverable amount of the assets to below their carrying amount.

Recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the Group recognises an impairment loss in the income statement. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to a maximum of the original carrying amount that would have been recognised had no impairment loss been recognised.

5.4. Leases

Leases are classified as finance or operating leases depending on the substance and the nature of the transaction. The main leases entered into by the Group are for aircraft and do not contemplate the automatic transfer of ownership at the end of the lease term.

Leases are classified as finance leases whenever the terms of the leases include an option for the lessee to acquire the asset (purchase option) and Group management has decided to exercise the option. Other leases, with or without a purchase option, are classified as operating leases unless, based on the agreed terms and conditions the transaction can be equated to an acquisition (evaluating for the purpose the following indicators: purchase option, lease term and present value of the payment obligations).

Consolidated Financial Statements

5.4.1. Finance leases

For finance leases, the Group recognises the cost of the leased assets in the consolidated balance sheet based on the nature of the leased asset and, simultaneously, a liability for the same amount. This amount is calculated as the lower of the fair value of the leased asset and the present value, at the beginning of the lease term, of the minimum payments agreed upon, plus the purchase option, when there is no reasonable doubt as to its exercise. The calculation does not include contingent payments, the service cost or the taxes that can be passed on by the lessor. The total finance charge on the lease is allocated to the income statement for the year in which it is incurred, using the effective interest rate method. Contingent payments, if any, are recognised as an expense for the year in which they are incurred.

The assets recognised for these types of transactions are depreciated on the basis of their nature using similar criteria to those applied to items of property, plant and equipment taken as a whole.

5.4.2. Operating leases

The costs arising from operating leases are charged to the income statement in accordance with the terms of the related agreements.

5.5. Inventories

Inventories are measured at the lower of acquisition cost (weighted average cost) or market value (net realisable value) and include mainly aircraft spare parts, repairable aircraft engine parts and fuel.

The Group makes the appropriate valuation adjustments, and recognises them as an expense in the income statement when the net realisable value of the inventories is lower than their acquisition cost.

5.6. Financial assets

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

1. Held to maturity investments: debt securities with fixed maturity and determinable payments that are traded in an active market and which the Group has the positive intention and ability to hold to the date of maturity.
2. Loans and receivables: financial assets arising from the sale of goods or the rendering of services in the ordinary course of the Company's business, or financial assets which, not having commercial substance, are not equity instruments or derivatives, have fixed or determinable payments and are not traded in an active market.
3. Available for sale financial assets: these include debt securities and equity instruments of other companies that are not classified in any of the previous categories.

Loans and receivables and held to maturity investments are initially recognised at the fair value of the consideration paid, plus any directly attributable transaction costs. They will subsequently be measured at amortised cost. The Group has recognised provisions to cover uncollectibility risks. These provisions are calculated according to the probability of recovery of the debt based on age thereof and the debtor's solvency.

Available for sale financial assets are measured at fair value until the asset is disposed of or has become permanently impaired, at which time the cumulative gains or losses previously recognised in equity are recognised in the income statement.

At least at each reporting date the Group tests its financial assets not measured at fair value through profit or loss for impairment. Objective evidence of impairment is considered to exist when the recoverable amount of the financial asset is lower than its carrying amount. When this occurs, the impairment loss is recognised in the income statement.

Deposits and guarantees given are recognised at the amount delivered. Deposits include the amounts delivered under the contracts for the acquisition of new aircraft, which may be reimbursed on delivery of the aircraft.

The Group generally classifies its temporary cash surpluses under "Current Financial Assets" at the amounts actually paid. The interest income associated with these transactions is recognised as income when accrued while unmatured interest is presented in the balance sheet as an addition to the balance of the aforementioned heading.

5.7. Cash and cash equivalents

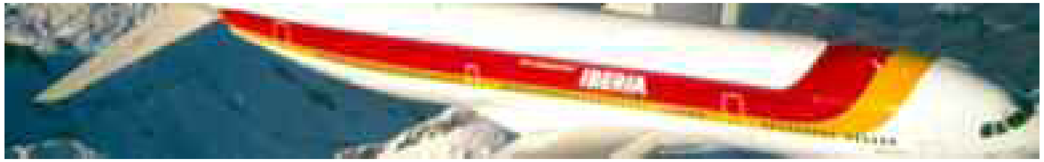
The Group includes under "Cash" and "Cash Equivalents" cash and short-term highly liquid investments maturing in less than three months that are readily convertible to cash and which are subject to an insignificant risk of changes in value. The interest income associated with these transactions is recognised as income when accrued while unmatured interest is presented in the balance sheet as an addition to the balance of the aforementioned heading.

5.8. Financial liabilities

Financial liabilities are accounts payable by the Group that have arisen from the purchase of goods and services in the normal course of its business and those which, not having commercial substance, cannot be considered to be derivative financial instruments.

Accounts payable are initially recognised at the fair value of the consideration received, adjusted by the directly attributable transaction costs. These liabilities are subsequently measured at amortised cost.

The Group derecognises financial liabilities when the obligations they generate are extinguished.



5.9. Treasury shares of the Parent

Treasury shares are recognised at the value of the consideration paid and are deducted from equity. Gains and losses on the acquisition, sale, issue or retirement of treasury shares are recognised in equity.

5.10. Derivative financial instruments and hedging transactions

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

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

1. Fair value hedges: the hedged item and the hedging instrument are both measured at fair value, and any changes in the fair values are recognised in the consolidated income statement; the effects of these changes are offset under the same heading in the consolidated income statement.
2. Cash flow hedges: changes in the fair value of the derivatives are recognised under "Equity – Valuation Adjustments". The cumulative

gain or loss recognised in this heading is transferred to the consolidated income statement to the extent of the impact of the underlying (resulting from the risk hedged) on the consolidated income statement; thus this effect is netted off under the same heading in the consolidated income statement.

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

5.11. Current / Non-current classification

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

5.12. Provisions for restructuring costs

In December 2001 the Parent obtained authorisation from the employment authorities for a collective redundancy procedure. Subsequently, the required authorisations were obtained (the last of which was granted in November 2007) to extend the procedure to various employee groups. The procedure will remain in force until December 31, 2010 for ground personnel. Also, a collective redundancy procedure for handling personnel associated with the process for the assignment of resources by way of subrogation was approved in 2006 which will remain in force until 2014. The accompanying consolidated balance sheet at December 31, 2008 does not include any provision for this second collective redundancy procedure, since there was no cost commitment in relation thereto.

The first collective redundancy procedure provides for the payment of certain amounts until the statutory retirement age to employees who meet certain conditions and decide to request early retirement.

The Parent recognises provisions for the effective cost commitments which will be disbursed in subsequent years.

The actuarial studies used to determine the liability to the employees who have opted for early retirement under these conditions are based on similar assumptions to those described in Note 5.13. The successive payments resulting from these commitments are deducted from the provisions recorded.

5.13. Obligations to employees

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

The collective labour agreements in force at the Parent also provide that flight crew who meet certain conditions may take early retirement (special leave of absence and voluntary termination). The Parent is required to pay certain amounts of remuneration to these employees until they reach the statutory retirement age. The Parent recognises, with a charge to the consolidated income statement in the year in which this circumstance arises, the provision required, calculated on the basis of actuarial studies, to meet the future payment obligations to the employees concerned. 164 employees are currently on special leave and 300 employees have opted for voluntary termination.

"Long-Term Provisions – Provisions for Obligations to Employees" in the consolidated balance sheet includes, inter alia, the liabilities incurred in this connection (see Note 11).

The aforementioned amounts were calculated on the basis of actuarial studies conducted by independent actuaries using the projected unit credit method and based on a discount rate of 4% and PERM/F-2000 P mortality tables. The main assumption used was 2.5% growth in pensions and the CPI.

5.14. Montepío de Previsión Social Loreto

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

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

Both in 2008 and 2007 the Parent's contributions in this connection amounted to EUR 22 million and were recognised under "Staff Costs – Recurring" in the accompanying consolidated income statements.

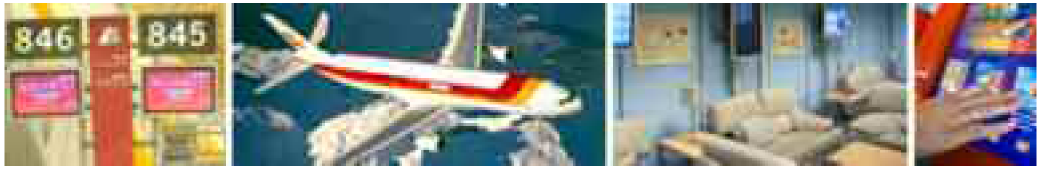
5.15. Long-term provisions

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

- Provisions: credit balances covering present obligations arising from past events, the settlement of which is likely to cause an outflow of resources, but which are uncertain as to their amount and/or timing.
- Contingent liabilities: possible obligations that arise from past events and whose existence will be confirmed only by the occurrence of one or more future events not wholly within the control of the consolidated companies.

The consolidated financial statements include all the provisions with respect to which it is considered that it is more likely than not that the obligation will have to be settled. Contingent liabilities are disclosed in the notes to the financial statements, unless the possibility of an outflow in settlement is considered to be remote.

Provisions are measured at the present value of the best possible estimate of the amount required to settle or transfer the obligation, taking into account the information available on the event and its consequences. Where discounting is used, adjustments made to provisions are recognised as finance cost on an accrual basis. The Group reverses these provisions, fully or partially, when such obligations cease to exist or are reduced.



5.16. Revenue and expense recognition

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

Ticket sales and sales of the traffic documents for cargo and other services are initially credited to "Customer Advances" in the consolidated balance sheet. The balance of this heading reflects the estimated liability for ticket sales and traffic documents sold each year prior to December 31, but not yet used at that date. The revenue relating to ticket sales and traffic documents is recognised when the transport or service is performed.

Iberia, Líneas Aéreas de España, S.A. has in place the "Iberia Plus" card the purpose of which is to foster customer loyalty. Cardholders accumulate points for taking certain flights, using the services of entities included in the programme or making purchases with credit cards covered by the programme. The points can be exchanged for free tickets or other services offered by the companies included in the programme. "Trade and Other Payables" in the accompanying consolidated balance sheets at December 31, 2008 and 2007 include provisions of EUR 115 million and EUR 103 million, respectively, in this connection, based on the estimated redemption value of the unused points accumulated at those dates, taking into account the historical experience in the redemption of points.

Interest income from financial assets is recognised using the effective interest method and dividend income is recognised when the shareholder's right to receive payment is established. Interest and dividends from financial assets accrued after the date of acquisition are recognised as income in the income statement.

In general, any incentives, bonuses or reductions received in cash or in kind by the Parent relating to aircraft coming into service under operating lease are recognised in the consolidated income statement on a straight-line basis over the term of the lease or when the discounted use arises. "Non-Current Accruals and Deferred Income" in the consolidated balance sheet includes the amounts not yet recognised as income at each year-end.

5.17. Income tax

Since January 1, 2002 Iberia, Líneas Aéreas de España, S.A. and certain subsidiaries file consolidated tax returns under the tax system provided for by Chapter VII of Title VII of the Consolidated Spanish Corporation Tax Law. The companies composing the Consolidated Tax Group are the fully consolidated companies except for Binter Finance, BV and Iberia México, S.A., which do not meet the legally established requirements to be included in the group.

For each company, the current tax for the year is the amount paid in settlement of the income tax returns for that year. Tax credits and other tax benefits applied to the taxable profit, excluding withholdings, prepayments and tax loss carryforwards effectively offset during the year, reduce the current tax amount.

The deferred tax expense or income relates to the recognition and derecognition of deferred tax assets and liabilities. These include the temporary differences measured at the amount expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities and their tax bases, and tax loss and tax credit carryforwards. These amounts are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled.

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are only recognised to the extent that it is considered probable that the Group will have sufficient taxable profits in the future against which the deferred tax asset can be utilised.

Deferred tax assets and liabilities arising from items directly charged or credited to equity accounts are also recognised with a charge or credit, respectively, to equity.

The deferred tax assets recognised are reassessed at the end of each reporting period and the appropriate adjustments are made to the extent that there are doubts as to their future recoverability. Also, unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that they will be recovered through future taxable profits.

5.18. Non-current assets and disposal groups classified as held for sale

The Group classifies a non-current asset or disposal group classified as held for sale when it has taken the decision to sell it and the sale is expected to be completed within twelve months.

These assets or disposal groups are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets classified as held for sale are not depreciated, but rather at the date of each consolidated balance sheet the related valuation adjustments are made to ensure that the carrying amount is not higher than fair value less costs to sell.

Income and expenses arising from non-current assets and disposal groups classified as held for sale which do not qualify for classification as discontinued operations are recognised under the related heading in the consolidated income statement on the basis of their nature.

5.19. Earnings per share

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

5.20. Balances and transactions in currencies other than the euro

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

The balances of accounts receivable and payable denominated in currencies other than the euro are translated to euros at the exchange rates prevailing at December 31 of each year. However, following customary airline practice, the balance of the liability for unused traffic documents is reflected in the consolidated balance sheet at the exchange rate prevailing in the month of the sale, as set by the International Air Transport Association (IATA). The IATA exchange rate for each month is the average exchange rate for the last five bank working days prior to the 25th day, inclusive, of the preceding month.

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

5.21. Consolidated cash flow statements

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

1. Cash flows: inflows and outflows of cash and cash equivalents, which are short-term investments that are subject to an insignificant risk of changes in value.
2. Operating activities: the principal revenue-producing activities of the Company and other activities that are not investing or financing activities.
3. Investing activities: the acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents.
4. Financing activities: activities that result in changes in the size and composition of the equity and borrowings of the Group companies that are not operating activities.

5.22. Risk management policy

The Group has adopted numerous measures to control and manage risks and has implemented systems to enable it to identify, assess, manage and mitigate the main risks affecting its various business activities.

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

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

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

Exchange rate risk

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

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

Interest rate risk

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

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

Fuel price risk

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

This risk is normally reduced by arranging swaps and options.

Liquidity risk

In view of the cyclical nature of its business and the investment and financing requirements resulting from the renewal of its aircraft, the Group has a liquidity policy to ensure a significant volume of available cash and current financial assets.

This cash position is invested in highly liquid, short-term instruments such as debt repos, eurodeposits and bank promissory notes arranged through top level banks, in accordance with the current counterparty risk policy.

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

5.23. Activities with an environmental impact

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

Investments made in connection with environmental activities are measured at cost and are capitalised as an addition to non-current assets in the year in which they are made.

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

Provisions for probable or certain third-party liabiltiy, litigation in progress and outstanding indemnity payments or obligations of undetermined amount -which, relating to the environment, are not covered by the insurance policies taken out- are recognised, if applicable, when the liability or obligation giving rise to the indemnity or payment arises.

6. PROPERTY, PLANT AND EQUIPMENT

The changes in this heading in the consolidated balance sheet in 2007 and 2008 were as follows:

Millions of euros

2007	31-12-06	Additions or Charge for the year	Transfers	Disposals	31-12-07
Cost:					
Aircraft	2,369	85	147	(509)	2,092
Other items of property, plant and equipment:					
Land	3	-	-	-	3
Buildings and other structures	152	3	7	(3)	159
Machinery, fixtures and tools	461	24	4	(25)	464
Transport equipment	40	1	-	(5)	36
Furniture and fixtures	21	1	-	(1)	21
Computer hardware	119	8	-	(27)	100
Spare parts	201	19	-	(13)	207
Flight simulators	3	-	-	-	3
Property, plant and equipment in the course of construction	19	10	(16)	(5)	8
	1,019	66	(5)	(79)	1,001
Accumulated depreciation:					
Aircraft	(1,214)	(143)	(39)	234	(1,162)
Other items of property, plant and equipment:					
Buildings and other structures	(114)	(4)	-	2	(116)
Machinery, fixtures and tools	(325)	(23)	-	19	(329)
Transport equipment	(25)	(3)	-	5	(23)
Furniture and fixtures	(13)	(2)	-	-	(15)
Computer hardware	(88)	(13)	-	28	(73)
Spare parts	(97)	(9)	-	7	(99)
Flight simulators	(1)	-	-	-	(1)
	(663)	(54)	-	61	(656)
Impairment losses and provisions:					
Aircraft	(157)	-	(10)	28	(139)
Other items of property, plant and equipment	(3)	-	-	-	(3)
	1,351				**1,133**

Millions of euros

2008	31-12-07	Additions or Charge for the year	Transfers	Disposals	31-12-08
Cost:					
Aircraft	2,092	137	(315)	(365)	1,549
Other items of property, plant and equipment:					
Land	3	-	-	-	3
Buildings and other structures	159	-	-	(1)	158
Machinery, fixtures and tools	464	10	1	(25)	450
Transport equipment	36	-	-	(4)	32
Furniture and fixtures	21	-	-	-	21
Computer hardware	100	15	-	(3)	112
Spare parts	207	19	-	(10)	216
Flight simulators	3	-	-	-	3
Property, plant and equipment in the course of construction	8	21	(6)	(2)	21
	1,001	65	(5)	(45)	1,016
Accumulated depreciation:					
Aircraft	(1,162)	(121)	280	272	(731)
Other items of property, plant and equipment:					
Buildings and other structures	(116)	(4)	-	2	(118)
Machinery, fixtures and tools	(329)	(24)	-	23	(330)
Transport equipment	(23)	(3)	-	3	(23)
Furniture and fixtures	(15)	(1)	-	-	(16)
Computer hardware	(73)	(11)	-	3	(81)
Spare parts	(99)	(10)	-	4	(105)
Flight simulators	(1)	-	-	-	(1)
	(656)	(53)	-	35	(674)
Impairment losses and provisions:					
Aircraft	(139)	-	(54)	46	(39)
Other items of property, plant and equipment	(3)	-	-	-	(3)
	1,133				**1,118**

6.1. Aircraft

Additions

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

Millions of euros

	2007	2008
Aircraft	29	73
Engines	36	44
Refurbishments	20	20
	85	**137**

Aircraft additions in 2008 relate to two A320 units subsequently sold during the year (see “Disposals”) and to two A340 units which had been operated under an operating lease. A finance lease was arranged for one of these A340 units and the purchase option on the other was exercised.

Transfers

Transfers in 2007 included EUR 92 million in relation to deposits given previously for the acquisition of aircraft and engines, which were recognised under “ Non-Current Financial Assets – Other Financial Assets” (see Note 7.1.3.). Transfers also include EUR 50 million in relation to engines of the B747 aircraft classified in 2006 under “Other Non-Current Assets Held for Sale” (the related accumulated depreciation of EUR 39 million and provisions of EUR 10 million were also transferred) and EUR 5 million previously classified as property, plant and equipment in the course of construction under “Other Items of Property, Plant and Equipment”.

In 2008 the Group reclassified the MD aircraft, which it no longer operates and for which there are sale agreements anticipating delivery in 2009, to “Non-Current Assets Classified as Held for Sale”, recognising a cost of EUR 345 million, accumulated depreciation of EUR 280 million and impairment losses of EUR 54 million. The remaining transfers in 2008 relate mainly to deposits previously given for the acquisition of aircraft and engines, which were recognised under “Non-Current Assets – Other Financial Assets” (see Note 7.1.3).

Disposals

The disposals were as follows:

Millions euros

Aircraft	2007			2008		
	Cost	Accumulated depreciation	Provisions	Cost	Accumulated depreciation	Provisions
A320	314	(72)	-	47	(10)	-
MD	134	(111)	(20)	152	(132)	(18)
A340	-	-	-	15	(9)	-
B747	36	(29)	(7)	148	(120)	(28)
MD88	25	(22)	(1)	3	(1)	-
	509	**(234)**	**(28)**	**365**	**(272)**	**(46)**

Disposals in 2007 were as follows:

A320 aircraft

The Parent sold six A320 aircraft operated under finance lease on which the purchase option had been exercised. This sale was made to banks which subsequently leased the aircraft to the Company under operating lease.

The carrying amount of these 6 aircraft at the time of sale totalled EUR 123 million and the Group recognised losses of approximately EUR 1 million as a result of the sale.

Additionally, the Group sold a further six A320 aircraft that had been purchased in the same year but which the Parent had never brought into service. These aircraft were sold to banks and the proceeds of the sale were included under “Net Gains on Disposal of Non-Current Assets” in the consolidated income statement.

MD87 and MD88 aircraft

Disposals of MD87 and MD88 aircraft relate to the sale of 6 MD87 aircraft and the derecognition of an MD88 aircraft. The gain of EUR 5 million obtained on these disposals is recognised under “Net Gains on Disposal of Non-Current Assets” in the consolidated income statement.

B747 aircraft

The Parent sold 14 B747 aircraft engines, giving rise to a gain of approximately EUR 1 million.

Disposals in 2008 were as follows:

A320 aircraft

In 2008 the Parent sold two A320 aircraft which had been purchased during the year but which were not brought into service. These aircraft were sold to banks and the proceeds of the sale are recognised under “Net Gains on Disposal of Non-Current Assets” in the 2008 consolidated income statement. The Parent also carried out overhauls of these aircraft as scheduled, and derecognised the cost of the overhauls which had been fully depreciated.

MD87 aircraft

The MD87 aircraft disposals relate to the sale of 8 MD87 aircraft and 20 MD87 engines on which the Parent obtained a gain of EUR 5 million, which is recognised under “Net Gains on Disposal of Non-Current Assets” in the accompanying consoildated income statement.

B747 aircraft

The Company derecognised two B747 aircraft and two B747 engines whose carrying amount was zero.

Aircraft allowances

In order to provide for possible impairment losses for planned aircraft disposals, the Group records allowances to adjust the carrying amount of the aircraft to be derecognised to their net realisable value. The changes in 2007 and 2008 were as follows:

Millions of euros

Aircraft	Balance at 31-12-06	Disposals	Transfers	Balance at 31-12-07	Disposals	Transfers	Balance at 31-12-08
B747	60	(7)	10	63	(28)	-	35
MD	93	(21)	-	72	(18)	(54)	-
Other	4	-	-	4	-	-	4
	157	(28)	10	139	(46)	(54)	39

Obligations and other guarantees on aircraft

The Group is using two aircraft under finance lease and four aircraft under operating lease the payments under which secure, together with the aircraft, the repayment of a bond issue launched by the lessor in the European market in 2000. At December 31, 2008, EUR 82 million of the bonds had not yet been repaid.

Also, the Parent is guaranteeing the use of 20 aircraft under operating or finance lease for periods of between 9 and 14 years vis-à-vis the subscribers of a bond issue with outstanding amounts at December 31, 2008 of USD 101 million and EUR 120 million.

The Group is currently implementing a fleet renewal plan instrumented through various agreements entered into with Airbus, for A319, A320, A330 and A 340 type aircraft. The aircraft not yet delivered at December 31, 2008 and the year in which they are scheduled to be added to the fleet are as follows:

Type of aircraft	2009	2010	2011	Total
A320	2	5	5	12
A340/600	3	2	-	5
	5	7	5	17

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered at December 31, 2008 amounted to approximately EUR 1,324 million.

The Parent also has options on 24 A320 aircraft, giving rise to an advance of EUR 3 million, which is recognised under "Other Non-Current Financial Assets – Other Financial Assets" in the consolidated balance sheet at December 31, 2008 (see Note 7.1.3.).

Aircraft in service

Following is a summary of the Group's aircraft in service at December 31, 2008:

Type of aircraft	Owned	Under finance lease	Under operating lease	Under wet lease (a)	Total
A319 (b)	-	-	22	-	22
A320	10	6	29	-	45
A321	-	4	15	-	19
A340/300	6	1	11	3	21
A340/600	-	-	12	-	12
	16	11	89	3	119

(a) Lease type which includes the aircraft, maintenance, technical crews and insurance.
(b) Excludes two "parked" A-319 aircraft yet to be received.

The foregoing table excludes three B747 aircraft owned by the Parent which were grounded at December 31, 2008 because they were to be sold or scrapped and which have a carrying amount of zero. It also excludes the MD aircraft discussed in the paragraph on "Non-Current Assets Classified as Held for Sale" at the end of this Note.

Aircraft operated under operating lease and wet leases

In 2008 three A319 aircraft were included under operating lease. The wet leases for two B757 aircraft were also cancelled and a third B757 aircraft, that had been grounded and in the process of being returned at 2007 year-end, was returned.

Following are the expiry dates of the operating leases of aircraft being operated by the Parent:

Aircraft	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Number of aircraft
A319	-	-	-	6	10	3	-	-	-	-	3	22
A320	1	1	1	2	6	2	2	5	-	-	9	29
A321	-	-	-	-	1	-	2	3	2	1	6	15
A340/300	1	3	1	3	-	2	1	-	-	-	-	11
A340/600	-	-	-	-	-	-	3	2	3	4	-	12
Total	**2**	**4**	**2**	**11**	**17**	**7**	**8**	**10**	**5**	**5**	**18**	**89**

In addition to the foregoing aircraft, the Parent had arranged wet leases for one B757 unit and one A320 unit, which at December 31, 2008 were subleased to other airlines, and one A320 unit, which at December 31, 2008 was not in service, awaiting its return to the lessor.

Certain of the operating leases include a purchase option on the aircraft that can be exercised during the lease term, and the possibility of extending the lease for periods ranging from one to nine years. At the date of preparation of these consolidated financial statements, the Parent's directors did not intend to exercise the purchase options or to request or avail of the extensions considered in the aforementioned leases that would involve the use of the aircraft concerned for periods exceeding 16 years.

Operating lease expenses

The lease payments accrued in 2008 and 2007 for aircraft operating leases and wet leases amounted to EUR 357 million and EUR 393 million, respectively, and are included under "Other Operating Expenses - Recurring" in the accompanying consolidated income statements (see Note 15.3). The detail of the approximate total operating lease payments payable calculated on the basis of the interest rates and exchange rates prevailing at December 31, 2008 for these aircraft is as follows:

Year	Millions of euros
2009	292
2010	267
2011	252
2012	239
2013 and subsequent years	778
	1,828 (*)

(*) Equivalent to USD 2,544 million at the 2008 year-end exchange rate. The exchange rate and interest rate risks on these lease payments are partially hedged with derivatives (see Note 12).

Assets held under finance lease

At December 31, 2008 there were items of property, plant and equipment acquired under finance lease, mainly aircraft, for a total cost of EUR 408 million and accumulated depreciation of EUR 104 million (2007: cost of EUR 385 million and accumulated depreciation of EUR 88 million).

The lease payments outstanding at December 31, 2008 including the amount of the purchase options, fall due as detailed in Note 10.

6.2. Other items of property, plant and equipment

The carrying amount of the buildings and facilities built on state-owned land, mainly at Spanish airports, amounted to EUR 32 million and EUR 34 million, respectively, at December 31, 2008 and 2007. The Parent's directors do not expect any material losses to arise as a result of the reversion process since the maintenance programmes ensure that the items are always in good operating condition.

6.3. Fully depreciated items

At December 31, 2007 and 2008, the cost of the Group's fully depreciated items of property, plant and equipment amounted to EUR 349 million and EUR 356 million, respectively, the detail being as follows:

Millions of euros

	2007	2008
Buildings	60	59
Machinery, fixtures and tools	198	196
Furniture and fixtures	7	8
Computer hardware	40	57
Transport equipment and other items of property, plant and equipment	15	12
Aircraft	29	24
	349	**356**

6.4. Insurance coverage

The Group companies have taken out insurance policies for their property, plant and equipment and intangible assets which provide adequate cover for their carrying amount at December 31, 2008. Also, the Group has taken out insurance policies to cover aircraft leased to third parties.

6.5. Non-current assets not in service

The Group maintains certain assets in the consolidated balance sheet, basically aircraft and engines, which are not in service. The cost of these assets, EUR 204 million, is covered by the related depreciation and the impairment losses and provisions recognised.

6.6. Non-current assets classified as held for sale

All balance recognised under this heading in the accompanying consolidated balance sheet relates to the Parent's MD aircraft to be sold foreseeably in 2009 under the sale contracts for this fleet in force at year-end.

At December 31, 2008 these aircraft were not in service.

7. FINANCIAL ASSETS

7.1. Non-current financial assets

The detail of "Non-Current Financial Assets" in 2007 and 2008 is as follows:

Millions of euros

2007	Non-Current financial instruments				
	Equity instruments	Loans and receivables	Derivatives (Note 12)	Other financial assets	Total
Held to maturity investments	25	-	-	217	242
Loans and receivables	-	116	-	-	116
Available for sale financial assets					
- At fair value	1	-	-	-	1
- At cost	16	-	-	-	16
Derivatives	-	-	26	3	29
Total	42	116	26	220	404

Millions of euros

2008	Non-Current financial instruments				
	Equity instruments	Loans and receivables	Derivatives (Note 12)	Other financial assets	Total
Held to maturity investments	12	-	-	238	250
Loans and receivables	-	123	-	-	123
Available for sale financial assets					
- At fair value	219	-	-	-	219
- At cost	16	-	-	-	16
	-	-	70	(6)	64
Total	247	123	70	232	672

7.1.1. Equity instruments

The changes in "Equity Instruments" in the 2007 and 2008 consolidated balance sheets, together with the related impairment losses were as follows:

Millions of euros

2007	% of Ownership at 31-12-2007	Balance at 31-12-2006	Disposals	Balance at 31-12-2007
Held to maturity investments:				
Iberbus companies	40.00-45.00	25	-	25
Available for sale financial assets:				
• At fair value				
Venezolana Internacional de Aviación, S.A.	45.00	88	-	88
Interinvest, S.A.	0.1438	30	-	30
Opodo, Ltd.	2.38	19	-	19
Other		6	(2)	4
• At cost				
Servicios de Instrucción de Vuelo, S.L..	19.9	9	-	9
Wam Acquisition, S.A.	11.57	14	(7)	7
Total cost		191	(9)	182
Provisions		(142)	2	(140)

Millions of euros

2008	% of Ownership at 31-12-2008	Balance at 31-12-2007	Additions	Disposals	Exchange differences	Balance at 31-12-2008
Held to maturity investments: Iberbus companies	40.00-45.00	25	-	(9)	(4)	12
Available for sale financial assets:						
• At fair value						
Venezolana Internacional de Aviación, S.A.	45.00	88	-	-	-	88
Interinvest, S.A.	0.1438	30	-	-	-	30
Opodo, Ltd.	2.38	19	-	-	-	19
British Airways	9.99	-	331	-	-	331
Others		4	-	-	-	4
• At cost						
Servicios de Instrucción de Vuelo, S.L.	19.9	9	-	-	-	9
Wam Acquisition, S.A.	11.57	7	-	-	-	7
Total cost		182	331	(9)	(4)	500
Provisions		(140)	(114)	1	-	(253)

The majority shareholder of the Iberbus companies, Airbus, has guaranteed Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of its investments in and loans to the aforementioned companies, and, accordingly, the value of the Group's ownership interest in these companies is the same as their acquisition cost and they are not included in the scope of consolidation.

The ownership interests in Venezolana Internacional de Aviación, S.A. and Interinvest, S.A. are fully provided for. Approximately EUR 18 million of the ownership interest in Opodo, Ltd. has been provided for.

In 2008 the Parent acquired shares representing 9.9% of the share capital of British Airways plc. for EUR 331 million. At December 31, 2008, a provision of EUR 114 million was charged to "Equity – Reserves of the Parent" in the accompanying consolidated balance sheet, to recognise this investment at its fair value, calculated on the basis of its market value at that date.

The investment in Wam Acquisition, S.A. was acquired as partial consideration for the sale of Amadeus, S.A. and is instrumented in ordinary shares and preference shares. The preference shares grant the right to receive a fixed and cumulative dividend of 13.75% on the par value. "Finance Income" in the accompanying 2007 and 2008 consolidated income statements includes EUR 6 million and EUR 4 million, respectively, in this connection. These shares are convertible into ordinary shares in the event the investee is floated.

7.1.2. Loans and receivables

The changes in this heading in the consolidated balance sheet in 2007 and 2008 were as follows:

Millions of euros

2007	Balance at 31-12-06	Additions	Exchange differences (a)	Disposals	Transfers	Balance at 31-12-07
Loans to Venezolana Internacional de Aviación, S.A. (b)	26	-	-	-	-	26
Loans to Iberbus companies	150	-	(13)	-	(59)	78
Loans to Aerolineas Argentinas, S.A. (c)	36	-	-	-	-	36
Loan to Wam Acquisition, S.A.	46	1	-	(47)	-	-
Clickair, S.A. - preference shares	14	9	-	-	-	23
Loans to Iberlease 2004 Ltd.	41	-	(5)	-	-	36
Other loans	4	-	-	-	(3)	1
Total cost	**317**	**10**	**(18)**	**(47)**	**(62)**	**200**
Provisions	**(61)**	**(23)**	**-**	**-**	**-**	**(84)**

Millions of euros

2008	Balance at 31-12-07	Additions	Exchange differences (a)	Transfers	Balance at 31-12-08
Loans to Venezolana Internacional de Aviación, S.A. (b)	26	-	-	-	26
Loans to Iberbus companies	78	-	4	(28)	54
Loans to Aerolineas Argentinas, S.A. (c)	36	-	-	-	36
Clickair, S.A. – preference shares (d)	23	53	-	-	76
Loans to Iberlease 2004 Ltd.	36	-	2	-	38
Other loans	1	-	-	-	1
Total cost	**200**	**53**	**6**	**(28)**	**231**
Provisions	**(84)**	**(18)**	**-**	**(6)**	**(108)**

(a) Classified under "Exchange Differences (Gains and Losses)" in the consolidated income statements and hedged.
(b) The loans granted to Venezolana Internacional de Aviación, S.A. (VIASA) arose in prior years and had been provided for in full at December 31, 2007 and 2008.
(c) The loans of approximately EUR 36 million to Aerolíneas Argentinas, S.A. relate to the subrogation to a loan of USD 43 million granted by Banesto, S.A. secured by a mortgage on two B-747 aircraft, the repayment of which was guaranteed by Iberia, Líneas Aéreas de España, S.A. These loans have been provided for in full.
(d) Due to the preference shares of Clickair, S.A., "Provisions" includes a balance of approximately EUR 44 million.

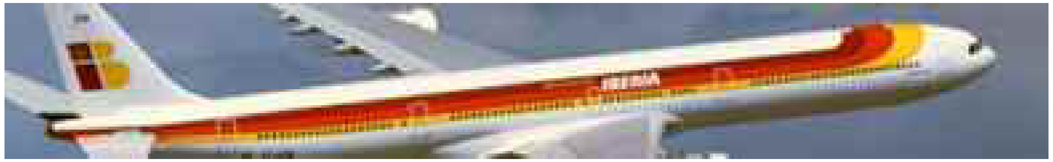
Iberbus companies

Iberia, Líneas Aéreas de España, S.A. granted a loan to each of its Iberbus investees and entered into aircraft operating and finance leases with them. The principal ranges between USD 11 million and USD 22 million. These loans were granted for a period equal to the term of the operating or finance lease for the related A340-300 aircraft and earn annual interest ranging from 4% to 6%. The loans are repayable in a one-off lump sum upon maturity, which will take place in the period from 2009 to 2012. The loans maturing in 2009 were reclassified to "Current Financial Assets – Loans and Receivables" (see Note 7.2).

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

Millions of euros

Maturing in	
2010	29
2011	8
2012	17
	54



Wam Acquisition, S.A.

The full amount of the loan granted to Wam Acquisition, S.A. was collected in 2007.

Clickair, S.A.

At December 31, 2008, Iberia, Líneas Aéreas de España, S.A. owned ordinary shares in the share capital of Clickair, S.A. amounting to EUR 4 million, granting it a 20% ownership interest in the share capital of this investee, although, based on the agreements with the other shareholders, the dividend rights on this shareholding amount to 80%.

The investment in Clickair, S.A. is instrumented in, besides the aforementioned ordinary shares, preference shares, the cost of which at December 31, 2008 was EUR 76 million (of which EUR 53 million were paid in 2008). The impairment losses recognised to present this investment at the fair value estimated by the Parent's directors total EUR 46 million (of which EUR 23 million were recognised in 2008).

The directors of Clickair S.A. and of Vueling Airlines, S.A. have initiated the process for the merger of the two companies. At the date of preparation of the accompanying consolidated financial statements, the merger plan had been approved by the European Commission and approval of the issue prospectus was awaited from the shareholders at the respective Annual General Meetings and from the Spanish National Securities Market Commission. The Parent's directors consider that the merger process will be completed before September 2009. If the merger ultimately takes place, Iberia, Líneas Aéreas de España, S.A. would acquire the ownership interests of three of the other four shareholders of Clickair, S.A. for the amounts paid by them.

Iberlease 2004 Ltd.

Iberlease 2004 Ltd., the lessor of four aircraft held by the Parent under finance leases, is in turn the recipient of four loans granted by Iberia, Líneas Aéreas de España, S.A. for a term identical to that established in the finance leases, which are repayable in a single payment in December 2014. The principal of these loans amounts to USD 54 million and the interest is earned at a annual rate of between 6% and 6.5% payable quarterly.

7.1.3. Other non-current financial assets

The changes in the accounts under this heading in 2007 and 2008 were as follows:

Millions of euros

2007	Balance at 31-12-06	Additions	Disposals and recoveries	Transfers	Exchange differences	Balance at 31-12-07
Deposits for acquisition of aircraft	289	133	(108)	(92)	(21)	201
Measurement of the hedging transactions	(7)	-	(1)	-	11	3
Other	24	3	(8)	(1)	(2)	16
	306	136	(117)	(93)	(12)	220

Millions of euros

2008	Balance at 31-12-07	Additions	Disposals and recoveries	Transfers	Exchange differences	Balance at 31-12-08
Deposits for acquisition of aircraft	201	81	(31)	(50)	15	216
Measurement of the hedging transactions	3	4	-	-	(13)	(6)
Other	16	7	-	(1)	-	22
	220	92	(31)	(51)	2	232

Deposits

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

Millions of euros

	2007		2008	
	Outright purchase	Option/right	Outright purchase	Option/right
A320 Family	115	3	70	3
A340 Family	75	1	137	-
Engines	7	-	6	-
	197	**4**	**213**	**3**

Based on scheduled aircraft deliveries, the Group considers that deposits amounting to EUR 128 million will be taken to income in 2009.

7.2. Current financial assets

The detail of this heading in the accompanying consolidated balance sheets at December 31, 2007 and 2008 is as follows:

Millions of euros

2007	Current financial instruments			
	Loans and receivables	Derivatives (Note 12)	Other financial assets	Total
Held to maturity investments	-	-	708	708
Loans and receivables	60	-	57	117
Derivatives	-	35	-	35
Total	**60**	**35**	**765**	**860**

Millions of euros

2008	Current financial instruments			
	Loans and receivables	Derivatives (Note 12)	Other financial assets	Total
Held to maturity investments	-	-	1,582	1,582
Loans and receivables	34	-	56	90
Derivatives	-	79	-	79
Total	**34**	**79**	**1,638**	**1,751**

The average return on the amounts placed in current financial assets, mainly deposits, eurodeposits, euronotes and fixed-term deposits and promissory notes was 3.93% in 2007 and 4.74% in 2008.

The return on the investments recognised under “Other Cash Equivalents” in the consolidated balance sheet was 4.50% in 2007 and 4.70% in 2008.

8. ACCOUNTS RECEIVABLE

This heading in the accompanying consolidated balance sheets at December 31, 2007 and 2008 includes mainly receivables from customers for sales performed directly by the Parent and from passenger and cargo agents marketing the services rendered by the Parent. This heading also includes receivables from airlines, mainly for services provided by the Parent in relation to tickets sold originally by other airlines, and tax receivables (see Note 13.1.).

The collection periods established by the Group companies range between 20 to 45 days.

The allowances recognised by the Group on the basis of its analysis of the recoverability of accounts receivable, based on an ageing and a case-by-case analysis, form part of the balance of this heading.

9. EQUITY

9.1. Share capital

The changes in 2007 and 2008 in the Parent's share capital were as follows:

	Number of Shares	Par Value (euros)
Number of shares and par value of the share capital at January 1, 2007	948,066,632	0.78
Capital increase	4,842,183	0.78
Number of shares and par value of the share capital at December 31, 2007	952,908,815	0.78
Capital increase	194,193	0.78
Number of shares and par value of the share capital at December 31, 2008	953,103,008	0.78

In 2007 the Parent increased capital by EUR 3,776,903 by issuing 4,842,183 ordinary shares of EUR 0.78 par value each, with a share premium of the same amount per share. This capital increase was performed to cater for the conversion into shares of the same number of convertible debentures issued to cover the share option plan approved by the shareholders at the Annual General Meeting in 2003 and aimed at certain executive directors, executives and other employees. In this connection, in 2008 capital was increased by EUR 151,471, relating to 194,193 ordinary shares of EUR 0.78 par value each, with a share premium of EUR 0.84 per share.

At December 31, 2007 and 2008, the shareholders of the Parent were as follows:

	2007		2008	
	Number of shares	Percentage of ownership	Number of shares	Percentage of ownership
Caja de Ahorros y Monte de Piedad de Madrid	219,098,519	22.99	219,098,519	22.99
British Airways Holdings B.V.	94,309,090	9.90	125,321,425	13.15
Sociedad Estatal de Participaciones Industriales	49,212,526	5.16	49,212,526	5.16
State Street Bank	43,512,185	4.57	-	-
El Corte Inglés, S.A.	27,387,215	2.87	32,151,759	3.37
B. Metzler seel. Sohn & Co	-	-	28,458,106	2.99
Other	519,389,280	54.51	498,860,673	52.34
	952,908,815	**100.00**	**953,103,008**	**100.00**

At December 31, 2008 all the shares were of the same class, were fully subscribed and paid and were traded by the book-entry system. The shares of the Parent are listed on the Continuous Market of the Spanish stock exchanges and all carry the same voting and dividend rights.

9.2. Treasury shares of the Parent

The changes in “Treasury Shares” in 2007 and 2008 were as follows:

	2007		2008	
	Number of shares	Millions of euros	Number of shares	Millions of euros
At beginning of year	6,702,368	14	8,050,000	19
Additions	2,559,890	8	20,255,916	46
Disposals	(1,212,258)	(3)	(407,645)	(1)
At end of year	**8,050,000**	**19**	**27,898,271**	**64**

The treasury shares held by Iberia, Líneas Aéreas de España, S.A. at December 31, 2008 and 2007 represent respectively, 2.93% and 0.84% of the share capital, with an aggregate par value of EUR 22 million and EUR 6 million. The average acquisition price of the shares of the Parent held by the Group at 2008 and 2007 year-end was EUR 2.31 and EUR 2.37, respectively, per share. The average selling price of the shares of the Parent in 2008 and 2007 was EUR 2.69 and EUR 2.68, respectively, per share.

At December 31, 2008 the treasury shares of the Parent held by the Group were intended for trading on the market.

9.3. Earnings per share

Basic earnings per share

The basic earnings per share for 2007 and 2008 were as follows:

	2007	2008
Profit for the year attributable to the Parent (millions of euros)	327	32
Weighted average number of shares outstanding (millions of shares)	945	929
Basic earnings per share (euros)	0.346	0.034

9.4. Share premium

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

9.5. Legal reserve

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

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

9.6. Reserves at fully consolidated companies

The detail, by company, of the balance of "Reserves at Fully Consolidated Companies" in the consolidated balance sheets at December 31, 2007 and 2008 is as follows:

Millions of euros

Entity	2007	2008
Iberia, Líneas Aéreas de España, S.A.	74	80
Compañía Auxiliar al Cargo Exprés, S.A.	3	3
VIVA, Vuelos Internacionales de Vacaciones, S.A.	2	3
Total	79	86
Adjustments due to application of IFRSs	(91)	(91)
	(12)	**(5)**

9.7. Reserves at companies accounting for using the equity method

The detail, by company, of the balance of "Reserves at Companies Accounted for Using the Equity Method" in the consolidated balance sheets at December 31, 2007 and 2008 is as follows:

Millions of euros

Entity	2007	2008
Clickair, S.A.	-	(31)
Multiservicios Aeroportuarios, S.A.	2	1
Empresa Logística de Carga Aérea, S.A.	1	1
Empresa Hispano Cubana de Mantenimiento de Aeronaves Ibeca, S.A.	1	1
Handling Guinea Ecuatorial, S.A.	1	-
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.	2	3
Serpista, S.A.	1	1
Air Miles Group	-	1
Total	8	(23)
Adjustments due to application of IFRSs	2	2
Total	**10**	**(21)**

9.8. Valuation adjustments

“Valuation Adjustments” in the consolidated statement of changes in equity includes mainly the changes in the value of hedging derivatives and the provisions recorded to recognise at fair value the financial assets available for sale.

9.9. Capital management

The Group manages its capital to ensure that the Group companies are able to continue operating as profitable businesses whilst maximising shareholders' returns. The policy implemented by the Group to meet the objectives established is supported by, among other instruments, the maintenance of a correct balance between debt and equity. This policy makes it possible to reconcile the creation of value for shareholders with access to financial markets at a competitive cost for the purpose of covering the borrowing requirements of the investment plan which are not covered by the funds generated by its business activities.

The Group's capital management operates on the basis of three financial aggregates: equity and debt, as reported in the balance sheet and adjusted or equivalent net debt, the last of which takes into account the commitments acquired under leases:

- Equity includes share capital, reserves and profit.
- Net debt reported in the balance sheet includes bank borrowings less cash and cash equivalents, excluding the measurements of derivatives.
- Adjusted or equivalent net debt includes in net debt the capitalised aircraft leases, excluding the impact of derivatives, and eliminates capitalised interest on loans to Iberbus companies.

The description of these parameters and the corresponding amounts are as follows:

Millions of euros

	2007	2008
Consolidated profit	328	32
Equity	2,006	1,564
Net debt	(2,500)	(1,803)
Interest-bearing debt	467	469
Liquidity available	(2,967)	(2,272)
Adjusted debt	532	1,012
Gearing	**26.5%**	**64.7%**
ROE	**16.3%**	**2.1%**

10. NON-CURRENT AND CURRENT LIABILITIES

The detail, by maturity, of the bank borrowings at December 31, 2007 and 2008 is as follows:

Millions of euros

2007	Financial liabilities				
	Bank borrowings	Finance leases	Derivatives (Note 12)	Other financial liabilities	Total
Non current liabilities	77	227	114	3	421
Current liabilities	121	42	83	23	269
Total	**198**	**269**	**197**	**26**	**690**

Millions of euros

2008	Financial liabilities				
	Bank borrowings	Finance leases	Derivatives (Note 12)	Other financial liabilities	Total
Non-current liabilities	76	223	103	1	403
Current liabilities	115	55	448	22	640
Total	**191**	**278**	**551**	**23**	**1,043**

10.1. Bank borrowings and other financial liabilities

The detail, by maturity, of the bank borrowings at December 31, 2008 relating to loans and credit facilities is as follows:

Millions of euros

2007				2008			
Due in	Euros	US Dollar	Total	Due in	Euros	US Dollar	Total
Principal:				**Principal:**			
2008	10	110	120				
2009	7	8	15	2009	57	58	115
2010	3	49	52	2010	3	53	56
2011	3	-	3	2011	4	-	4
Subsequent years	7	-	7	Subsequent years	16	-	16
Interest:				**Interest:**			
2008	1	-	1	2009	-	-	-

These loans and credit facilities bore weighted average annual interest of 5.74% in 2007 and 4.86% in 2008.

The Group arranged credit lines with limits of EUR 190 million in 2007 and EUR 201 million in 2008 against which EUR 200 million had not been drawn down at December 31, 2008.

10.2. Obligations under finance leases

The detail of the Group's finance leases at December 31, 2007 and 2008 is as follows:

Millions of euros

	Obligations denominated in euros		Obligations denominated in US dollars	
	2007	2008	2007	2008
Amounts payable under finance leases:				
Within one year	29	38	13	17
Between two and five years	90	90	30	124
After five years	26	3	81	6
Present value of finance lease obligations	**145**	**131**	**124**	**147**

The Group's most important finance leases relate to aircraft (see Note 6).

The terms of the finance leases on aircraft range from 7 to 16 years.

11. LONG-TERM PROVISIONS

The changes in 2008 in the balance of this heading in the consolidated balance sheet were as follows:

Millions of euros

	Balance at 31-12-07	Additions	Amounts used	Transfers	Reversals	Balance at 31-12-08
Provisions for obligations to employees (Note 5.13)	641	67	(26)	(13)	-	669
Provision for major repairs (Note 5.2)	64	25	(14)	(1)	-	74
Provisions for restructuring costs (Note 5.12)	525	1	(106)	13	-	433
Other provisions (Note 5.15)	147	-	(4)	(6)	(30)	107
	1,377	**93**	**(150)**	**(7)**	**(30)**	**1,283**

11.1. Provisions for obligations to employees

The additions to “Provisions for Obligations to Employees” include the period provision for the normal cost and for the amounts relating to the interest income from the provision already recognised, which is classified under “Staff Costs” (EUR 42 million) and under “Finance Costs” (EUR 25 million) in the consolidated income statement for 2008. The disbursements in this connection are amortised on an approximately straight-line basis.

11.2. Provisions for restructuring costs

The balance of “Provisions for Restructuring Costs” relates to the present value of the liabilities arising from the voluntary collective redundancy procedure (see Note 5.12) approved in 2001 and extended until 2010 for ground personnel (3,968 employees at December 31, 2008). Additionally, the Group recognised a provision of EUR 19 million for the estimated cost of the group of employees who are expected to avail themselves of these measures, based on the cost commitments approved by the directors of the Parent.

The payments related to this provision will continue over the next seven years in accordance with the age of the employees who have availed or will finally avail themselves of the procedure.

11.3. Other provisions

Other Provisions” includes the estimated amount required for probable liabilities of a diverse nature related mainly to litigation and unresolved tax assessments (see Note 5.15).

12. DERIVATIVE FINANCIAL INSTRUMENTS

In line with the risk management policy described in Note 5.22, the Iberia Group arranges derivative transactions, mainly foreign exchange, interest rate and aviation fuel hedges.

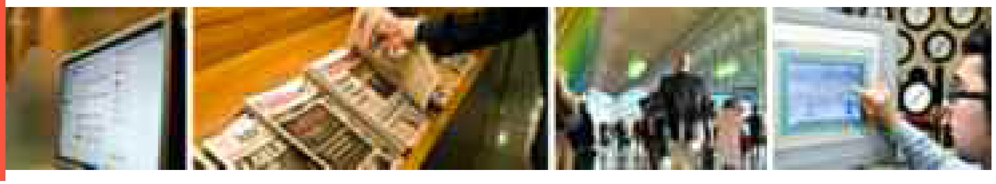
The most frequently used foreign exchange derivatives are cross currency swaps, forwards and options. The most commonly used interest rate derivatives are interest rate swaps. The fuel price derivatives are mainly swaps and options.

The Group classifies its derivatives into three types pursuant to International Financial Reporting Standards (IFRSs):

1- Derivatives designated as cash-flow hedges: derivatives that mainly enable the cash flows from operating leases, ticket sales in currencies other than the euro and fuel purchases to be hedged.

2- Derivatives designated as fair value hedges: derivatives that enable the fair value of balance-sheet assets and liabilities to be hedged.

3- Other derivatives: those which have not been designated as hedges or do not meet the requirements established in IFRSs.



Foreign exchange hedges

At December 31, 2008, the derivatives hedging exchange rate fluctuations which were not specifically designated as hedges under IFRSs (since they are naturally offset in the income statement) were as follows:

Underlying	Currency	Amount (Millions of USD)	Derivative	Nominal amount (Millions of USD)
Loans to IBERBUS companies	USD	115	Cross currency swaps	20
Advances on aircraft and engines	USD	300	Fx swaps	178
Guarantees	USD	52		
A320 equities	USD	54		
4 A320/321 debt	USD	(164)		
5 A340 debt	USD	(185)		
Total		**172**		**198**

The fair value of these derivatives at December 31, 2008 was EUR -6 million and the EUR 9 million change in value as compared to December 31, 2007 was recognised in loss for the year, having offset the valuation gains on asset items.

At the date of the consolidated balance sheet, the total notional amount, by foreign exchange risk, of cash flow hedges was as follows:

Millions of USD

Underlying	Millions of USD	Type of hedge	Forecast cash flows				
			2009	2010	2011	2012	2013
Foreign currency expenses	(1,367)	Cross Currency Swaps	292	187	150	57	36
		Options:					
		USD "Four Ways"	885	435	-	-	-
		USD "Tunnels"	22	-	-	-	-
		Fx Forwards	85	65	-	-	-
New aircraft	(80)	Options:					
		Fx Forwards	15	-	-	-	-

The market value at December 31, 2008 of the exchange rate derivatives (FX forwards and options) was positive and amounted to EUR 23 million (2007: EUR -45 million). The 2008 net balance was made up of EUR 124 million recognised in the asset accounts "Non-Current Financial Assets – Derivatives" and "Current Financial Assets – Derivatives", and EUR 101 million recognised under "Non-Current Liabilities" and "Current Liabilities" on the liability side of the accompanying consolidated balance sheet. These hedges are linked to cash flows that will arise in 2009 and 2010.

Changes in the fair value of exchange rate derivatives that are effective as cash flow hedges amounted to EUR 67 million net of the tax effect and were deferred in equity, net of their tax effect.

Changes in the fair value of the ineffective portion of forwards, amounting to EUR 1 million, were charged to income in 2008.

The exchange rate and interest rate risks related to aircraft leases were hedged with cross currency swaps (CCS) which convert payments originally in US dollars to euros.

The effect of a change in the EUR/USD exchange rates of more than 10% of the value of the hedges at December 31, 2008 would be approximately EUR –100 million. If the change in exchange rates were less than 10%, the change in value of the hedged position at December 31, 2008 would be positive at approximately EUR 105 million.

Cash flow hedges at December 31, 2008

(Currency in millions) (*)

Instrument	Parent	Parent	Amount				
			Nominal amount at				
			31-12-08	31-12-09	31-12-10	31-12-11	31-12-12
Cross Currency Swaps:							
Floating to fixed	Receives USD	Pays EUR	417	208	173	127	88
Floating to floating	Receives USD	Pays EUR	683	435	190	-	-
Floating to floating	Receives EUR	Pays USD	599	296	77	-	-
Fixed to fixed	Receives USD	Pays EUR	307	187	74	75	50

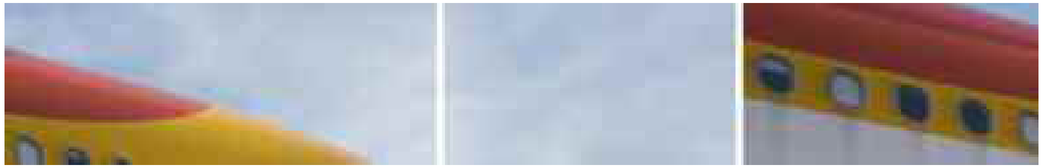
(*) The amounts are recorded in the currency in which the Parent pays.

Interest rate hedges

The Parent uses cross currency swaps and interest rate swaps to manage its exposure to interest rate fluctuations on its aircraft financing transactions.

Instrument	Currency	Nominal amount in millions				
		31-12-08	31-12-09	31-12-10	31-12-11	31-12-12
Interest Rate Swaps						
Floating to floating (1)	USD	277	256	235	212	63

(1) The Parent pays a floating interest rate with a cap and floor and receives a floating interest rate.



The fair value of the cross currency swaps and interest rate swaps arranged at December 31, 2008 amounted to EUR –52 million (2007: EUR –101 million). The 2008 amount is made up of assets of EUR 25 million and liabilities of EUR 77 million. These hedges are linked to flows which will arise in 2009, 2010, 2011, 2012 and 2013.

The changes in value accumulated by the effective portion of the swaps in the cash-flow hedges amounted to EUR 44 million, net of their related tax effect, and were recognised in equity, net of their tax effect. The changes in value accumulated by the ineffective portion (EUR -4 million) were allocated to profit for the year.

The effect of a change of more than 50 basis points in the euro interest rate curve on the value of the hedges at December 31, 2008 is approximately EUR 6 million. A change of less than 50 basis points would change the value of the hedged position at December 31, 2008 by approximately EUR -6 million.

A change of +/- 50 basis points in the USD interest rate curve would have the following effects: more than 50 basis points would affect the value of the hedges by approximately EUR -2 million. Conversely, a change of less than 50 basis points would have an effect of approximately EUR 2 million.

For the purposes of these calculations, the Parent considers a change of this magnitude in the interest rate curves to be the most likely scenario during 2009. However, in order to simplify this analysis, it was considered that the change in interest rates would take place at 2008 year-end and would then remain stable in 2009.

Fuel price hedges

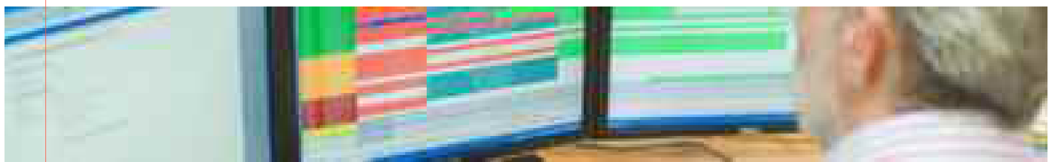
Underlying	Commodity	(mT)	Type of hedge	2009
				Nominal (mT)
Fuel purchases - JET Kerosene	JET Kero CIF-NEW	1.95 million	SWAPS	348,000
			Options: "Four ways"	660,000

Fuel price risk is hedged through swaps and options structures that hedge cash-flow fluctuations due to changes in fuel prices within a certain range.

The market value of the fuel derivatives amounted to EUR -373 million at December 31, 2008 (2007: EUR 9 million), which was recognised in full as a liability under “Current Liabilities” in the accompanying consolidated balance sheet.

The changes in value accumulated by the effective portion of the fuel derivatives amounted to EUR -380 million, net of the tax effect, and were recognised in equity, net of their tax effect. The changes in value accumulated by the ineffective portion amounted to EUR -2 million and were allocated to profit for the year. In 2008 settlements of excessive hedges amounting to EUR 23 million were recognised under “Other Income and Expenses” in the accompanying income statement.

The effect of a change in fuel prices of more than 50% of the value of the hedges at December 31, 2008 amounts to EUR 150 million. If a change in fuel prices of less than 50% were considered, the change in the value of the hedging position at December 31, 2008 would amount to EUR -119 million.



13. TAX MATTERS

The corporation tax for each fully consolidated company is calculated on the basis of accounting profit, which does not necessarily coincide with taxable profit.

Since January 1, 2002 Iberia, Líneas Aéreas de España, S.A. and certain subsidiaries file consolidated tax returns under the tax system provided for by Title VII, Chapter VII of the Consolidated Spanish Corporation Tax Law (Legislative Royal Decree 4/2004, of March 5) as part of Tax Group 148/02, of which Iberia, Líneas Aéreas de España, S.A: is the Parent. The companies composing the Consolidated Tax Group are the fully consolidated companies, except for Binter Finance, BV and Iberia México, S.A., which do not meet the legally established requirements for forming part of the Group.

13.1. Tax receivables and payables

The detail of the tax receivables at December 31, 2007 and 2008 is as follows:

Millions of euros

	2007	2008
Deferred tax assets	481	591
Current tax receivables:		
Foreign tax receivables	7	7
VAT	12	21
Other tax receivables	-	2
	19	**30**

The source of the deferred tax assets is described in Note 13.6 below.

The detail of the tax payables at December 31, 2007 and 2008 is as follows:

Millions of euros

	2007	2008
Deferred tax liabilities	1	1
Current tax payables:		
Take-off and security charges at airports	38	35
Foreign tax payables	38	35
Social security taxes	22	21
Personal income tax withholdings	29	29
Income tax payable	34	-
Other tax receivables	1	5
	162	125

13.2. Reconciliation of the accounting profit to the taxable profit

The reconciliation of consolidated accounting profit for 2007 and 2008 of the Consolidable Group companies to the taxable profit for income tax purposes is as follows:

Millions of euros

	2007			2008		
	Increase	Decrease	Amount	Increase	Decrease	Amount
Accounting profit for the year (before tax)			447			36
Permanent differences	1	(1)	-	2	(10)	(8)
Temporary differences:						
Arising in the year	227 (a)	-	227	117 (a)	-	117
Arising in prior years	1	(167) (b)	(166)	-	(210) (b)	(210)
Consolidation adjustments:						
Permanent differences	11	(6)	5	-	-	-
Offset of prior years' tax losses	-	-	(1)	-	-	-
Taxable profit (loss)			**512**			(65)

(a) Relating mainly to period provisions for obligations to employees and other provisions for contingencies and charges and amounts received in 2007 in relation to memorandum credits and other deferred incentives.
(b) Relating basically to amounts used of provisions recorded in prior years for obligations to employees and income recognised in 2007 in relation to credit memorandums and other incentives received in prior years.

13.3. Tax recognised in equity

The detail of the taxes recognised with a direct impact on equity in 2007 and 2008 is as follows:

Millions of euros

	2007			2008		
	Increases	Decreases	Total	Increases	Decreases	Total
Total current tax						
Due to deferred tax:						
Available for sale assets	-	-	-	34	-	34
Measurement of other financial assets	24	(12)	12	101	(20)	81
Total deferred tax	24	(12)	12	135	(20)	115
Total tax recognised directly in equity			**12**			**115**

13.4. Income tax expense

The detail of the balance of "Income Tax" in the accompanying consolidated income statements for 2007 and 2008 relates to the sum of the income tax expenses recognised by each fully consolidated company, the detail being as follows:

Millions of euros

	2007	2008
Application of the tax rate to accounting profit adjusted by permanent differences	146	8
Add/(Less):		
Tax credits	(24)	(6)
Adjustment of prior years' income tax	-	(1)
Other	6	3
Tax effect of IFRS adjustments	(9)	-
Income tax	**119**	**4**

Current Spanish corporation tax regulations provide certain tax incentives to encourage investments and contributions to employees' mutual funds. The consolidated companies availed themselves of certain tax benefits in this connection and used tax credits amounting to EUR 4 million in the income tax return for 2007 and intend to use tax credits of EUR 3 million in the income tax return for 2008.

The Iberia Group took domestic and international double taxation relief amounting to EUR 4 million in the income tax return for 2007 and intends to use tax credits amounting to EUR 3 million in this connection in 2008.

In 2007 the Group reinvested EUR 123 million arising from the sale of assets, which gave rise to tax credits of EUR 16 million. The amounts reinvested in recent years and the related tax credits are as follows:

Millions of euros

	Reinvestment	Tax credits
2004	125	17
2005	825	129
2006	1	-
2007	123	16
2008	-	-

The effective income tax rate for 2007 and 2008 was 27% and 11% respectively.

13.5. Detail of the income tax expense

The detail of the income tax expense for 2007 and 2008 is as follows (in millions of euros):

	2007	2008
Current tax:		
Continuing operations	142	-
Deferred tax:		
Continuing operations	(14)	5
Prior years' tax:		
Continuing operations	-	(1)
Other	(9)	-
Total tax expense	**119**	**4**

13.6. Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are recognised in the consolidated balance sheet under "Deferred Tax Assets" and "Deferred Tax Liabilities", respectively, as follows:

Millions of euros

	2007		2008	
	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Temporary differences arising in the period	82	-	150	-
Temporary differences arising in prior years	399	1	415	1
Tax loss carryforward	-	-	20	-
Tax credits	-	-	6	-
	481	**1**	**591**	**1**

The deferred tax assets arose mainly from the provisions made for obligations to employees and other provisions which will become tax deductible in coming years and from income received in relation to memorandum credits and other deferred aircraft-related incentives. Also included are the taxes recognised with a direct impact on equity.

The changes in the balance of deferred tax assets in 2007 and 2008 were as follows:

Millions of euros

	Balance at 31-12-2006	Additions	Disposals	Balance at 31-12-2007	Additions	Disposals	Other	Balance at 31-12-2008
Deferred tax assets	445	82	(46)	481	178	(66)	(2)	591

The deferred tax assets at December 31, 2008 are expected to be utilised as follows:

Millions of euros

Year of recovery	
2009	216
2010	40
2011 and subsequent years	335
	591

13.7. Tax audits

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

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

During the audit performed in 2007 and 2008, the authorities issued assessments in relation to income tax for the period 2002 to 2004, and VAT and non-resident tax for 2003 and 2004. The Parent appealed against the latter two assessments.

The directors of Iberia, Líneas Aéreas de España, S.A. consider that no tax liabilities additional to those recognised under “Other Provisions” will arise from the resolution of the various appeals described above (see Note 11).

The Parent is currently undergoing a tax audit in relation to personal income tax for 2003 and 2004.

In relation to the tax periods for which the limitation period has not expired, from 2005 to 2008 for all the taxes applicable to the Group's operations, the directors of Iberia, Líneas Aéreas de España, S.A. do not expect any liabilities to arise in addition to those recognised which might have a material effect on the consolidated financial statements.

14. REVENUE

14.1. Revenue

The breakdown of the Consolidable Group's revenue in 2007 and 2008 is as follows:

Millions of euros

By activity	2007	2008
Passenger ticket revenue [a]	4,325	4,218
Cargo revenue	343	347
Handling (aircraft dispatching and airport services)	280	275
Technical assistance to airlines	273	297
Other income	83	86
	5,304	**5,223**

(a) Including other income (recovery of unused tickets, commercial agreements, etc.) amounting to EUR 291 million and EUR 327 million in 2007 and 2008, respectively.

The breakdown of passenger ticket revenue excluding “Other Income”, by network, is as follows:

Millions of euros

	2007	2008
Domestic	1,113	929
Medium-haul	1,119	1,124
Long-haul	1,802	1,838
	4,034	**3,891**

14.2. Other operating income

The detail of “Other Operating Income” in the accompanying consolidated income statements is as follows:

Millions of euros

Description	2007	2008
Recurring:		
Commissions	85	80
Rental income	24	18
Other sundry income	108	129
Non-recurring:		
Overprovisions (Note 11)	1	30
Other non-recurring operating income	13	35
	231	**292**

The income from commissions relates basically to the commissions on the sale of tickets for other airlines, the commissions arising from the franchise agreement with Air Nostrum and the sale of tickets for Clickair, S.A. under Iberia's code.

"Other Non-Recurring Operating Income" for 2008 includes mainly EUR 15 million of the settlement received from an insurance company.

14.3. Net gains on disposal of non-current assets

The detail of the balance of "Net Gains on Disposal of Non-Current Assets" in the accompanying consolidated income statements for 2007 and 2008 is as follows:

Millions of euros

	2007	2008
WAM Acquisition, S.A.	94	-
Disposal of aircraft and engines (Note 6)	73	24
Compulsory purchase of land and disposal of buildings	28	-
Other	1	1
	196	**25**

The gain obtained in 2007 by Wam Acquisition, S.A. relates to shares of this company which were sold for EUR 101 million.

14.4. Finance income

The detail of the balance of "Finance Income" in the accompanying consolidated income statements is as follows:

Millions of euros

	2007	2008
Interest on short-term deposits	104	122
Interest on loans to associates	6	4
Other finance income	16	11
	126	**137**

15. EXPENSES

15.1. Procurements

The detail of "Procurements" in the accompanying consolidated income statements for 2007 and 2008 is as follows:

Millions of euros

	2007	2008
Recurring:		
Aircraft fuel	1,145	1,666
Aircraft spare parts	169	160
Catering materials	23	21
Other purchases	17	17
	1,354	**1,864**

15.2. Headcount and other staff costs

The detail of "Staff Costs" in the accompanying consolidated income statements for 2007 and 2008 is as follows:

Millions of euros

	2007	2008
Wages, salaries and similar expenses	1,044	1,001
Employee welfare costs	336	319
Non-recurring staff costs:		
Provisions for extension of collective redundancy procedure (Note 11.2)	64	1
	1,444	**1,321**

The average number of employees at the Group companies, measured in terms of equivalent average headcount, by professional category, in 2007 and 2008 was as follows:

	Number of employees	
	2007	2008
Senior Executives:	**10**	**10**
Ground personnel:		
Senior Managers and other line personnel	1,118	1,121
Clerical Staff	6,095	5,694
Ancillary Services	5,495	5,104
Aircraft Maintenance Technicians	2,895	2,875
Other	1,264	1,207
	16,867	**16,001**
Flight personnel:		
Pilots	1,707	1,644
Cabin Crew	3,931	3,923
	5,638	**5,567**
	22,515	**21,578**

At December 31, 2008 the distribution of the workforce, by gender and by professional category, was as follows:

	2007		2008	
	Women	Men	Women	Men
Senior Executives	**1**	**9**	**1**	**9**
Ground personnel:				
Senior Managers and other line personnel	414	692	433	719
Clerical Staff	4,341	2,214	4,032	2,026
Ancillary Services	552	5,465	479	5,071
Aircraft Maintenance Technicians	30	2,795	31	2,894
Other	567	691	552	679
	5,904	**11,857**	**5,527**	**11,389**
Flight personnel:				
Pilots	61	1,675	60	1,608
Cabin Crew	3,167	1,131	3,084	1,070
	3,228	**2,806**	**3,144**	**2,678**
	9,133	**14,672**	**8,672**	**14,076**

15.3. Other operating expenses

The detail of “Other Operating Expenses” in the accompanying consolidated income statements for 2007 and 2008 is as follows:

Millions of euros

	2007	2008
Air traffic services	389	362
Aircraft lease payments:		
Dry lease	347	324
Wet lease	46	33
Cargo	15	16
Cash-flow derivative transactions	13	-
Other	12	13
Navigation charges	274	258
Aircraft maintenance	236	228
Commercial expenses	243	200
Booking system expenses	144	137
Other rent	76	76
In-flight services	72	72
Other types of maintenance	44	49
Stopover expenses	41	37
Indemnities for passengers, luggage and cargo	37	33
Other recurring expenses	299	314
Non-recurring expenses	17	5
	2,305	**2,157**

"Aircraft Maintenance" includes the expenses for subcontracted maintenance work and the provision for major repairs of aircraft operated under operating leases.

The fees for financial audit services provided to Iberia, Líneas Aéreas de España, S.A. and its subsidiaries by the principal auditor and by other entities related to the auditor amounted to EUR 611,500 in 2008 (2007: EUR 497,000).

Also, the fees for other professional services provided to Iberia, Líneas Aéreas de España, S.A. and its subsidiaries by the principal auditor and by other entities related thereto amounted to EUR 428,000 in 2008 (2007: EUR 118,500).

15.4. Finance costs

The detail of “Finance Costs” in the accompanying consolidated income statements is as follows:

Millions of euros

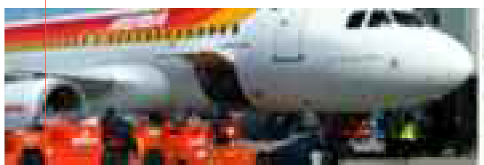
	2007	2008
Interest on loans	12	6
Interest on finance leases	19	15
Interest on employee liabilities	25	25
Other finance costs	4	6
	60	**52**

16. CONTRIBUTION OF SUBSIDIARIES AND ASSOCIATES TO CONSOLIDATED PROFIT

The contribution of subsidiaries and associates to the consolidated profit in 2007 and 2008 is as follows:

Millions of euros

Company	Profit / (Loss)	
	2007	2008
Iberia, Líneas Aéreas de España, S.A.	356	48
Compañía Auxiliar al Cargo Exprés, S.A.	1	1
Iberia México, S.A.	-	1
Other subsidiaries	(1)	-
Handling Guinea Ecuatorial, S.A.	-	1
Sociedad Conjunta para la Emisión y gestión de Medios de Pago EFC, S.A.	1	1
Clickair, S.A.	(31)	(19)
Internacional Supply Management, S.L.	(1)	-
Other	2	(1)
Profit attributable to the Parent	**327**	**32**



17. BUSINESS AND GEOGRAPHICAL SEGMENTS

Basis of segmentation

Segment reporting is structured on a primary basis by business segment and on a secondary basis by geographical segment

Primary segments - business segments

The business lines described below were established on the basis of the Iberia Group's organisational structure at 2008 year-end and take into account the nature of the services provided and the customer segments at which they are targeted.

In 2008 the Iberia Group engaged mainly in the following major lines of business, which provides the basis for the Group's primary segment reporting:

1. Transport business (including passenger and cargo transport).
2. Airports business (including handling).
3. Maintenance and engineering business.
4. Other business activities.

Income and expenses that cannot be specifically attributed to any operating line or that are the result of decisions affecting the Group as a whole -including expenses incurred in projects or activities affecting several lines of business, or income from strategic investments, income tax expenses, etc.- are attributed to a “Corporate Unit” to which the reconciling items arising from the reconciliation of the result of integrating the financial statements of the various lines of business (prepared using a management approach) into the Group's consolidated financial statements are also allocated.

The costs incurred by the Corporate Unit are allocated among the various lines of business using an internal cost allocation system.

Secondary segments - geographical segments

The Group's activities are also classified into geographical segments: Domestic (Spain), Short- and Medium-Haul International (Europe, Africa excluding South Africa, and the Middle East) and Long-Haul markets.

Basis and methodology for segment reporting

The segment reporting below is based on monthly reports prepared by the Iberia Group which are generated on the basis of the Group's cost accounting system which classifies transactions carried out by the Group by business line and geographical segment.

Segment revenue relates to the external and internal revenue directly attributable to the segment and excludes finance income, dividends or proceeds from the disposal of investments.

The expenses of each segment are determined by the directly allocable expenses incurred in the operating activities of the segment plus the corresponding proportion of the corporate expenses which can be allocated to the segment using reasonable allocation bases. The expenses thus allocated do not include interest, losses arising from the disposal of investments or the income tax expense that are not related to the segments' operating activities and, therefore, that cannot be allocated using reasonable allocation bases.

Segment assets and liabilities are those directly related to each segment's operations, plus the assets and liabilities that can be directly attributed thereto using the aforementioned allocation bases. Segment liabilities do not include income tax debts.

Segment information about these businesses is presented below.

Millions of euros

	Transport		Airports		Maintenance		Corporate unit and other businesses		Total Group	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
Operating income:										
External	4,904	4,813	295	289	289	309	33	39	5,521	5,450
Inter-segment	7	5	278	202	401	387	174	381	-	-
Operating expenses:										
External	3,875	4,239	566	480	617	616	179	194	5,237	5,529
Inter-segment	776	694	33	31	29	31	22	219	-	-
Operating profit	**260**	**(115)**	**(26)**	**(20)**	**44**	**49**	**6**	**6**	**284**	**(80)**
E.B.I.T.D.A.R.	856	413	(10)	(4)	68	73	18	17	932	499
Aircraft lease payments	(433)	(386)	-	-	-	-	-	-	(433)	(386)
E.B.I.T.D.A.	423	27	(10)	(4)	68	73	18	17	499	113
Depreciation and amortisation charge	(163)	(142)	(16)	(16)	(24)	(24)	(12)	(11)	(215)	(193)
Non-recurring profit							129	85	129	85
Financial profit							63	49	63	49
Investments in companies accounted for using the equity method							(29)	(18)	(29)	(18)
Profit before tax									447	36
Income tax							(119)	(4)	(119)	(4)
Net profit									**328**	**32**
Equivalent headcount	8,942	8,776	8,493	7,769	3,806	3,767	1,274	1,266	22,515	21,578
Investments	198	231	21	5	30	27	16	22	265	285
Property, plant and equipment	853	829	89	74	155	172	36	43	1,133	1,118
Inventories	42	39	-	-	153	179	2	6	197	224
Other assets	-	-	-	-	-	-	4,687	4,292	4,687	4,292
Total assets									**6,017**	**5,634**
Customer advances	455	394	-	-	-	-	-	-	455	394
Remuneration payable	122	91	44	37	25	21	11	10	202	159
Other liabilities	-	-	-	-	-	-	3,369	3,517	3,384	3,517

Inter-segment sales are made applying an internal transfer pricing system based on market prices on the basis of equivalent areas and volumes.

The following table shows the geographical breakdown of the Group's revenue:

Secondary segment	Revenue	
	2007	2008
Domestic	2,351	2,076
Short- and Medium-Haul International	1,198	1,272
Long-Haul	1,972	2,102
	5,521	**5,450**

All the Group's assets would be allocable to the domestic market except for the aircraft, which do not have defined geographical location. The percentages of use of the aircraft in each geographical market, measured in terms of total block hours, are as follows:

Secondary segment	Percentage of use	
	2007	2008
Domestic	30.13%	25.07%
Short- and Medium-Haul International	37.82%	39.36%
Long-Haul	32.05%	35.57%
	100.00%	**100.00%**

18. RELATED PARTY TRANSACTIONS

Balances and transactions with other related parties

The following transactions were performed with related companies in 2007 and 2008:

Millions of euros

Significant shareholders	2007		2008	
	Collected from Iberia G.	Paid to Iberia G.	Collected from Iberia G.	Paid to Iberia Group
British Airways	7	19	8	37
El Corte Inglés Group	22	-	29	-
BBVA	4	1	-	-
Caja Madrid	7	-	4	1
	40	**20**	**41**	**38**

The transactions with British Airways relate mainly to commissions on passenger tickets collected from and paid to this company, for tickets issued by one company with the related flight being flown by the other, collections and payments arising from loyalty building programmes, and collections and payments for handling services provided.

The main transactions with the El Corte Inglés Group relate to the supply of uniforms for flight personnel, commissions and incentives for passenger ticket sales under commercial agreements, technical advisory services and computer software and hardware maintenance and development.

Lastly, the transactions with Caja Madrid relate to the interest on aircraft financing transactions, guarantees given on aircraft and other items.

In addition, the accompanying consolidated balance sheets at December 31, 2007 and 2008 include the following balances with related parties arising in the normal course of business:

Millions of euros

Related parties	2007	2008
British Airways	6	9
Caja Madrid	18	13
El Corte Inglés Group	9	5

19. REMUNERATION OF DIRECTORS AND SENIOR EXECUTIVES

The detail of the remuneration received in 2007 and 2008 by the members of the Board of Directors in their capacity as directors of the Parent is as follows:

Thousands of euros

Directors' Remuneration	2007	2008
Fixed remuneration	753	780
Attendance fees	703	774
Compensation in kind	86	85
Total remuneration	**1,542**	**1,639**

In 2008 Iberia, Líneas Aéreas de España, S.A. incurred expenses relating to the performance of non-executive directors' functions amounting to EUR 5,000 (2007: EUR 8,000).

In addition, one of the directors occupies an executive position in the Parent for which he received the following remuneration in 2007 and 2008:

Thousands of euros

Executive Directors	2007	2008
Fixed remuneration	630	693
Variable remuneration	448	503
Compensation in kind	8	11
Share options	310	-
	1,396	1,207

The social security, insurance and other costs recognised by Iberia, Líneas Aéreas de España, S.A. in relation to the activities performed by the executive directors amounted to EUR 128,000 in 2008 (2007: EUR 154,000).

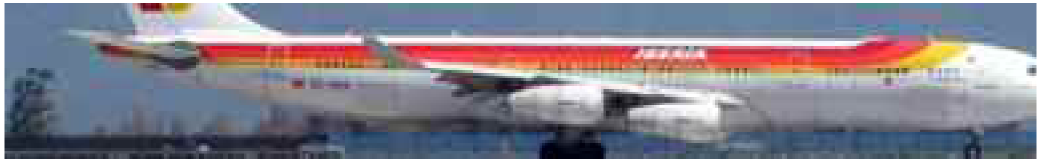
In 2008 no advances or loans were granted to the directors of Iberia, Líneas Aéreas de España, S.A., and there are no pension commitments to them.

Remuneration of Senior Executives

The remuneration of the Parent's senior executives -excluding those who are simultaneously directors (whose remuneration is disclosed above)- in 2007 and 2008 is summarised as follows:

Thousands of euros

Description	2007	2008
Salary (fixed and variable)	2,544	3,010
Compensation in kind	111	112
Share-option-based payments	954	-
Other	135	151
	3,744	3,273



In 2007 senior executives exercised all the share options previously unexercised (1,000,840 shares).

In 2007 and 2008 no advances or loans were granted to the members of the Management Committee of Iberia, Líneas Aéreas de España, S.A., and there are no pension obligations to them.

20. DETAIL OF THE INVESTMENTS IN COMPANIES ENGAGING IN SIMILAR ACTIVITIES AND OF THE PERFORMANCE, BY THE DIRECTORS, AS INDEPENDENT PROFESSIONALS OR AS EMPLOYEES, OF SIMILAR ACTIVITIES

Pursuant to Article 127 ter.4 of the Spanish Companies Law, introduced by Law 26/2003, of July 17, which amends Securities Market Law 24/1988, of July 28, and the Consolidated Spanish Companies Law, in order to reinforce the transparency of listed corporations, following is a detail of the activities carried on in 2008 by directors that are identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A. and subsidiaries:

Name	Line of Business	Type of arrangement	Company	Position/Function
Mr. Miguel Blesa de la Parra	Handling	Employee	Flightcare (FCC)	FCC Board Member
Mr. Roger Maynard	Air transport	Employee	British Airways	Director of Alliances and Investments
	Air transport	Employee	BA Citiflyer and BA European	Executive/Director
Lord Garel-Jones	Handling	Employee	Acciona	Board Member

Fernando Conte is also a member of the Board of IATA.

Also, pursuant to the aforementioned Law, it is hereby stated that the only directors who own any equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A. and subsidiaries are Miguel Blesa de la Parra, who has a 0.004% ownership interest in Flightcare indirectly through FCC, and Roger Maynard, who has a 0.0004994% ownership interest in British Airways.

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

21. INFORMATION ON THE ENVIRONMENT

Within the framework of its environmental policy, the Group continued to undertake various activities and projects in 2008 in order to guarantee the proper management of the main environmental impacts of the air transport business as a whole.

In 2008 the Group incurred environmental expenses of EUR 4 million (2007: EUR 3 million), the detail being as follows:

Millions of euros

	2007	2008
Environmental repair and maintenance	1	1
Staff costs relating to environmental management	1	1
Environmental taxes and other	1	2
	3	4

At December 31, 2008, the acquisition cost and accumulated depreciation of the environmental assets, which include, inter alia, water-treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, amounted to EUR 77 million and EUR 52 million, respectively (2007: EUR 63 million and EUR 33 million, respectively).

With respect to its aircraft, the Group has a renewal policy in which the environment (minimising the impact of noise and air emissions) is an important factor to be borne in mind. Accordingly, the Group is continuing to add new aircraft models that reduce fuel consumption by approximately 20% compared to earlier generation aircraft. Therefore, in 2007 9 A-320 aircraft were added and 3 B757, 11 A320 and 7 MD aircraft were retired. In 2008 3 A320 aircraft were added and 3 B757 and 23 MD aircraft were retired.

In the area of ground operations, the Parent achieved certification under the ISO 14001/AENOR Environmental Management System including the Parent's aircraft maintenance facilities at Barajas airport in Madrid. As a result of this certification, together with the existing ones in handling and the Parent's other maintenance facilities, all of the Parent's significant environmental issues are covered by external certification.

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

Lastly, the environmental investments made in 2008 amounted to EUR 1 million.

22. CASH FLOW STATEMENT

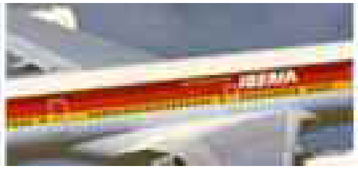
In preparing the cash flow statement the Company considered “Cash and Cash Equivalents” to be the balances included under “Cash and Cash Equivalents” and under “Other Financial Assets - Held-To-Maturity Investments” (see Note 7.2) since the latter met the conditions to be considered as highly liquid investments that are subject to an insignificant risk of changes in value.

The main items in the cash flow statement relate to: payments for investments arising from aircraft acquisitions (see Note 6) and other financial assets (see Note 7).

The payments made to employees arising from the provisions for restructuring and from the obligations to personnel (see Note 11) are included under “Other Cash Flows from Operating Activities - Other Collections (Payments)” in the cash flow statement.

23. EXPLANATION ADDED FOR TRANSLATION TO ENGLISH

These consolidated financial statements are presented on the basis of IFRSs as adopted by the European Union. Certain accounting practices applied by the Group that conform with IFRSs may not conform with other generally accepted accounting principles.

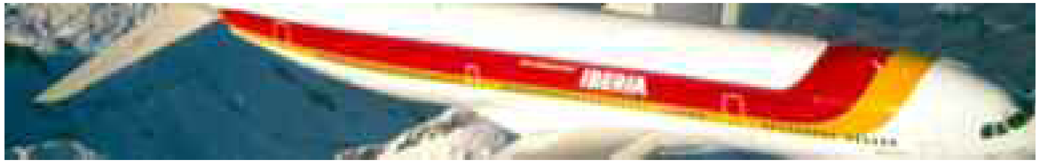


Consolidated Management Report

CONSOLIDATED MANAGEMENT REPORT

KEY DATA

IBERIA GROUP	2008	2007	% Change
Income and result (millions of euros)			
Recurring operating income	5,450	5,522	(1.3)
EBITDAR (1)	500	932	(46.4)
Profit (Loss) from recurring operations	(79)	284	(127.9)
Profit from operations (2)	5	413	(98.8)
Profit before tax	36	447	(91.9)
Consolidated profit for the year	32	328	(90.2)
Profit attributable to the Shareholders of the Parent	32	327	(90.2)
Basic earnings per share (euro cents) (3)	3.4	34.6	(90.1)
Dividends per share (euro cents)	-	17.0	-
Passenger traffic: capacity and revenue			
ASK (millions)	66,098	66,454	(0.5)
RPK (millions)	52,885	54,229	(2.5)
Load factor (%)	80.0	81.6	(1.6 p.)
Passenger ticket revenue (millions of euros)	3,891	4,034	(3.5)
Average revenue per RPK (euro cents)	7.36	7.44	(1.1)
Average revenue per ASK (euro cents)	5.89	6.07	(3.0)
Financial aggregates and ratios			
Equity (millions of euros)	1,564	2,006	(22.0)
Net debt per balance sheet (millions of euros) (4)	(1,803)	(2,500)	(27.9)
Adjusted net debt (millions of euros) (5)	1,012	532	90.3
EBITDAR margin (%) (1)	9.2	16.9	(7.7 p.)
Operating profit margin (%) (1)	(1.5)	5.1	(6.6 p.)
Consolidated profit margin (%)	0.6	5.9	(5.3 p.)
ROE (%) (6)	2.1	16.3	(14.3 p.)
Operating income per ASK (euro cents) (1)	8.24	8.31	(0.8)
Operating cost per ASK (euro cents) (1)	8.36	7.88	6.1
Operating cost per ASK excluding fuel (euro cents) (1)	5.84	6.16	(5.1)
Resources			
Average number of equivalent employees (7)	21,578	22,515	(4.2)
Operating income per employee (thousands of euros) (1) (8)	254	246	3.0
Productivity (thousands of ASK per employee) (8)	3,097	2,980	3.9
Operating aircraft at December 31	119	136	(12.5)
Fleet utilisation (block hours per aircraft per day)	10.0	9.6	4.3



(1) EBITDAR, recurring income margins, unit revenue and costs exclude non-recurring items.
(2) Profit from operations includes profit from recurring and non-recurring operations.
(3) Weighted average number of shares outstanding (in thousands): 929,348 in 2008 and 945,467 in 2007.
(4) Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding the valuation of hedges at 2008 and 2007 year-end).
(5) Calculated as follows: Net debt per balance sheet + Capitalised aircraft leases – Capitalised interest on Iberbus loans. The method used to calculate the capitalised aircraft leases was reviewed and the figure for 2007 adjusted accordingly.
(6) Return on equity: Consolidated profit / Equity.
(7) Including the employees of Iberia, CACESA, ALAER and Binter Finance.
(8) Productivity of Iberia's total workforce.

1. HIGHLIGHTS

Economic backdrop and performance of the airline industry

The sub-prime mortgage crisis in the US in mid-2007 triggered a period of extraordinary financial turmoil, marked by a general loss of confidence in the economic players and by much tighter lending conditions. The prolonged international financial crisis is affecting world economic growth, which suffered a progressive slowdown in 2008. Consequently, International Monetary Fund (IFM) estimates indicate that the increase in the gross world product (GWP) for 2008 taken as a whole was only 3.4% compared with 5.2% in 2007.

Oil prices and prices of raw materials in general experienced intense volatility in 2008. Oil prices reached very high levels in the first half of the year, culminating in an all-time high in July, and exerting additional adverse pressure on world economic activity and, in particular, on airline profitability, thereby heightening the uncertainty over their future performance. In the second half of the year the weakening of the world economy and the marked dampening of expectations led to a significant drop in fuel prices.

The industrialised countries have suffered most as a result of the economic downturn, with the majority entering into recession in the second half of the year. The emerging countries continued to grow, although at a slower rate. The Spanish economy is going through a serious correction, brought about by the effects of the international financial crisis and by the conclusion of a long expansion phase that was primarily driven by the growth in the construction industry and domestic demand. Spain registered a significant increase in unemployment and a drop in consumption in the second half of 2008. Thus, Spanish GDP growth was 1.2% for the year (according to the most recent data published by the European Commission), which represents a loss of 2.5 points with respect to the growth achieved in 2007.

Growth of actual GDP (a)	2008	2007
At world level (b)	3.4	5.2
US	1.1	2.0
Euro zone (b)	1.0	2.6
Japan	(0.3)	2.4
Latin America and the Caribbean (b)	4.6	5.7
Spain	1.2	3.7

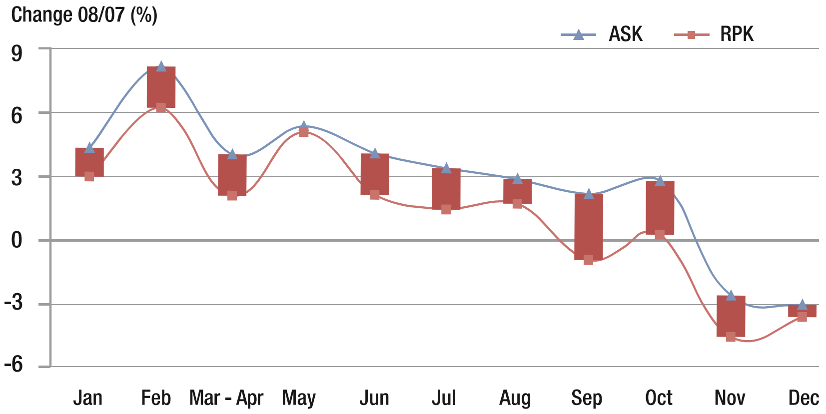
Sources: IMF, World Economic Outlook (January 2009),
(a) Annual change in Gross Domestic Product percentage, constant prices.
(b) The world and regional growth aggregates relate to the weighted average GDP per levels of purchasing power.

Poor economic performance had a significant impact on the world airline industry. According to the most recent estimates of the International Air Transport Association (IATA), airlines lost USD 5,000 million in 2008, negatively affected by high fuel prices in the first half of the year when they reached historic levels and by the progressive decline in demand during the second half of the year due to the close ties between economic growth and air traffic performance.

IATA considers that in the airline industry taken as a whole, the volume of international passenger traffic in 2008 only grew 1.6% with respect to 2007, and international cargo traffic decreased 4.0%. Growth in demand was still solid in the first months of the year, but it suffered a gradual slowdown, registering year-on-year declines in the final months of 2008 (in December international passenger traffic decreased 4.6% with respect to 2007, while cargo traffic plunged 22.6%).

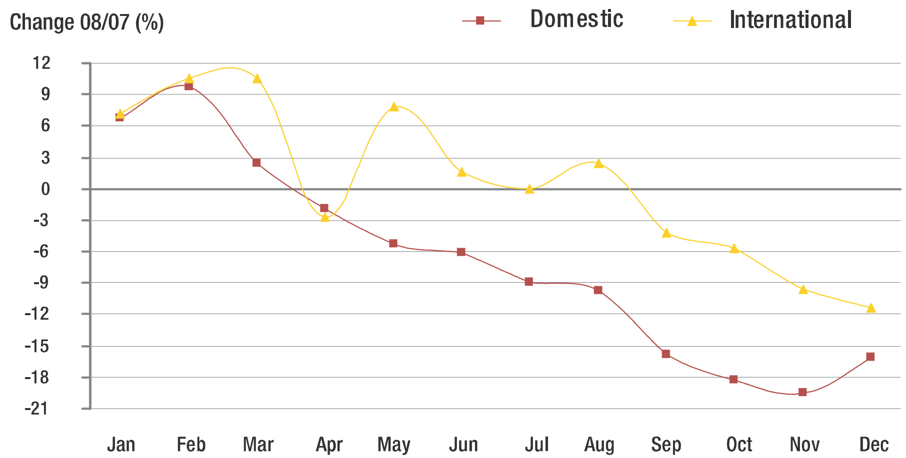
Similarly, growth in demand for European network airlines decreased throughout 2008. According to preliminary data from the Association of European Airlines (AEA), revenue passenger-kilometres (RPK) on scheduled flights increased 1.2% in 2008, registering moderate increases in the summer and decreases towards year-end. With 3.0% growth in available seat-kilometres (ASK), the load factor of the AEA fell 1.3% in relation to 2007, to stand at 76.0%. Regarding cargo traffic for the European network carrier, over the twelve months as a whole, revenue tonne-kilometre (RTK) fell 2.8% with respect to 2007 with monthly drops from July onwards.

Total AEA scheduled traffic.
Monthly change in 2008 with respect to 2007



Data for March and April are presented together to avoid distortion due to the different Easter calendar in 2007 and 2008 when comparing monthly activity for the two years.

No. of passengers at AENA airports.
Monthly change in 2008 with respect to 2007



In addition to the impact of the economic crisis, the Spanish airline industry had to meet the challenge of considerable railway infrastructure development with the launch of the new high-speed lines linking Madrid and Málaga (since December 2007) and Madrid and Barcelona (from February 2008). Thus, the Spanish airline industry lost an extraordinary number of passengers in the second half of 2008 and suffered the suspension of operations of certain airlines. According to AENA (the Spanish public airports and aviation agency) data, the number of passengers on commercial flights (domestic and international) dropped 3.0% in 2008 as a whole with respect to 2007, with a sharp decline in domestic traffic without precedent in the history of the Spanish airline industry, beginning in April, and a progressive slowdown of international traffic, which registered declines from September onward.

Operational and economic performance of the Iberia Group

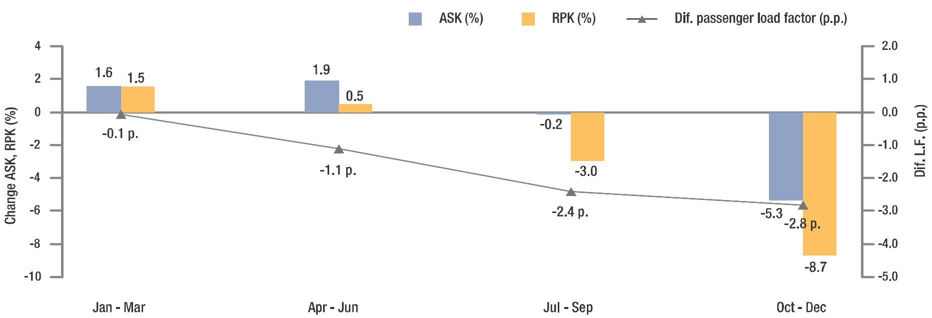
The negative panorama which the airline industry faced influenced the Iberia Group's performance in 2008. In particular, the increase in the fuel expense (up EUR 521 million on 2007) had a significant impact on operating results which were partially cushioned by the success of the achievement of the objectives of the 2006-2008 Master Plan. In 2008 the Company worked diligently to adapt rapidly to the change in the economic cycle and explored possible strategic agreements to improve its competitive position in the markets.

Iberia, Líneas Aéreas de España, S.A. (“Iberia”) completed the revision and optimisation of the flight programme in 2008, one of the strategic cornerstones of the 2006-2008 Master Plan, thereby consolidating its position as a network carrier. The Company increased the capacity made available on its short and medium-haul flights from/to Madrid by 8.6% with respect to 2007, and strengthened its hub connections. It also completed the planned supply adjustments to domestic point-to-point connecting flights and, to a lesser extent, to international medium-haul flights.

In addition, as a result of the worsening international economic situation, the Company had to make certain selective adjustments to its flight offerings in response to the progressive slackening of demand in the markets in 2008.

As a result of far-reaching network restructuring and the aforementioned additional adjustments, the total supply of the Company decreased slightly (0.5% with respect to 2007). The year-on-year changes in traffic (measured in RPK) performed negatively in 2008, growing 1.0% in the first half of the year and falling 5.7% in the second half, resulting in a 2.5% decrease over the twelve months taken as a whole. The passenger load factor stood at 80% in 2008, down 1.6 points on the record level achieved in 2007, and remained within the highest range among comparable European companies.

Iberia’s passenger traffic and supply. Quarterly change 2008 / 2007



Quarterly performance of the business activity reflects the progressive slackening of demand, particularly in the last months of the year, affected by the worsening of the economic situation. The Company gradually made more capacity adjustments in 2008: the volume of supply went from increasing by 1.7% in the first half of the year to falling by 0.2% in the third quarter and by 5.3% in the fourth.

In the long-haul sector, Iberia had to bring its supply into line with the gradual slowdown in demand throughout 2008 which, due to the effects of the economic crisis, suffered decreases from September onwards. Over the twelve months taken as a whole, traffic rose by 0.5% with respect to 2007, with a 3% increase in volume of supply, thereby enabling the Company to maintain its position of leadership in the Europe-Latin America market.

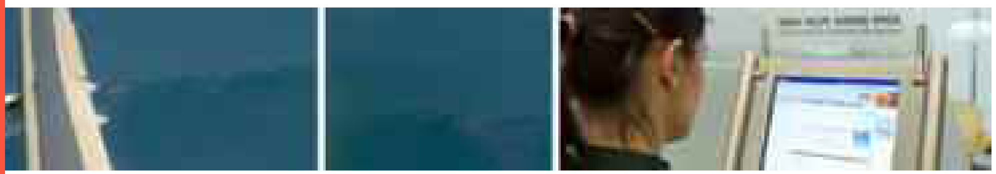
In 2008 Iberia and American Airlines extended the scope of their code-share agreement, to include a total of 25 new US destinations operated by the American company with the Iberia marketing code. As a result, at year-end the Spanish Company marketed a total of 47 US destinations, five of which are Company operated.

Furthermore, Iberia, American Airlines and British Airways entered into a joint business agreement in August 2008 in order to promote their commercial cooperation covering their flights between Europe and North America. This may be extremely important in the future within the framework of opportunities arising from the “Open Skies” agreement in force since March 31, 2008. The undertaking arising from the agreement between these three members of the oneworld alliance is in the process of obtaining anti-trust immunity from the American and European anti-trust authorities.

In the international medium-haul sector, traffic increased by 3.4% in 2008 with respect to 2007 due to the strengthening of connections with the hub. In the aggregate of international medium-haul flights with arrival in or departure from Madrid, the volume of supply (measured in ASK) increased by 16.1% with respect to 2007, increasing demand by 16.7% and raising the load factor 73.7%. Iberia added Dubrovnik to its network of European destinations in the summer season.

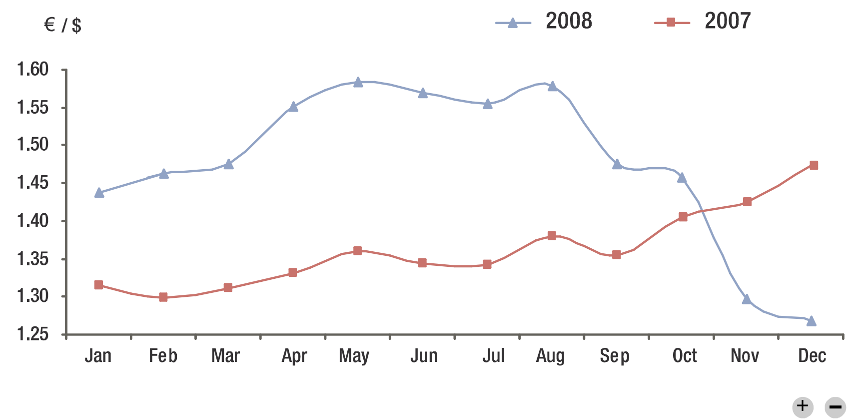
In accordance with the planned network restructuring strategy, the volume of supply in the domestic sector fell by 17.1% with respect to 2007, due to a 22.1% drop in demand weakened by the worsening economic situation and by the impact of the entry into service of the high-speed railway lines. Iberia reduced the number of seats made available on the Madrid-Barcelona route (Madrid-Barcelona shuttle and flights with reservation) by 21.8% with respect to 2007 -despite frequencies scarcely being reduced- to adapt to strong railway competition in the corridor which since February 20, gradually increased its supply. As regards the other domestic flights operated in the hub, the capacity made available increased by 2.9% in relation to 2007.

The gradual deterioration of the economy particularly affected airline business traffic. As a result, the number of passengers travelling Business Plus Class on the Iberia long-haul flights decreased by 2.4% with respect to 2007, with an increase of 0.3% in the number of total passengers in the sector which exceeded 4.2 million in 2008. As regards flights between Spain and Europe, business traffic decreased by 13.2% in 2008 in the market as a whole, expanding Iberia's market share by 1.8 points with respect to 2007.



The Iberia Group's operating income decreased by 0.4% in 2008 with respect to 2007. Once the non-recurring items were excluded, operating income stood at EUR 5,450 million, down 1.3% from 2007. When analysing these year-on-year changes, the impact of the depreciation of the dollar against the euro during most of the year must be taken into account, and although there was a sharp appreciation of the US currency in the last quarter, the average exchange rate in 2008 exceeded that of the previous years by 8%. This appreciation of the euro reduced the operating income and expenses, having a moderately positive effect on profit before tax. With constant exchange rates, consolidated operating income (recurring) would have increased slightly.

Development of Euro / Dollar exchange rate



In 2008 the passenger revenue for the Iberia Group decreased by 2.5% in relation to 2007 due to the lower volume of traffic and the 1.1% decrease in the average revenue per RPK (or yield) with respect to 2007 for the network as a whole. The drop in yield was due mainly to the effect of the increase in the average stage length (12.6% in relation to 2007) and to the decrease in the value of the dollar against the euro. With constant exchange rates, the average revenue per RPK would have increased by 1.3% with relation to 2007. The Company managed to obtain an increase in yield in 2008, achieving 2.2% growth with respect to the last quarter of 2007.

The aggregate amount of other recurring operating income increased by 2.9%, with yet another year of strong progress in revenue from aeronautical maintenance services (up 8.7% on 2007). In accordance with the 2006-2008 Master Plan, Iberia has consolidated this business area, promoting the execution of higher value added work for other airlines, consisting mainly of engine and component inspections, and the outsourcing of jobs requiring a lower level of expertise.

Although the Company's cargo traffic was down by 5.6%, seriously affected by the economic crisis over the last months of the year, the Iberia Group's cargo revenue increased by 1.0% with respect to 2007. This was due mainly to an increase in unit revenue per tonne-kilometre (4.9%), despite being adversely affected by the negative impact of the depreciation of the dollar and by the increase in the average stage length.

The handling services at Spanish airports continued to adapt to a significantly more fragmented and competitive market since the beginning of March 2007, when the effective incorporation of new ramp-handling operators was completed. In addition, the sector was also adversely affected by the decrease in Spanish air traffic in 2008 (according to AENA data, the number of operations at the airports registered a decrease of 3.0% with respect to 2007).

In this difficult environment, Iberia performs third-party handling services at 36 airports, and in addition, since March 2007, the Company has participated in the unincorporated joint ventures (UTE) which were awarded public tenders in Barcelona, Lanzarote and Fuerteventura. In 2008 the Company continued to develop diverse initiatives to improve resource flexibility and productivity, safeguard the customer portfolio, increase process efficiency and provide new services at the airports, of particular note being the award of licenses for services to passengers with reduced mobility to the unincorporated joint ventures participated in by Iberia at the main airports, thereby stabilising its position in the new competitive market. In 2008 consolidated handling revenue decreased by 1.8% with respect to 2007, due partly to the effect of a non-uniform comparison since in the first two months of 2007, Iberia still provided service to the five airports (the three discussed and Almeria and Jerez de la Frontera) at which new licenses were not awarded.

In 2008 the Iberia Group's operating expenses increased by 4.0% with respect to 2007. Once the non-recurring items were excluded, which amounted to EUR 6.0 million in 2008 and EUR 81 million in 2007, operating expenses stood at EUR 5,529 million, 5.5% above the 2007, figure due mainly to the sharp increase and volatility of the price of fuel in 2008, the impact of which was partially offset by the cost-cutting measures included in the 2006-08 Master Plan together with the positive effect of the depreciation of the dollar against the euro.

JET CIF NWE – Development 2005 - 2008

In the first half of 2008, oil and refined product prices, as in the case of aviation kerosene, continued the upward trend of 2007 to reach all-time highs. According to the Jet CIF NWE index, the price of kerosene began the year fluctuating around USD 900 per metric tonne, and continued to rise until reaching more than USD 1,400 in July. From July onwards, unpredictably, the price of kerosene changed its trend, beginning a sharp decline which brought it down below USD 500 per tonne (a level it has not reached since the beginning of 2005). Despite falling sharply in the final months of 2008, the average market price of kerosene in dollars increased by 41% with respect to 2007.

The Iberia Group's fuel expense increased by 45.5% in 2008, to stand at EUR 1,666 million (30.1% of the total consolidated operating expenses), due to a sharp rise in the average price in dollars after hedges, partially offset by the depreciation of the dollar and by enhanced aircraft fuel consumption efficiency.

The other recurring operating expenses amounted to EUR 3,863 million, down EUR 230 million from 2007, which represents a considerable reduction of 5.6%. Recurring staff costs were down 4.4% in relation to 2007 due to a significant reduction in the Group's average number of employees (4.2%) and the containment of salary increases. It should be noted that aircraft lease costs decreased by 10.9% in 2008 due mainly to the fall in interest rates and the improved prices obtained in new operating leases. There was also a significant decrease in commercial expenses (down 17.4% on 2007).

The Iberia Group's unit operating cost increased to 8.36 euro cents per ASK in 2008, up 6.1% on 2007. Excluding the fuel expense, the unit cost was 5.84 euro cents per ASK, a decrease of 5.1% with respect to 2007 as a result of rigorous cost control.

In 2008 the productivity of resources at the Company continued to improve. The average aircraft utilisation stood at ten block hours per aircraft per day, up 4.3% on 2007. Iberia employee productivity (in terms of ASK per employee) increased by 3.9% with respect to 2007.

In 2008 the Iberia Group's profit from operations amounted to EUR 5 million compared with EUR 413 million in 2007.

The net financial balance stood at EUR 85 million in 2008, increasing by EUR 19 million with respect to 2007, although it was offset in part by the effect of the valuation of the derivatives, and to a lesser extent, by the exchange differences. Accordingly, in 2008, the aggregate financial profit amounted to EUR 49 million. The balance of the share of results of the Group's associates improved by 40% with respect to 2007 to stand at EUR 18 million of losses in 2008.

As a result of all the foregoing, the profit after tax of the Iberia Group amounted to EUR 32 million in 2008, the thirteenth consecutive year of profit.

At year-end, the consolidated balance sheet reflected the sound financial position of the Company with equity of EUR 1,564 million and a cash balance of EUR 2,351 million.

Corporate Culture

The tenets of Iberia's corporate culture form part of its corporate responsibility policy, and include the mission, vision and values shared by all the employees.

Iberia's mission is to offer air transport, airport and aircraft maintenance services that live up to the expectations of our customers and create economic and social value on a sustainable basis.

Iberia seeks to become the leading company in terms of customer satisfaction in its strategic markets (Latin America, Europe and Domestic), and to offer the optimal price/service quality relationship. Iberia wishes to offer its shareholders notable and sustained profitability and strives to attain the maximum professional development of all its employees.

Iberia endeavours to be recognised for its transparency and its firm social and environmental commitment. Accordingly, the Company is committed to entities that implement social cooperation projects and improve living conditions by promoting the involvement of its customers and suppliers and counting on the active participation of its employees. Also, Iberia pursues a global environmental protection policy that includes all its activities, both on the ground and in flight.

Iberia is committed to innovation, ongoing improvement and management excellence as key tools to create value and guarantee the future of the Company.

In recognition of the actions implemented by the Company in this field, in 2008 Iberia simultaneously joined the most prestigious stock market indexes; the select European Dow Jones Sustainability STOXX Index and the Dow Jones Sustainability Index World and the FTSE4Good IBEX. These indexes select the companies with the best practices in economic, social and environmental matters, of which only three are airlines.

The Corporate Responsibility Report provides ample information on these matters.

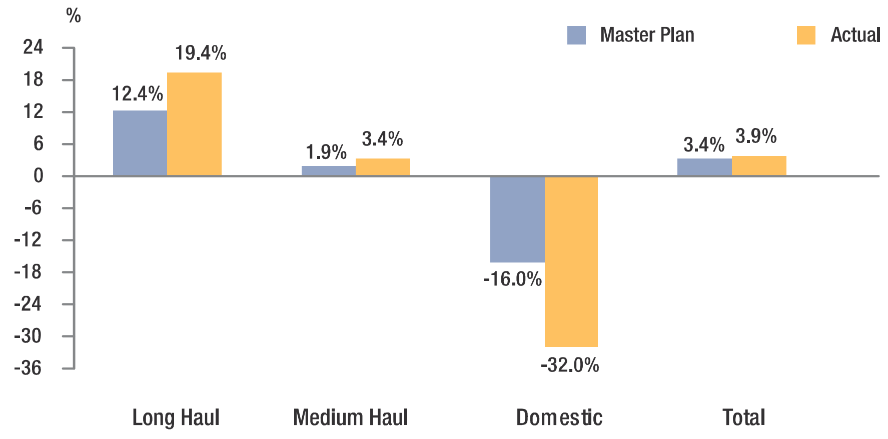
Fulfilment of the 2006-2008 Master Plan

Following the implementation of the 2006-2008 Master Plan and the evaluation of the measures put into practice, the conclusion reached is that the level of compliance with the main strategic objectives was very high. The network revision and optimisation process was completed and the total volume of revenue increased, clearly beyond initial projections. Operating costs were reduced as planned and the productivity of resources, in general terms, increased although flight crew productivity grew to a lesser extent.

One of the cornerstones of the 2006-2008 Master Plan was the revision and optimisation of the flight programme in order to strengthen network operations. The Company bolstered its activity at the Madrid-Barajas airport, operating out of the new Terminal 4 facilities from February 2006 onwards. Iberia performed a complex and extensive restructuring of the short- and medium-haul programme from 2006 to 2008, making selective adjustments to European routes, and to a greater extent, to domestic connections while strengthening its hub connections. As a result, in 2008 the volume of capacity in the international medium-haul sector exceeded the number of ASKs (available seat-kilometres) in 2005 (base year of the Master Plan) by 3.4%, while capacity in connecting flights from Madrid to Europe rose by more than 45% over the three years taken as a whole.

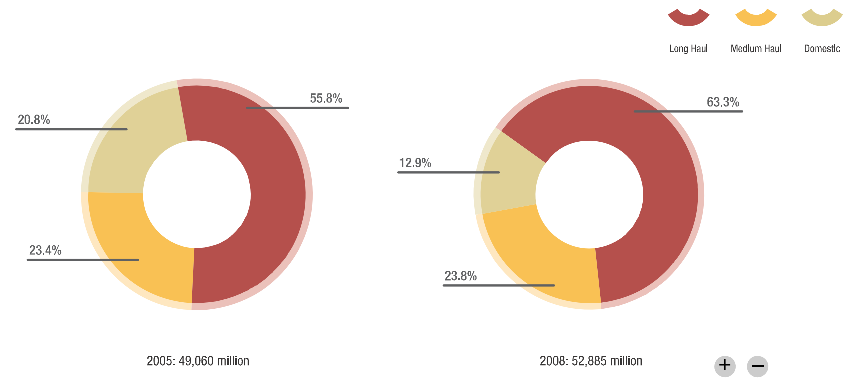
Also, Iberia significantly increased long-haul-flight capacity over the three-year period (up 19.4% on 2005), thereby exceeding the Master Plan's target for growth in this sector by seven percentage points. Furthermore, as a result of this expansion the Company consolidated its strategic position as the leading airline in connecting flights between Europe and Latin America, obtaining a market share of 19.2% in 2008, up 1.7 points on 2005. The cumulative increase in supply in the aggregate of all of the sectors was 3.9% with respect to 2005, slightly more than the growth planned.

Growth of supply (in ASK). Cumulative change 2008 / 2005



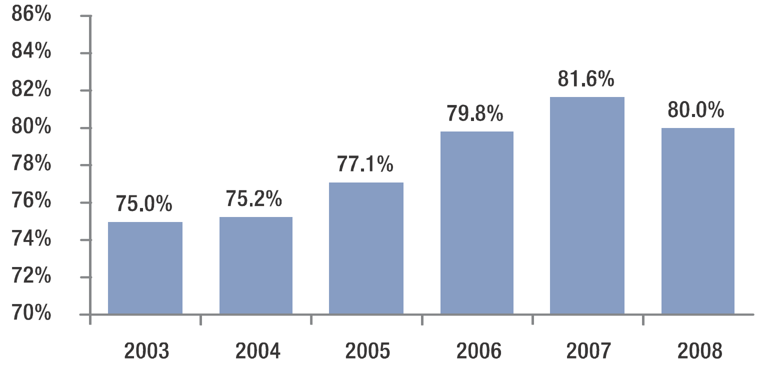
The relative weight of the long-haul sector increased as a result of the progress made in the network revision and optimisation process. Also, long-haul traffic represented 63.3% of total RPK (revenue passenger-kilometres) in 2008, 7.5 percentage points more than its weight in 2005.

Traffic (in RPK). Breakdown by sector



The load factors of the network taken as a whole were higher than the level recorded in 2005 in each of the three years of the Master Plan primarily as a result of the improvements in international flights, which enabled the Company to achieve leading positions amongst the European network carriers.

Development of the annual load factor. Total network



The increase in revenue and quality improvement formed the second strategic target of the 2006-2008 Master Plan. The Company invested heavily to improve the product and took various steps to increase the service level both on the ground and in flight, paying particular attention to its high-value passengers. In particular, mention should be made of the fact that the Business Plus Class was well received and valued highly by passengers. In 2008, the number of paying passengers travelling business class on long-haul flights was up 45% as compared with 2005, thereby improving the class mix (the number of total passengers in this sector rose by 19.5% over the three-year period). Furthermore, Iberia improved its European-Latin America market share of the Business traffic segment by 2.7 points compared to 2005.

Unit passenger revenue per ASK within the long-haul sector grew considerably over the last three years taken as a whole, exceeding the 2005 figure by 22.9% despite the appreciation of the euro against other currencies, which reduced this growth by 8.5 points. In 2008, unit revenue in the domestic sector was 10.3% more than the figure recorded in the base year of the Plan. As regards international medium-haul flights, unit revenue decreased by 2.8% with respect to 2005, since it was adversely affected by the growth in the average stage length (9.7%), the proliferation of low-cost carriers in the Spanish-European market and the aforementioned appreciation of the euro (which had an adverse effect of 3.5 points).

The 2006-2008 Master Plan also included an ambitious increase in revenue from maintenance services to other airlines. Total billing to other airlines (for technical assistance, lease and sale of material) amounted to EUR 309 million in 2008, outstripping 2005 income by more than 83%. During the last three years, Iberia's maintenance business has broadened its customer portfolio, obtained the relevant licences from manufacturers and entered into major agreements for its strategic development, thereby consolidating its profitability.

In the last three years, the Iberia Group has implemented a vast array of measures in order to improve the productivity of resources and reduce unit costs – the other two cornerstones of the 2006-2008 Master Plan.

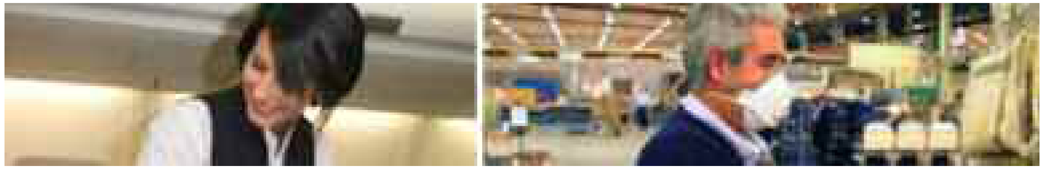
Iberia also met its fleet management objectives. From November 2008, it operated all its flights with just two families of aircraft (the Airbus A340 and A320), having retired (earlier than initially planned) the McDonnell-Douglas (MD) fleet. This measure helped to achieve the objective of reducing the age of the aircraft in service, the average age of which stood at seven years at the end of 2008.

In 2008 Iberia completed the second programme of cabin space reconfiguration affecting its entire short and medium-haul aircraft, which began in the second half of 2006. The fitting of latest-generation seats, which are more comfortable and have more available space, affords added comfort to our customers and optimises the layout of the cabins. A total of 66 Airbus aircraft were converted and 20 new aircraft equipped with the new configuration were added to the fleet (141 seats on the A319 aircraft, 171 on the A320 aircraft, and 200 on the A321 aircraft).

The fulfilment of the standardisation and aircraft age-reduction objectives was achieved together with a significant reduction in the unit cost of aircraft ownership (depreciation, lease and net finance cost), which in 2008 stood at 0.61 euro cents, a decrease of 24.7% with respect to 2005. Fuel consumption efficiency was also enhanced (measured in litres per ASK) by 9.4% over the three years taken as a whole.

Despite the early withdrawal from service of the MD aircraft, Iberia surpassed its global objectives for aircraft utilisation, which achieved an average of ten block hours per aircraft per day in 2008. This figure represents an all-time high for the Company and one of the highest amongst the network airlines with similar stage lengths.

For the purpose of improving staff productivity and optimising the cost structure, the 2006-2008 Master Plan envisaged a reduction of 9% in Iberia's workforce. The staff restructuring plan consisted of voluntary redundancies, mainly under the framework of collective redundancy procedures (72/2001 and 35/2005), and a redundancy scheme abroad. The average headcount at Iberia in 2008 amounted to 21,345 equivalent employees compared to 24,487 in 2005 and, therefore, represents an actual decrease of 12.8% in the three-year period taken as a whole, marking a clear improvement on the objectives of the Plan.



The productivity (in terms of ASK per equivalent employee) of the workforce of the Group's parent, including flight crew, was up by 3.9% in 2008, with a cumulative increase of 19.2% in the last three years. The productivity of Iberia's ground employees stood at 4,189 thousand ASK per employee in 2008, which is 21.1% more than the figure recorded in 2005. In 2008 a rigorous plan was initiated to improve the productivity of personnel from the Iberia Airport Services Division, which will be ongoing over the next few years.

In July 2008 the 17th Collective Labour Agreement covering Iberia ground employees (representing 74% of the Company's workforce) was signed, in force between January 1, 2008 and December 31, 2008. This new collective agreement lent continuity to the main agreements reached in the collective agreements signed in 2006 and 2007, and included new initiatives aimed at improving productivity and flexibility to facilitate management in the various areas of the Company. At the beginning of 2007 the 15th Collective Agreement of cabin crew members (CCMs) was entered into –in force until the end of 2007 and extended thereafter until December 2008– which enabled various productivity improvement initiatives to be put in place from summer 2007 onwards. The measures in relation to staff costs included in the collective agreements entered into meet the criteria established in the 2006-2008 Master Plan.

Also, an agreement was reached in January 2009 on the collective agreement with the technical crew which, after ratification through a technical crew vote, resulted in the achievement of the objectives of the Master Plan completed in 2008. This agreement will also ensure a new framework to face up to future challenges.

The implementation of rationalisation schemes for the other expenses also helped to meet the cost-cutting commitments. Particularly noteworthy is the decrease in net commercial expenses, which represented 2.6% of traffic revenue in 2008 compared to 4.3% in 2005. The unit operating cost (per ASK), excluding the cost of fuel, stood at 5.84 euro cents in 2008, which represents a reduction of 6% with respect to the 2005 cost (more than 13% when taking into consideration inflation for the period).

2009-2011 Strategic Plan

In 2008 Iberia prepared the Strategic Plan for the coming three years. The plan sets out the objectives that will enable the Company to consolidate its leadership against a difficult panorama. The macroeconomic backdrop is expected to be marked by a severe economic crisis which will give rise to a general slump in air traffic in 2009 and a slow and gradual recovery in the two years thereafter. The airline industry must also face the uncertain future of oil prices, strong competition across all markets and a foreseeable process of extensive industry consolidation.

The 2009-2011 Strategic Plan sets out specific initiatives and measures that will be put into effect by each business unit and management area of the Iberia Group, enabling the following strategic objectives to be met:

- A qualitative advance in improving customer service.
- Reinforcement of Iberia's leadership in the Europe-Latin America and Madrid-Europe markets and maintenance of its current position in the domestic market.
- Recovery of profitability levels, obtaining an average EBITDAR margin of more than 14% in the three-year period and 15-17% in 2011, and consolidation of the Group's financial soundness, achieving equity of EUR 2,040 million by 2011 year-end.
- Strengthening of the Company's considerable strategic positioning in a changing industry.

As the cornerstone of the Strategic Plan, Iberia will launch an Integral Customer Service Plan in line with its firm commitment to improve quality and focus on the customer. This Integral Plan includes specific measures that require the involvement of all of the Company's areas and employees and is centred on three initiatives:

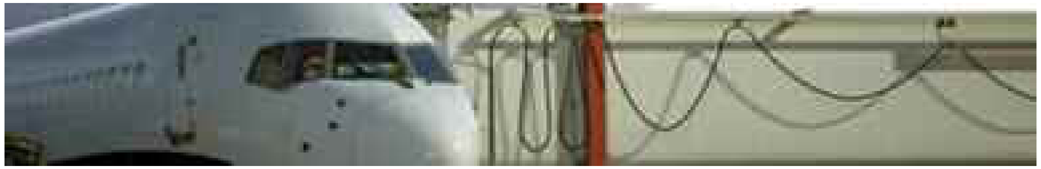
- Improvements to the product and service level throughout the entire customer relationship, from the decision to buy the ticket to the post-flight experience. The Company will invest EUR 150 million in 2009-2011, envisaging, inter alia, a revamp of the long-haul economy and business classes, redesign of the VIP lounges at key airports and separate boarding for business class customers or the reduction in waiting time at baggage claims in Terminal 4 at Barajas airport (in collaboration with the Spanish Airports and Aviation Authority in the last two cases).
- Complementary action plans to improve the attitude towards customer service.
- Revision of operational processes on the ground and in flight, customer-focused and taking into consideration the customer loyalty endeavours, together with an internal and external communication plan.

In addition to the significant improvement in the quality of customer service -an initiative shared by all departments- the 2009-2011 Strategic Plan also foresees the following principal measures for the Transport business:

- Shore up revenue, setting apart the value proposal. Best practices will be applied to revenue management, inter alia, the dynamic management by origin and destination according to network availability, optimisation of the hub and network, sales mix, group management and the promotion of Iberia Plus.
- Optimise the structure and size of the network, tailoring growth to demand. The Plan foresees an adjustment of 1.7% to the Company's capacity in 2009 and annual growth of approximately 4.2% over the following two years.
- Further operational efficiency, achieving increased productivity and efficiency.
- Manage the consolidation environment across the various fronts, positioning the Company right at the centre of a super alliance.

As regards the profitable Maintenance business, the primary objective of the Strategic Plan for the three-year period is to consolidate the position achieved over the last few years, through the following lines of action:

- Promotion of the customer service culture.
- Increased revenue and productivity and improved profitability across all production areas: engines (an increase in production capacity is planned), components, fuselage (overhaul of production centres) and maintenance at aircraft lines.
- Development of advanced management and logistic tools to buoy up business growth.
- Procurement of new business opportunities through agreements with other companies.



Lastly, in the case of the Handling business, the main challenge is to regain sustained profitability (cut short by the award of new handling licences from 2007 onwards). The 2009-2011 Master Plan establishes various ways to transform the dynamics of this business, with specific and diverse lines of action for each airport that may be summarised in the following five points:

- Significant increase in productivity, this being the central feature.
- Increased revenue through the implementation of new billable items and the adaptation of the pricing policy.
- Reduction of overheads.
- Additional measures to reduce the rise in the unit cost of personnel.
- Promotion of the customer service culture.

Service quality

Iberia considers service quality to be fundamental to its competitive edge and a commitment to both the customer and value. Therefore, the Company has invested considerable resources in improving its product. It has also equipped itself with the systems and procedures required to provide the adequate service level in each segment and continually assess service quality and satisfaction.

As discussed in the previous section, one of the cornerstones of the 2009-2011 Strategic Plan is to reinforce the focus on the customer and make significant headway in service quality. For this purpose, the Integral Customer Service Plan was designed which hinges on three main points: improvements to the product and service level, revision of the operational processes and the communication plans, and a structured plan to improve the attitude of its employees towards the customer through training programmes as well as staff selection processes.

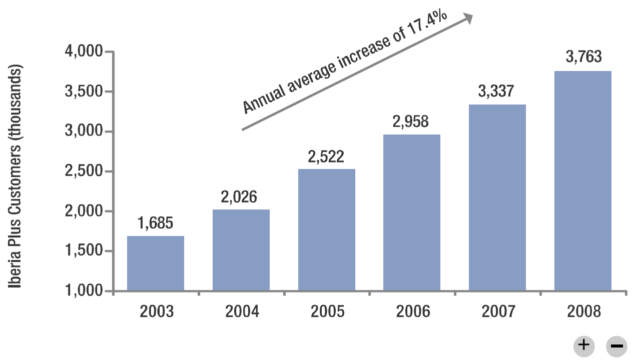
In 2008 Iberia continued to revamp its in-flight service and the services offered to its Business Plus passengers, seeking the best way to complement modern-seat comfort and the advanced communication and entertainment systems onboard its aircraft. Prestigious chefs and renowned companies worked alongside the Company to extend the variety and quality of the Spanish food and wine offered in-flight and in the VIP lounges.

Iberia also improved the service provided on its short and medium-haul flights. The reconfiguration of the passenger cabins of all the Airbus aircraft began mid-2006, fitting latest-generation seats, more comfortable than the current ones and less voluminous. At the end of August 2008 this plan was completed and a total of 86 aircraft fitted with the new seats were in service.

From December 1, 2008, Iberia ceased to market the central seats of the rows in its business class on all domestic flights; the middle seat is always free so that business class customers have more room and greater comfort. By doing so, the Company equipped its national routes with the business service it already provided on its flights with Europe, North Africa and the Middle East. Business class customers also enjoy other benefits such as more Iberia Plus points with their journeys, check-in at separate desks or access to the VIP lounges.

Under its plan for ongoing quality improvement, Iberia implemented various commercial measures aimed at making the Madrid-Barcelona shuttle flights more attractive. As a result, from March, the business class catering of this product was completely revamped, also improving the service. Under the guidance of chef Sergi Arola, the Company prepared a proposal based on natural products found in the Mediterranean diet. With the frequent flyers of the Madrid-Barcelona shuttle service in mind, different dishes are offered according to the meal time and season. For example, in winter hot dishes are offered for all meals (breakfasts, snacks and dinners).

Iberia Plus, the Group's customer loyalty programme had 3.8 million members at the end of 2008, up 12.8% with respect to 2007 and, therefore, remaining one of the biggest frequent flyer schemes in Europe. The programme consists of the accumulation of points through the use of the card, which may be exchanged for flights or other services offered by companies associated with the programme. As a result of this programme and the possibilities offered through state of the art technologies, Iberia maintains close ties with its best customers, who represent one of its most valuable assets, and can pay particular attention to them. In recent years, Iberia has significantly increased the number of companies associated with the programme (87 associated companies at the end of 2008). In the last year, 19 new members joined, including most notably the World Hotels chain, Hotelcolor, Mapfre and Banco Popular e-com.



Thanks to the ongoing efforts of all the areas involved in this operation, the Company achieved a punctuality index (15 minute limit) of 83% for the network taken as a whole in the run up to November 2008, up 2.4 percentage points on the figure recorded in the same period in 2007 and, therefore, keeping Iberia at the forefront of other network airlines. However, in December the Company's operation was affected by general delays and cancellations due to the action taken by a portion of the technical crew and, consequently, cumulative punctuality in 2008 stood at 81.4%, an improvement of 0.6 percentage points as compared to 2007.

Innovation and Technology

For the Iberia Group, innovation permeates all of its business concepts: strategy, processes, services and products. Every year the Company manages dozens of projects aimed at improving service quality, technological progress in processes and resource savings. The great majority of such initiatives are recognised as innovative projects through the award of certifications or independent assessments made by various national and international official bodies.

For the past 12 years, the Company has been improving and innovating the functionality of Iberia.com, its commercial website, through which customers can reserve and purchase airline tickets. They may also check timetables, prices, flight arrivals and departures or information on weather, in real time, at the various destinations to which Iberia flies. The Company also offers other services through its website including, in particular, the online issue of boarding cards from any computer. In 2008, close to 3.5 million boarding cards were issued using the auto check-in online facility, which represents a daily average of 13,000 boarding cards.

In 2008 Iberia.com implemented new functions aimed at improving the service offered to its customers. Specifically, flight search options were included based on a customer's budget and for weekend breaks. A specific "Fairs-Congresses" section was also included where special prices can be found. Tickets may also be purchased against Iberia Plus points to fly with other **one**world airlines British Airways and Qantas. Noteworthy amongst the existing functions is the development of a communication platform that enables the content of the website to be consulted through various types of mobile devices such as telephones or PDAs.

Iberia.com is available in seven different languages and has specific versions that cover substantially all the Company's destination countries. Sales of the air transport product (airline tickets and fees) amounted to EUR 532 million in 2008, up 7.5% on 2007. Agreements were entered into with other companies (inter alia, Avis, Lastminute and Viva Tours) to enable them to offer their products (hotels, car rental services, package deals, etc.) through the Iberia website.

In 2008 Iberia's Cargo Division led the implementation of the IATA's (International Air Transport Association) e-Freight project in Spain. The primary objective of this project is to eliminate the paper documentation system used in the management of air cargo and to replace it with electronic messages. Iberia was chosen as a result of its effective e-ticket roll out for passengers (a process that has now been completed) and the successful launch of the innovative electronic air waybill tool for the domestic area mid-2007 by the company (Iberia Cargo e-AWB). At the end of 2008, Iberia put this new air freight e-documentation system into effect on certain European routes and it is expected to be extended to the remaining routes in the coming months. The implementation of IATA's e-Freight system will afford a number of benefits to the various players in the freight area such as streamlined operational processes, cost savings and a reduction in the environmental impact.

Iberia's Maintenance and Engineering Division, together with other bodies and companies, is implementing a project to create a compressor blade workshop which, through the integration of consecutive automated processes, enables these parts to be fully repaired. Design of this R&D project, classified as Technological Development by the Spanish Ministry for Industry, began in 2007 and is expected to be completed in 2010, requiring a total investment of EUR 6 million.

Fleet renewal

The Company continued its plan to renew and standardise its short and medium-haul fleet with the aim of using more modern aircraft equipped with the best features that consume less fuel and are more environmentally friendly. In the first half of 2008 Iberia added three A319 aircraft to its fleet, which were sourced directly from the Airbus plant.

At the end of October, ahead of the initial schedule, the Company concluded the retirement of the McDonnell-Douglas fleet from service. In the last 19 months, a total of 30 aircraft were retired from service, namely, 18 MD87 aircraft and 12 MD88 aircraft. In the first few months of 2008, two B757 aircraft were also retired under the restructuring framework of the wet lease operation. Consequently, from November 2008 Iberia operated all its short- and medium-haul flights with a single family of Airbus aircraft (using the A319, A320 and A321 models), with an average age of 6.7 years.

Also, from mid-2006 the Company operated its long-haul flights with a single type of aircraft, the Airbus A340. Therefore, the Company standardised the aircraft in both fleets (on short-, medium- and long-haul flights) under the renewal process, thereby reducing maintenance costs and optimising the use of technical crew, while offering advantages vis-à-vis the operational management of the commercial programme.

At the end of 2008, following the addition of two aircraft in the first half of the year, Iberia's long-haul fleet consisted of 33 A340 aircraft (21 of the 300 version and 12 of the 600 version), three of which were operated under a wet lease. The short and medium-haul fleet totalled 86 Airbus aircraft (22 A319, 45 A320 and 19 A321).

The implementation of the fleet renewal and standardisation plan reduced the average age of the aircraft in service as a whole, which stood at seven years at the end of 2008. As a result, Iberia is currently one of the airlines with the most modern fleet in the global aviation industry.

Corporate transactions

On July 29, the Board of Directors of Iberia resolved to begin talks with **British Airways** on a potential merger between the two airlines through an exchange of shares. In relation to this transaction, Iberia acquired a strategic ownership interest in the share capital of British Airways in 2008, which represented 9.99% of British Airways share capital at December 31. Both companies continue to work on the complex process of negotiating an agreement and planning the transaction.

On July 7, 2008, the Board of Directors of **Vueling and Clickair** -the latter being an investee of Iberia- approved a framework agreement for the integration of the two new generation airlines on the basis of a merger of equals, respecting the independence of the resulting company. The transaction, structured as a merger by absorption of Clickair by Vueling, was subject to clearance from the anti-trust authorities and compliance with other legal requirements.

On January 9, 2009 the European Commission's Competition Service authorised this merger. The legal formalities and commercial processes required to complete the transaction continue, which are basically to gain the approval on the merger project of the shareholders of Vueling and Clickair at their respective general meetings, and to file a request with the Spanish National Securities Market Commission for its approval of the prospectus for the issue of Vueling shares in relation to the share capital increase that will give rise to the entry of the new shareholders. Once the required authorisation has been granted, the merger is expected to be completed before the end of summer 2009.

Changes in the shareholder structure

In the first half of 2008, British Airways, through its subsidiary British Airways Holdings B.V., acquired 31 million Iberia shares, representing 3.25% of the share capital. At December 31, 2008, the majority shareholders of the Iberia Group's Parent were Caja de Ahorros y Monte de Piedad de Madrid (Caja Madrid), holding 22.99% of the share capital, and British Airways Holdings B.V. with an ownership interest of 13.15%.

2. OPERATIONAL PERFORMANCE IN MANAGEMENT AREAS

2.1. Transport

The Iberia Group engages mainly in the air transport of passengers and cargo. In 2008 the revenue generated from this line of business represented 83.8% of total recurring operating income.

Set forth below are the statistics of Iberia, Líneas Aéreas de España, S.A. ("Iberia") on capacity, traffic and passenger transport revenue for 2007 and 2008, broken down into the three following commercial sectors: domestic, which includes the connections among Spanish airports; medium-haul, which groups together the international flights that connect Spain with European destinations in Europe, the Middle East and North and Central Africa; and long-haul, which includes the connections to America and South Africa.

2.1.1. Capacity and passenger traffic

From the end of 2007, there was a slowdown in traffic growth in the air transport industry, compounded in the second half of 2008 by the international economic situation. Revenue passenger-kilometres (RPK) on scheduled flights by all of the companies forming the Association of European Airlines (AEA) showed a slight increase of 1.2% in 2008 compared to the 5.4% increase in 2007. The industry also adjusted its increase in capacity but not by a proportion sufficient enough to offset the slump in demand. Consequently, the load factors recorded widespread downswings from the beginning of 2008. The average load factor of the AEA companies slid 1.3 percentage points in 2008 to 76.0%.

Iberia obtained a passenger load factor of 80.0% in 2008 compared to 81.6% in 2007, an annual record for the Company, and stayed ahead (together with the Air France-KLM group) of the other European network operators. Iberia's capacity volume, measured in available seat-kilometres (ASK), dropped 0.5% with respect to 2007 across the entire network, mainly as a result of the supply rationalisation process in the domestic market. Therefore, Iberia increased its capacity in aggregate international flights by 2.7% in comparison with 2007.

In 2008 Iberia concluded the flight-programme revision and optimisation designed in the 2006-2008 Master Plan, which boosted network operation. The Company continued to increase its capacity and optimise connections at its Madrid-Barajas hub, while also completing its plan to make selective adjustments on point-to-point routes, which by and large affected domestic routes. The effect of these measures, together with the growth in capacity on transatlantic flights and in Central and Eastern Europe gave rise to an increase of 12.6% in the average stage length to 2,273 kilometres.

Iberia operated a total of 80 of its own destinations at the end of 2008: 23 long-haul destinations, 34 international medium-haul destinations (two additional routes during the summer season) and 23 domestic routes. If we also add other cities covered by its franchisee, Iberia Regional Air Nostrum, the Group network flew to 109 destinations in total (and four more during the summer). Furthermore, the extension of the code sharing agreement with American Airlines in 2008 (25 new destinations offered in the US in 2008), the maintenance of existing code sharing agreements with other carriers (Avianca, British Airways, Clickair, Japan Airlines, Mexicana de Aviación, the TACA Group, Royal Air Maroc, etc.) and the signing of new agreements (with Pluna and Meridiana) have put the total number of destinations offered by Iberia to its passengers at approximately 230 in December 2008.

In 2008 taken as a whole, the Company achieved 66,098 million ASKs in all its operations, with the following breakdown by market:

Millions

ASK	2008	2007	% Change
Long haul	39,330	38,201	3.0
Medium haul	17,223	16,738	2.9
The Continent of Europe	15,192	14,762	2.9
Africa and the Middle East	2,031	1,975	2.8
Domestic	9,546	11,516	(17.1)
Total	**66,098**	**66,454**	**(0.5)**

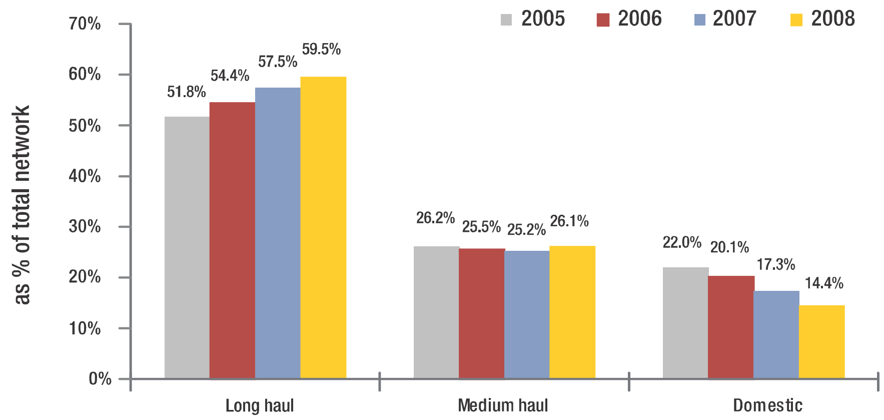
Capacity volume in the long-haul sector, was up 3.0% with respect to 2007 (1,129 million ASKs in absolute terms). Just over half of this increase related to Central American flights, the supply volume of which represents 26.8% of the Company's total following its recorded rise of 3.4% in 2008. The Company curbed its increase in capacity in South America in 2008 by 1.5% with respect to 2007 following the surge recorded in 2007 (12.9%). Lastly, the subsector with the largest growth in relative terms was North America, increasing the number of ASKs by 6.4% in comparison to 2007, primarily due to the addition of Boston and Washington to the flight programme in May and June 2007, respectively. This explains the major increase in capacity recorded in the first half of 2008 as compared to 2007.

As a result of the network revision and optimisation, the number of ASKs in international European flights arriving at or departing from Madrid-Barajas soared 14.9% as compared to 2007, 12 points more than the growth in capacity volume in the European sector taken as a whole. Certain Eastern European destinations celebrated their first year in operation (Bucharest in March and Prague and Warsaw in October) recording surges in supply and demand in 2008. The Company also added a new destination (Dubrovnik) to its programme in 2008, which was operated from June to October. The capacity of flights to other European countries also grew, most notably to Switzerland, Russia and Turkey.

The Company increased its capacity in flights to Africa and the Middle East from its hub and vice versa by 25.2% with respect to 2007. However, the total number of ASKs in this sector rose by 2.8% as a result of the adjustments made to other connections in accordance with the network restructuring plan. Highlights in 2008 in this regard include the increases recorded in flights with Israel, Equatorial Guinea and Algeria, which were partially offset by the falls in Morocco and Egypt.

As regards the domestic sector, Iberia decreased the total capacity by 17.1% as compared to 2007. In accordance with the strategy designed in the 2006-2008 Master Plan, the Company continued to reduce its capacity on internal point-to-point connections and increase it on routes reinforcing the network operation at the hub.

Annual growth of the breakdown of supply (as a percentage of total ASK)



In 2008 the Company also had to face the challenge posed by the start-up of the new high-speed train lines linking Madrid and Malaga from the end of 2007, and Madrid and Barcelona from February 20, 2008. In particular, Iberia initially adjusted the capacity of the major Barcelona-Madrid connection by reducing the aircraft size, but maintained practically the same number of flights in order for it to remain an attractive product. It also underpinned the competitive position of the Madrid-Barcelona shuttle service with an array of sales initiatives in 2008. However, in the last few months of 2008, further adjustments were made to capacity to counteract weakening demand for flights stemming from the sudden impact of new competition from the high-speed train and the effects of the economic crisis. As a result, in 2008 the number of total ASKs on the Madrid-Barcelona route plummeted 21.8% as compared to 2007, while the volume of capacity for the rest of the domestic flights to and from Madrid rose by 2.9%.

Iberia's passenger aircraft production in terms of block hours was 5.2% lower than in 2007, and the number of hours of aircraft under wet lease agreements also fell by 12%.

Passenger aircraft block hours	2008	2007	% Change
Owned aircraft	445,331	469,636	(5.2)
Wet lease	20,891	23,736	(12.0)
Other leases	422	88	n.m.
Total	**466,645**	**493,460**	**(5.4)**

n.m.not meaningful

In 2008 Iberia carried 23.3 million passengers on the network as a whole, outstripping, for the second consecutive year, the all-time high of four million on long-haul flights, which actually increased by 0.3% to 4.2 million passengers.

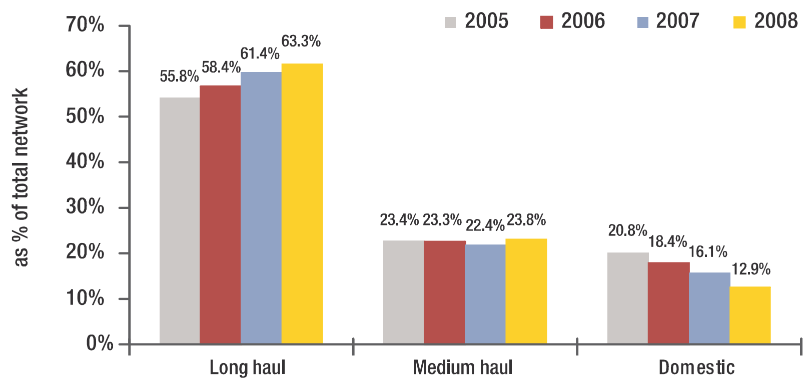
The following table reflects the distribution of Iberia traffic in RPK:

Millions

RPK	2008	2007	% Change
Long haul	33,490	33,319	0.5
Medium haul	12,584	12,172	3.4
The Continent of Europe	11,049	10,693	3.3
Africa and the Middle East	1,535	1,478	3.8
Domestic	6,810	8,738	(22.1)
Total	**52,885**	**54,229**	**(2.5)**

The number of RPKs in the network as a whole was 2.5% lower than in 2007 due to the network restructuring process in the domestic sector and the waning demand for air travel in the markets in 2008. Total international traffic (the aggregate of the medium- and long-haul sectors) was up 1.3% as compared to 2007. Following the trend set in recent years, the relative weight of long-haul traffic in the network taken as a whole stood at 63.3%, an increase of just under two percentage points.

Annual growth of the breakdown of demand (as a percentage of total RPK)



Traffic in the long-haul sector grew by 0.5% with respect to 2007. The largest increase in RPK, in absolute terms, related to North America, where demand rocketed in the first quarter (more than 24%) due to the positive effect of the addition of new routes (Boston and Washington) from the second quarter of 2007 onwards. However, it gradually eased off over the year, resulting in average growth of 4.4% in the twelve-month period taken as a whole. Traffic on flights with Central America increased by 1.2% in 2008 whilst flights with South America dipped 1.2%, affected in part by the major increase in capacity of competitors.

In the international medium-haul sector, demand was up 3.4% on 2007, spurring on growth in flights to and from Madrid to 16.7%. Iberia traffic within the EU as a whole scarcely changed (-0.4%) as compared to 2007, although it increased considerably to and from non-EU European destinations (32.4%), with more conservative growth on routes to and from Africa and the Middle East (3.8%).

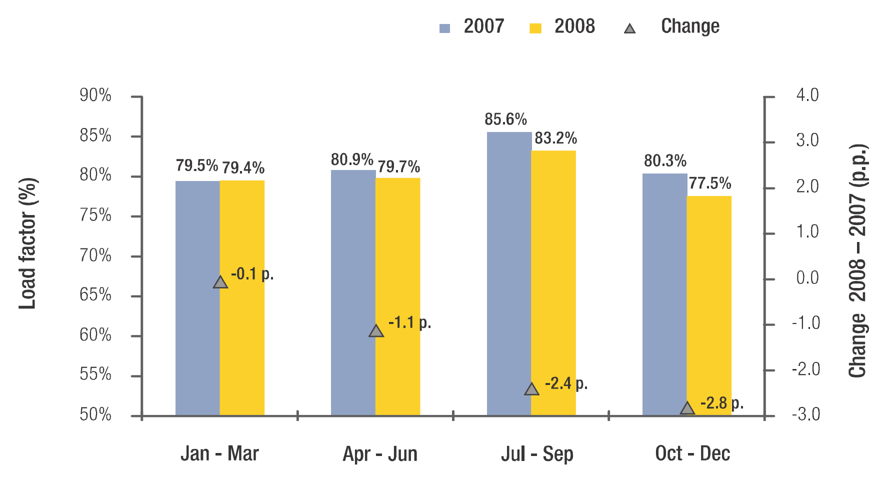
The number of RPKs in the domestic sector fell by 22.1% with respect to 2007 as a result of the reduction in Iberia's capacity (-17.1%) and the growing weakness in market demand, which was affected by the start-up of the high-speed train lines and the difficult economic situation. According to data from AENA, in 2008 the airline traffic taken as a whole decreased by 24% compared to 2007 in the Madrid-Barcelona corridor and by 28% in the Madrid-Malaga corridor.

The following table shows the breakdown, by sector, of the changes in the load factor:

Load factor (%)	2008	2007	Change 08/07
Long haul	85.2	87.2	(2.1)
Medium haul	73.1	72.7	0.3
The Continent of Europe	72.7	72.4	0.3
Africa and the Middle East	75.6	74.8	0.7
Domestic	71.3	75.9	(4.5)
Total	**80.0**	**81.6**	**(1.6)**

In 2008 the load factor stood at 80% for the network taken as a whole, 1.6 percentage points less than the all-time high achieved in 2007. In 2008 Iberia had one of the highest load factors of the European network carriers. Falling demand meant that the load factor recorded the biggest disparities in the second half of the year with respect to 2007 levels despite the adjustments that the Company made to capacity.

Quarterly development of passenger load factor



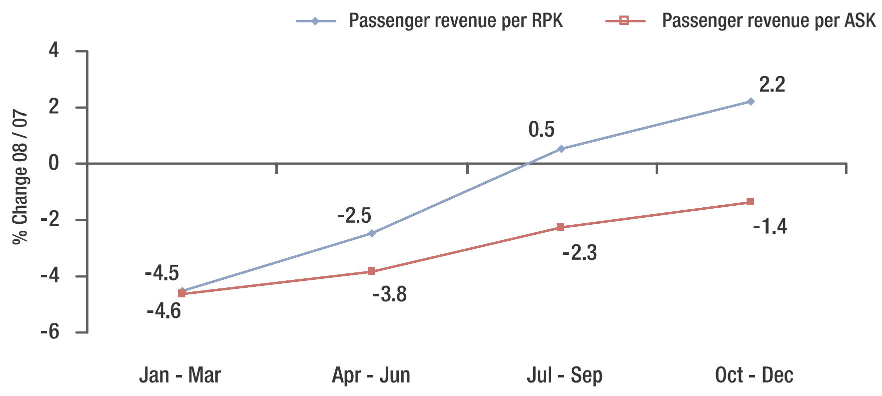
In relation to 2007, the load factor improved slightly in the medium-haul sector, with increases of 0.3 points in the Continent of Europe and 0.7 points in Africa and the Middle East. The load factor for international medium-haul flights to and from the hub improved 0.4 points to 73.7%.

2.1.2. Passenger traffic revenue

For the network as a whole, Iberia's yield in 2008 decreased by 1.1% with respect to 2007, due to the significant effect of the growth in average stage length (12.6%). Yield was also affected by the fall in value of the dollar against the euro for most of the year, with the exception of the last quarter. With constant exchange rates, yield would have increased by 1.3% with respect to 2007.

Changes in passenger revenue per RPK with respect to 2007 showed an upward trend during 2008 due to ongoing price adjustments and a more comprehensive use of the new yield management tools, with an increase of 2.2% in the fourth quarter, thereby lessening the impact of increased fuel prices. The following graph shows the quarterly changes in 2008 in passenger revenue per RPK and per ASK with regard to 2007.

Quarterly change in passenger revenue per RPK and per ASK 2008 / 2007
Total Network



The following table shows the breakdown by sector of the changes in yield:

Euro cents

Yield	2008	2007	% Change	% Change (*)
Long haul	5.49	5.41	1.4	5.1
Medium haul	8.94	9.19	(2.8)	(0.8)
Domestic	13.64	12.73	7.1	7.8
Total	**7.36**	**7.44**	**(1.1)**	**1.3**

(*) Using constant exchange rates

In the long-haul sector average yield increased by 1.4% with respect to 2007, in spite of the highly detrimental effect of the fall in value of the dollar against the euro. For the year as a whole, with constant foreign exchange rates, this sector's yield would have increased by 5.1% with respect to 2007.

In the medium-haul sector, average yield decreased by 2.8% with respect to 2007 due mainly to the increase in average stage length in this sector (5.4%), the fall in value of the dollar and the pound sterling against the euro and the pressure from competitors in relation to prices on European routes. The change in exchange rates led to a decrease of two percentage points.

In the domestic sector yield improved by 7.1% with respect to 2007, with the highest year-on-year increase in the second quarter (11.7%), as a result of the revenue optimisation strategy developed by the company.

For the network as a whole, average passenger revenue per ASK decreased by 3.0% with respect to 2007. As in the case of yield, unit revenue suffered the impact of the growth in average stage length and the fall in value of the dollar, on top of the effect of the decreases in the load factor on the long-haul and domestic sectors. Excluding the adverse effect of the change in foreign exchange rates, the increase in revenue per ASK with respect to 2007 would have been 0.7%.

The following table shows the breakdown, by sector, of average revenue per ASK:

Euro cents

Revenue per ASK	2008	2007	% Change	% Change (*)
Long haul	4.67	4.72	(1.0)	2.6
Medium haul	6.53	6.68	(2.3)	(0.3)
Domestic	9.73	9.66	0.7	1.4
Total	**5.89**	**6.07**	**(3.0)**	**(0.7)**

(*) Using constant exchange rates

In the long-haul operations sector average revenue per ASK decreased by 1.0% with respect to 2007, due mainly to the adverse effect of the fall in value of the dollar. With constant exchange rates, unit revenue for this sector would have increased by 2.6%.

In the international medium-haul sector, average revenue per ASK decreased by 2.3% with respect to 2007. The increase in value of the euro against the dollar and the pound sterling accounts for 2.0 percentage points of this change, excluding this impact, the decrease would be limited to 0.3% with respect to 2007.

In the domestic sector, the significant increase in yield was greater than the effect of the decrease in the load factor which led average revenue per ASK to increase by 0.7% in the year as a whole.

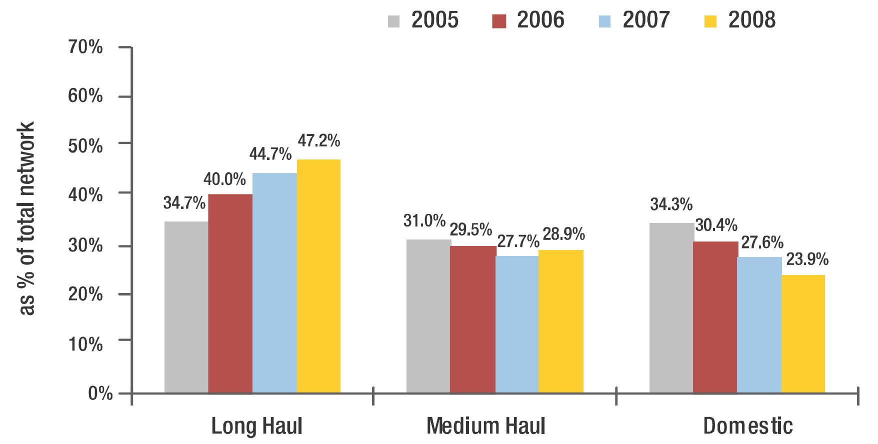
The following table shows the quarterly evolution of the total changes in passenger revenue:

Millions of euros

Passenger revenue	2008	2007	% Change
Long haul	1,838	1,803	2.0
Medium haul	1,124	1,119	0.5
Domestic	929	1,113	(16.5)
Total	**3,891**	**4,034**	**(3.5)**

In 2008, Iberia's passenger traffic revenue amounted to EUR 3,891 million across the network as a whole, a decrease of 3.5% with respect to 2007. Broken down by sector, noteworthy was the progressive increase in the relative weight of the long-haul sector, which accounted for more than 47.2% of passenger revenue for the whole network in 2008 (2.5 points higher than its weight in 2007 and 7.2 points more than in 2006).

Annual growth of the breakdown of passenger revenue (as a percentage of total)



2.1.3. Cargo

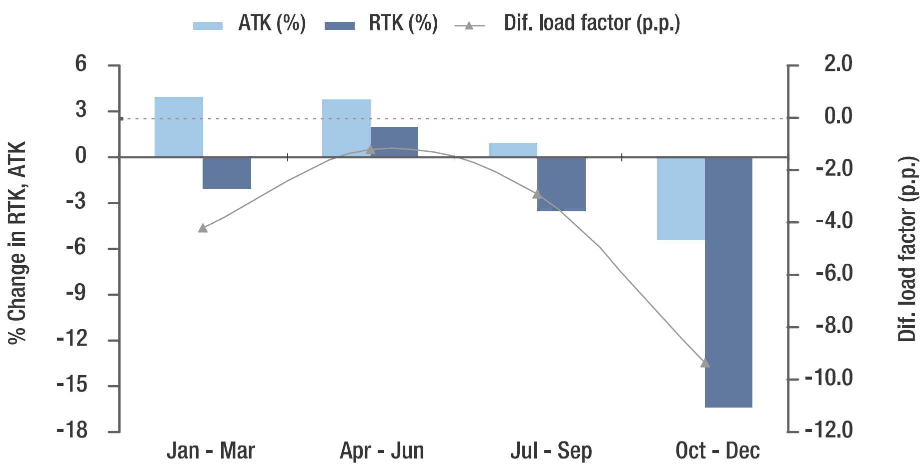
In 2008 cargo air traffic worldwide was severely affected by the economic crisis, the impact of which continued to worsen during the year. According to data provided by the AEA the revenue tonne-kilometres (RTK) of cargo for all European airlines decreased by 2.8% during the year taken as a whole, but with a decrease of 8.2% in the second half of the year, indicating not only the magnitude of the crisis but also its downward trend in the last months of the year.

In the case of Iberia the RTK of goods and mail amounted to EUR 1,156.1 million in 2008, a decrease of 5.6% with respect to 2007, although the total number of available tonne- kilometres increased by 0.7%. Also, the load factor increased by 4.5 percentage points. A comparison of air traffic data from the second half of the two years shows a decrease of 10.6%.

Revenue tonne-kilometres decreased by 5.7% for long-haul flights (the Americas and South Africa), which had a weight of 84.4% of total network traffic in 2008. In the short and medium-haul sectors (including the domestic sector) the decrease in the volume of traffic with respect to 2007, measured in RTK, was 4.7%.

Revenue from goods and mail transport decreased by 1.0% with respect to 2007, to stand at EUR 297 million. Yield stood at 25.7 euro cents, an increase of 4.9% with respect to 2007 as a result of the endeavours made to increase unit revenue, despite being adversely affected both by the increase in average stage length and the fall in value of the dollar. With constant exchange rates, the increase in yield would have been 7.5%.

Cargo traffic. Quarterly change in 2008 / 2007



In March 2008 Iberia and Globalia Handling formed an unincorporated joint venture on an equal footing basis, in order to improve the economic management of the cargo terminal at Barcelona airport. The joint venture commenced operations on May 1, 2008 in the same terminal that Iberia was leasing to CLASA, where the joint venture controls and handles the cargo of Iberia, Air Europa (part of the Globalia Group) and other airlines. Under the agreement Iberia transferred to the joint venture the permanent employees assigned to this terminal, who remain as Iberia employees.

In 2008 the audits for the renewal of Quality Certification under ISO 9005:2000 granted by AENOR were successfully passed in relation to cargo activities.

The main activity aggregates were as follows:

Cargo Transport	2008	2007	% Change
ATK (millions)	1,714.2	1,702.3	0.7
Holds	1,591.6	1,577.3	0.9
Cargo carriers	122.6	125.0	(1.9)
RTK (millions)	1,156.1	1,224.7	(5.6)
Holds	1,080.7	1,149.6	(6.0)
Cargo carriers	75.4	75.1	0.4
Load factor (%) (a)	67.4	71.9	(4.5 p.)
Holds	67.9	72.9	(5.0 p.)
Cargo carriers	61.5	60.1	1.4 p.
Av. Rev. RTK (euro cents/ RTK)	25.67	24.47	4.9
Cargo transport revenue (millions of euros)	297	300	(1.0)

(a) The difference between both years is expressed in percentage points.

2.2. Handling

The Airport Services Division (Iberia Handling) is responsible for the management of the ground handling services for other airlines and Iberia itself at the Spanish airports.

In July 2006 the award was made public of the new concessions for third-party ramp handling services throughout the entire state airport network for a term of seven years. With the award of these public tenders the industry has been further deregulated, the number of handling agents increasing from 4 to 10 and licences from 58 to 73 at the Spanish airports taken as a whole. The effective addition of the new ramp handling operators was completed in March

2007, although the effects of the consolidation of clients continued to be felt throughout 2008. Also in 2008, especially from October onwards, the performance of the handling sector was affected by the decrease in the number of airline operations caused by the economic crisis.

In 2008 Iberia Handling continued to operate as a ramp handling agent in 36 airports, by way of the 21 licenses granted to it in public tender. The company also operates at airports in Barcelona, Lanzarote and Fuerteventura through its participation in the joint ventures that obtained the licenses, with a 32% share in the former and a 30% share of the joint ventures at the two Canary Island airports.

In 2008 the licenses for the provision of services to passengers requiring special attention were the subject of a call for tenders. Iberia was awarded this license at the airports where it is the sole ramp handling operator. Also, the joint ventures formed by Iberia and other operators obtained the corresponding licenses for the airports of Madrid, Alicante and Palma de Mallorca. The provision of these services began mid-year.

In 2008 Iberia Handling handled a total of 80 million passengers, representing a decrease of 8.3% with respect to 2007. The total weighted number of aircraft handled was 376,040, down 6.8% on 2007, due to the provision of services in the first two months of 2007 in the five airports at which the licence was lost (Barcelona, Almeria, Jerez de la Frontera, Lanzarote and Fuerteventura) and the adjustments made for the presence of new operators and the resulting market competition.

The volume of business with other airlines, which in terms of weighted aircraft handled represented 56.2% of total production, decreased by 2.2% with respect to 2007. Iberia's handling business managed to maintain a market share above that of its competitors at each airport due to the addition to its client portfolio of Atlas Blue, TAM and Turkish Airlines at the beginning of the year and First Choice in March. The incorporation of the latter into the TUI Group consolidated its position as Iberia Handling's largest client, behind Iberia Línea Aérea, by number of flights serviced.

The operating income of the handling business amounted to EUR 491 million in 2008, down 14.4% on 2007, due both to the aforementioned decrease in activity and to the decrease in unit revenue.

The average annual headcount of Iberia Handling was 7,769 equivalent employees in 2008 (including 577 transferred to the Barcelona UTE), decreasing by 724 employees with respect to 2007. The number of hours of labour decreased proportionately more than the fall in production, thereby improving employee productivity by 3.1%. Various actions carried out as part of the 2006-2008 Master Plan contributed to this increase in productivity.

In 2007 the Airport Services Division initiated a major project, known as GAUDÍ, which entails the implementation of a new system (Groundstart) to manage airport stopovers. At 2007 year-end the planning and rostering modules came into operation (planning and management of the shifts of the various groups operating at the airport). The current module, Real Time, which allows planning to be carried out in real time and adjustments to be made to solve incidents relating to traffic, human resources and material resources, is being gradually adopted by divisions at Madrid-Barajas airport in 2008-2009. The project as a whole has led to significant resources being saved and has been one of the tools that makes it possible to streamline the workforce at this airport, significantly improving its productivity and management.

2.3. Maintenance

The object of the Maintenance and Engineering Division (Iberia Maintenance) is to provide integral maintenance services to the company's own aircraft and other aeronautical operators.

An increasingly diversified product portfolio, together with an offering of competitive prices based on market conditions, have consolidated its position in the market of services provided to other airlines, making the Maintenance Division one of the Iberia Group's most important business lines.

Iberia Maintenance carried out a total of 225 C and D inspections weighted by value, representing an increase of 4.3% with respect to 2007. The percentage of inspections carried out for other airlines was 59.7% (35% in 2007). In the area of engines, the weighted production of engines rose to 243, representing an increase of 30% with respect to 2007.

Operating income from maintenance work for other airlines amounted to EUR 309 million in 2008, surpassing the 2007 figure by 7%.

In 2008 major commercial agreements were entered into all the operating areas of this Division, improving the company's overall position in the aircraft maintenance market, and setting it apart in terms of economic and strategic relevance:

- Long-term agreement with DHL Air and EAT whereby the company will perform the major inspection and maintenance of more than 80 Rolls Royce RB211-535 C37 engines.
- Agreement with Dana Airlines and Aurora Airlines for the maintenance of engines and MD80-88 aircraft components.
- Contract with Air Europa for the maintenance of CFM56-7B engines for a fleet of 33 B737, resulting in the first maintenance job in the history of the company of a CFM56-7B engine.
- Cooperation agreement with EAD/CASA for the development of the new A330 Tankers.
- Contract with the North American company Precision Conversions to change the configuration of B757s from passenger to cargo.
- Contract with GE Aviation making Iberia Maintenance the Preferred Regional Centre for the maintenance of CFM56-5A engines.
- Agreement with SR Technics for the joint maintenance of CFM56-5C engines and the repair of components.

It should be noted that Iberia Maintenance is one of the few maintenance centres in the world, and the only one in Europe, which offers technical support for the RB211-535 engine. Additionally, the Engines Subdivision is the only one in Spain and the third ranking in Europe with respect to maintenance of the CF34 engine manufactured by General Electric.

Iberia Maintenance's customer base consists of practically all the Spanish airlines, a market in which it is leader, and a numerous group of international airlines: Air Comet, Air Europa, Air Finland, Airbus, Aircraft Avionics, Aladia Airlines, Armavia, Belair Airlines, Berkut, Blue Airways/Kyrano Services, Clickair, Conviasa, Cygnus Air, Dubrovnic Airlines, DVB, Euro Atlantic, Eurofly, Finnair Technical Services, Gestair, Iberworld, Interjet, Krassair, Mare Nostrum Aviation Ferhat, Meridiana, Olympic Airways, Pluna, Precision Conversions, LLC, LTE, Mexicana Presidents Office, Privilege Style, Pullmantur, Santa Bárbara, Sky Service, Spanair, Swiftair and Wind Rose Aviation Company, among others.

Among the numerous significant agreements for the strategic development of Iberia Maintenance is the creation of two joint ventures.

At international level, Iberia and Singapore Technologies Aerospace (STA) created Madrid Aerospace Services for the maintenance of landing gear. This new company specialises in the inspection and repair of landing gear of aircraft belonging to the A320, A330 and A340 families, which is a currently growing market. Additionally, Iberia Maintenance and Singapore Technologies Aerospace Solutions Europe (part of the STA group) have entered into an exclusive agreement whereby the former will inspect and repair aeronautical components of 24 Airbus aircraft of models A319, A320, A330 and A340 owned by SAS and Air Greenland. The agreement is the most significant entered into with respect to the number of components and represents a comprehensive and high standard service complemented by additional support which includes access to pool and transport.

At national level, an agreement was entered into with Gestair for the joint creation (on an equal footing) of Corjet. The creation of this new company enables Iberia to boost its activity of the maintenance of executive aircraft. Previously, Iberia Maintenance had been awarded a contract by the North American manufacturer Gulfstream, whereby it is considered to be the Official Centre for Gulfstream Aircraft in Europe, Africa and the Middle East with AOG service. The creation of the joint venture binds Corjet to this contract.

The construction of Iberia Maintenance's new hangar in Barcelona commenced in April. The hangar, which has a surface area of 12,600 m2, is capable of housing the A380 aircraft.

In 2008 Iberia Maintenance joined the Airbus Maintenance Training Network and became the first maintenance centre to enter into the agreement with the aeronautical manufacturer. This agreement enables the company to offer technical training for the A320 and A340 aircraft of the same quality and guarantees as Airbus, and consists of an advanced method involving interactive and virtual programs.

Iberia Maintenance received new certifications for aircraft, engines and components for both the Russian and Nigerian civil aviation authorities. It also passed the audits for the renewal of the certificates of the aeronautical authorities of Chile, Canada, Nepal, Venezuela and Uruguay, and the FAA (Federal Aviation Administration).

It also renewed, through audit, the IOSA (IATA Operational Safe Audit), ISO 9001:200 (Quality Management System) and ISO 14001:2004 (Environmental Management System, zone 1 and zone 2) certifications.

2.4. Project implementation

2.4.1. Integral Customer Service Plan

In the recently finalised 2006-2008 Master Plan, Iberia achieved notable advances in the quality of service provided to its customers. Among the most important is the comfort of the intercontinental Business Plus class; the transfer to the modern T4 terminal and the improvement of the VIP lounges at Barajas; punctuality achieved, Iberia being one of the most punctual European companies in the last two years; and the creation of the Customer Service Centre for Iberia Plus Oro and Platino Card holders, which is the first call centre of its kind created in Spain whose service is highly appreciated by its customers.

However, Iberia considers that certain aspects can be improved and that it should strive to achieve the highest level of excellence in relation to its customers. Therefore, in the recently approved Strategic Plan developed for 2009-2011, it was proposed that quality and customer service be upped a level through the implementation of the Integral Customer Service Plan.

The aforementioned Plan, in which all the areas of the Company are involved, rests on three fundamental principles:

- Review of all the **operating** processes which affect the customer in one way or another.
- Ongoing improvement of the **product** offered: renovation of the long-haul product, both of the Business Plus class cabin and the Intercontinental Economy class cabin; define a new European Business class capable of adapting to the requirements of the customers in that business sector; and boost domestic Business class, making it more comfortable by leaving the middle seat unoccupied (measure already implemented in December 2008). Spanish and foreign VIP lounges is another of the areas on which the Integral Customer Service Plan places special emphasis. The company would like the level of service achieved at T4 in Madrid, which is so greatly appreciated by its customers, to be exported to the main long-haul airports. At the same time, the offering will continue to be improved in Spanish lounges.

Improvements have been planned that are in line with the Company's priorities regarding products and services, which will foreseeable require an investment of around EUR 150 million as part of the 2009-2011 Strategic Plan, which should remain at a similar volume during the following two years (2012-2013).

- Focus on the areas of **attitude and behaviour**: improve further the service attitude at all points of contact with the customer so that such improvement is perceived by them.

In order to ensure that the objectives set out in the plan are achieved, an ongoing monitoring of the performance of the initiatives defined therein and the indicators of achieved and perceived quality is required. At the same time it is vital to effectively communicate this commitment to the customer both internally and externally, placing value on the company's strengths.

This is therefore an ambitious, all-encompassing Plan through which Iberia wishes to instil the customer focus across all areas of the Company, and the multidisciplinary vision of the Plan is a fundamental factor in its competitive positioning.

2.4.2. Implementation of sales agreements

The **one**world alliance

oneworld is a global alliance of ten highly prestigious and internationally renowned airlines: American Airlines, British Airways, Qantas, Iberia, Cathay Pacific Airways, LAN, Finnair, JAL Japan Airlines, Malév Hungarian Airlines and Royal Jordanian.

oneworld allows a passenger to enjoy and benefit from a series of additional advantages such as: access to a network of more than 700 destinations across 150 countries, the possibility of obtaining and exchanging points from the Frequent Flyer programmes of each airline throughout the **one**world network, the possibility of accessing over 500 VIP lounges distributed worldwide and of enjoying the assistance provided by the more than 260,000 employees of the alliance members.

oneworld continued its expansion in 2008 and invited Mexicana de Aviación to form part of the alliance. It is important to note that the process is being managed and coordinated by Iberia. In this respect it is expected that Mexicana will become a oneworld company towards the end of 2009, together with its affiliated airline Click Mexicana.

The **one**world Alliance offers the most diverse portfolio of products designed to satisfy the needs of non-corporate flyers, from trips around the world to products designed for visiting one or more continents using the **one**world network. In order to consolidate this position and facilitate our customer's access to these products, since December 2008 it has been possible to plan all aspects of around-the-world trips (**one**world Explorer) on the alliance website, from the design of itineraries and flights, to the reservation and purchase of tickets.

Agreement with American Airlines and British Airways

On August 14, 2008 American Airlines, British Airways and Iberia entered into a joint business agreement for flights between North America and Europe. This cooperation will benefit customers as it will enable them to fly to more destinations across more countries with better and easier connections. The three airlines will also be able to offer flight times which are better suited to the needs of passengers and improve the offering of frequent flyer programmes. This increased level of cooperation between the three airlines will have a positive effect on consumer choice, which will enable the **one**world alliance to compete more effectively with the other alliances around the world.

On August 14, the three airlines applied to the United States Ministry of Transport for antitrust immunity and subsequently delivered the additional information requested. It is expected that this phase will be completed around summertime. A similar process is also in progress before the relevant authorities of the European Union, who have asked for additional information, and this request is currently being dealt with.

Under the joint business agreement, the three airlines will cooperate in the commercial arena for flights between the United States, Mexico and Canada on the one hand, and the European Union, Switzerland and Norway on the other; all three will, however, continue to operate as separate entities. American Airlines, British Airways and Iberia will increase their codeshare agreements for flights between the EU and the US, which will lead to a significant increase in the number of destinations that the three airlines are able to offer their passengers. This agreement will allow **one**world to compete in a genuine and effective manner with the other two rival alliances which have already been granted antitrust immunity: currently, six Sky Team airlines and nine Star Alliance airlines have this immunity.

Codeshare agreement with American Airlines

In 2008 Iberia and American Airlines also agreed to broaden the scope of their codeshare agreement. Also, since mid-April, Iberia has marketed 15 new destinations in the US through connections operated by the American airline. Specifically, the new destinations are: Austin, Indianapolis, Memphis, Portland, San José, Salt Lake City, Orange County, Tucson, Nashville, Kansas City, El Paso, Cincinnati, Columbus, Raleigh-Durham and Tampa. American Airlines added its code to twelve destinations in Spain and Europe operated by Iberia out of Madrid. Additionally, American Airlines, through a shared code with Iberia, has offered connections to Barcelona and New York since the end of April.

The scope of the agreement was broadened further at the end of November. Iberia provides its marketing code on American Airlines flights between Chicago and the following ten destinations in the US: Alburquerque, Buffalo, Baltimore, Charlotte, Milwaukee, Oklahoma City, Pittsburgh, Richmond VA, Rochester NY and San Antonio.

At the end of 2008 Iberia offered flights to a total of 47 destinations in the US, five of which were operated by the company itself: Boston, Chicago, Washington, Miami and New York (the last two were also operated by American Airlines), and the rest operated by American Airlines under a shared code.

Franchise agreement with Air Nostrum

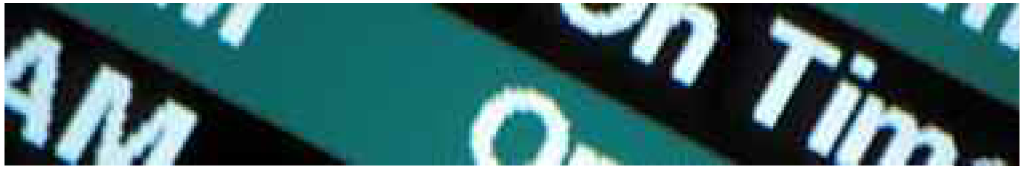
The franchise agreement between Iberia and the regional carrier Air Nostrum continues to give rise to results for both companies.

Iberia Regional Air Nostrum operates a total of 123 routes throughout the year at 58 airports, in addition to a further 51 special routes at Christmas and during the summer season at another 9 airports. Its fleet, which at December 31, 2008 totalled 69 aircraft, has 35 CRJ200 and 11 CRJ900 jets.

In 2008 Air Nostrum opened ten international routes: from Madrid to Clermont Ferrand, Montpelier, Lille and Rennes, from Barcelona to Tangier, from Málaga to Tangier and Casablanca, from Burgos to Paris, from León to Paris, and from Salamanca to Paris.

In 2008, Iberia Regional Air Nostrum opened eight new domestic routes: from Barcelona to Burgos and Ciudad Real; from Sevilla to Melilla (this route was cancelled on January 12, 2009); from Zaragoza to A Coruña and Vigo; from Valencia to León, Melilla and Valladolid; as well as a new route between the Canary Islands and the Iberian Peninsula, from Gran Canaria to Ciudad Real.

Iberia Regional Air Nostrum carried a total of 5.2 million passengers in 2008 of whom more than a million connected with Iberia lines.



Codeshare agreements

Iberia has codeshare agreements with 25 airlines, most notably including due to their size: American Airlines, British Airways, Finnair, the Lan Group, JAL, Avianca, Mexicana de Aviación, Royal Air Maroc, the TACA Group (Transportes Aéreos de Centroamérica), El Al, Malev and Clickair.

In March 2008 the codeshare agreement with the Italian carrier Meridiana came into force, whereby Iberia offers connections between Rome or Bologna and Cagliari, Olbia and Catania.

In November 2008 the agreement with the Uruguayan company Pluna came into force. As a result of this agreement, Iberia's passengers have a connection from Montevideo to Asunción. Pluna provides its codes for the flights operated by Iberia between Madrid and Montevideo and the following domestic destinations: Barcelona, Sevilla, Valencia, Las Palmas, Tenerife and Vigo.

In 2008 code sharing operations with Clickair increased and opened up numerous domestic and international destinations.

Frequent Flyer agreements with airlines

As regards Frequent Flyer programmes (FFP), Iberia currently has 14 agreements in force with oneworld alliance members, Mexicana de Aviación and the TACA Group, Royal Air Maroc and Binter Canarias. Avianca joined the programme in July 2008.

2.4.3. Management support platforms and systems

Although the majority were developed as part of the projects initiated in 2007, following is a summary of the most important modules developed specifically by Iberia's Systems Division in 2008, grouped together by strategic objective as defined in the 2006-2008 Master Plan and divided by the functional areas that gave rise to them, which are, without a doubt, the areas that must benefit from the effectiveness and improvement of the processes of each business.

Increased revenue and quality

The objective of the airline's Revenue Management Improvement Project in the area of passenger revenue was to provide the Commercial Division with a new system that would enable it to optimise the revenue generated from the sale of tickets by Origin/Destination (O/D) and not by segment as with the previous tool. In 2008 it was implemented for a small number of O/D (35 which equates to approximately 56 flights), with the objective of fine tuning and calibrating the system. Work has also been carried out on the implementation of a functional tool that will enable revenue to be optimised for groups and prices.

A Revenue Management tool, similar to that used for passenger revenue, has been implemented in the airline's Cargo area, allowing it to accept or reject cargo bookings in real time depending on the revenue/cost generated thereby. In 2008 implementation of the quota management module was completed, thereby enabling optimisation of the pre-allocation of quotas to the various cargo agents that work with Iberia, based on the profit that Iberia Cargo could obtain.

In relation to quality, in 2008 a project was undertaken in the Security Division, the main objective of which is the implementation of a video surveillance system that covers the Company's facilities located at the airport zone of the Old Industrial Zone, and the integration thereof into the system which is currently operational in the New Industrial Zone.

Lastly, in 2008 work commenced on the development of a new portal, www.iberiacorporate.com, aimed at large companies that have formalised incentive contracts with Iberia. The first stage of the project will culminate in the implementation of a website in 2009 that will make it possible for these large companies to manage their commercial activity with Iberia.

Increased productivity

As the Airport Services Division is a labour-intensive business, it requires a technological platform that boosts the aspects of planning and allocation of resources in order to achieve increased productivity and control of the management of the business, allowing decisions to be made in relation to operations. Since 2007 the Systems Division has been developing the adaptation of a software package for Automated Stopover Management called INFORM, designed to replace current platforms, as part of the larger Gaudí project. In 2008 the main module applications were implemented, of which the following were worthy of note: planning of flight handling resources; planning and management of the shifts of various groups working at the airport; and real-time supervision of the use of resources and allocation of staff, among others.

In 2007 the Systems Division was developing a new system for routing and maintenance management for the Maintenance and Engineering area, the implementation of which finalised in 2008, and which has been in use since June. This system provides real-time graphic information on the current status and short-term programming of flights and the maintenance downtimes for each aircraft belonging to Iberia's various fleets. The system keeps a log of actions performed for subsequent analysis and also contains a simulation module.

Also for the Maintenance and Engineering area, in 2008 an Electronic Signature project was undertaken which aims to integrate digital documentation into access cards. This will make it possible to work with these cards using devices such as PCs, laptops, etc. which can improve the quality of the system and reduce work times. This is a strategic solution for meeting the increasing demands to deliver all the documentation related to aeronautical maintenance placed on this area by the Administration and Control Division, the owners of the aircraft and engines and the customers of the Maintenance and Engineering area.

In recent years, the airline undertook the first phase of development of a system which automates crew member administrative processes (including, inter alia, calculation of holidays or incidences, fleet transfers and allocation of postings) and monitoring of crew members during flights -using a graphic system- , with rules and alerts that enable the Airline to pre-empt possible problems relating to flight services. In 2008 the second phase was undertaken, in which a simulation module allowing for a greater number of contingencies was implemented with the aim of improving its efficiency.

2.5. Corporate responsibility

More detailed information on the Company's sustainability management is contained in Iberia's Social Responsibility Report

2.5.1. Enviroment

In 2008 the Iberia Group continued to implement measures aimed at the ongoing improvement of its management of environmental issues, as an essential element of its Corporate Responsibility Policy.

As regards flight operations, the reduction of the average age of the fleet through the renewal of aircraft (mainly the McDonnell-Douglas aircraft), the adoption of new operational measures, and the improvements obtained in flight programming and the load factor enabled Iberia, for yet another year, to reduce sound emissions and emissions affecting climate change. These improvements will allow the company to successfully meet the requirements of future European legislation, which comes into force in 2012, to limit CO2 emissions in the aviation industry, and which was included in an EU directive approved last November.

In relation to ground operations, in 2008 significant environmental improvements were achieved through the Environmental Management Systems ISO 14001/AENOR, for which Iberia was awarded certificates in the areas of Airports and Aircraft Maintenance.

Iberia also participates in various work groups which, at both national and international level, analyse, promote and inform on the best environmental practices in the sector.

Also, in 2008 Iberia was simultaneously admitted to the most significant sustainability indexes in the world, the Dow Jones Sustainability Index (World), the Dow Jones Sustainability Index (European) and the FTSE4Good (IBEX). They all acknowledge the best environmental, social and economic practices at international level obtained through an exhaustive analysis amongst a group of large companies. Iberia achieved the maximum score in categories such as the local air quality.

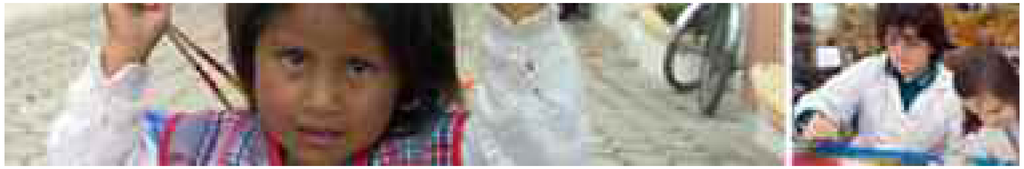
2.5.2. Social Action

The Company assumes its social responsibility by converting social action into a priority strategy through projects relating to the access to employment for the disabled, the voluntary service of its employees, the transportation of passengers that require any manner of assistance and the giving over of hold space to transport humanitarian aid. During 2008 around EUR 3 million were earmarked for social action projects.

In 2008 Iberia continued its close cooperation with the NGO Mano a Mano and Asociación de Empleados Padres de Minusválidos de Iberia (APMIB), which are the entities to which most of its resources for assistance are dedicated.

Through sponsorship agreements, the Company continues to back the institutions with which it has cooperated in the past, such as the Ministry of Education, Social Policies and Sport and the Agencia Española de Cooperación Internacional para el Desarrollo, for which more than a million euros were earmarked through the provision of cargo and passenger transport in 2008. It also maintains a close collaboration with other public and private bodies included the Fundación Ilusiones, the Spanish Ornithological Society Fundación Respira, or Fundación Prevevida, among many others.

It should be noted that Iberia continues to encourage its customers to participate in projects of this nature through the agreements entered into with the Spanish Red Cross and the Special Olympics and to involve its suppliers in social action projects such as the well-established collection of funds during the Christmas Campaign.



3. RESOURCES

3.1. Fleet

At 2008 year-end, the Iberia group had a total of 119 passenger aircraft in operation, which included 33 long-haul aircraft and 86 short-and medium-haul aircraft. The following table shows the composition of the fleet by aircraft type:

Aircraft Type (a) (b)	Owned	Aircraft under Finance Lease	Aircraft under Operating Lease	Wet lease	Total Operated
A340/300	6	1	11	3	21
A340/600			12		12
Long-haul	**6**	**1**	**23**	**3**	**33**
A319			22		22
A320	10	6	29		45
A321		4	15		19
Short-and medium-haul	**10**	**10**	**66**		**86**
Total	**16**	**11**	**89**	**3**	**119**

a) Excluding inactive aircraft.
b) Also, at December 31, 2008 Iberia had one Boeing B757 and one Airbus A320 leased to other companies.

At December 31, 2007 Iberia operated a total of 136 aircraft (not including a MD87 which was in the hangars waiting the granting of a Technical Acceptance Certificate of delivery for sale). The following list shows the detail of aircraft additions and retirements in 2008:

Additions

- 3 A319 under operating lease.
- 2 A320, under finance lease and a third under operating lease.
- 2 A340/300 under wet lease.

Retirements

- 2 A320 under operating lease.
- 2 B757 under wet lease.
- 9 MD87 owned.
- 11 MD88 owned.

Iberia, continuing with its plan for the renewal and standardisation of the short and medium-haul fleet, added three A319 aircraft directly from the Airbus factory under operating lease in the first half of 2008, designed to transport up to 141 passengers. Also, two A320, which had previously been leased to another company, were added to the aircraft in operation in April, one under finance lease and the other under operating lease. In October and December the company withdrew two A320 aircraft under operating lease from service.

Also, there were certain changes in the leases of some of the aircraft during the year. One A321 aircraft that at the start of 2008 was under operating lease, operated for ten months under wet lease. In the first half of the year, two A340/300 aircraft that were under operating lease began to be owned by the company. At the end of October 2008 one of these A340 aircraft moved to a finance lease.

In 2008 three A340/300 aircraft operated for the company under wet lease, which affords Iberia greater flexibility to adjust its capacity to the market situation. The number of wet lease block hours rose by 18.8% on the long-haul routes, which are operated using aircraft from the A340 family, a decrease of 56.2% on the short and medium-haul flights, which were operated by one A321 and, at the start of the year, by two B757 aircraft.

Under the aforementioned short- and medium-haul aircraft renewal and standardisation plan, a total of 30 McDonnell-Douglas aircraft (18 MD87 and 12 MD88) were withdrawn from service between April 2007 and October 2008. In February 2007 Iberia entered into a contract with Tiger & Engine Support for the sale of all these aircraft, including the engines. Consequently, since November 2008 the company operates all its flights with two families of aircraft: the Airbus A340 for long haul flights, with an average age of 7.9 years, and the A320 (which includes the A319, A320 and A321) for the short and medium-haul flights, with an average age of 6.7 years.

Utilisation of the Company's operative aircraft reached 10 hours per aircraft per day, an improvement of 4.3% on 2007, thereby meeting one of the objectives of the 2006-2008 Master Plan.

Block Hours / Aircraft / Day	2008	2007
Average short-and medium-haul aircraft utilisation	8.4	8.2
Average long-haul aircraft utilisation	14.5	14.3
Average utilisation of own aircraft	**9.8**	**9.5**
Average utilisation of aircraft under wet lease (a)	13.4	10.7
Average utilisation of total aircraft	**10.0**	**9.6**

(a) In 2008 aircraft operating under wet lease contracts for Iberia included: three A340/300 all year, two B757 (one in January and the other until March) and one A321 from March to December.

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3.2. Personnel

3.2.1. Headcount

The table below shows the number of Iberia Group employees in 2008 and 2007, measured in terms of the average number of equivalent employees.

	Ground		Flight		Total	
	2008	2007	2008	2007	2008	2007
IBERIA	15,778	16,662	5,567	5,638	21,345	22,300
CACESA	120	125			120	125
ALAER	110	87			110	87
BINTER FINANCE	3	2			3	2
IBERIA GROUP	**16,011**	**16,877**	**5,567**	**5,638**	**21,578**	**22,515**
Change 2008 / 2007 (%)	(5.1)		(1.3)		(4.2)	

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The Group's average headcount decreased by 937 employees with respect to 2007, a decrease of 4.2% to 21,578 equivalent employees. The decrease in the average headcount of ground staff (5.1%), was greater than that of flight personnel (1.3%).

Iberia's average headcount, which accounts for 99% of the Group's total, decreased by 4.3% in 2007. At December 31, 2008, 38% of the company's total employees were women.

The equivalent number of Iberia ground staff fell by 5.3% with respect to 2007, with decreases in all management areas, both in Spain and abroad. The reduction in headcount was due mainly to voluntary redundancies taken in the framework of the collective redundancy procedures. There was a significant reduction of 724 equivalent employees in the Airport Services Division, a decrease of 8.5% compared with the average headcount in 2007.

The average number of Iberia flight personnel, who represent 26% of the Group total, was 5,567 equivalent employees in 2008. The average number of technical crew members decreased by 3.7% with respect to 2007, and that of the passenger cabin crew members by 0.2%. The reduction in the latter group was smaller because intercontinental flights, which require a greater number of passenger cabin crew, had the strongest growth.

On November 27, 2007, the Directorate General of Employment authorised the extension of collective redundancy procedure 72/01 until December 31, 2010 for Iberia's ground staff. Also, on the same date, it authorised collective redundancy procedure 35/05, to be applied specifically to employees working in the Handling area, until December 31, 2014. Finally, on July 21, 2008, the Ministry of Employment also authorised the extension of collective redundancy procedure 72/01 until December 31, 2010 for Iberia's passenger cabin crew members.

In 2008, 307 of Iberia's ground staff employees left the Company (1,092 in 2007), availing themselves of one of the early retirement methods addressed in the two collective redundancy procedures. A further 15 ground staff employees in Spain availed themselves of the National Employment Agreement in 2008 (36 in 2007). Iberia also developed a plan for ground staff abroad, and a further 17 employed abroad left the Company in 2008 (73 in 2007). Consequently, a total number of 339 ground staff employees departed in 2008.

In 2008, 123 passenger cabin crew members left the Company, availing themselves of one or other of the collective redundancy methods contained in procedure 72/01, in addition to the 260 employees who left the Company in 2007.

3.2.2. Productivity

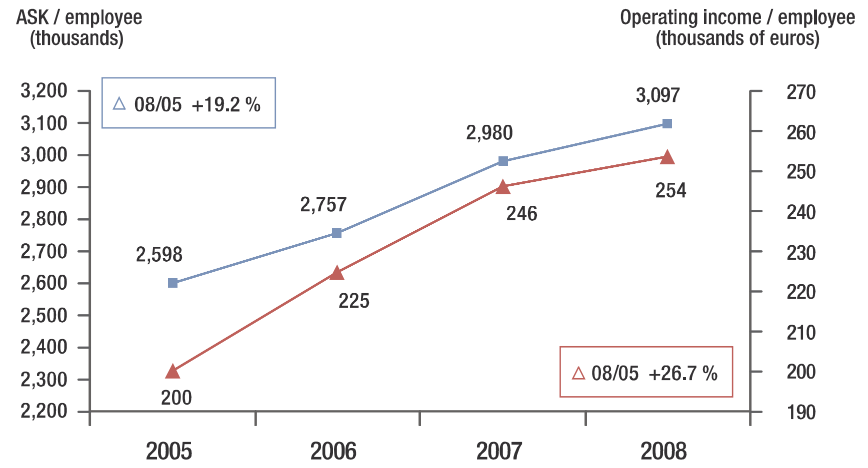
The productivity of total workforce of Iberia Líneas Aéreas de España S.A., measured in terms of available seat-kilometres performed, increased to 3.10 million ASK per employee in 2008, an increase of 3.9% compared with 2007. In the case of ground staff, productivity increased by 5.0%, due mainly to the decrease in the number of equivalent employees over the past two years, especially within the Airport Services Division. In 2008 the development of a plan to improve the productivity of the staff in this division was begun and will reach its peak in the coming years.

The following table details the productivity by group of employees:

Productivity of Iberia's employees	2008	2007	% Change
Total workforce (thousands of ASK per employee)	3,097	2,980	3.9
Ground workforce (thousands of ASK per employee)	4,189	3,988	5.0
Technical crews (block hours per crew member)	270.9	275.1	(1.6)
Auxiliary crews (block hours per crew member)	118.8	121.4	(2.1)

Productivity –measured in terms of ASK per employee– of Iberia's total workforce showed a cumulative increase of 19.2% over the last three years. The economic productivity of Iberia's workforce as a whole -measured in terms of operating income per employee– increased by 3.0% in 2008 with respect to 2007, and showed a cumulative increase of 26.7% over the last three years.

Productivity Performance. Total Iberia workforce



Consolidated Management Report

4. FINANCIAL PERFORMANCE

4.1. Profit from operations

In a climate marked by the international financial crisis and the progressive deterioration of most developed countries' economies, the Iberia Group's performance during 2008, was affected by the sharp increase in its fuel expenses, arising from a high average annual price, and by the downturn in traffic in the global airline industry, aggravated in Spain by the strong competition from new high-speed train lines.

The Iberia Group's profit from operations in 2008, which includes non-recurring items, stood at EUR 5 million, compared with EUR 413 million in 2007. The consolidated loss from recurring operations totalled EUR 79 million, a drop of EUR 363 million on the profit from operations obtained in 2007.

The table below shows the breakdown, by company, of the Iberia Group's profit (loss) from operations in the last two years in accordance with International Financial Reporting Standards (IFRSs):

Thousands of euros

Profit (Loss) from recurring operations	2008	2007
IBERIA	(87,748)	275,468
CACESA	1,351	1,339
ALAER	194	168
BINTER FINANCE	21	21
IBERIA GROUP (a)	**(79,175)**	**283,544**

a) The total figures for the Iberia Group include the consolidation adjustments.

EBITDAR (profit from operations before depreciation and amortisation and aircraft leases) generated by the Iberia Group was EUR 500 million in 2008, down 46.4% on 2007. The EBITDAR margin as a percentage of revenue stood at 9.2% in 2008, as compared with 16.9% in 2007.

Following are the consolidated income statements of the Iberia Group for 2008 and 2007 with a breakdown of the most noteworthy operating income and expense items:

Millions of euros

Iberia Group	2008	2007	% Change
PROFIT FROM OPERATIONS	**5**	**413**	**(98.8)**
OPERATING INCOME	**5,515**	**5,536**	**(0.4)**
REVENUE	**5,223**	**5,304**	**(1.5)**
Passenger ticket revenue	4,218	4,325	(2.5)
Cargo revenue	347	343	1.0
Handling revenue	275	280	(1.8)
Technical assistance to airlines	297	273	8.7
Other income from services and sales	86	83	3.1
OTHER OPERATING INCOME	**292**	**231**	**26.4**
Recurring	227	217	4.5
Non-recurring	65	14	n.m.
OPERATING EXPENSES	**5,535**	**5,319**	**4.0**
PROCUREMENTS	**1,864**	**1,358**	**37.2**
Aircraft fuel	1,666	1,145	45.5
Aircraft spare parts	160	173	(7.2)
Catering materials	21	23	(11.1)
Other procurements	17	17	1.1
STAFF COSTS	**1,321**	**1,444**	**(8.5)**
Of which: Non-recurring	1	64	(97.8)
DEPRECIATION AND AMORTISATION CHARGE	**193**	**215**	**(10.4)**
OTHER OPERATING EXPENSES	**2,157**	**2,301**	**(6.3)**
Aircraft leases	386	433	(10.9)
Other leases	76	76	0.5
Aircraft maintenance (subcontracts)	228	246	(7.3)
Of which: Non-recurring	-	10	n.a.
Commercial expenses	200	243	(17.4)
Traffic services	413	447	(7.5)
Navigation charges	258	274	(5.8)
In-flight services	72	72	(1.2)
Booking systems	137	144	(4.9)
Other expenses	386	366	5.4
Of which: Non-recurring	5	7	(34.2)
NET GAINS ON DISPOSAL OF NON-CURRENT ASSETS	**25**	**196**	**(87.5)**
IMPAIRMENT LOSSES	**-**	**0**	**n.a.**
PROFIT (LOSS) FROM OPERATIONS (recurring)	**(79)**	**284**	**(127.9)**
Operating income (recurring)	5,450	5,522	(1.3)
Operating expenses (recurring)	5,529	5,238	5.5
EBITDA	**114**	**499**	**(77.2)**
EBITDAR	**500**	**932**	**(46.4)**

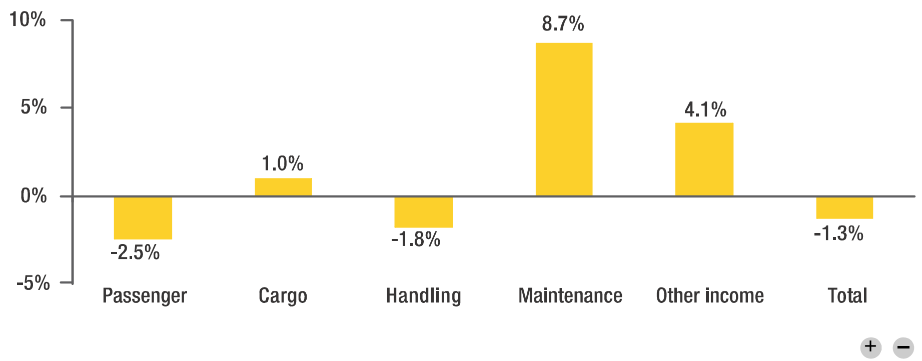
n.m.: not meaningful; n.a.: not applicable

4.1.1. Operating income

The Iberia Group's operating income amounted to EUR 5,515 million in 2008, a slight drop (0.4%) compared with 2007 due mainly to the increasing weakness of air traffic in the markets and the appreciation of the euro against the dollar (an average annual increase of approximately 8%). Had the exchange rate remained stable operating income would have risen by approximately 1.8% with respect to 2007.

Income from recurring operations stood at EUR 5,450 million in 2008, down EUR 72 million (1.3%) on 2007. Noteworthy is the steady increase in revenue from maintenance services (EUR 24 million), despite being partially affected by the depreciation of the dollar.

Change in the Iberia Group's operating income 2008 / 2007 (%)



Passenger ticket revenue

In 2008 total passenger revenue fell by 2.5% with respect to 2007 to stand at EUR 4,218 million. The difference between the amount in the consolidated income statement and that included in "Key Data" and "Passenger Traffic Revenue" (section 2.1.2.) arises from the fact that the latter is related to the actual production of each year, excluding accounting adjustments and revaluations, and also the revenue arising from the unused ticket recovery process, which is included in the figure in the consolidated income statement.

Passenger revenue from tickets effectively used amounted to EUR 3,891 million in 2008, down 3.5% on 2007. The main reasons for this decrease were the strong impact of the depreciation of several currencies, mainly the dollar against the euro, and the drop in the volume of traffic (2.5% per RPK) as a result of falling market demand and the reduction in the volume of capacity in the Spanish industry. If the change in exchange rates were excluded, passenger revenue from tickets effectively used would have dropped 1.2% as compared with 2007.

A more detailed analysis of passenger ticket revenue can be found in section 2.1. of this Management Report.

Cargo revenue

The Iberia Group's cargo revenue (including the billings for goods and mail transport, fuel and security charges or surcharges and excess baggage revenue) totalled EUR 347 million in 2008, up 1.0% on 2007. This increase was achieved as a result of the increased billings of the subsidiary Cacesa and the rise in excess baggage revenue. Iberia's revenue from cargo transport decreased by 1.0% in 2008 due to the 5.6% reduction in the revenue tonne-kilometres performed as a result of the economic downturn. The drop in the volume of traffic was partially offset by an increase of 4.9% in the average revenue (per RTK) of the network taken as a whole, despite being affected by the depreciation of the dollar and the increase in the cargo average stage length.

Handling revenue

Revenue from ground handling services to other airlines' passengers and aircraft amounted to EUR 275 million, a decrease of 1.8% with respect to 2007 due to a lower level of activity (-2.2% in terms of the weighted number of aircraft handled). It should be borne in mind that the new licence framework affected ten months of 2007 and, logically, the whole of 2008, and therefore this evolution evidences the consolidation of Iberia’s position in this business. “Handling Revenue” also includes the handling revenue obtained by the joint ventures through ramp operations at Barcelona (Groundforce), Lanzarote and Fuerteventura (Clever) airports, which performed positively in comparison with 2007, and the joint ventures’ revenue from the provision of services for persons with reduced mobility, which started up during the summer.

Maintenance revenue

Revenue from maintenance services to other airlines amounted to EUR 297 million, up EUR 24 million on the figure for 2007, which represents an increase of 8.7%. This was owing to an increase in the volume of technical assistance services: engine inspections (particularly CFM56), components, C and D inspection and supplementary work. Maintenance revenue was affected by the depreciation of the dollar, which accounted for a drop of 4%.

Other income from services and sales

“Other Income from Services and Sales” increased by EUR 3 million (3.1%) with respect to 2007. Noteworthy was the increase in income from terminals and other cargo services, sundry sales and particularly income from using the Amadeus booking system, which amounted to EUR 55 million, and the elimination of income from in-flight sales, the management of which was outsourced in mid-2007.

Other operating income

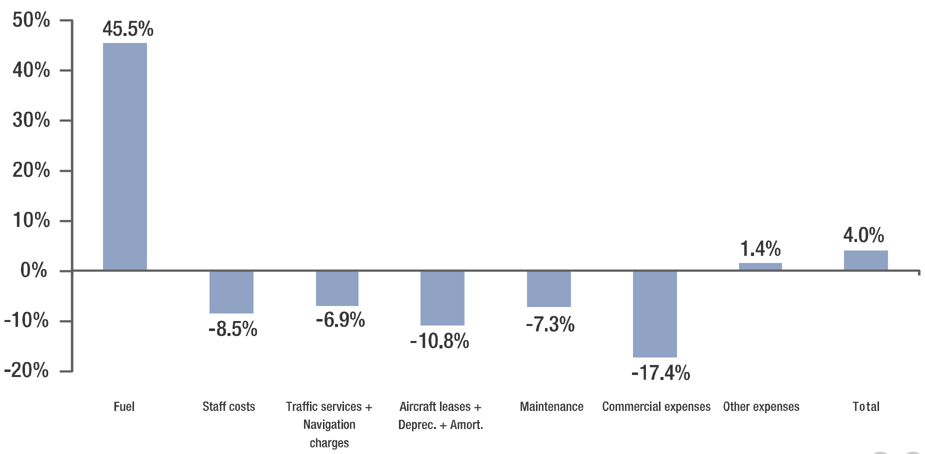
“Other Operating Income–Recurring” (fees, deferred income, income from the temporary transfer of employees to unincorporated joint ventures, rentals and other sundry income) increased by a total of 4.5% with respect to 2007 to reach EUR 227 million.

Non-recurring income totalling EUR 65 million was recognised in 2008 (compared with EUR 14 million in 2007), relating mainly to the release of various provisions and EUR 15 million obtained from the insurance for an Airbus A340.

4.1.2. Operating expenses

In 2008 the Iberia Group’s operating expenses rose by 4.0% with respect to 2007, to stand at EUR 5,535 million, due mainly to the sharp increase in the average fuel price. This impact was partially offset by the reduction in costs achieved through the implementation of the strategic measures established in the 2006-2008 Master Plan and through the beneficial effect of the depreciation of the dollar against the euro. Except for fuel, all significant operating expenses decreased as compared with 2007.

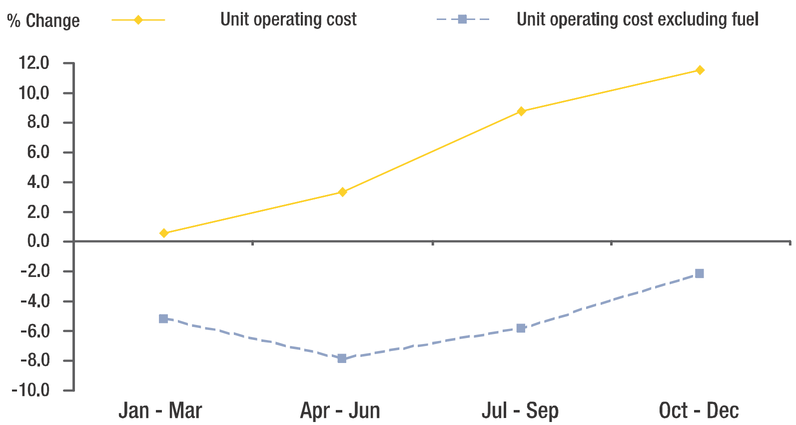
Change in the Iberia Group’s operating expenses 2008 / 2007 (%)



Recurring operating expenses amounted to EUR 5,529 million in 2008, up 5.5% on 2007. Disregarding the fuel expense in the two years, the aggregate figure of the other recurring operating expenses fell by 5.6% with respect to 2007.

Unit operating costs were up 6.1% on 2007 to stand at 8.36 euro cents per ASK in 2008. Disregarding fuel expenses, unit costs dropped by 5.1% to 5.84 euro cents per ASK and throughout 2008 stayed below the levels recorded in 2007.

Quarterly change in Iberia Group's unit cost 2008 / 2007 (*)



(*) Excluding the annual expenses of the unincorporated joint ventures, accounted for in full in the last quarter of 2007.

Fuel

The Iberia Group's fuel expense amounted to EUR 1,666 million in 2008, an increase of 45.5% on the fuel expense in 2007. As a result of this increase, fuel now accounts for 30.1% of the consolidated operating expenses and 33.6% of the Transport business's operating expenses.

The generally high price of oil and oil products during most of the year and their extreme volatility –which hindered risk management– account for the final increase of EUR 521 million in fuel expenses in 2008. In the first half of the year the price of aviation kerosene, which was already extremely high (around USD 900 per metric tonne), continued to rise, partly as a result of speculation, until in July it reached the record price of USD 1,450 per metric tonne. In the following months kerosene prices fell sharply due to the sudden economic downturn and the more negative outlook for the future, standing at under USD 500 per tonne at year-end.

The following table shows the detail of the items that were involved in this exceptional increase in the fuel expense in comparison with 2007:

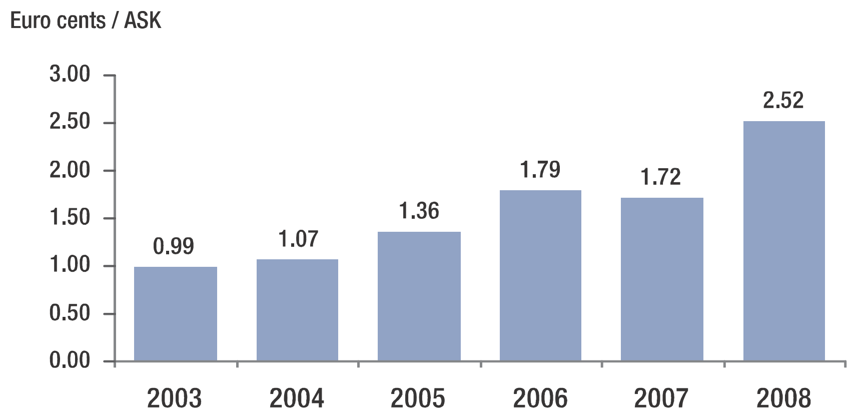
Millions of euros	Causes of the change in the fuel expense				Total change 2008 / 2007
	Price (*)	Volume	Exchange rate (*)	Efficiency	
Iberia Group	737	(8)	(165)	(44)	521

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

The increase in the price of aviation kerosene in dollars after hedges led to a 63.6% rise in the fuel expense, which was partially offset by the positive effect of depreciation of the dollar and lower unit consumption due to more efficient aircraft.

The Iberia Group's unit fuel cost stood at 2.52 euro cents per ASK in 2008, up 46.2% on 2007.

Development of the Iberia Group's unit fuel cost



Staff costs

In 2008 the Iberia Group's recurring staff costs, which account for 23.9% of total operating expenses, stood at EUR 1,320 million. This represented a decrease of 4.4% on 2007, due mainly to the reduction in the average number of employees at the Iberia Group (4.2%).

Wages, salaries and other similar costs amounted to EUR 1,001 million, down 4.1% on 2007, whereas aggregate social security taxes and other employee benefit costs totalled EUR 319 million in 2008, a decrease of 5.2%.

The average number of the Iberia Group's ground equivalent employees was 16,011 in 2008, a drop of 5.1% with respect to 2007, owing to the voluntary redundancies over the last two years as part of the initiatives implemented to improve productivity in the Master Plan, mainly within the framework of the collective redundancy procedures at the Parent. The average number of flight crew employees (flight technicians and cabin crew) was 5,567, down 1.3% on 2007. Staff costs fell in all three groups.

The productivity of the Group's employees, measured in terms of ASK per employee, increased by 3.8% over the year. The unit staff cost decreased by 3.9% with respect to 2007 to stand at 2.0 euro cents per ASK.

Depreciation and amortisation charge

The depreciation and amortisation charge fell by 10.4% as compared with 2007 to stand at EUR 193 million. Of this amount, 64% related to the depreciation of aircraft, which was down 13.8% due to the reduction in the number of aircraft recognised in the balance sheet partially as a result of the withdrawal of the MD 87/88 aircraft, which were finally eliminated from the Group's operating aircraft in the last quarter of 2008.

Aircraft lease expenses

In 2008 the aircraft lease expense dropped by 10.9% in comparison with 2007, to stand at EUR 386 million. The passenger aircraft lease cost decreased by EUR 35 million as a result of the drop in the interest rates, the obtainment of better prices and the depreciation of the dollar. Wet lease costs also fell by EUR 13 million (-28.7%) due to the restructuring of stable operations (not occasional) under this type of contract, which resulted in the operation of a smaller number of aircraft and block hours (12.0% less than in 2007). The cargo aircraft lease expense, which has a relatively lower weight within this item, increased by 3.6% due to a 5.5% increase in the number of block hours leased, mainly in the first part of the year.

The aircraft lease unit cost was 0.58 euro cents per ASK, down 10.5% on 2007.

Aircraft maintenance

The aggregate recurring aircraft maintenance expenses (which include external services and spare parts consumed) amounted to almost EUR 389 million in 2008, a drop of 4.9% with respect to 2007. Most of this decrease, which was due in part to the depreciation of the dollar, relates to the reduction in the consumption of spare parts, which fell by 7.2% with respect to 2007. The recurring costs for outside services also decreased by 3.2% as compared with 2007. These decreases, which are related to improved productivity and more modern and uniform aircraft, have even greater value taking into account the increase in the volume of maintenance services to other airlines performed by Iberia.

The unit cost per ASK of the maintenance of the aircraft operated under the Group's own transport business dropped by 5.9% with respect to 2007 to stand at 0.65 euro cents.

Commercial expenses

In 2008 commercial expenses amounted to EUR 200 million, down 17.4% on 2007. The aggregate amount of the commissions, promotional expenses and development expenditure fell by 15.4% to EUR 176 million, whereas advertising expenses totalled EUR 24 million, down 29.4% on 2007. As a result of the emphatic measures taken in recent years by the Company in this area of expenses, the ratio of net commercial expenses to traffic revenue in 2008 was 2.6%, down 0.8 percentage points on 2007.

Traffic services

In 2008, the traffic services cost decreased by 7.5% with respect to 2007 due to a drop in practically all the operating expenses included under this heading. This decrease was due in part to the lower number of takeoffs (15% fewer than in 2007) as a result of an extensive restructuring of the short and medium-haul programme and to the increasing relative weight of long-haul flights. Landing charges and expenses relating to boarding bridges and other airport services decreased by 5.1% with respect to 2007. The expenses arising from incidents (discontinued journeys, missed connecting flights and baggage delivery) dropped by 20.5% as a result of the improved quality of operations (except for the last few weeks of the year). The aggregate expense of the other items (aircraft dispatch, H fare types, aircraft cleaning services and crew stopover expenses, etc.) fell by 8.5% with respect to 2007.

Navigation charges

In 2008 navigation charges decreased by 5.8% due to the reduction in the number of flights operated during the year and, to a lesser extent, to the depreciation of the dollar. The cost of in-flight navigation assistance services dropped by 5.1% with respect to 2007, to stand at EUR 210 million. Eurocontrol's unit navigation charges for the main countries over which Iberia flies were 0.3% lower in 2008 than in 2007.

Airport approach rates amounted to EUR 48 million, down 8.8% on 2007, due mainly to the lower number of flights. The Spanish airport approach unit rates increased by 3% in 2008 compared with 2007.

Booking systems

Booking system expenses dropped by 4.9% as compared with 2007, due in part to the lower volume of bookings. Taking into account the increased revenue from the booking systems, arising mainly from the new agreement entered into with Amadeus, the net cost of the booking systems fell by 12.6% in comparison with 2007.

Other recurring expenses

"Other Recurring Expenses" amounted to EUR 381 million in 2008, up 6.2% on 2007 due to the increase in staff transport costs, other maintenance expenses (software applications, ground equipment, tools and facilities), computer programs, sundry services and taxes other than income tax, among other items.

Non-recurring expenses

Non-recurring expenses totalled EUR 6 million in 2008 and included provisions for certain items such as an extraordinary provision of EUR 1.4 million to update the amount forecast by the Company for the extension of the collective redundancy procedure.

Non-recurring expenses recognised at 2007 year-end amounted to EUR 81 million, of which EUR 64 million related to an exceptional provision for the extension of the collective redundancy procedure. Also, non-recurring maintenance costs in connection with work required for the return of aircraft, amounting to EUR 10 million, were recognised in 2007.

4.1.3. Other gains or losses

The net gains on the disposal of non-current assets amounted to EUR 25 million in 2008 and arose substantially in full from the sale of aircraft.

In 2007 the net gains on the disposal of assets totalled EUR 196 million, of which EUR 94 million related to gains on the sale of part of Iberia's ownership interest in Wam Acquisition, S.A., in connection with the recapitalisation at this company. The remainder of the net gains arose mainly from various transactions related to aircraft (approximately EUR 70 million) and from the sale of land owned by Iberia in La Muñoza industrial area (approximately EUR 25 million).

4.2. Financial profit

The detail of the other items included in the consolidated income statement is as follows:

Millions of euros

Iberia Group	2008	2007	% Change
PROFIT FROM OPERATIONS	**5**	**413**	**(98.8)**
FINANCIAL PROFIT	**49**	**63**	**(22.9)**
Finance income	137	126	8.7
Finance costs	(52)	(60)	(13.6)
Exchange losses	(2)	(3)	48.6
Other income and expenses	(34)	0	n.m.
SHARE OF RESULTS OF ASSOCIATES	**(18)**	**(29)**	**40.0**
PROFIT BEFORE TAX	**36**	**447**	**(91.9)**
TAX	(4)	(119)	96.7
CONSOLIDATED PROFIT	**32**	**328**	**(90.2)**
Attributable to Shareholders of the Parent	32	327	(90.2)
Basic earnings per share (euros)	0.034	0.346	(90.1)
Diluted earnings per share (euros)	0.034	0.346	(90.0)

n.m.: not meaningful.

In 2008 net financial profit amounted to EUR 85 million, up 28.8% on 2007, due to the 8.7% rise in finance income to EUR 137 million as a result of the increase in interest on short-term deposits and the increase in the Company's cash balance. The notable drop in finance costs –13.6%, due mainly to the decrease in interest on loans and obligations under finance leases– also contributed to this improvement.

Total financial profit amounted to EUR 49 million in 2008, down EUR 15 million on 2007 due to the adverse effect of the change in the fair value of hedges. This had an impact of EUR 29 million in 2008 and is recognised under “Other Income and Expenses”. Most of this amount relates to impairment losses on fuel hedges considered to be ineffective (a negative amount of EUR 23 million). In 2008 “Other Income and Expenses” also includes a provision related to Iberia’s ownership interest in the subsidiary Clickair.

The measurement of derivatives had a net negative effect of EUR 7 million on profit before tax for 2007, which were recognised according to their nature, as follows: EUR 13 million increase in expenses relating to the measurement of the financial instruments linked to aircraft operating leases; EUR 5 million decrease in expenses arising from the ineffectiveness of a portion of the fuel hedges; and EUR 0.2 million decrease in expenses relating to the measurement of other financial instruments.

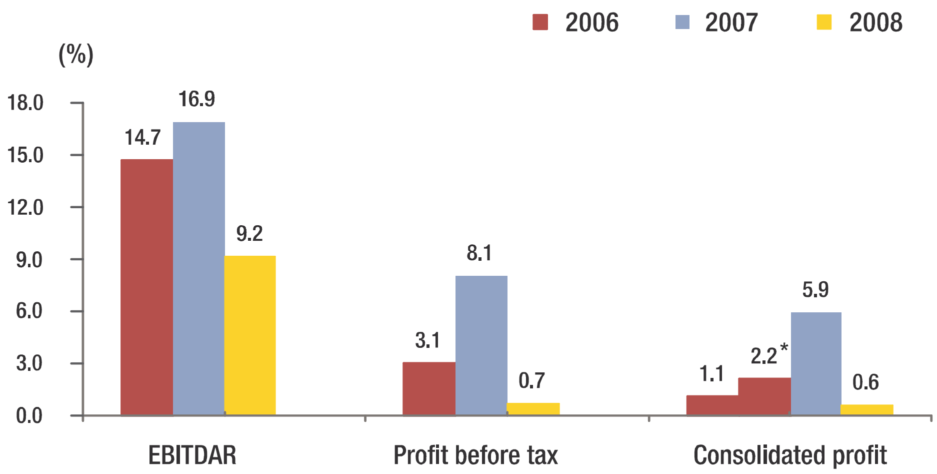
The share of results of associates increased by EUR 12 million with respect to the negative balance recognised in 2007 due mainly to the improvement in the results of Clickair.

4.3. Profit for the year

The Company’s consolidated profit before tax amounted to EUR 36 million in 2008, as compared with EUR 447 million in 2007. Consolidated profit after tax totalled EUR 32 million in 2008, as opposed to EUR 328 million in 2007.

The following chart shows the Iberia Group’s EBITDAR, profit before tax and profit after tax as a percentage of operating income over the last three years:

Iberia Group´s margins (as a percentage of operating income)



* Consolidated profit before tax adjustments

4.4. Investments

The Iberia Group's net investments (net of divestments) in property, plant and equipment and intangible assets amounted to EUR 167 million in 2008.

Aircraft investment transactions related to modifications and service bulletins for A319, A320, A321 and A340 aircraft (EUR 31 million in total) and to the purchase of four spare engines for the A319 (EUR 4 million), A320 (EUR 5 million), A321 (EUR 6 million) and A340 (EUR 12 million). In addition, two A340/300 that were previously under operating leases were included in the balance sheet (EUR 70 million), one of which was transferred to owned aircraft and the other to finance lease. The Company also sold eight MD87 (carrying amount of EUR 5 million), and the remaining units were transferred to short term.

The main investments made in other assets related to maintenance machinery and tools, computer hardware and software, airport machinery and equipment and aircraft assembly facilities and equipment.

As regards non-current financial assets, the most significant investments in terms of amount were the advances on aircraft of the models A340 (EUR 60 million) and A320 (EUR 32 million). Iberia also disbursed EUR 56 million for its ownership interest in Clickair Líneas Aéreas, in accordance with the capital increases envisaged in this investee's Business Plan.

The most significant financial divestments relate to the following events: the refund of advances on A319 and A320 aircraft, giving rise to a divestment of EUR 31 million and transfers of EUR 45 million; the disposal of the ownership interests in Iberbus Concha, Rosalía, Chacel and Arenal (EUR 9 million); and the derecognition of the loans to Iberbus Teresa and Emilia (EUR 27 million).

In connection with the current valuation process for a potential merger between Iberia and British Airways, approved by the Board of Directors on July 29, Iberia acquired 9.99% of the share capital of British Airways in 2008, with a carrying amount of EUR 217 million.

4.5. Balance sheet

The following table shows the main items in the consolidated balance sheets at December 31, 2008 and 2007:

Millions of euros

Iberia Group	2008	2007	% Change
Property, plant and equipment and intangible assets	1,170	1,184	(1.2)
Non-current financial assets	689	420	63.8
Other non-current assets	591	482	22.8
Non-current assets classified as held for sale	11	-	n.a.
Receivables and other current assets	822	928	(11.4)
Current financial assets and cash and cash equivalents	2,351	3,003	(21.7)
Total Assets	**5,634**	**6,017**	**(6.4)**
Equity	1,564	2,006	(22.0)
Long-term provisions	1,283	1,377	(6.8)
Interest-bearing non-current liabilities	299	304	(1.9)
Other non-current payables	183	215	(14.6)
Interest-bearing current liabilities	170	163	4.7
Other current liabilities	2,135	1,952	9.3
Total equity and liabilities	**5,634**	**6,017**	**(6.4)**

n.a.: not applicable

The equity of the Iberia Group amounted to EUR 1,564 million at December 31, 2008, down EUR 442 million on the figure for 2007, due mainly to the dividend charged to 2007 profit (EUR 158 million) and to the adjustments to the balance of reserve accounts as a result of the change in value of hedging instruments together with impairment losses on certain financial investments.

At December 31, 2008, the consolidated balance sheet of the Parent included EUR 64 million relating to 27,898,271 treasury shares representing 2.927% of the share capital with a total par value of EUR 22 million and an average acquisition price of EUR 2.313 per share.

The long-term provisions for contingencies and charges amounted to EUR 1,283 million at 2008 year-end, down 6.8% on 2007 due mainly to the provisions used for redundancy payments in 2008. The breakdown of the balance is as follows: EUR 74 million of provisions for major aircraft repairs; EUR 669 million of provisions for obligations to employees, which included the allowances for reserve flight crew members; and EUR 540 million of provisions for third-party liabilities, which include the provisions recorded for the restructuring of the workforce.

Interest-bearing current and non-current liabilities (debentures, bank borrowings and finance lease obligations) amounted to EUR 469 million at 2008 year-end, practically the same as at 2007 year-end (EUR 467 million).

The cash balance (current financial assets plus cash and cash equivalents) amounted to EUR 2,351 million at 2008 year-end, down EUR 652 million on 2007 year-end, due mainly to the payment of dividends (charged to 2007 profit), the acquisition of shares in British Airways and the decrease in profit from operations. This amount includes the measurement of hedging transactions (in application of IAS 39), which at December 31, 2008 represented an increase of EUR 79 million in the balance of "Non-Current Financial Assets" in the balance sheet, as compared with EUR 35 million recognised at 2007 year-end.

The Iberia Group's net indebtedness continued to improve and to be clearly negative, i.e. the balance of the current financial asset accounts (excluding the measurement of hedges) exceeded the total balance of interest-bearing debt. Accordingly, net indebtedness stood at EUR -1,803 million at December 31, 2008, as compared with EUR -2,500 million recognised at 2007 year-end.

Adjusted net debt, including the conversion to debt of the operating lease instalments (excluding the effect of the measurement of hedges and taking into account the adjustment of interest on the loans to the Iberbus companies), amounted to EUR 1,012 million, up EUR 480 million on 2007.

The balance of "Non-Current Financial Assets" increased by 64% with respect to 2007 year-end, owing mainly to the payment of advances for A340 and A320 aircraft, the increase in value of the Iberbus and Iberlease loans due to the discounting of exchange differences and the purchase of British Airways shares in connection with corporate transactions.

4.6. Cash flow statement

The following table reflects the main aggregates of the consolidated cash flow statements for 2008 and 2007:

Millions of euros

Iberia Group	2008	2007
Profit for the year before tax	36	447
Adjustments to profit	113	142
Changes in working capital	(56)	(8)
Other cash flows from operating activities	(55)	(200)
Cash flows from operating activities	**38**	**381**
Payments relating to investments	(633)	(328)
Collections from disposals	243	679
Cash flows from investing activities	**(390)**	**351**
Collections and payments relating to equity instruments	(45)	3
Collections and payments relating to equity liability instruments	(98)	(209)
Dividends paid and income from other equity instruments	(158)	(33)
Cash flows from financing activities	**(301)**	**(239)**
Net increase / decrease in cash and cash equivalents	**(653)**	**493**
Cash and cash equivalents at the beginning of the year	2,835	2,342
Cash and cash equivalents at the end of the year	2,182	2,835

4.7. Management of non-operating risks

To control and limit the potential adverse effect of fluctuations in exchange rates, interest rates, and fuel prices on the Company's earnings, Iberia has a global management programme for its non-operating risks.

To achieve this objective, Iberia uses a VaR (Value at Risk) model to conduct statistical assessments of the possible impact of these market variables on its earnings, and defines the maximum volatility targets and the hedging programmes required to attain them.

To this end, Iberia arranges derivatives so as to fully or partially neutralise the fluctuations in prices, seeking highly effective hedges in line with the risk management strategy initially documented for each hedging relationship and with the methods established in International Accounting Standards (IASs) and the new Spanish National Chart of Accounts for hedge accounting.

The following three sections describe the Company’s aforementioned hedging programme.

4.7.1. Foreign currency risk

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

- **Cash flows**

  The Company took a short dollar-position of around USD 1,870 million in 2008, since US dollar revenue (21% of the total) was lower than expenses in US dollars (44% of the total).

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

  - Up to 50% by strategic hedging of up to a five-year term, by means of swaps of aircraft lease income denominated in dollars to euros.
  - The remaining percentage is managed through tactical transactions with a time horizon of between one and three years, which can be adapted to market trends and which are also associated with the Company's actual flows of US dollar payments.

  At December 31, 2008, Iberia had hedged 90% of its US dollar cash-flow positions for 2009 and 50% of the 2010 position.

- **Balance sheet**

  The Company has assets denominated in US dollars amounting to USD 521 million, including most notably the loans granted to the Iberbus companies, the advances paid to aircraft and engine suppliers, the equities of A320 aircraft and guarantees. It also has a liability position in dollars amounting to USD 349 million which, together with arranged swaps, enables the Company to neutralise the effect of the translation differences.

- **Aircraft additions**

  In order to limit the volatility of currency markets and the impact thereof on the financing or acquisition of new aircraft, the Company hedges the foreign currency risk relating to aircraft financing/acquisition/additions through forward purchase transactions and option structures that make it possible to assure a certain level or range. The addition of the new aircraft planned for 2009 gave rise to a short position of USD 80 million at 2008 year-end, 19% of which was hedged.

4.7.2. Interest rate risk

Although Iberia has negative net debt in its balance sheet, if the notional debt relating to operating lease payments (multiplying by eight the aircraft lease payments) is included, the adjusted total net debt amounts to EUR 1,034 million in its individual financial statements. At December 31, 2008 the Company maintained 58% of the adjusted gross debt at a fixed interest rate, 6% at a floating interest rate with protection and the remaining 36% at a floating interest rate.

Sensitivity to a 1% rise in euro interest rates is positive by EUR 17.5 million, due to the Company's cash position. However, sensitivity to a 1% rise in dollar interest rates is negative by EUR 7.9 million.

Liquidity risk

At December 31, 2008 Iberia maintained an equivalent cash position amounting to EUR 2,250 million (cash plus current financial assets, excluding the measurement of hedges) in its individual financial statements, which is invested in highly liquid short-term instruments, debt repos, Eurodeposits, and commercial paper transacted through leading Spanish banks, in accordance with the prevailing risk policy. The portfolio matures at a maximum of twelve months.

In addition to the current financial assets and the cash position, the Company has undrawn credit facilities amounting to EUR 195 million that guarantee its liquidity requirements.

4.7.3. Fuel price risk

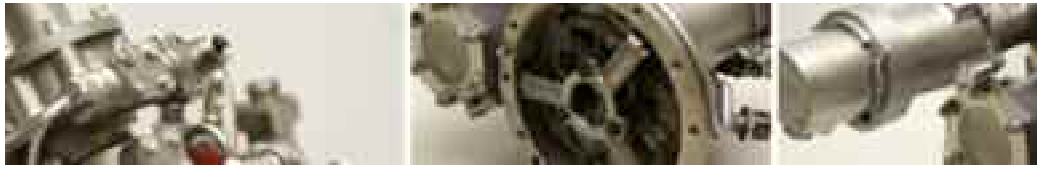
Iberia controls the cost of aviation fuel, which is directly linked to changes in oil prices, through active risk management policies in order to mitigate the impact of fluctuations in the price of kerosene in the international market and limit deviations from the Company's budget in this respect.

The Company has directly hedged the price of kerosene using a combination of financial tools such as swaps and zero-cost options.

Fuel prices were extraordinarily volatile in 2008, varying far more than usual. In the first half of the year prices rose, reaching record levels of over USD 140 per barrel (50% more than the highs reached in 2007), to then sink to under USD 50 per barrel in the last five months of the year due to the economic and financial crisis. The hedges of the price of fuel covered around 75% of the volume consumed over the year, thereby largely limiting the volatility of cash flows due to fuel.

Iberia consumes almost two million metric tonnes per year and this volume is expected to be maintained in 2009. At December 31, 2008 the Company had hedged approximately 50% of its fuel position which, depending on the evolution of fuel prices in 2009, may have a positive or negative impact on the Group's income statement.

Note 12 to the accompanying financial statements includes a sensitivity analysis of the hedges.

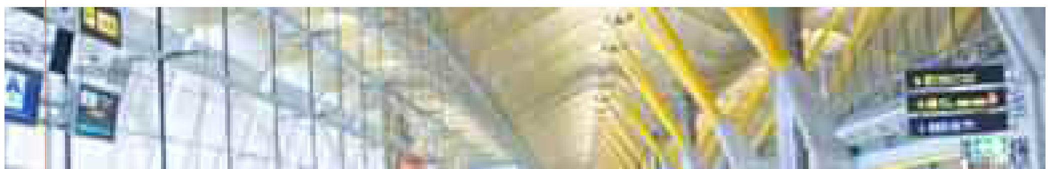


4.8. Performance of Iberia shares

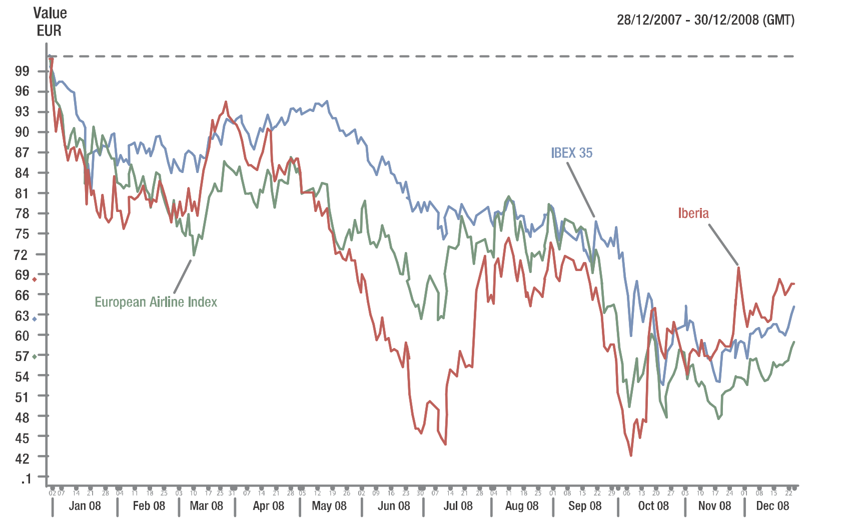
Share price at December 31, 2008	1.98
Share price at December 31, 2007	3.00
Annual change	(34%)
Average annual share price	2.07
High	2.92
Low	1.25
Daily average volume of trading (no. shares)	10,855,711

All the share prices are expressed in euros.

2008 has been described as the worst year for the stock markets since the crisis of 1929. The international financial crisis had a considerable impact on the world's leading stock exchanges, causing drops of over 30% on the main indices. The airline industry was particularly affected by the progressive slowing of demand and by the enormous volatility of oil prices which reached record levels in July of over USD 140 per barrel. Iberia shares dropped by 34%, the best performance of its European peers and exceeding that of the selective IBEX 35.



Daily Iberia - IBEX 35 - European Airline Index
(Rebasing 1st January 2008)

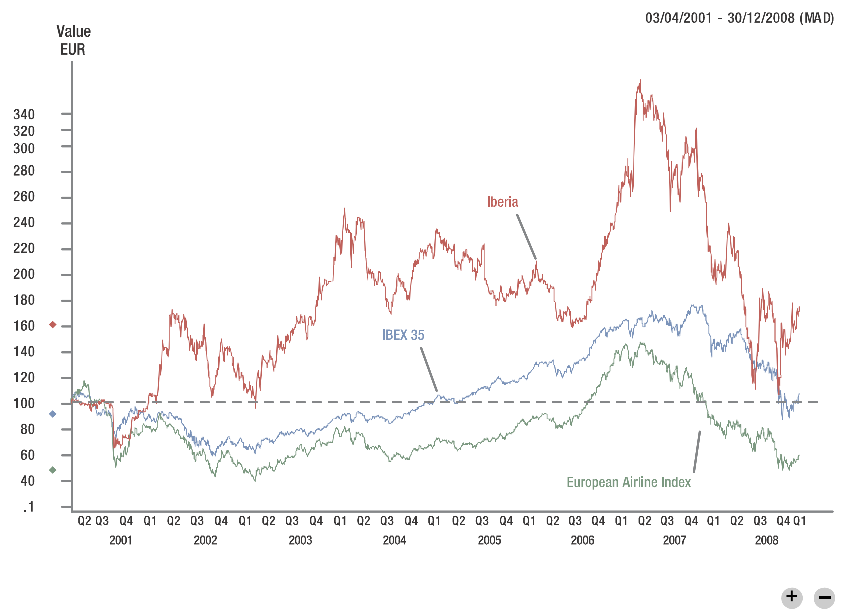


At December 31, 2008, the Company's total number of shares amounted to 953,103,008. In the first half of 2008 Iberia increased capital by EUR 151,471 by issuing 194,193 ordinary shares of EUR 0.78 par value each with a share premium of EUR 0.84 per share. This capital increase was performed to cater for the conversion into shares of the same number of convertible debentures issued to cover the share option plan aimed at certain executive directors, executives and other employees. The share option plan has now expired.

In July 2008 the Company paid its shareholders a dividend of EUR 0.17 per share out of 2007 profit.

Iberia's shares have risen more than those of its European peers since they were first floated in April 2001, with a cumulative increase of 66.4% to 2008 year-end, as compared with a decrease of 43.4% in the European Airline Index.

Daily Iberia - IBEX 35 - European Airline Index
(Rebasing 3rd April 2001)



4.9. Outlook

4.9.1. Growth forecast

The outlook for the growth of the world economy in 2009 has worsened in recent months in which the deleverage of the financial industry occurred and there was a loss of confidence among both manufacturers and consumers. The latest projections (January 2009) of the International Monetary Fund (IMF) suggest that world growth will slow to an average of 0.5% in 2009. Advanced economies' GDP will decrease in 2009, which is the first time that this has happened since the Second World War. The growth of emerging economies will decrease considerably although it will remain positive. However, the measures taken around the world to shore up the financial markets and encourage tax incentives and a relaxed monetary policy may curb the drop in growth.

The outlook for the Spanish economy has deteriorated radically in recent months with the economic forecast being revised downwards on several occasions. In January 2009, the European Commission forecast a 2% fall in Spanish GDP in 2009. The Eurozone is also expected to see negative growth. Latin America will not be immune to the economic crisis but many countries in the region are likely to recover more easily than at other times thanks to their strong economic policy during the last few years.

The forecast for the airline industry has also changed drastically. In view of the negative evolution of business and consumer confidence in recent months, a significant decrease in passenger and cargo traffic is anticipated. The latest forecasts of the International Air Transport Association (IATA) point to a 3% drop in passenger traffic and a 5% fall in cargo. This represents a decrease in global traffic (measured in revenue tonne-kilometres performed) of 3.6%, after growth of only 0.9% in 2008.

IATA has also forecast a 6.5% drop in industry revenue in an extremely difficult climate that will give rise to losses of around USD 2,500 million in 2009. The exception may be the United States where the low fuel hedges together with substantial reductions of capacity carried out in the past may lead to a return to profit, however small. In other regions airlines have started to cut back capacity although in Europe they should consider the danger of losing slots in congested airports if they are not used. On the other hand, a significant number of new aircraft are to be delivered in Asia and the Middle East. Consequently, traffic is expected to fall more sharply than capacity, leading to a drop in load factors and putting pressure on yield and profitability.

Against this adverse backdrop the expected transformation of the industry is likely to accelerate. Iberia, thanks to its financial strength and strategic positioning, faces the future with the capacity to manage the probable period of consolidation.

In July 2008 negotiations got underway with British Airways regarding a potential merger between the two companies through a share exchange. Both companies continue to work on the complex negotiation process.

An important event for European and US airlines was the entry into force on March 31, 2008 of the "Open Skies" agreement to liberalise international routes between the European Union (EU) and the United States (US). The agreement was due to come into force in 2008 but, due possibly to the fact that the airline industry has been hit hard by the economic crisis, airlines on both sides of the Atlantic have yet to avail themselves of the advantages it affords, perhaps waiting for total liberalisation of the airline market. A new round of negotiations will be held in May which aims to make progress in this area.

In this context, in August 2008 American Airlines, British Airways and Iberia signed a joint business agreement for flights between North America and Europe and requested immediate antitrust immunity from the United States Department of Transportation, of which the European authorities were informed. The companies are in the process of furnishing the information requested by the respective government authorities with a view to obtaining a favourable decision in the third quarter of 2009.

The Company will continue to be managed on the basis of three strategic lines: improving the quality of the service offered to customers, optimising revenue and increasing competitive efficiency.

The transport business will be affected by the global economic crisis and the impact it will have on demand. In line with the strategic optimisation of the network, the Company plans to reduce passenger transport supply by around 1.6% in 2009 (with respect to actual 2008 data), with long-haul flights growing by 0.8% and short and medium-haul flights decreasing by 5.2%. Cargo supply will increase by 1.5% and will continue to focus on America. In any event, Iberia has various options under the agreement with Airbus which, together with the aircraft operated under wet leases, afford it the flexibility to adjust capacity to the evolution of the market.

The Company has also drawn up an ambitious Integral Customer Service Plan to enhance the quality of the service provided. Investments and adjustments to the entire travel experience of customers will result in an improved product and level of service. Measures to be taken include the revamp of long-haul Tourist and Business class, the refurbishment of VIP lounges at key airports to incorporate the latest innovations in technology and service, separate boarding for Business passengers and shorter baggage collection times.

The new terminal at El Prat airport in Barcelona will come into service in the first half of 2009. The new building will be home to three airline alliances and represents a significant advance in the airport industry and Spanish aviation. Iberia will be present at the airport through its ownership interest in Clickair and, if the merger process is completed, through the new Vueling.

The global aircraft maintenance industry is likely to grow moderately over the next few years within the context of increasing globalisation and consolidation processes. The trend towards the outsourcing of these services by airlines is also expected to continue with manufacturers acquiring increasing importance. Iberia therefore expects its production and billings in maintenance services provided to other airlines, which were fully consolidated in 2008, to continue increasing through the diversification of products and the customer portfolio. The Company has started to build a maintenance hangar at El Prat-Barcelona airport which is expected to be completed by the end of 2009.

With regard to the handling business, Iberia will continue to implement measures aimed at optimising revenue, reducing overheads and above all substantially increasing employees' productivity in order to achieve the appropriate level of profitability after the impact of the second phase of the liberalisation of handling services brought in at Spanish airports in 2007.

4.9.2. Description of the main risks and uncertainties

Thanks to the objectives achieved in recent years, the Iberia Group is on a sound footing to face the considerable challenges of the future.

Spain is now in a recession of uncertain intensity and length. The deterioration of the economic situation has been brought about by internal and external factors: the end of a period of expansion has given rise to a series of macroeconomic imbalances and Spain has also suffered the impact of the international financial crisis on interest rates and credit restrictions. As a result, all the economic forecasts have been adjusted and recent estimates of the IMF estimate that Spanish GDP will drop by 1.7% in 2009 and by 0.1% in 2010.

Another important risk is the high volatility and uncertainty surrounding fuel prices. Airline profitability fell sharply in 2008 as the price of fuel rose from USD 90 per barrel in January to over USD 140 in July. In the last few months of 2008, the price per barrel of Brent crude plummeted to less than USD 40 although a large portion of airlines were unable to benefit from this fall. In view of the enormous volatility of the market it is extremely difficult to predict how oil prices will behave over the next few months. Iberia has implemented a complex structure of kerosene hedges for the coming quarters using various financial instruments to hedge around 50% of its expected annual consumption.

Another uncertainty is the exchange rate of the dollar since a possible appreciation would increase income but also expenses since around 45% of the Company’s costs and 25% of its income are linked to the US dollar.

The Company adopts numerous measures to control and manage risks and has implemented systems to enable it to identify, assess, manage and mitigate the main risks that affect the various activities of the Company. In particular, Iberia uses a global management programme designed to control and reduce the potential impact of fluctuations in fuel prices, exchange rates and interest rates on the Group's earnings.

The Company will also have to face growing competition across all markets. In Spain the new high-speed rail network has become a clear competitor for the airline companies. The inauguration in February 2008 of the high-speed line (AVE) between the two main Spanish cities, Madrid and Barcelona, led to sharp fall in air traffic in this corridor. Previously, in December 2007, the corridors linking Madrid with Málaga and Valladolid came into operation. Other connections planned for 2009 will link Madrid with Valencia and Alicante and Madrid with Bilbao.

In Europe, the traditional airlines will continue to face competition from the expansion of low-cost carriers. In long-haul flights Iberia has increasing competition from South American airlines such as Mexicana de Aviación or Lan Chile, which are expanding their networks and the frequency of flights to and from Europe. However, rational behaviour and limited increases in capacity are expected from several airlines.

The trade union representatives of Iberia’s technical crew and Company management held long negotiations to establish the terms of the new collective labour agreement. A preliminary agreement was reached in the second half of January 2009, which envisages measures that will allow most of the objectives established for this group of employees in the 2006-2008 Master Plan, in terms of unit costs and productivity, to be achieved.

In July 2008, the 18th Collective Labour Agreement for Iberia's ground staff, applicable from January 1, to December 31, 2008, was signed. In 2008 management and the representatives of the cabin crew also agreed to extend until December 31, 2008 the 15th Collective Labour Agreement applicable to these employees.

5. PERFORMANCE OF INVESTEES

5.1. Fully-consolidated companies

Compañía Auxiliar al Cargo Express, S.A. (CACESA) , which operates as a cargo forwarding agent and consignee, was incorporated in 1987 by Iberia, which has an ownership interest of 75% in its share capital, and by Marítimas Reunidas S.A. (MARESA) which owns the other 25%. The company also engages in goods transport, storage and distribution activities, as well as ancillary activities at airports.

CACESA's operating income amounted to EUR 50.7 million in 2008, up 4.6% on 2007. Overall, the first part of the year was quite positive for the various business lines, but from September onwards there was a significant drop in production caused by the rapid downturn in the national and world economies.

Revenue from the express courier services (the Ibexpress product) decreased by 1.1% with respect to 2007, totalling EUR 20.8 million, and there was a decrease in national traffic, which was partially offset by the growth in international traffic. Freight-forwarding product revenue (Ibertrás) amounted to EUR 26.9 million in 2008, up 10.5% on 2007, with a significant increase in the traffic of the Canary Islands and the volume of imports and exports. The ancillary logistics services provided at the cargo terminal at Madrid airport were transferred to the subsidiary ALAER in July.

The company's average headcount decreased by 4.5% to 120 equivalent employees as part of an expense minimisation policy. CACESA obtained profit from operations (recurring) amounting to EUR 1.35 million in 2008, up 0.9% on 2007. Profit before tax amounted to EUR 1.57 million (in accordance with IFRSs), up 6.5% on 2007, with slight increases in financial and extraordinary profit also recorded.

Auxiliar Logística Aeroportuaria, S.A. (ALAER) was incorporated by CACESA in June 2002. Iberia has a 75% ownership interest in ALAER through CACESA, and both companies are included within the scope of the Iberia Group's fully-consolidated companies. This company provides various ancillary logistics services and operates and manages cargo terminals.

Operating income for 2008 increased by 13.3% with respect to 2007, amounting to EUR 10.5 million. This improvement was due to the increase in services provided by Iberia Maintenance, both in Madrid and Barcelona, and to the commencement of the provision of ancillary logistics services for Iberia at the Madrid cargo terminal in July.

The company increased its headcount by 23 persons to 110 employees in order to tackle the increase in production. Profit from operations increased to EUR 0.19 million, up 15.7% on 2007. Profit before tax increased by 19.7% to EUR 185 thousand (in accordance with IFRSs).

The Dutch company **Binter Finance B.V.**, wholly-owned by Iberia, began operating in 1991. Through its permanent establishment in Spain, it performs its duties as Iberia's international treasury department. The company manages and optimises the cash flows denominated in foreign currency generated by Iberia outside Spain. It also advises on the management of and executes Iberia's foreign currency and interest rate risk hedging transactions on international markets. This company obtained profit before tax of EUR 21 thousand in 2008, similar to the result for 2007.

5.2. Companies accounted for using the equity method

Clickair S.A. (Clickair) is a new generation airline which began operations in October 2006. It has its headquarters and central base of operations at El Prat airport-Barcelona and it operates various national and international short and long-haul flights through a fleet of Airbus A320s, of which there were 18 units at 2008 year end.

Clickair’s shareholders include Iberia and four other Spanish companies (Nefinsa, S.A., Iberostar Hoteles y Apartamentos, S.L., Cobra Ingeniería de Montajes, S.A. and Agrolimen Inversiones S.C.R., S.A.), each with an ownership interest of 20%, although Iberia’s share of the dividend rights is 80%. At December 31, 2008, the shareholders had made a collective investment of EUR 120 million, EUR 70 million of which were invested in 2008. Through this investment, Iberia implements a differential strategy that enables it to take part in the considerable expansion of the European sector of non-traditional companies, and to defend the Group’s leadership at Barcelona airport.

Clickair combines the advantages of the low-cost carriers, such as low prices and high productivity, with the value-added services typical of traditional airlines, such as flexibility, flights to the main European airports, the use of the main booking systems (GDS), or offering its passengers the possibility of accumulating points on the Iberia Plus loyalty programme, thus making it a new generation airline.

Clickair carried 6.3 million passengers in 2008, representing an increase of 40.8% with respect to 2007. Through an ASK of 8,224 million (+21.2%), it achieved a load factor of 70.4%, an improvement of one percentage point on 2007. At 2008 year-end its workforce consisted of 643 employees, of which 533 were flight crew. Losses from operations in 2008 (excluding non-recurring items) amounted to EUR 14 million, representing a significant improvement on the figure for 2007 (EUR 68 million). During 2008, the losses before taxes were EUR 46 million, being EUR 25 million better than 2007. In 2008 Clickair began a review of its flight network and its structure with the aim of improving its profitability.

In July 2008 the Board of Directors of Clickair and Vueling (airline controlled by Inversiones Hemisferio, S.L.) resolved to approve a framework agreement for the integration of both companies. This operation, which is structured as merger by absorption of Clickair by Vueling, remains subject to the approval of the competent authorities and the fulfilment of other legal requirements.

On January 9, 2009, the European Union Competition Authority authorised the merger of both companies. Over the next few months it is expected that the necessary remaining authorisations will be granted (Shareholder's Meetings, CNMV, etc.) and, if this occurs, the operation could be finalised by mid-2009.

Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A. (Iberia Cards), is a credit finance establishment that engages in activities related to the issuance and management of credit cards and other means of payment. The company was incorporated in April 2002 by Iberia, which owns 43.5% of its share capital, and the banks Banco Popular, BBVA and Caja Madrid.

Iberia Cards completed its new range of products in 2008, in accordance with the Strategic Plan approved at the end of 2006, which established a business model adapted to the continual drop in the market interchange rates which have witnessed a cumulative decrease of more than 40% in the last three years. The change in range was initiated in November 2007 with the launch of the MasterCard Iberia MAX card, designed specifically for the revolving credit sector, which reached 45,000 cards at 2008 year-end. Also, as the result of an agreement entered into with American Express®, Iberia Cards launched Iberia Sendo in October 2008, which combines the prestige of the American Express card with the universal acceptance of Visa card. At 2008 year-end Iberia Cards had issued around 200,000 Sendo cards and this product enabled it to regain the lead in the market. These new cards, which have the additional advantage of participating in the Iberia Plus loyalty programme, have undoubtedly provided their holders with added value and enabled the company to maintain a high level of profitability.

The volume of business of Iberia Cards remained at a similar level to 2007 until August, when it began to show weakness in the last four months of 2008, as a result of a decrease in consumption. Late payment continues to be a key variable that must be controlled and it is the main concern of the payment Card industry. In 2008, Iberia Cards obtained a profit before tax of EUR 2.2 million.

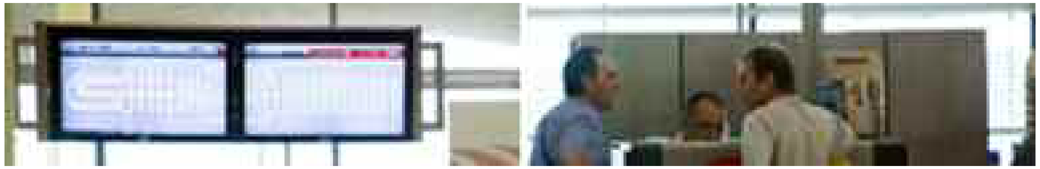
Multiservicios Aeroportuarios S.A. (MASA) was incorporated in April 2002 by ZENIT Servicios Integrales, S.A. holding 51% of its share capital, and by Iberia, the other 49%. This company provides all manner of airports ancillary services, which includes inter alia, internal and external cleaning of aircraft, equipment and facilities, baggage handling, cargo and mail handling, assistance for persons with reduced mobility and runway handling operations. Through this company Iberia has developed a major business that supplements handling. Its customers include Iberia itself, AENA, Air Europa and Groundforce.

In 2008, MASA entered into an agreement with Iberia for the renewal -for a period of six years, of the framework agreement for cleaning aircraft, runway equipment and airport premises. Also, it has continued to diversify its portfolio through the inclusion of new activities. In 2008, the company made a loss before tax of EUR 0.3 million.

Other companies in which Iberia has a significant ownership interest are:

- **IBECA**, incorporated in March 2001 by Iberia, which has an ownership interest of 50% through Iberia Tecnología, and Cubana de Aviación, with the other 50% of the share capital. The company provides aircraft line maintenance services at Cuban airports.
- **ELCA** was created in October 2001 by Cargosur, through which Iberia has an ownership interest of 50%, and by Aerovaradero, which owns the remaining capital. It engages in the marketing and storage of air cargo in transit in Cuba.

- **SERPISTA** was created in Madrid in June 2004. Its shareholders are COBRA (51%), Iberia (39%), and TEMG (a subsidiary of electro-mechanical workshops GORRIS) with 10%. The company performs the activities of maintenance and repair of equipment for ground handling at Spanish airports.
- **HANGESA**, was incorporated in October 2000 to carry out passenger and cargo handling activities at Malabo airport. Iberia holds a 51% ownership interest in the company through Viva Air and local shareholders hold 49%.
- **ISM (Internacional Supply Management)** was incorporated in March 2006 by Iberia, which owns 49% of its share capital, and by GECI Española Levante S.A., which owns the remaining 51%. ISM's main business line is the purchase and sale of chemical products, industrial machinery, spare parts and accessories mainly for the aeronautical industry
- **Madrid Aerospace Service** was incorporated in June 2008 by Iberia and Singapore Technologies Aerospace (STA), with an initial capital of EUR 2.6 million distributed evenly between the two shareholders (through their respective subsidiaries Iberia Tecnología and STA Solutions Europe). It has its headquarters in Madrid and engages in the maintenance, repair, revision and inspection of aircraft landing gear and components.



IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A.

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Translation of a report originally issued in Spanish based on our work performed in accordance with generally accepted auditing standards in Spain and of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Note 23). In the event of a discrepancy, the Spanish-language version prevails.

AUDITORS' REPORT ON FINANCIAL STATEMENTS

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

We have audited the financial statements of IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A. comprising the balance sheet at 31 December 2008 and the related income statement, statement of changes in equity, statement of cash flows and notes to the financial statements for the year then ended. The preparation of these financial statements is the responsibility of the Company's directors. Our responsibility is to express an opinion on the financial statements taken as a whole based on our audit work performed in accordance with generally accepted auditing standards, which require examination, by means of selective tests, of the evidence supporting the financial statements and evaluation of their presentation, of the accounting policies applied and of the estimates made.

The accompanying financial statements for 2008 are the first that the directors of the Company have prepared in accordance with the Spanish National Chart of Accounts approved by Royal Decree 1514/2007. In this regard, in accordance with Transitional Provision Four.1 of the aforementioned Chart of Accounts, these financial statements have been considered to be initial financial statements and, therefore, they do not include comparative figures. The section "Matters arising from the transition to the new Spanish National Chart of Accounts" in Note 2 to the accompanying financial statements includes the balance sheet and income statement contained in the approved financial statements for 2007, which were prepared in accordance with the Spanish National Chart of Accounts in force in that year, together with an explanation of the main differences between the accounting policies applied in 2007 and those applied in 2008, as well as a quantification of the impact of this change in accounting policies on equity at 1 January 2008, the date of transition. Our opinion refers only to the financial statements for 2008. On 31 March 2008, we issued our auditors' report on the 2007 financial statements, prepared in accordance with generally accepted accounting principles and standards under the Spanish regulations in force in that year, in which we expressed an unqualified opinion.

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

In our opinion, the accompanying financial statements for 2008 present fairly, in all material respects, the equity and financial position of Iberia, Líneas Aéreas de España, S.A. at 31 December 2008 and the results of its operations, the changes in equity and its cash flows for the year then ended, and contain the required information, sufficient for their proper interpretation and comprehension, in conformity with the generally accepted accounting principles and standards under the Spanish regulations applicable to the Company.

The accompanying management report for 2008 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 2008. Our work as auditors was confined to checking the management report with the aforementioned scope, and did not include a review of any information other than that drawn from the Company's accounting records.

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

José Manuel Rodríguez
27 February 2009

Deloitte, S.L. Inscrita en el Registro Mercantil de Madrid, Tomo 13.650, folio 188, sección 8, hoja M-54414, inscripción 96, C.I.F.: B-79104469. Domicilio social: Plaza Pablo Ruiz Picasso, 1 - Torre Picasso, 28020 Madrid.

FINANCIAL STATEMENTS

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A. Balance sheet at December 31, 2008

ASSETS	Notes	Millions of euros	EQUITY AND LIABILITIES	Notes	Millions of euros
NON-CURRENT ASSETS:		**2,438**	**EQUITY:**	10	**1,525**
Intangible assets	4.a	**53**	**Owner's Equity**		
Property, plant and equipment	5	**1,111**	**Share capital**		**743**
Aircraft		773	**Share premium**		**120**
Other items of property, plant and equipment		338	**Reserves**		**1,058**
Investments in Group companies and associates	7	**44**	**Treasury shares**		**(64)**
Non-current financial assets	6.1	**635**	**Profit for the year**		**25**
Equity instruments		245	**Valuation Adjustments:**		
Loans to third parties		93	**Available for sale financial assets**		**(80)**
Derivatives		70	**Hedges**		**(277)**
Other financial assets		227	**NON-CURRENT LIABILITIES:**		**1,791**
Deferred tax assets	13	**595**	**Long-term provisions**	11	**1,309**
CURRENT ASSETS:		**3,176**	**Non-current payables**	12	**403**
Non-current assets classified as held for sale	5	**21**	**Deferred tax liabilities**	13	**1**
Inventories	4.h	**224**	**Non-current accruals and deferred income**	4.k	**78**
Aircraft spare parts		176	**CURRENT LIABILITIES:**		**2,298**
Other inventories		48	**Current payables**	12	**639**
Trade and other receivables	9	**589**	**Current payables to Group companies and Associates**		**9**
Current financial assets	6.2	**1,748**	**Customer advances**	4.k	**394**
Loans to companies		34	**Trade and other payables**		**1,243**
Derivatives		79	Payable to suppliers and sundry accounts payable		942
Other financial assets		1,635	Payable to suppliers, Group companies and Associates		19
Current prepayments and accrued income		**13**	Remuneration payable		158
Cash and cash equivalents	4.e	**581**	Accounts payable to public authorities	13	124
Cash		58	**Current accruals and deferred income**		**13**
Cash equivalents	6.2	523			
TOTAL ASSETS		**5,614**	**TOTAL EQUITY AND LIABILITIES**		**5,614**

The accompanying Notes 1 to 20 are an integral part of this balance sheet.

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A. Income statement for 2008

	Notes	Millions of euros
CONTINUING OPERATIONS		
Revenue	15.a	**5,188**
In-house work on non-current assets		**15**
Procurements	15.c	**(1,864)**
Other operating income:	15.b	**233**
Non-core income, grants and other current operating income		198
Other non-recurring operating income		35
Staff costs:	15.e	**(1,313)**
Wages, salaries and similar expenses		(995)
Employee benefit costs		(318)
Other operating expenses	15.f	**(2,133)**
Depreciation and amortisation charge		**(198)**
Excessive provisions	11	**44**
Impairment and gains or losses on disposals of non-current assets:	5	**24**
Impairment and other losses		(3)
Gains or losses on disposals and other		27
LOSS FROM OPERATIONS		(4)
Finance income	15.g	**137**
Finance costs	15.h	**(52)**
Change in fair value of financial instruments		**(28)**
Exchange differences		**(1)**
Impairment and gains or losses on disposals of financial instruments	7	**(26)**
FINANCIAL PROFIT		30
PROFIT BEFORE TAX		26
Income tax	13	(1)
PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		25
PROFIT FOR THE YEAR		25

The accompanying Notes 1 to 20 are an integral part of this income statement.

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A. Statement of changes in equity for 2008.
A) Statement of recognised income and expense.

	Notes	Millions of euros
Profit per income statement (I)		25
Income and expenses recognised directly in equity:		
Arising from revaluation of financial instruments:		
Available-for-sale financial assets	6.1.1	(114)
Arising from cash flow hedges	8	(335)
Tax effect		135
Total income and expenses recognised directly in equity (II)		(314)
Transfers to profit or loss:		
Arising from cash flow hedges	8	66
Tax effect		(20)
Total transfers to profit or loss (III)		46
Total recognised income and (expenses) (I+II+III)		(243)

The accompanying Notes 1 to 20 are an integral part of this statement of recognised income and expense.

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A. Statement of changes in equity for 2008.
B) Statement of total changes in equity.

Millions of euros

	Share capital	Share premium	Legal reserve	Other reserves	Treasury shares	Profit for the year	Valuation adjustments	Total
Balance at beginning of 2008	**743**	**120**	**148**	**745**	**(19)**	**323**	**(89)**	**1,971**
Total recognised income (expenses)	-	-	-	-	-	**25**	**(268)**	**(243)**
Transactions with shareholders or owners								
Distribution of profit								
To reserves	-	-	1	164	-	(165)	-	
Dividends	-	-	-	-	-	(158)	-	(158)
Treasury share transactions (net)	-	-	-	-	(45)	-	-	(45)
2008 ending balance	**743**	**120**	**149**	**909**	**(64)**	**25**	**(357)**	**1,525**

The accompanying Notes 1 to 20 are an integral part of this statement of changes in total equity.

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LINEAS AÉREAS DE ESPAÑA, S.A. Cash flow statement for 2008.

Millions of euros

CASH FLOWS FROM OPERATING ACTIVITIES (I)	**40**
Profit for the year before tax	**26**
Adjustments for:	**120**
Depreciation and amortisation charge	198
Impairment losses	25
Changes in provisions	52
Gains/Losses on derecognition and disposal of non-current assets	(24)
Finance income	(137)
Finance costs	52
Changes in fair value of financial instruments	5
Other income and expenses	(51)
Changes in working capital:	**(50)**
Inventories	(26)
Trade and other receivables	133
Other current assets	(35)
Trade and other payables	(181)
Other current liabilities	11
Other non-current assets and liabilities	48
Other cash flows from operating activities:	**(56)**
Interest paid	(26)
Dividends received	1
Interest received	136
Income tax recovered (paid)	(30)
Other amounts received (paid)	(137)

CASH FLOWS FROM INVESTING ACTIVITIES (II)	**(381)**
Payments due to investment:	**(533)**
Group companies and associates	(56)
Intangible assets	(20)
Property, plant and equipment	(127)
Other financial assets	(425)
Other assets	95
Proceeds from disposal:	**152**
Property, plant and equipment	106
Other financial assets	46
CASH FLOWS FROM FINANCING ACTIVITIES (III)	**(301)**
Proceeds and payments relating to equity instruments:	**(45)**
Purchase of treasury shares	(46)
Disposal of treasury shares	1
Proceeds and payments relating to financial liability instruments:	**(98)**
Proceeds from issue of bank borrowings	56
Repayment of bank borrowings	(154)
Dividends and returns on other equity instruments paid:	**(158)**
Dividends	(158)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES (IV)	
NET INCREASE / DECREASE IN CASH AND CASH EQUIVALENTS (I+II+III+IV)	**(642)**
Cash and cash equivalents at beginning of year (*)	2,802
Cash and cash equivalents at end of year (*)	2,160

The accompanying Notes 1 to 20 are an integral part of this statement of cash flows.

(*) The Company considered "Cash and Cash Equivalents" to be the balances included under "Cash and Cash Equivalents" and under "Other Financial Assets - Held-To-Maturity Investments" (see Note 6.2)

Translation of financial statements originally issued in Spanish and prepared in accordance with generally accepted accounting principles in Spain (see Notes 2 and 20). In the event of a discrepancy, the Spanish-language version prevails.

IBERIA, LÍNEAS AÉREAS DE ESPAÑA, S.A.
NOTES TO THE 2008 FINANCIAL STATEMENTS

1. COMPANY ACTIVITIES

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

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

Iberia, Líneas Aéreas de España, S.A. is a fully-fledged member of the **one**world alliance, one of the world's largest airline groups, which facilitates the globalisation of its air transport business.

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

Iberia, Líneas Aéreas de España, S.A. is the head of a group of subsidiaries and is obliged under current legislation to prepare consolidated financial statements separately. The consolidated financial statements of the Iberia Group for 2008 were formally prepared by its Directors at the Board of Directors Meeting held on February 26, 2009. The consolidated financial statements for 2007 were approved by the shareholders at the Annual General Meeting of Iberia, Líneas Aéreas de España, S.A. on May 29, 2008, and were filed at the Madrid Mercantile Registry.

2. BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

Fair presentation

The financial statements for 2008, which were obtained from the Company's accounting records, are presented in accordance with Royal Decree 1514/2007 approving the Spanish National Chart of Accounts and, accordingly, present fairly the Company's equity, financial position, results of operations and cash flows for 2008. These financial statements, which were formally prepared by the Company's directors, will be submitted for approval by the shareholders at the Annual General Meeting, and it is considered that they will be approved without any changes.

Key issues in relation to the measurement and estimation of uncertainty

In preparing the financial statements for 2008 estimates were made by the Company's directors in order to measure and, where appropriate, recognise certain of the assets, liabilities, income, expenses or obligations. These estimates relate basically to the following:

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

These estimates were made on the basis of the best information available at December 31, 2008 on the events analysed.

In any event, events that take place in the future may make it necessary to change these estimates in coming years, in which case, such changes would be applied prospectively.

Matters arising from the transition to new Spanish National Chart of Accounts

In compliance with the obligation established in Article 35.6 of the Spanish Commercial Code and for the purposes of applying the principle of consistency and meeting the requirement of comparability, the financial statements for the year ended December 31, 2008 are considered to be initial financial statements and, accordingly, it is not obligatory to include comparative figures.

However, pursuant to Royal Decree 1514/2007, set forth below are the balance sheet and income statement for 2007 approved by the shareholders at the related Annual General Meeting. These financial statements were prepared in accordance with the rules established in Royal Decree 1643/1990, of December, 20.

Balance sheet at December 31, 2007

Millions of euros

ASSETS	
FIXED ASSETS:	
Intangible fixed assets	**346**
Tangible fixed assets:	**849**
Aircraft fleet:	
Cost	1,690
Depreciation and provisions	(1,181)
	509
Other tangible fixed assets:	
Cost	995
Depreciation and provisions	(655)
	340
Financial fixed assets:	**390**
Investments in Group and associated companies	130
Loans to Group and associated companies	25
Long-term securities portfolio	92
Other loans	152
Long-term deposits and guarantees	220
Provisions	(229)
Long-term accounts receivable from public authorities	**292**
Total fixed assets	1,877
DEFERRED EXPENSES	58
CURRENT ASSETS:	
Treasury stock	**18**
Inventories:	**197**
Engine parts	111
Aircraft parts	88
Other inventories	47
Provisions	(49)
Receivable from Group companies	**44**
Accounts receivable	**733**
Short-term investments	**2,890**
Cash in hand and at banks	**44**
Accruals	**10**
Total current assets	3,936
TOTAL ASSETS	5,871

SHAREHOLDER'S EQUITY AND LIABILITIES	
SHAREHOLDER'S EQUITY:	
Capital stock	**743**
Share premium	**120**
Legal reserve	**148**
Voluntary reserves	**628**
Reserve for treasury stock	**18**
Other reserves	**1**
Profit for the year	**323**
Total shareholder's equity	**1,981**
DEFERRED REVENUES	94
PROVISIONS FOR CONTINGENCIES AND CHARGES:	
Provisions for commitments with employees	**641**
Provision for major repairs	**64**
Provision for liabilities	**699**
Total provisions for contingencies and charges	**1,404**
NON-CURRENT LIABILITIES:	
Bank loans	**353**
Other long-term payables	**4**
Total non-current liabilities	**357**
CURRENT LIABILITIES:	
Bank loans	**169**
Payable to Group and associated companies	**28**
Trade accounts payable:	**1,454**
Customer advances	455
Payable on purchases and services	999
Salaries payable	**184**
Other non-trade accounts payable:	**198**
Payable to Public authorities	160
Other payables	38
Accruals	**2**
Total current liabilities	2,035
TOTAL SHAREHOLDER' S EQUITY AND LIABILITIES	5,871

Income statement for 2007

Millions of euros

DEBIT	
EXPENSES:	
Materials consumed	1,359
Personnel expenses	1,372
Depreciation and amortization	221
Change in trade provisions	8
Other operating expenses	2,250
	5,210
Profit from operations	**284**
Financial and similar expenses	61
Foreign exchange losses	68
	129
Net financial profit	**160**
Profit from ordinary activities	**444**
Change in provisions for fixed assets	23
Losses on intangible and tangible fixed assets, and investments in Group and associated companies	8
Extraordinary expenses	87
	118
Net extraordinary profit	**4**
Profit before taxes	**448**
Corporate Income Tax	125
Profit for the year	**323**

CREDIT	
INCOME:	
Net sales	5,277
Other operating revenues	217
	5,494
Income from equity investments	8
Other interest and similar revenues	215
Foreign exchange gains	66
	289
Gains on disposal of intangible and tangible fixed assets, and investments in Group and associated companies	107
Income on treasury stock operations	1
Extraordinary revenues	13
Prior year's revenues and profits	1
	122

The Company chose January 1, 2008 as the date of transition to the new Spanish National Chart of Accounts.

In accordance with current legislation, set forth below is the reconciliation of the equity at January 1, 2008 calculated in accordance with the former Spanish National Chart of Accounts to the equity at that date calculated in accordance with the new accounting rules established in Royal Decree 1514/2007:

Millions of euros

Equity at January 1, 2008 under former Spanish National Chart of Accounts (*)	1,981
Effects of transition to new Spanish National Chart of Accounts	
Treasury Shares	(18)
Derivatives	(89)
Deferred tax assets	68
Reversal of provisions	29
Equity at January 1, 2008 under new Spanish National Chart of Accounts	1,971

(*) Obtained from the financial statements at December 31, 2007 prepared in accordance with the accounting principles and standards applicable at that date.

The new accounting legislation, with respect to that in force at December 31, 2007, entails changes in accounting policies, measurement bases, presentation and disclosures to be included in the financial statements. More specifically, the main differences between the accounting policies applied in the prior year and the current policies are as follows:

- The treasury shares recognised in accordance with Royal Decree 1643/1990, of December 20, in current assets are classified in equity under the new Spanish National Chart of Accounts.
- Derivative financial assets and liabilities are measured and recognised with a balancing entry in equity at the transition date, due to first-time application.
- Under Royal Decree 1643/1990, of December 20, deferred tax assets that will not be recovered within ten years from the date on which they arose could not be recognised. This time limit is not envisaged under Royal Decree 1514/2007 and, accordingly, the related deferred tax assets were recognised with a positive effect in equity at the transition date. Also, certain provisions for contingent liabilities recognised at December 31, 2007 were reversed.

3. DISTRIBUTION OF PROFIT

The proposed distribution of the profit for 2008 prepared by the Company's directors for submission for approval by the shareholders at the Annual General Meeting consists of appropriating the profit in full to voluntary reserves.

4. ACCOUNTING POLICIES AND MEASUREMENT BASES

The principal accounting policies and measurement bases used by the Company in preparing its financial statements for 2008, in accordance with the Spanish National Chart of Accounts, were as follows:

a) Intangible assets

Intangible assets include computer software mainly purchased from third parties. The Company recognises under "Intangible Assets" the costs incurred in the purchase and development of computer programs. Computer software maintenance costs are recognised with a charge to the income statement for the year in which they are incurred. Computer software is amortised on a straight-line basis over five years.

b) Property, plant and equipment

Property, plant and equipment are carried at historical cost, net of the related accumulated depreciation and of any accumulated impairment losses, as indicated in Note 4.c).

Improvements to items of property, plant and equipment that increase capacity or efficiency, or extend the useful lives of assets are capitalised.

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

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

	Years
Aircraft	18 - 22
Buildings and other structures	20 - 50
Machinery, fixtures and tools	10 - 15
Land transport equipment	7 - 10
Furniture	10
Computer hardware	4 - 7
Spare parts	8 - 18
Flight simulators	12 - 14

The estimated residual value of rotatable parts, which are assigned specifically to aircraft types or families and are included under "Spare Parts", ranges from 10% to 20% of acquisition cost, depending on the type of aircraft to which they are assigned. The estimated residual value of repairable fuselage parts, which are also included under “Spare Parts”, is 10% of acquisition cost.

The Company depreciates in full the cost of other items of property, plant and equipment.

When owned aircraft and aircraft operated under finance lease are added to the fleet, the Company separates the cost of the parts scheduled for replacement at the major overhauls carried out at intervals of between four and seven years, from the cost of the aircraft. This cost is depreciated on a straight-line basis over the period between the acquisition of the aircraft and the first major overhaul. The cost of the repairs carried out at the major overhauls is capitalised as an addition to the value of property, plant and equipment and is depreciated over the period until the next major overhaul.

The costs incurred in the maintenance of property, plant and equipment and the cost of minor repairs to aircraft operated by the Company are taken to the income statement in the year in which they are incurred.

For each aircraft operated under an operating lease, in accordance with the terms of the lease agreements, the Company recognises an allowance for the total cost to be incurred in the scheduled overhauls and this cost is taken to the income statement on a straight-line basis over the period between two successive major repairs (see Note 11).

c) Impairment of intangible assets and property, plant and equipment

When there are indications of impairment, the Company tests the tangible and intangible assets for impairment to determine whether the recoverable amount of the assets has been reduced to below their carrying amount.

Recoverable amount is the higher of fair value less costs to sell and value in use.

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

d) Leases

Leases are classified as finance or operating leases depending on the economic substance and nature of the transaction. The main lease agreements entered into by the Company relate to aircraft and do not include automatic transfer of ownership at the end of the lease.

If the terms of the agreements include the possibility of the lessee acquiring ownership of the asset (purchase option), and Company management has decided to exercise the option, then they are classified as finance leases. Other leases, whether or not they contain a purchase option, are classified as operating leases unless, in accordance with the terms of the agreement, the transaction is similar to an acquisition (taking into account for that purpose the following indicators: purchase option, lease term and present value of the committed payments).

Finance leases

In finance leases, the cost of the leased assets is presented in the balance sheet, based on the nature of the leased asset, and, simultaneously, a liability is recognised for the same amount. This amount will be the lower of the fair value of the leased asset and the present value, at the inception of the lease, of the agreed minimum lease payments, including the price of the purchase option when it is reasonably certain that it will be exercised. The minimum lease payments do not include contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor. The total finance charges arising under the lease are allocated to the income statement for the year in which they are incurred using the effective interest method.

Contingent rent is recognised as an expense for the period in which it is incurred.

Leased assets are depreciated, based on their nature, using similar criteria to those applied to the items of property, plant and equipment that are owned.

Operating leases

Expenses resulting from operating leases are charged to income in accordance with the terms of the agreements.

e) Financial assets

The financial assets held by the Company are classified in the following categories:

a) Loans and receivables: financial assets arising from the sale of goods or the rendering of services in the ordinary course of the Company's business, or financial assets which, not having commercial substance, are not equity instruments or derivatives, have fixed or determinable payments and are not traded in an active market.

b) Held to maturity investments: debt securities with fixed maturity and determinable payments that are traded in an active market and which the Company has the positive intention and ability to hold to the date of maturity.

c) Equity investments in Group companies, associates and jointly controlled entities: Group companies are deemed to be those related to the Company as a result of a relationship of control and associates are companies over which the Company exercises significant influence.

d) Available for sale financial assets: these include debt securities and equity instruments of other companies that are not classified in any of the aforementioned categories.

Loans and receivables and held to maturity investments are initially recognised at the fair value of the consideration given, plus any directly attributable transaction costs. They are subsequently measured at amortised cost. The Company recognises provisions to cover the risk of uncollectibility. These provisions are calculated based on the probability of recovering the debt depending on its age and the debtor's solvency.

Investments in the capital of Group companies and associates are measured at cost net, where appropriate, of any accumulated impairment losses. These losses are calculated as the difference between the carrying amount of the investments and their recoverable amount. Recoverable amount is the higher of fair value less costs to sell and the present value of the future cash flows from the investment. Unless there is better evidence of the recoverable amount, it is based on the value of the equity of the investee, adjusted by the amount of the unrealised gains existing at the date of measurement (including any goodwill).

Nevertheless, the acquisition cost of equity investments in Iberbus companies (see Note 6.1.1.) is not adjusted to market value because the other partner in these enterprises, Airbus, has guaranteed that Iberia, Líneas Aéreas de España, S.A. will recover the investment made in full, pursuant to the agreements entered into.

The effect of applying consolidation methods in accordance with International Financial Reporting Standards as adopted by the European Union to the investees in which the Company has a majority holding or exercises significant influence, in comparison to these financial statements, would be to increase assets, reserves and the profit for the year by EUR 20 million, EUR 31 million and EUR 7 million, respectively.

Lastly, available for sale financial assets are measured at fair value and the gains and losses arising from changes in fair value are recognised in equity until the asset is disposed of or it is determined that it has become permanently impaired, at which time the cumulative gains or losses recognised in equity are recognised in the net profit or loss for the year. In this regard, impairment is deemed to exist (permanent) if the market value of the asset has fallen by more than 40% over a period of 18 months without the value having recovered.

At least at each reporting date the Company tests financial assets not measured at fair value through profit or loss for impairment. Objective evidence of impairment is considered to exist when the recoverable amount of the financial asset is lower than its carrying amount. When it arises, the impairment loss is recognised in the income statement.

The Company generally classifies its temporary cash surpluses in short-term financial assets which are recognised under "Current Financial Assets" in the balance sheet at the amounts actually paid. The interest income associated with these transactions is recognised as income when accrued while unmatured interest at year-end is presented under this heading in the balance sheet.

Cash and cash equivalents

The Company includes under "Cash and "Cash Equivalents" cash and short-term highly liquid investments maturing in less than three months that are readily convertible into cash and which are subject to an insignificant risk of changes in value. The interest income associated with these transactions is recognised as income when accrued while unmatured interest at year-end is presented under this heading in the balance sheet.

f) Financial liabilities

Financial liabilities include accounts payable by the Company that have arisen from the purchase of goods or services in the normal course of the Company's business and those which, not having commercial substance, cannot be classed as derivative financial instruments.

Accounts payable are initially recognised at the fair value of the consideration received, adjusted by the directly attributable transaction costs. These liabilities are subsequently measured at amortised cost.

The Company derecognises financial liabilities when the obligations giving rise to them cease to exist.

g) Treasury shares

Treasury shares are recognised at the value of the consideration paid and are deducted from equity. Gains and losses on the acquisition, sale, issue or retirement of treasury shares are recognised in equity.

h) Inventories

Inventories are measured at the lower of acquisition cost (weighted average cost) or market value (net realisable value) and include mainly aircraft spare parts, repairable aircraft engine parts and fuel.

The Company recognises the appropriate write-downs as an expense in the income statement when the net realisable value of the inventories is lower than their acquisition cost.

i) Balances and transactions in currencies other than the euro

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

The balances of accounts receivable and payable denominated in currencies other than the euro are translated to euros at the exchange rates prevailing at 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 prevailing in the month of the sale, as set by the International Air Transport Association (IATA). The IATA exchange rate for each month is the average exchange rate for the last five bank working days prior to the 25th day, inclusive, of the preceding month.

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

j) Income tax

Since January 1, 2002 the Company and certain of its subsidiaries have filed income tax returns under the consolidated tax regime provided for in Chapter VII, Title VII of the Consolidated Spanish Corporation Tax Law.

Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

The current income tax expense is the amount payable by the Company as a result of income tax settlements for a given year. Tax credits and other tax benefits, excluding tax withholdings and pre-payments, and tax loss carryforwards from prior years effectively offset in the current year reduce the current income tax expense.

The deferred tax expense or income relates to the recognition and derecognition of deferred tax assets and liabilities. These include temporary differences measured at the amount expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities and their tax bases, and tax loss and tax credit carryforwards. These amounts are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled.

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are recognised to the extent that it is considered probable that the Company will have taxable profits in the future against which the deferred tax assets can be utilised.

Deferred tax assets and liabilities arising from transactions charged or credited directly to equity are also recognised in equity.

The deferred tax assets recognised are reassessed at the end of each reporting period and the appropriate adjustments are made to the extent that there are doubts as to their future recoverability. Also, unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that they will be recovered through future taxable profits.

k) Revenue and expense recognition

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

Ticket sales and sales of the traffic documents for cargo and other services are initially credited to “Customer Advances” in the balance sheet. The balance of this heading reflects the estimated liability for ticket sales and traffic documents sold prior to December 31, 2008 but not yet used at that date. The revenue relating to ticket sales and traffic documents is recognised when the transport or service is performed.

The Company has in place the "Iberia Plus" card the purpose of which is to foster customer loyalty. Cardholders accumulate points for taking certain flights, using the services of entities included in the programme or making purchases with credit cards covered by the programme. The points can be exchanged for free tickets or services offered by the companies included in the programme. "Trade and Other Payables – Payable to Suppliers and Sundry Accounts Payables" in the accompanying balance sheet at December 31, 2008 include a provision of EUR 115 million in this connection, based on the estimated redemption value of the unused points accumulated at that date, taking into account the historical experience of points redeemed.

In general, any incentives, bonuses or reductions received in cash or in kind by the Company relating to aircraft coming into service under operating lease are recognised in the income statement on a straight-line basis over the term of the lease or when the discounted use arises. "Non-Current Accruals and Deferred Income" in the consolidated balance sheet includes the amounts not yet recognised as income at each year-end.

Interest income from financial assets is recognised using the effective interest method and dividend income is recognised when the shareholder's right to receive payment has been established. Interest and dividends from financial assets accrued after the date of acquisition are recognised as income.

l) Provisions for restructuring costs

In December 2001 the Company received approval from the employment authorities for a collective redundancy procedure which has been extended with the necessary approvals to apply to various employee groups. The last approval was received in relation to ground personnel in November 2007 and is valid until December 31, 2010. Also, a collective redundancy procedure for ground handling personnel associated with the process for the assignment of resources by way of subrogation was approved in 2006 which will remain in force until 2014. The accompanying balance sheet at December 31, 2008 does not include any provision for this second collective redundancy procedure, since there was no cost obligation in relation thereto.

The first procedure provides for the payment of certain amounts until the statutory retirement age is reached to employees who meet certain conditions and decide to request early retirement.

The Company recognises provisions each year for the effective cost obligations which will be disbursed in subsequent years.

The actuarial studies used to determine the liability to the employees who have decided to take early retirement under these conditions use assumptions similar to those described in Note 4-m. The successive payments relating to these items are deducted from the provisions created.

m) Obligations to employees

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

The current collective labour agreements also provide the possibility for flight personnel who meet certain conditions to take early retirement (special leave of absence and voluntary termination), whereby the Company is required to pay certain amounts to these employees until they reach statutory retirement age. The Company recognises a provision, calculated on the basis of actuarial studies for the necessary amount in the income statement for the year in which this occurs to supplement the provision already recognised for personnel on reserve, in order to meet the future payment obligations to the related personnel. 164 employees are currently on special leave and 300 employees have opted for voluntary termination.

"Long-Term Provisions – Provisions for Long-Term Employee Benefit Obligations" include the liabilities relating to these items (see Note 11).

The aforementioned liabilities were calculated on the basis of actuarial studies conducted by independent actuaries using the projected unit credit method and based on a discount rate of 4% and PERM/F-2000P life-expectancy tables. The assumptions used included annual growth of 2.5% in the CPI.

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 Company's employees) and other welfare benefits in certain circumstances (death and permanent disability).

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

In 2008 the Company's contributions in this respect amounted to EUR 22 million and were recognised under "Staff Costs - Other Employee Benefit Costs" in the accompanying income statement for 2008.

o) Long-term provisions

When preparing the financial statements the Company's directors made a distinction between:

a) Provisions: credit balances covering present obligations arising from past events with respect to which it is probable that an outflow of resources embodying economic benefits that is uncertain as to its amount and/or timing will be required to settle the obligations; and
b) Contingent liabilities: possible obligations that arise from past events and whose existence will be confirmed only by the occurrence of one or more future events not wholly within the Company's control.

The financial statements include all the provisions with respect to which it is considered that it is more likely than not that the obligation will have to be settled. Contingent liabilities are disclosed in the notes to the financial statements, unless the possibility of an outflow in settlement is considered to be remote.

Provisions are measured at the present value of the best possible estimate of the amount required to settle or transfer the obligation, taking into account the information available on the event and its consequences and where discounting is used, adjustments made to provisions are recognised as interest cost on an accrual basis. The Company reverses such provisions, either in full or in part, when the related obligations cease to exist or are reduced.

p) Related party transactions

The Company performs all its transactions with related parties on an arm's length basis. Also, the transfer prices are adequately supported and, therefore, the Company's directors consider that there are no material risks in this connection that might give rise to significant liabilities in the future.

q) Non-current assets and disposal groups classified as held for sale

The Company classifies a non-current asset or disposal group as held for sale when the decision to sell them has been taken and the sale is expected to occur within twelve months.

These assets or disposal groups are measured at the lower of their carrying amount and fair value less costs to sell.

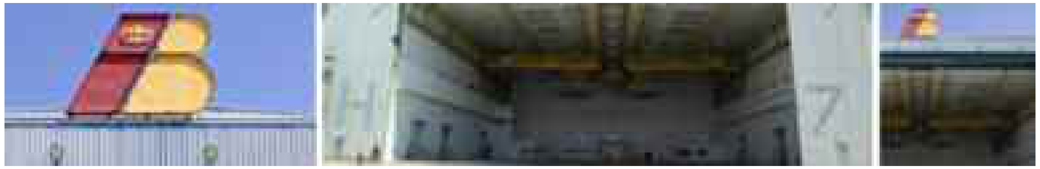
Non-current assets classified as held for sale are not depreciated, but rather at the end of each reporting period the related valuation adjustments are made to ensure that the carrying amount is not higher than fair value less costs to sell.

Income and expenses arising from non-current assets and disposal groups classified as held for sale which do not qualify for classification as discontinued operations are recognised under the related heading in the income statement on the basis of their nature.

r) Derivative financial instruments and hedge accounting

The derivatives held by the Company relate mainly to hedges of foreign currency, interest rate and fuel price risk in order to significantly reduce these risks in the underlying hedged transactions.

Derivatives are initially recognised at acquisition cost in the balance sheet and the necessary valuation adjustments are subsequently made to reflect their fair value at any given time. They are classified under "Non-Current Financial Assets – Derivatives" o "Current Financial Assets – Derivatives" in the balance sheet if they are positive and as "Non-Current Payables – Derivatives" or "Current Payables – Derivatives" if negative. Gains or losses resulting from such fluctuations are recognised in the income statement, unless the derivative is designated and highly effective as a hedge, in which case the recognition criteria are as follows:



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

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

s) Activities with an environmental impact

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

In this respect, investments made in connection with environmental activities are measured at acquisition cost and are capitalised as an addition to non-current assets in the year in which they are made, using the methods described in Note 4-b above.

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

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

5. PROPERTY, PLANT AND EQUIPMENT

The changes in the property, plant and equipment accounts in 2008 were as follows:

Millions of euros

	01-01-08	Additions	Transfers	Disposals	31-12-08
Cost:					
Aircraft	**2,072**	**137**	**(303)**	**(365)**	**1,541**
Other items of property, plant and equipment:					
Land	3	-	-	-	3
Buildings and other structures	159	-	-	(2)	157
Machinery, fixtures and tools	463	10	1	(25)	449
Land transport equipment	35	-	-	(4)	31
Furniture and fixtures	20	1	-	(1)	20
Computer hardware	99	15	-	(4)	110
Spare parts	207	18	-	(9)	216
Flight simulators	3	-	-	-	3
Property, plant and equipment in the course of construction	8	21	(6)	(2)	21
	997	**65**	**(5)**	**(47)**	**1,010**

Millions of euros

	01-01-08	Additions	Transfers	Disposals	31-12-08
Accumulated depreciation:					
Aircraft	**(1,129)**	**(128)**	**258**	**270**	**(729)**
Other items of property, plant and equipment:					
Buildings and other structures	(116)	(4)	-	2	(118)
Machinery, fixtures and tools	(329)	(22)	-	23	(328)
Land transport equipment	(23)	(3)	-	4	(22)
Furniture and fixtures	(13)	(2)	-	-	(15)
Computer hardware	(72)	(11)	-	3	(80)
Spare parts	(99)	(10)	-	4	(105)
Flight simulators	(1)	-	-	-	(1)
	(653)	**(52)**	**-**	**36**	**(669)**
Impairment losses and provisions:					
Aircraft:					
Impairment losses on aircraft	(139)	-	54	46	(39)
Other items of property, plant and equipment	(3)	-	-	-	(3)
	(142)	**-**	**54**	**46**	**(42)**

Fleet

Additions

The additions for the year were as follows:

Millions of euros

Aircraft	73
Engines	44
Refurbishments	20
	137

Aircraft additions in 2008 relate to two A320 units subsequently sold during the year (see “Disposals”) and to two A340 units which had been operated under an operating lease. A finance lease was arranged for one of these A340 units and the purchase option on the other was exercised.

Transfers

In 2008 the Company reclassified the MD aircraft, which it no longer operates and for which there are sale agreements anticipating delivery in 2009, to "Non-Current Assets Classified as Held for Sale", recognising a cost of EUR 333 million, accumulated depreciation of EUR 258 million and impairment losses of EUR 54 million.

The other transfers relate mainly to deposits previously given for the acquisition of aircraft and engines, which were recognised under "Non-Current Financial Assets - Other Financial Assets" (see Note 6.1.3).

Disposals

The disposals for the year were as follows:

Millions of euros

Aircraft	Cost	Accumulated depreciation	Impairment losses
A320	47	(10)	-
MD87	152	(130)	(18)
A340	15	(9)	-
B747	148	(120)	(28)
MD88	3	(1)	-
	365	**(270)**	**(46)**

A320 aircraft

In 2008 the Company sold two A320 aircraft which had been purchased during the year but which were not brought into service. These aircraft were sold to banks and the result on the sale was included under "Gains or Losses on Disposals and Other" in the income statement. The Company also carried out overhauls of these aircraft as scheduled, and derecognised the cost of the overhauls which had been fully depreciated.

MD87 aircraft

The disposals of MD87 aircraft relate to the sale of 8 MD87 aircraft and 20 MD87 engines. The Company obtained a gain of EUR 5 million on these disposals which was recognised under "Gains or Losses on Disposals or Other" in the accompanying income statement

B747 aircraft

The Company derecognised two B747 aircraft and two B747 engines whose carrying amount was zero.

Impairment losses

The changes in 2008 were as follows:

Millions of euros

	Balance at 01-01-08	Amounts taken to income	Transfers	Balance at 31-12-08
Aircraft (fuselage and engines):				
B747	63	(28)	-	35
B757	3	-	-	3
MD	72	(18)	(54)	-
Other non-operating aircraft	1	-	-	1
	139	**(46)**	**(54)**	**39**

Commitments and other guarantees on aircraft

The Company is using two aircraft under finance leases and four aircraft under operating leases, the income from which, together with the aircraft themselves, guarantee repayment of a bond issue carried out by the lessor in the European market in 2000, of which EUR 82 million has not been repaid.

The Company is also guaranteeing the use of 20 aircraft under operating or finance lease for a period of between 9 and 14 years to the subscribers of a bond issue, on which USD 101 million and EUR 120 million remain outstanding.

The Company is currently implementing a fleet renewal plan instrumented through various agreements entered into with Airbus for A320 and A340 type aircraft. The aircraft not yet delivered at December 31, 2008 and the years in which they are scheduled to be added to the fleet are as follows:

Type of aircraft	2009	2010	2011	Total
A320	2	5	5	12
A340/600	3	2	-	5
	5	**7**	**5**	**17**

Based on the basic prices established in the agreements, the total cost of the aircraft subject to firm purchase commitments not yet delivered at December 31, 2008 amounted to approximately EUR 1,324 million.

The Company also has options on 24 A320-type aircraft, giving rise to an advance of EUR 3 million, which is recognised under "Other Financial Assets" in the balance sheet (see Note 6.1.3.).

Aircraft in service

The summary of the Company's aircraft in service at December 31, 2008 is as follows:

Type of aircraft	Owned	Under finance lease	Under operating lease	Under wet lease [a]	Total
A319 (b)	-	-	22	-	22
A320	10	6	29	-	45
A321	-	4	15	-	19
A340/300	6	1	11	3	21
A340/600	-	-	12	-	12
	16	**11**	**89**	**3**	**119**

(a) Lease type which includes the aircraft, maintenance, technical crews and insurance.
(b) Excludes two "parked" A319 aircraft yet to be received.

The foregoing table excludes three B747 aircraft owned by the Company which were grounded at December 31, 2008 because they were to be sold or scrapped and which have a carrying amount of zero. It also excludes the MD aircraft discussed in the paragraph on "Non-Current Assets Classified as Held for Sale" at the end of this Note.

Aircraft operated under operating lease and wet lease contracts

In 2008 three A319 aircraft were included under operating lease. The wet leases for two B757 aircraft were also cancelled and a third B757 aircraft, that had been grounded and in the process of being returned at 2007 year-end, was returned.

Following are the expiry dates of the operating leases of aircraft being operated by the Company:

Aircraft	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Number of aircraft
A319	-	-	-	6	10	3	-	-	-	-	3	22
A320	1	1	1	2	6	2	2	5	-	-	9	29
A321	-	-	-	-	1	-	2	3	2	1	6	15
A340/300	1	3	1	3	-	2	1	-	-	-	-	11
A340/600	-	-	-	-	-	-	3	2	3	4	-	12
Total	**2**	**4**	**2**	**11**	**17**	**7**	**8**	**10**	**5**	**5**	**18**	**89**

In addition to the aforementioned aircraft, the Company had arranged operating leases for one B757 unit and one A320 unit, which at December 31, 2008 were subleased to other airlines, and one A320 unit, which at December 31, 2008 was not in service, awaiting its return to the lessor.

Certain of the operating lease contracts include a purchase option on the aircraft that can be exercised during the lease term, and the possibility of extending the lease for periods ranging from one to nine years. At the date of preparation of these financial statements, the Company's directors did not intend to exercise the purchase options or to request or avail of the extensions considered in the aforementioned leases that would involve the use of the aircraft for periods exceeding 16 years.

Operating lease expense

The lease payments accrued in 2008 for aircraft operating lease and wet lease contracts amounted to EUR 357 million and are included under "Other operating expenses" in the income statement (see Note 15-f). The detail of the approximate total operating lease payments payable calculated on the basis of the interest rates and exchange rates prevailing at December 31, 2008 for these aircraft is as follows:

Millions of euros

Year	
2009	292
2010	267
2011	252
2012	239
2013 and subsequent years	778
	1,828 (*)

(*) Equivalent to USD 2,544 million at the year-end exchange rate. The exchange rate and interest rate risks on these lease payments are partially hedged with derivatives (see Note 8).

Assets held under finance lease

At December 31, 2008, there were items of property, plant and equipment, mainly aircraft, held under finance lease with a cost of EUR 408 million and accumulated depreciation of EUR 104 million.

The lease payments outstanding at December 31, 2008, including the amount of the purchase options, fall due as detailed in Note 12.1.2.

Other items of property, plant and equipment

The buildings and facilities built on land owned by the State, mainly at Spanish airports, had a carrying amount of EUR 32 million at December 31, 2008. The Company's directors do not expect any material losses to arise as a result of the reversion process since the Company's maintenance programmes ensure that these assets remain permanently in good operating condition.

Fully depreciated items

At December 31, 2008, the cost of the Company's fully depreciated property, plant and equipment amounted to EUR 353 million. The detail is as follows:

Millions of euros

Buildings	58
Machinery, fixtures and tools	195
Furniture and fixtures	8
Computer hardware	56
Transport equipment and other items of property, plant and equipment	12
Aircraft	24
	353

Insurance coverage

The Company has taken out insurance policies for its property, plant and equipment and intangible assets which sufficiently cover the carrying amount thereof at December 31, 2008. The Company has also taken out insurance policies for the aircraft leased from third parties.

Non-current assets not in service

The Company recognises in the balance sheet certain assets, mainly aircraft and engines, which are not in service, with a cost of EUR 204 million, which is covered substantially in full by the related depreciation and the impairment losses recognised.

Non-current assets classified as held for sale

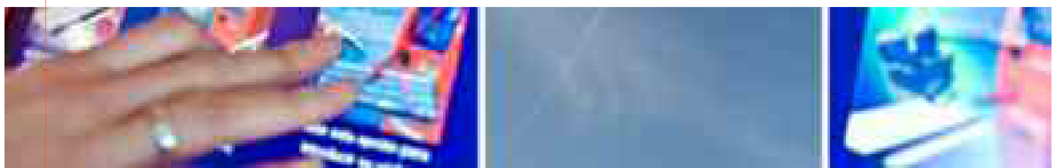
The balance recognised under this heading in the accompanying balance sheet relates in full to the Company's MD aircraft to be sold foreseeably in 2009 under the sale contracts for these aircraft in force at year-end.

At December 31, 2008, these aircraft were not in service.

6. FINANCIAL ASSETS

6.1. Non-current financial assets

The detail of "Non-Current Financial Assets" at the end of 2008 is as follows (in millions of euros):



	Non-Current financial instruments				
	Equity instruments	Loans to third parties	Derivatives (Note 8)	Other financial assets	Total
Held to maturity investments	12	-	-	233	245
Loans and receivables	-	93	-	-	93
Available for sale financial assets:					
At fair value	219	-	-	-	219
At cost	14	-	-	-	14
Derivatives	-	-	70	(6)	64
Total	245	93	70	227	635

6.1.1. Equity instruments

The changes in "Equity Instruments" and in the related allowances in 2008 were as follows:

Millions of euros

	% of Ownership at 31-12-2008	Balance at 01-01-2008	Additions	Disposals	Exchange differences	Balance at 31-12-2008
Held to maturity investments:						
Iberbus companies	40.00 - 45.00	25	-	(9)	(4)	12
Available for sale financial assets:						
• At fair value						
Venezolana Internacional de Aviación, S.A.	45.00	88	-	-	-	88
Interinvest, S.A.	0.1438	30	-	-	-	30
Opodo, Ltd.	2.38	19	-	-	-	19
British Airways	9.99	-	331	-	-	331
Other		4	-	-	-	4
• At cost						
Servicios de Instrucción de Vuelo, S.L.	19.9	9	-	-	-	9
Wam Acquisition, S.A.	11.57	5	-	-	-	5
Total cost		180	331	(9)	(4)	498
Provisions		(140)	(114)	1	-	(253)

The majority shareholder of the Iberbús companies, Airbus, has guaranteed Iberia, Líneas Aéreas de España, S.A. the recovery of the full amount of its investments in and loans to these companies and, accordingly, no allowances were recognised in relation to the investments in these companies, which continue to be recognised at cost.

The ownership interests in Venezolana Internacional de Aviación, S.A. and Interinvest, S.A. are fully provided for. Approximately EUR 18 million of the ownership interest in Opodo, Ltd. has been provided for.

In 2008 the Company acquired shares representing 9.9% of the share capital of British Airways Plc for EUR 331 million. At December 31, 2008, a provision of EUR 114 million, net of the related tax effect, was recognised to reduce the carrying amount of this investment to its fair value, calculated on the basis of its market value at that date, with a charge to "Equity – Valuation Adjustments – Available-for-Sale Financial Assets" in the accompanying balance sheet.

The investment in Wam Acquisition, S.A. was acquired as partial consideration for the sale of Amadeus, S.A. and is instrumented in ordinary shares and preference shares. The preference shares grant the right to receive a fixed and cumulative dividend of 13.75% on the par value. "Finance Income" in the accompanying 2008 income statement includes EUR 4 million in this connection. These shares are convertible into ordinary shares if the investee is floated.

6.1.2. Loans to third parties

The changes in this line item in the balance sheet were as follows:

Millions of euros

	Balance at 01-01-2008	Exchange differences	Transfers	Balance at 31-12-2008
Loans to Venezolana Internacional de Aviación, S.A. [a]	26	-	-	26
Loans to Iberbus companies	78	4	(28)	54
Loans to Aerolíneas Argentinas, S.A. [b]	36	-	-	36
Loans to Iberlease 2004 Ltd.	36	2	-	38
Other loans	2	-	(2)	-
Total cost	**178**	**6**	**(30)**	**154**
Provisions	**(61)**	-	-	**(61)**

(a) The loans to Venezolana Internacional de Aviación, S.A. (VIASA) relate to prior years and had been provided for in full at December 31, 2008.
(b) The loans to Aerolíneas Argentinas, S.A. relate to the subrogation in a loan secured with a mortgage on two B-747 aircraft granted by Banesto, S.A. in the amount of USD 43 million, the repayment of which was guaranteed by Iberia, Lineas Aéreas de España, S.A. These loans have been provided for in full.

Iberbus companies

The Company granted a loan to each of its Iberbus investees and entered into aircraft operating and finance leases with them. The principal ranges from USD 11 million to USD 22 million. These loans were granted for a period equal to the term of the operating or financial lease for the related A340/300 aircraft and earn annual interest ranging from 4% to 6%. The loans are repayable in a one-off lump sum upon maturity, which will take place in the period from 2009 to 2012. The Company has reclassified the loans maturing in 2009 (see Note 6.2) to "Non-Current Financial Assets – Loans to Companies".

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

Millions of euros

Maturing in	
2010	29
2011	8
2012	17
	54

Iberlease 2004 Ltd.

Iberlease 2004 Ltd., from which Iberia, Líneas Aéreas de España, S.A. acquired four aircraft under finance lease arrangements, has in turn been granted four loans by Iberia, Líneas Aéreas de España, S.A. for the same term as that established in the finance lease agreements, which are repayable in a single payment in December 2014. The principal of these loans amounts to USD 54 million and the interest is earned at an annual rate of between 6% and 6.5% payable quarterly.

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6.1.3. Other financial assets

The changes in the items comprising this heading in the balance sheet in 2008 were as follows:

Millions of euros

Item	Balance at 01-01-2008	Additions	Disposals	Transfers	Exchange differences	Balance at 31-12-2008
Deposits for acquisition of aircraft	201	81	(31)	(50)	15	216
Valuation of hedging transactions	3	4		-	(13)	(6)
Other deposits	16	2	-	(1)	-	17
	220	87	(31)	(51)	2	227

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

Millions of euros

	Outright purchase	Options
A320 Family	70	3
A340 Family	137	-
Engines	6	-
	213	3

On the basis of the scheduled aircraft deliveries, the Company estimates that deposits totalling EUR 128 million will be taken to income in 2009.

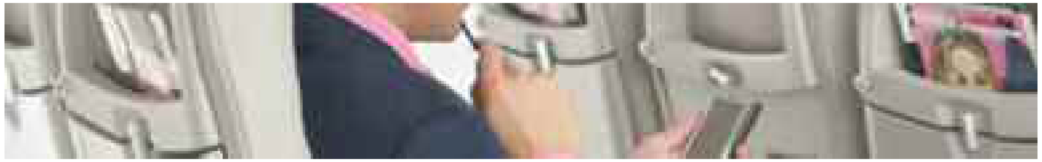
6.2. Current financial assets

The detail of "Current Financial Assets" at the end of 2008 is as follows (in millions of euros):

	Current financial instruments			
	Loans to companies	Derivatives (Note 8)	Other financial assets	Total
Held to maturity investments	-	-	1,579	1,579
Loans and receivables	34	-	56	90
Derivatives	-	79	-	79
Total	34	79	1,635	1,748

The average return on the amounts placed in current financial assets, mainly deposits, eurodeposits, euronotes and fixed-term deposits and promissory notes was 4.74% in 2008.

Also, the average return on the investments recognised under "Cash Equivalents" in the balance sheet was 4.70%.



7. INVESTMENTS IN GROUP COMPANIES AND ASSOCIATES

The changes in 2008 in "Investments in Group Companies and Associates" in the balance sheet were as follows

Millions of euros

Group companies and Associates	Cost	Provision
Balance at 01-01-08	41	(27)
Additions and charge for the year	56	(26)
Balance at 31-12-08	**97**	**(53)**

The most significant information in relation to Group companies, jointly controlled entities and associates at December 31, 2008 is as follows:

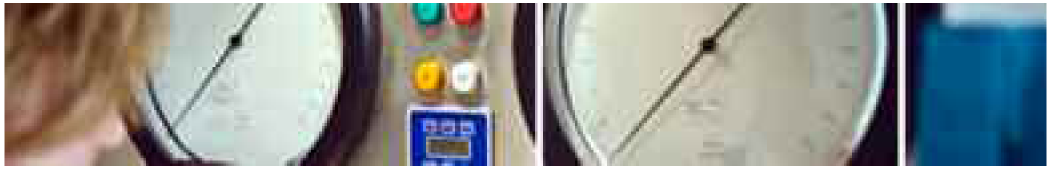
Millions of euros

Business Name Registered Office Company Object	% Of ownership		Shared capital	Profit/(Loss)		Other equity items	Total equity	Carrying amount		
	Direct	Indirect		From operations	Net			Cost	Impairment loss recognised in the year	Accumulated impairment losses at 31-12-2008
Compañía Auxiliar al Cargo Exprés, S.A.	75.00%	-	-	1	1	5	6	1	-	-
Centro de Carga Aérea Parcela 2 p.5 nave 6;										
Madrid										
Transport of cargo										
Cargosur, S.A.	100.00%	-	6	-	-	-	6	9	-	(3)
Velázquez, 130; Madrid										
Air transport of cargo										
Iber-America Aerospace, LLC	65.30%	-	1	-	-	-	1	1	-	-
Miami, Florida										
Purchase and sale of aircraft components and engines										
Iberia Tecnología, S.A.	100.00%	-	1	-	-	-	1	1	-	-
Velázquez, 130; Madrid										
Maintenance and advisory services										
Serpista, S.A.	39.00%	-	1	1	1	3	5	1	-	-
Marcelo Espínola, 10. Madrid										
Airport equipment maintenance										
Sociedad Conjunta para la Emisión y Gestión de Medios de Pago EFC, S.A.	43.50%	-	6	2	1	11	18	4	-	-
José Ortega y Gasset, 22; Madrid										
Issuance and management of payment means										
Clickair, S.A.	20.00%	-	12	(46)	(33)	48	27	80	(26)	(50)
Parque de Negocios Mas Blau; Barcelona										
Passenger transport										

Clickair, S.A.

At December 31, 2008, Iberia, Líneas Aéreas de España, S.A. owned ordinary shares of Clickair, S.A. amounting to EUR 4 million, giving it a 20% ownership interest in the share capital of this investee, although, based on the agreements with the other shareholders, the dividend rights on this shareholding amount to 80%. The shareholders' agreements provide for the possibility that, subject to certain conditions, the Company takes a majority ownership interest in the share capital of Clickair, S.A. and control over its operations. The investment in Clickair, S.A. is instrumented in, besides the aforementioned ordinary shares, preference shares, the cost of which at December 31, 2008 was EUR 76 million (of which EUR 53 million were paid in 2008). The impairment losses recognised to present this investment at the fair value estimated by the directors total EUR 50 million (of which EUR 26 million were recognised in 2008).

The directors of Clickair S.A. and of Vueling Airlines, S.A. have initiated the process for the merger of the two companies. At the date of preparation of these financial statements, the merger plan had been approved by the European Commission and approval of the prospectus by the shareholders at the respective Annual General Meetings and by the Spanish National Securities Market Commission was pending. The Company's directors consider that the merger process will be completed before September 2009. If the merger ultimately takes place, the Company has undertaken to acquire the ownership interests of three of the other four shareholders of Clickair, S.A. for the amounts paid by them.



8. DERIVATIVE FINANCIAL INSTRUMENTS

8.1. Qualitative information

The Company has put in place procedures and systems that enable it to identify, assess, manage and mitigate the main risks that affect its various activities.

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

As regards financial risks, the Company has a global management programme the aim of which is to control and lessen the potential negative impact of fluctuations in exchange rates, interest rates and the price of fuel on earnings and to preserve the liquidity required for its operations and investments.

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

Foreign currency risk

As a result of its international activities, the Company generates receivables and payables in currencies other than the euro. The greatest risk exposure relates to the appreciation of the US dollar against the euro, since its payments in US dollars exceed its revenue in this currency.

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

Interest rate risk

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

To manage this risk the Company maintains at least a percentage of its debt at fixed or hedged rates. Also, by diversifying the borrowing currencies (US dollar, euro, Swiss franc and pound sterling), the Company is able to reduce the risk of an overall rise in the interest rates on its borrowings.

Fuel price risk

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

This risk is normally reduced by arranging swaps and options.

Liquidity risk

In view of the cyclical nature of its business and the investment and financing requirements resulting from the renewal of its aircraft, the Company has a liquidity policy to ensure a significant volume of available cash and current financial assets.

This cash position is invested in highly liquid, short-term instruments such as debt repos, eurodeposits and bank promissory notes arranged through top level banks, in accordance with the current counterparty risk policy.

In addition to the short-term investments and cash position, the Company has credit facilities that guarantee its liquidity requirements on a permanent basis.

8.2. Quantitative information

Following the aforementioned risk management policy, the Company arranges derivatives, mainly foreign currency, interest rate and aviation fuel price derivatives.

The most frequently used foreign currency derivatives are cross currency swaps, forwards and options. The most commonly used interest rate derivatives are interest rate swaps. The fuel price derivatives are mainly swaps and options.

The Company classifies its derivatives into three types:

1. Derivatives designated as cash-flow hedges: derivatives that mainly enable the cash flows from operating leases, ticket sales in currencies other than the euro and fuel purchases to be hedged.
2. Derivatives designated as fair value hedges: derivatives that enable the fair value of balance-sheet assets and liabilities to be hedged.
3. Other derivatives: derivatives that have not been designated as hedges or which do not meet the requirements established in accounting legislation.

Foreign currency hedges

At December 31, 2008, the derivatives hedging exchange fluctuations which had not been specifically designated as hedges under the Spanish National Chart of Accounts (since they are naturally offset in the income statement) were as follows:

Underlying	Currency	Amount (Millions of USD)	Derivative	Nominal amount (Millions of USD)
Loans to IBERBUS companies	USD	115	Cross Currency Swaps	20
Advances on aircraft and engines	USD	300	Fx swaps	178
Guarantees	USD	52		
A320 Equitys	USD	54		
4 A320/321 debt	USD	(164)		
5 A340 debt	USD	(185)		
Total		172		198

The fair value of these derivatives at December 31, 2008 was EUR -6 million and the EUR 9 million change in value as compared to January 1, 2008 was recognised in loss for the year, having offset the valuation gains on asset items.

At the balance sheet date, the total notional amount, by foreign exchange risk, of cash flow hedges was as follows:

Millions of USD

Underlying	Millions of USD	Type of hedge	Projected cash flows				
			2009	2010	2011	2012	2013
Foreign currency expenses	(1,367)	Cross Currency Swaps	292	187	150	57	36
		Options:					
		USD "Four Ways"	885	435	-	-	-
		USD "Collars"	22	-	-	-	-
		Fx Forwards	85	65	-	-	-
New aircraft	(80)	Options:					
		Fx Forwards	15	-	-	-	-

The market value at December 31, 2008 of the exchange rate derivatives (FX forwards and options) was positive and amounted to EUR 23 million. The net balance was made up of EUR 124 million recognised in the asset accounts

"Non-Current Financial Assets - Derivatives" and "Current Financial Assets - Derivatives", and EUR 101 million recognised under "Non-Current Liabilities" and "Current Liabilities" on the liability side of the accompanying consolidated balance sheet. These hedges are linked to cash flows that will arise in 2009 and 2010.

Changes in the fair value of foreign currency derivatives that are effective as cash flow hedges amounted to EUR 67 million, before the related tax effect and were deferred in equity, net of the related tax effect.

Changes in the fair value of the ineffective portion of forwards, amounting to EUR 1 million, were charged to income in 2008.

The foreign currency and interest rate risks related to aircraft leases were hedged with cross currency swaps (CCS) which convert payments originally in US dollars to euros.

The effect of a change in the EUR/USD exchange rates of more than 10% of the value of the hedges at December 31, 2008 would be approximately EUR -100 million. If the change in exchange rates were less than 10%, the change in value of the hedged position at December 31, 2008 would be positive at approximately EUR 105 million.

Cash flow hedges at December 31, 2008

Instrument	Company	Company	Amount (Currency in millions) (*)				
			Nominal amount at 31-12-08	Nominal amount at 31-12-09	Nominal amount at 31-12-10	Nominal amount at 31-12-11	Nominal amount at 31-12-12
Cross Currency Swaps: Floating to fixed	Receives USD	Pays EUR	417	208	173	127	88
Floating to floating	Receives USD	Pays EUR	683	435	190	-	-
Floating to floating	Receives EUR	Pays USD	599	296	77	-	-
Fixed to fixed	Receives USD	Pays EUR	307	187	74	75	50

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

Interest rate hedges

The Company uses cross currency swaps and interest rate swaps to manage its exposure to interest rate fluctuations on its aircraft financing transactions.

Instrument	Currency	Nominal Amount (Millions of USD)				
		31-12-08	31-12-09	31-12-10	31-12-11	31-12-12
Interest Rate Swaps Floating to floating (1)	USD	277	256	235	212	63

(1) The Company pays a floating interest rate with a cap and a floor and receives a floating interest rate

The fair value of the cross currency swaps and interest rate swaps arranged at December 31, 2008 amounted to EUR -52 million. Of this amount, EUR 25 million are recognised on the asset side of the balance sheet under "Non-Current Financial Assets - Derivatives" and "Current Financial Assets - Derivatives", and EUR 77 million are recognised on the liability side of the balance sheet under "Non-Current Liabilities" and "Current Liabilities". These hedges are linked to flows which will arise in 2009, 2010, 2011, 2012 and 2013.

The changes in value accumulated by the effective portion of the swaps in the cash flow hedges amounted to EUR 44 million, before the related tax effect, and were recognised in equity, net of the related tax effect. The changes in value accumulated by the ineffective portion (EUR -4 million) were allocated to profit for the year.

The effect of a change of more than 50 basis points in the euro interest rate curve on the value of the hedges at December 31, 2008 is approximately EUR 6 million. A change of less than 50 basis points would change the value of the hedged position at December 31, 2008 by approximately EUR -6 million.

A change of +/- 50 basis points in the USD interest rate curve would have the following effects: more than 50 basis points would affect the value of the hedges by approximately EUR -2 million. Conversely, a change of less than 50 basis points would have an effect of approximately EUR 2 million.

For the purposes of these calculations, the Company considers a change of this magnitude in the interest rate curves to be the most likely scenario during 2009. However, in order to simplify this analysis, it was considered that the change in interest rates would take place at 2008 year-end and would then remain stable in 2009.

Fuel price hedges

				2009
Underlying	Commodity	mT	Type of hedge	Nominal (mT)
Fuel purchases JET Kerosene	JET Kero CIF-NEW	1.95 millions	SWAPS	348,000
			Options: "Four ways"	660,000

Fuel price risk is hedged through swaps and options structures that hedge cash flow fluctuations due to changes in fuel prices within certain ranges.

The market value of the fuel derivatives amounted to EUR -373 million at December 31, 2008, which was recognised in full as a liability under "Current Liabilities" in the accompanying balance sheet.

The changes in value accumulated by the effective portion of the fuel derivatives amounted to EUR -380 million, before the related tax effect, and were recognised in equity, net of the related tax effect. The changes in value accumulated by the ineffective portion amounted to EUR -2 million and were allocated to profit for the year. Also, in 2008 settlements of excessive hedges amounting to EUR 23 million were recognised under "Change in Fair Value of Financial Instruments" in the accompanying income statement.

The effect of a change in fuel prices of more than 50% of the value of the hedges at December 31, 2008 amounts to EUR 150 million. In the case of a change in fuel prices of less than 50%, the change in value of the hedge position at December 31, 2008 would amount to EUR -119 million.

9. TRADE AND OTHER RECEIVABLES

"Trade and Other Receivables" in the accompanying balance sheet at December 31, 2008 includes mainly, the balances with customers for sales made directly by the Company, and with passenger and cargo agencies that market the services provided by the Company. It also includes the receivables from airlines mainly for the services provided by the Company in relation to tickets originally sold through other airline companies and, lastly, a balance with the tax authorities (see Note 13.1).

The allowances recognised by the Company on the basis of its analysis of the recoverability of accounts receivable, based on an ageing and a case-by-case analysis, form part of the balance of this heading.

10. EQUITY AND SHAREHOLDERS' EQUITY

10.1. Share capital

The changes in the Company's share capital in 2008 were as follows:

	Number of shares	Par value (euros)
Number of shares and par value of the share capital at January 1, 2008	952,908,815	0.78
Capital increase	194,193	0.78
Number of shares and par value of the share capital at December 31, 2008	953,103,008	0.78

In 2008 the Company increased capital by EUR 151,471 through the issuance of 194,193 ordinary shares of EUR 0.78 par value each, with a share premium of EUR 0.84 per share. This capital increase was performed to cater for the conversion into shares of the same number of convertible debentures issued to cover the share option plan approved by the shareholders at the Annual General Meeting in 2002 and aimed at certain executive directors, executives and other employees.

At December 31, 2008, the Company's shareholders were as follows:

	Number of shares	% of ownership
Caja de Ahorros y Monte de Piedad de Madrid	219,098,519	22.99
British Airways Holdings B.V.	125,321,425	13.15
Sociedad Estatal de Participaciones Industriales	49,212,526	5.16
El Corte Inglés, S.A.	32,151,759	3.37
B. Metzler seel. Sohn & Co	28,458,106	2.99
Other	498,860,673	52.34
	953,103,008	**100.00**

At December 31, 2008, all the shares were of the same class, were fully subscribed and paid and were traded by the book-entry system. The Company's shares are listed on the Spanish Stock Market Interconnection System and all carry the same voting and dividend rights.

10.2. Legal reserve

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

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

10.3. Share premium

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

10.4. Treasury shares

The changes in 2008 in "Treasury Shares" in the accompanying balance sheet were as follows:

	Number of shares	Millions of euros
Balance at January 1, 2008	8,050,000	19
Additions	20,255,916	46
Disposals	(407,645)	(1)
Balance at December 31, 2008	**27,898,271**	**64**

The treasury shares held by Iberia, Líneas Aéreas de España, S.A. at December 31, 2008 represent 2.93% of the share capital, with an aggregate par value of EUR 22 million and an average acquisition cost of EUR 2.31 per share. The average selling price of the Company's shares in 2008 was EUR 2.69 per share.

The treasury shares held by the Company at December 31, 2008 were intended for trading on the market.

11. LONG-TERM PROVISIONS

The detail of these provisions at December 31, 2008 and of the main changes therein in 2008 is as follows:

Millions of euros

	Balance at 01-01-2008	Additions	Amounts used	Transfers	Reversals	Balance at 31-12-2008
Provisions for long-term employee benefit obligations (Note 4.m)	641	67	(26)	(13)	-	669
Provision for restructuring costs (Note 4.l)	525	1	(106)	13	-	433
Provision for major repairs (Note 4.b)	64	25	(14)[a]	(1)	-	74
Other provisions (Note 4.o)	174	-	(5)	(6)	(30)[a]	133
	1,404	**93**	**(151)**	**(7)**	**(30)**	**1,309**

(a) Recognised under "Excessive Provisions" in the accompanying income statement.

11.1. Provisions for long-term employee benefit obligations

The additions to "Provisions for Long-Term Employee Benefit Obligations" include the period provision for the normal cost and for the amounts relating to the interest income from the provision already recognised, which is classified under "Staff Costs – Employee Benefit Costs" (EUR 42 million) and under "Finance Costs" (EUR

25 million) in the income statement for 2008. The disbursements in this connection are amortised on an approximately straight-line basis.

11.2. Provision for restructuring costs

The balance of "Provision for Restructuring Costs" relates to the present value of the liabilities arising from the voluntary collective redundancy procedure (see Note 4-l) approved in 2001 and extended until 2010 covering ground staff (3,968 employees at December 31, 2008). Additionally, the Company recognised a provision of EUR 19 million for the estimated cost of the group of employees who are expected to avail themselves of these measures, based on the cost commitments approved by the Company's directors.

The payments related to this provision will continue over the next seven years in accordance with the age of the employees who have availed or will finally avail themselves of the procedure.

11.3. Other provisions

"Other Provisions" includes the estimated amount required for probable liability of a diverse nature related mainly to litigation and unresolved tax assessments (see Note 4.0).

12. NON-CURRENT AND CURRENT LIABILITIES

The detail of "Non-Current Payables" and "Current Payables" at 2008 year-end is as follows:

Millions of euros

	Financial liabilities				
	Bank borrowings	Obligations under finance leases	Derivatives (Note 8)	Other financial liabilities	Total
Non-current payables	75	223	103	2	403
Current payables	115	55	448	21	639
Total	**190**	**278**	**551**	**23**	**1,042**

12.1.1. Bank borrowings

The detail, by maturity, of the loans and credit facilities from banks at December 31, 2008 is as follows:

Millions of euros

Debt	Currency	Maturing in					
		2009	2010	2011	2012	2013	Subsequent years
Principal	Euros	57	3	4	4	4	7
Principal	USD	58	53	-	-	-	-
		115	**56**	**4**	**4**	**4**	**7**

In 2008 the weighted average annual interest rates on the aforementioned loans and credit facilities were 5.23% for the euro loans and 4.86% for the loans in currencies other than the euro, most of which are tied to EURIBOR or LIBOR, respectively.

At December 31, 2008, the Company had arranged credit lines with a limit of EUR 201 million against which EUR 200 million had not yet been drawn down.

12.1.2. Obligations under finance leases

At December 31, 2008, the Company had contracted with lessors for the following minimum lease payments (including any purchase options), based on the leases currently in force:

Millions of euros

	Obligations denominated in euros	Obligations denominated in US dollars
Amounts payable under finance leases:		
Within one year	38	17
Between two and five years	90	124
After five years	3	6
Present value of finance lease obligations	**131**	**147**

13. TAX MATTERS

13.1. Tax receivables and accounts payable to public authorities

The detail of the tax receivables at December 31, 2008 is as follows:

Millions of euros

Deferred tax assets (*)	**595**
Current tax receivables:	
Foreign tax receivables	7
VAT	17
Other tax receivables	3
	27

(*) The source of these deferred tax assets is disclosed in Note 13.6.

The detail of the accounts payable to public authorities at December 31, 2008 is as follows:

Millions of euros

Deferred tax liabilities	**1**
Other accounts payable to public authorities:	
Take-off and security charges at airports	35
Foreign tax payables	35
Social security taxes	21
Personal income tax withholdings	29
Other tax payables	4
	124

13.2. Reconciliation of the accounting profit to the tax loss

The reconciliation of the accounting profit for 2008 to the tax loss for income tax purposes is as follows:

Millions of euros

	Increase	Decrease	Amount
Accounting profit for the year (before tax)			26
Permanent differences	2	(10)	(8)
Timing differences:			
Arising in the year	116 [(a)]	-	116
Arising in prior years	-	(210) [(b)]	(210)
Tax loss			**(76)**

(a) Relating mainly to period provisions for obligations to employees and other provisions for contingencies and charges and amounts received in 2008 in relation to credit memorandums and other deferred incentives.
(b) Relating basically to amounts used of provisions recorded in prior years for obligations to employees and income recognised in 2008 in relation to credit memorandums and other incentives received in prior years.

13.3. Taxes recognised in equity

The detail of the taxes recognised directly in equity in 2008 is as follows:

Millions of euros

	Increase	Decrease	Total
Deferred taxes:			
Available-for-sale financial assets	34	-	34
Measurement of other financial assets	101	(20)	81
Total deferred taxes	135	(20)	115
Total tax recognised directly in equity	**135**	**(20)**	**115**

13.4. Reconciliation of accounting profit to the income tax expense

The amount recognise under "Income Tax" in the accompanying income statement related to:

Millions of euros

	2008
Accounting profit before tax adjusted by permanent differences	**18**
Tax charge at 30%	**5**
Effect of temporary differences	
Tax credits:	
Double taxation	(3)
Investment	(2)
Other	**1**
Total income tax expense recognised in the accompanying income statement	**1**

Current Spanish income tax regulations provide certain tax incentives to encourage investments and contributions to employees' mutual funds. The Company has availed itself of tax relief in this connection and intends to take tax credits amounting to EUR 2 million in the income tax return for 2008. The Company also intends to take domestic and international double taxation tax credits amounting to EUR 3 million in the income tax return for 2008. The amounts reinvested in recent years and the related tax credits are as follows:

Millions of euros

	Reinvestment	Tax credits
2004	125	17
2005	825	129
2006	1	-
2007	123	16
2008	-	-

13.5. Detail of the income tax expense

The breakdown of the income tax expense is as follows (in millions of euros):

Millions of euros

	2008
Current tax:	
Continuing operations	-
Deferred tax:	
Continuing operations	2
Prior years' tax:	
2007 tax	(1)
Total tax expense	**1**

13.6. Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are recognised in the balance sheet under "Deferred Tax Assets" and Deferred Tax Liabilities" as follows:

Millions of euros

	Deferred tax assets	Deferred tax liabilities
Temporary differences arising in the year	149	-
Temporary differences arising in prior years not yet reversed	418	1
Tax loss carryforwards	23	-
Tax credits	5	-
Total	**595**	**1**

The deferred tax assets arose mainly from the provisions made for obligations to employees and other provisions which will become tax deductible in coming years and from income received in relation to credit memorandums and other deferred aircraft-related incentives. Also included are the taxes recognised directly in equity (see Note 13.3).

The changes in "Deferred Tax Assets" in 2008 were as follows:

Millions of euros

	Balance at 01-01-08	Additions	Disposals	Balance at 31-12-08
Deferred tax assets	483	177	(65)	595

The deferred tax assets at December 31, 2008 are expected to be recovered as follows:

Millions of euros

Year of recovery	
2009	216
2010	40
2011 and subsequent years	339
	595

13.7. Tax audits

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

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

In the tax audit performed in 2007 and 2008, the tax authorities issued assessments for income tax for 2002 to 2004, and VAT and non-resident income tax for 2003 to 2004. The non-resident income tax assessments were contested by the Company.

The directors consider that no tax liabilities additional to those recognised under "Long-Term Provisions - Other Provisions" will arise from the resolution of the various appeals described above (see Note 11).

The Company is currently being audited in relation to personal income tax withholdings for 2003 and 2004.

In relation to the non-statute barred years, from 2005 to 2008 for all the taxes applicable to the Company, the directors do not expect any liabilities to arise in addition to those recognised, which could have a significant impact on the financial statements.

14. TRANSACTIONS IN CURRENCIES OTHER THAN THE EURO

The detail of the most significant transactions in currencies other than the euro, measured at the average exchange rate, is as follows:

	Millions of euros
Sales	1,450
Services rendered	234
Purchases	1,035
Services received	629

The most significant balances in currencies other than the euro relate mainly to advances on aircraft, accounts receivable for ticket sales and maintenance services rendered and accounts payable for fuel and spare part purchases.

The exchange differences recognised in profit or loss, by class of financial instrument, relate mainly to derivatives and bank borrowings.

15. INCOME AND EXPENSES

a) Revenue

The breakdown of the Company's revenue for 2008 is as follows:

Millions of euros

By activity	
Passenger ticket revenue [a]	4,218
Cargo revenue	309
Handling (aircraft dispatching and airport services)	275
Technical assistance to airlines	297
Other income	89
	5,188

(a) Including other income (recovery of unused tickets, commercial agreements, etc.) amounting to EUR 327 million.

The breakdown of passenger ticket revenue excluding "Other Income", by network, is as follows:

Millions of euros

Network	
Domestic	929
Medium haul	1,124
Long haul	1,838
	3,891

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b) Other operating income

The detail, by item, of "Other Operating Income" in the accompanying income statement for 2008 is as follows:

Concept	Millions of euros
Sundry income, grants and other current operating expenses:	
Commissions	80
Rental income	18
Other sundry income	100
	198
Other non-recurring income	35
	233

The income from commissions relates basically to the commissions on the sale of tickets for other airlines, the commissions arising from the franchise agreement with Air Nostrum and the sale of tickets for Clickair, S.A. under the Iberia code.

"Other Non-Recurring Income" includes mainly EUR 15 million relating to the settlement received from an insurance company.

c) Procurements

The detail of "Procurements" in the accompanying income statement for 2008 is as follows:

	Millions of euros
Aviation fuel	1,666
Aircraft spare parts	160
Catering materials	21
Other purchases	17
	1,864

d) Detail of purchases by origin

The detail, by origin, of the purchases made by the Company in 2008 is as follows (in millions of euros):

	Spain	EU countries	Imports
Purchases	777	79	1,034

e) Headcount

The number of employees, measured in terms of average headcount, by professional category, in 2008 was as follows:

	Number of employees
Senior executives	**10**
Ground personnel:	
Senior Managers and other line personnel	1,113
Clerical Staff	5,587
Ancillary Services	4,986
Aircraft Maintenance Technicians	2,875
Other	1,207
	15,768
Flight personnel:	
Pilots	1,644
Cabin Crew	3,923
	5,567
	21,345

The distribution by gender and professional category of the workforce at December 31, 2008 was as follows:

	Women	Men
Senior executives	**1**	**9**
Ground personnel:		
Senior Managers and other line personnel	430	714
Clerical Staff	3,982	1,966
Ancillary Services	479	4,941
Aircraft Maintenance Technicians	31	2,894
Other	552	679
	5,474	**11,194**
Flight personnel:		
Pilots	60	1,608
Cabin Crew	3,084	1,070
	3,144	**2,678**
	8,619	**13,881**

f) Other operating expenses

The detail of “Other Operating Expenses” in the accompanying income statement is as follows:

	Millions of euros
Outside services:	
Air traffic services	361
Leased aircraft (Note 5):	
Dry lease	324
Wet lease	33
Cargo	16
Other	13
Navigation charges	258
Aircraft maintenance	228
Commercial expenses	201
Booking system expenses	137
Other rent	75
In-flight services	72
Other maintenance	49
Stopover expenses	37
Indemnities for passengers, luggage and cargo	33
Royalties	24
Incident expenses	16
Other operating expenses	256
	2,133

“Aircraft Maintenance” includes the expenses for subcontracted maintenance work and the provision for major repairs of aircraft operated under operating leases.

The fees for financial audit services provided to Iberia, Líneas Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related to the principal auditor amounted to EUR 611,500 in 2008. Also, the fees for other professional services provided to Iberia, Líneas Iberia Aéreas de España, S.A. and Group companies by the principal auditor and by other entities related to the principal auditor amounted to EUR 428,000 in 2008.

g) Finance income

The detail of “Finance Income” in the accompanying income statement is as follows:

	Millions of euros
Interest on short-term deposits	122
Interest on loans to associates	4
Other finance income	11
	137

h) Finance costs

The detail of “Finance Costs” in the accompanying income statement is as follows:

	Millions of euros
Interest on loans	6
Interest on finance leases	15
Interest on employee liabilities	25
Other finance costs	6
	52

16. RELATED PARTY TRANSACTIONS

Related party transactions

In 2008 the Company performed the following transactions with related parties:

Millions of euros

Expenses and income	31-12-2008		
	Significant shareholders	Persons, companies or entities of the Group	Total
Expenses:			
Finance costs	4	-	4
Services received	24	61	85
Purchases of goods (finished or in progress)	4	-	4
	32	61	93
Income:			
Services rendered	37	122	159
	37	122	159

Millions of euros

Other transactions	31-12-2008	
	Significant shareholders	Total
Purchases of property, plant and equipment, intangible assets or other assets	9	9
Financing agreements: loans and capital contributions (borrower)	88	88
Guarantees received	51	51

In 2008 the Company performed the following transactions with related parties:

Millions of euros

Significant shareholders	2008	
	Collected from Iberia	Paid to Iberia
British Airways	8	37
El Corte Inglés Group	29	-
Caja Madrid	4	-
	41	37

The transactions with British Airways relate mainly to commissions on passenger tickets collected from and paid to this company, for tickets issued by one company with the related flight being flown by the other, collections and payments arising from loyalty building programmes, and collections and payments for handling services provided.

The main transactions with the El Corte Inglés Group relate to the supply of uniforms for flight personnel, commissions and incentives for passenger ticket sales under commercial agreements, technical advisory services and computer software and hardware maintenance and development.

Lastly, the transactions with Caja Madrid relate to interest on aircraft financing transactions, guarantees provided for aeroplanes and other items.

Related party balances

The detail of the balances with related parties at December 31, 2008 is as follows:

	Significant Shareholders	Persons, Companies or Entities of the Group	Total
Trade receivables	18	36	54
Cash	13	-	13
Current payables	-	9	9
Trade payables	4	19	23

17. REMUNERATION AND OTHER BENEFITS OF DIRECTORS AND SENIOR EXECUTIVES

The breakdown of the remuneration received in 2008 by the directors of Iberia, Líneas Aéreas de España, S.A. is as follows:

Thousands of euros

Remuneration of the Board of Directors	
Fixed remuneration	780
Attendance fees	774
Compensation in kind	85
Total remuneration	**1,639**

In 2008 Iberia, Líneas Aéreas de España, S.A. incurred expenses relating to the performance of non-executive directors' functions amounting to EUR 5,000.

In addition, one of the directors holds an executive position in the Company for which he received the following remuneration in 2008:

	Thousands of euros
Fixed remuneration	693
Variable remuneration	503
Compensation in kind	11
	1,207

The social security, insurance and other costs recognised by Iberia, Líneas Aéreas de España, S.A. arising from the activities carried on by the executive director amounted to EUR 128,000.

In 2008 the Company did not grant any advances or loans to the directors and it did not have any pension obligations to them.

Remuneration of senior executives

The detail of the remuneration received by the Company's senior executives -excluding those who are simultaneously directors (whose remuneration is detailed above)- in 2008 is summarised as follows:

Thousands of euros

Concept	
Salary (fixed and variable)	3,010
Compensation in kind	112
Insurance premiums	151
	3,273

In 2008 no advances or loans were granted to the members of the Management Committee of Iberia, Líneas Aéreas de España, S.A. and there were no pension obligations to them.

18. DETAIL OF INVESTMENTS IN COMPANIES ENGAGING IN SIMILAR ACTIVITIES AND OF THE PERFORMANCE, AS INDEPENDENT PROFESSIONALS OR AS EMPLOYEES, OF SIMILAR ACTIVITIES BY THE DIRECTORS

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

Name	Line of Business	Type of Arrangement	Company	Position/Function
Mr. Miguel Blesa de la Parra	Handling	Employee	Flightcare (FCC)	FCC Board Member
Mr. Roger Maynard	Air transport	Employee	British Airways	Director of Investments
	Air transport	Employee	BA Citiflyer and BA European	Executive/Director
Lord Garel-Jones	Handling	Employee	Acciona	Director

Fernando Conte is also a member of the Board of IATA.

Also, pursuant to the aforementioned Law, it is hereby stated that the only directors who own any equity interests in companies engaging in an activity that is identical, similar or complementary to the activity that constitutes the company object of Iberia, Líneas Aéreas de España, S.A. and subsidiaries are Miguel Blesa de la Parra, who has a 0.004% ownership interest in Flightcare indirectly through FCC, and Roger Maynard, who has a 0.0004994% ownership interest in British Airways.

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

19. INFORMATION ON THE ENVIRONMENT

In the context of its environmental policy, in 2008 Iberia, Líneas Aéreas de España, S.A. continued to carry out various activities and projects with the aim of ensuring that the main effects on the environment caused by its air transport activities taken as a whole are properly managed.

In 2008 the Company incurred environmental expenses amounting to EUR 4 million, the detail of which is as follows:

	Millions of euros
Environmental repair and maintenance	1
Staff costs relating to environmental management	1
Environmental taxes and other	2
	4

Also, the environmental assets, which include, inter alia, water-treatment plants, hazardous waste storage facilities, gas recharge and filter systems and water recycling infrastructure, had an acquisition cost of EUR 77 million and accumulated depreciation of EUR 52 million at December 31, 2008.

With respect to its aircraft, the Company has a renewal policy in which the environment (minimising the impact of noise and air emissions) is an important factor to be borne in mind. Also, the Company continued to introduce new models that reduce fuel consumption by around 20% compared to previous-generation aircraft. In this regard, in 2008 3 A320 aircraft were added and 3 B757 and 23 MD aircraft were retired.

In the area of ground operations, the Company achieved certification under the ISO 14001/AENOR Environmental Management System standard including the Company's aircraft maintenance facilities at Barajas airport in Madrid. As a result of this certification, together with the existing ones in handling and the Company's other maintenance facilities, all of the Company's significant environmental issues are covered by external certification.

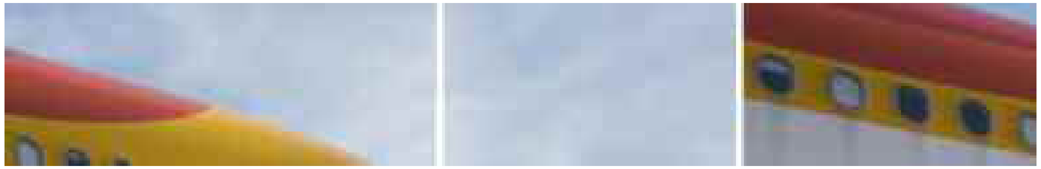
The Company considers that any possible environmental contingencies that might arise are covered sufficiently by its third-party liability insurance policies and by the provisions relating to probable or certain third-party liability arising from litigation in progress or from outstanding indemnity payments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

Lastly, the environmental investments made in 2008 amounted to EUR 1 million.

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.

20. EXPLANATION ADDED FOR TRANSLATION TO ENGLISH

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



MANAGEMENT REPORT

Management Report

KEY DATA

IBERIA	2008	2007	% Change
Income and result (millions of euros)			
Recurring operating income	5,415	5,494	(1.4)
EBITDAR (1)	496	926	(46.4)
Profit (Loss) from recurring operations	(88)	284	(131.0)
Profit (Loss) from operations (2)	(4)	310	(101.2)
Profit before tax	26	448	(94.3)
Profit for the year	25	323	(92.3)
Basic earnings per share (euro cents) (3)	2.7	34.2	(92.2)
Dividends per share (euro cents)	-	17.0	-
Passenger traffic: capacity and revenue			
ASK (millions)	66,098	66,454	(0.5)
RPK (millions)	52,885	54,229	(2.5)
Load factor (%)	80.0	81.6	(1.6 p.)
Passenger ticket revenue (millions of euros)	3,891	4,034	(3.5)
Average revenue per RPK (euro cents)	7.36	7.44	(1.1)
Average revenue per ASK (euro cents)	5.89	6.07	(3.0)
Financial aggregates and ratios			
Equity (millions of euros)	1,525	1,981	(23.0)
Net debt per balance sheet (millions of euros) (4)	(1,782)	(2,474)	(28.0)
Adjusted net debt (millions of euros) (5)	1,034	558	85.2
Operating profit margin (%) (1)	(1.6)	5.2	(6.8 p.)
Net profit margin for the year (%)	0.5	5.9	(5.4 p.)
Operating income per ASK (euro cents) (1)	8.19	8.27	(0.9)
Operating cost per ASK (euro cents) (1)	8.32	7.84	6.2
Operating cost per ASK excluding fuel (euro cents) (1)	5.80	6.11	(5.0)
Resources			
Average number of equivalent employees	21,345	22,300	(4.3)
Operating income per employee (thousands of euros) (1)	254	246	3.0
Productivity (thousands of ASK per employee)	3,097	2,980	3.9
Operating aircraft at December 31	119	136	(12.5)
Fleet utilisation (block hours per aircraft per day)	10.0	9.6	4.3

IBERIA GROUP	2008	2007	% Change
Income and result (millions of euros)			
Recurring operating income	5,450	5,522	(1.3)
EBITDAR (1)	500	932	(46.4)
Profit (Loss) from recurring operations	(79)	284	(127.9)
Profit before tax	36	447	(91.9)
Consolidated profit for the year	32	328	(90.2)
Financial aggregates and ratios			
Equity (millions of euros)	1,564	2,006	(22.0)
Adjusted net debt (millions of euros) (5)	1,012	532	90.3
EBITDAR margin (%) (1)	9.2	16.9	(7.7 p.)
Operating profit margin (%) (1)	(1.5)	5.1	(6.6 p.)
Consolidated profit margin (%)	0.6	5.9	(5.3 p.)

(1) EBITDAR, income margins, unit revenue and costs exclude non-recurring items.
(2) Profit from operations includes profit from recurring and non-recurring operations.
(3) Weighted average number of shares outstanding (in thousands): 929,348 in 2008 and 945,467 in 2007.
(4) Negative figure means cash and cash equivalents exceed interest-bearing debt (excluding interest on finance leases).
(5) Net debt per balance sheet + Capitalised aircraft leases – Capitalised interest on Iberbus loans.

Management Report

1. HIGHLIGHTS

Economic backdrop and performance of the airline industry

The sub-prime mortgage crisis in the US in mid-2007 triggered a period of extraordinary financial turmoil, marked by a general loss of confidence in the economic players and by much tighter lending conditions. The prolonged international financial crisis is affecting world economic growth, which suffered a progressive slowdown in 2008. Consequently, International Monetary Fund (IFM) estimates indicate that the increase in the gross world product (GWP) for 2008 taken as a whole was only 3.4% compared with 5.2% in 2007.

Oil prices and prices of raw materials in general experienced intense volatility in 2008. Oil prices reached very high levels in the first half of the year, culminating in an all-time high in July, and exerting additional adverse pressure on world economic activity and, in particular, on airline profitability, thereby heightening the uncertainty over their future performance. In the second half of the year the weakening of the world economy and the marked dampening of expectations led to a significant drop in fuel prices.

The industrialised countries have suffered most as a result of the economic downturn, with the majority entering into recession in the second half of the year. The emerging countries continued to grow, although at a slower rate. The Spanish economy is going through a serious correction, brought about by the effects of the international financial crisis and by the conclusion of a long expansion phase that was primarily driven by the growth in the construction industry and domestic demand. Spain registered a significant increase in unemployment and a drop in consumption in the second half of 2008. Thus, Spanish GDP growth was 1.2% for the year (according to the most recent data published by the European Commission), which represents a loss of 2.5 points with respect to the growth achieved in 2007.

Growth of actual GDP (a)	2008	2007
At world level (b)	3.4	5.2
US	1.1	2.0
Euro zone (b)	1.0	2.6
Japan	(0.3)	2.4
Latin America and the Caribbean (b)	4.6	5.7
Spain	1.2	3.7

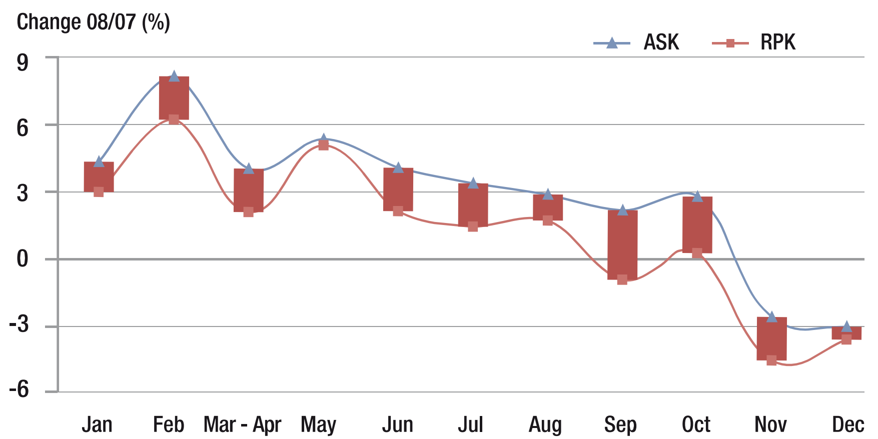
Sources: IMF, World Economic Outlook (January 2009),
(a) Annual change in Gross Domestic Product percentage, constant prices.
(b) The world and regional growth aggregates relate to the weighted average GDP per levels of purchasing power.

Poor economic performance had a significant impact on the world airline industry. According to the most recent estimates of the International Air Transport Association (IATA), airlines lost USD 5,000 million in 2008, negatively affected by high fuel prices in the first half of the year when they reached historic levels and by the progressive decline in demand during the second half of the year due to the close ties between economic growth and air traffic performance.

IATA considers that in the airline industry taken as a whole, the volume of international passenger traffic in 2008 only grew 1.6% with respect to 2007, and international cargo traffic decreased 4.0%. Growth in demand was still solid in the first months of the year, but it suffered a gradual slowdown, registering year-on-year declines in the final months of 2008 (in December international passenger traffic decreased 4.6% with respect to 2007, while cargo traffic plunged 22.6%).

Similarly, growth in demand for European network airlines decreased throughout 2008. According to preliminary data from the Association of European Airlines (AEA), revenue passenger-kilometres (RPK) on scheduled flights increased 1.2% in 2008, registering moderate increases in the summer and decreases towards year-end. With 3.0% growth in available seat-kilometres (ASK), the load factor of the AEA fel 1.3% in relation to 2007, to stand at 76.0%. Regarding cargo traffic for the European network carrier, over the twelve months as a whole, revenue tonne-kilometres (RTK) fell 2.8% with respect to 2007 with monthly drops from July onwards.

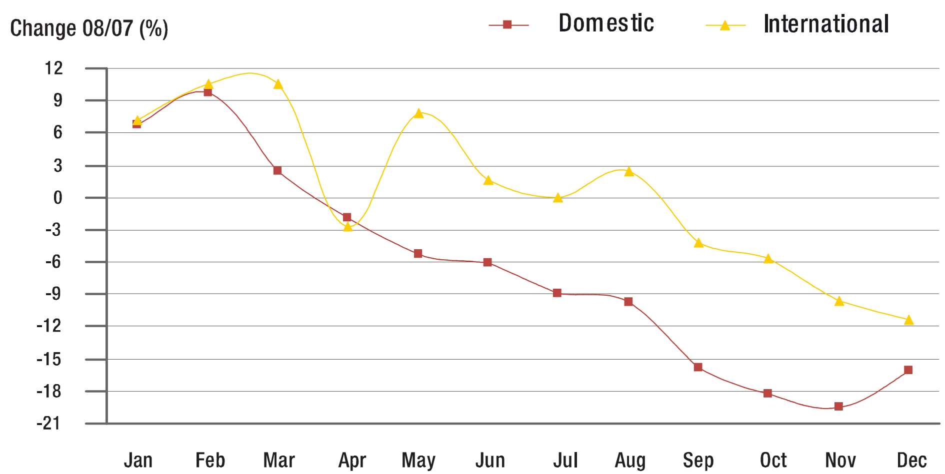
Total AEA scheduled traffic.
Monthly change in 2008 with respect to 2007



Data for March and April are presented together to avoid distortion due to the different Easter calendar in 2007 and 2008 when comparing monthly activity for the two years.

In addition to the impact of the economic crisis, the Spanish airline industry had to meet the challenge of considerable railway infrastructure development with the launch of the new high-speed lines linking Madrid and Málaga (since December 2007) and Madrid and Barcelona (from February 2008). Thus, the Spanish airline industry lost an extraordinary number of passengers in the second half of 2008 and suffered the suspension of operations of certain airlines. According to AENA (the Spanish public airports and aviation agency) data, the number of passengers on commercial flights (domestic and international) dropped 3.0% in 2008 as a whole with respect to 2007, with a sharp decline in domestic traffic without precedent in the history of the Spanish airline industry, beginning in April, and a progressive slowdown of international traffic, which registered declines from September onward.

No. of passengers at AENA airports.
Monthly change in 2008 with respect to 2007



Operational and economic performance of the Iberia Group

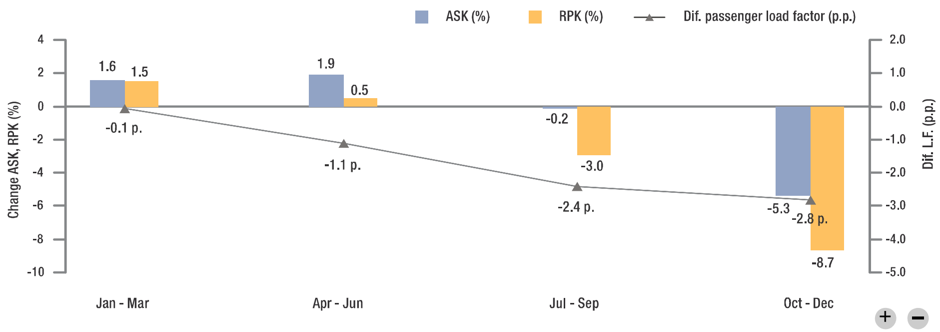
The negative panorama which the airline industry faced influenced the Iberia Group's performance in 2008. In particular, the increase in the fuel expense (up EUR 521 million on 2007) had a significant impact on operating results which were partially cushioned by the success of the achievement of the objectives of the 2006-2008 Master Plan. In 2008 the Company worked diligently to adapt rapidly to the change in the economic cycle and explored possible strategic agreements to improve its competitive position in the markets.

Iberia, Líneas Aéreas de España, S.A. ("Iberia") completed the revision and optimisation of the flight programme in 2008, one of the strategic cornerstones of the 2006-2008 Master Plan, thereby consolidating its position as a network carrier. The Company increased the capacity made available on its short and medium-haul flights from/to Madrid by 8.6% with respect to 2007, and strengthened its hub connections. It also completed the planned supply adjustments to domestic point-to-point connecting flights and, to a lesser extent, to international medium-haul flights.

In addition, as a result of the worsening international economic situation, the Company had to make certain selective adjustments to its flight offerings in response to the progressive slackening of demand in the markets in 2008.

As a result of far-reaching network restructuring and the aforementioned additional adjustments, the total supply of the Company decreased slightly (0.5% with respect to 2007). The year-on-year changes in traffic (measured in RPK) performed negatively in 2008, growing 1.0% in the first half of the year and falling 5.7% in the second half, resulting in a 2.5% decrease over the twelve months taken as a whole. The passenger load factor stood at 80% in 2008, down 1.6 points on the record level achieved in 2007, and remained within the highest range among comparable European companies.

Iberia's passenger traffic and supply. Quarterly change 2008 / 2007



Quaterly performance of the business activity reflects the progressive slackening of demand, particularly in the last months of the year, affected by the worsening of the economic situation. The Company gradually made more capacity adjustments in 2008: the volume of supply went from increasing by 1.7% in the first half of the year to falling by 0.2% in the third quarter and by 5.3% in the fourth.

In the long-haul sector, Iberia had to bring its supply into line with the gradual slowdown in demand throughout 2008 which, due to the effects of the economic crisis, suffered decreases from September onwards. Over the twelve months taken as a whole, traffic rose by 0.5% with respect to 2007, with a 3% increase in volume of supply, thereby enabling the Company to maintain its position of leadership in the Europe-Latin America market.

In 2008 Iberia and American Airlines extended the scope of their code-share agreement, to include a total of 25 new US destinations operated by the American company with the Iberia marketing code. As a result, at year-end the Spanish Company marketed a total of 47 US destinations, five of which are Company operated.

Furthermore, Iberia, American Airlines and British Airways entered into a joint business agreement in August 2008 in order to promote their commercial cooperation covering their flights between Europe and North America. This may be extremely important in the future within the framework of opportunities arising from the "Open Skies" agreement in force since March 31, 2008. The undertaking arising from the agreement between these three members of the oneworld alliance is in the process of obtaining anti-trust immunity from the American and European anti-trust authorities.

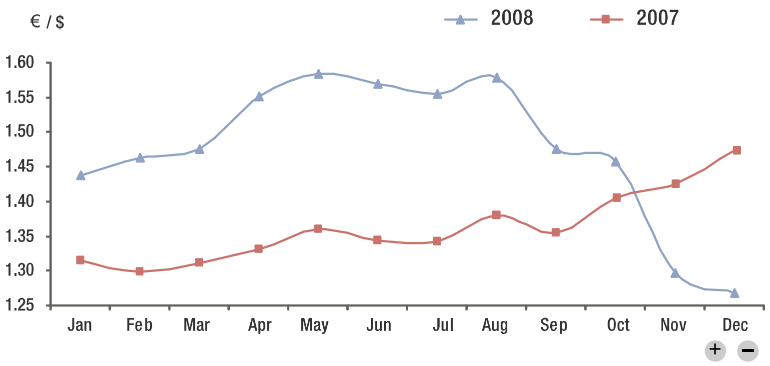
In the international medium-haul sector, traffic increased by 3.4% in 2008 with respect to 2007 due to the strengthening of connections with the hub. In the aggregate of international medium-haul flights with arrival in or departure from Madrid, the volume of supply (measured in ASK) increased by 16.1% with respect to 2007, increasing demand by 16.7% and raising the load factor 73.7%. Iberia added Dubrovnik to its network of European destinations in the summer season.

In accordance with the planned network restructuring strategy, the volume of supply in the domestic sector fell by 17.1% with respect to 2007, due to a 22.1% drop in demand weakened by the worsening economic situation and by the impact of the entry into service of the high-speed railway lines. Iberia reduced the number of seats made available on the Madrid-Barcelona route (Madrid-Barcelona shuttle and flights with reservation) by 21.8% with respect to 2007-despite frequencies scarcely being reduced- to adapt to strong railway competition in the corridor which since February 20, gradually increased its supply. As regards the other domestic flights operated in the hub, the capacity made available increased by 2.9% in relation to 2007.

The gradual deterioration of the economy particularly affected airline business traffic. As a result, the number of passengers travelling Business Plus class on the Iberia long-haul flights decreased by 2.4% with respect to 2007, with an increase of 0.3% in the number of total passengers in the sector which exceeded 4.2 million in 2008. As regards flights between Spain and Europe, business traffic decreased by 13.2% in 2008 in the market as a whole, expanding Iberia's market share by 1.8 points with respect to 2007.

The Iberia Group's operating income decreased by 0.4% in 2008 with respect to 2007. Once the non-recurring items were excluded, operating income stood at EUR 5,450 million, down 1.3% from 2007. When analysing these year-on-year changes, the impact of the depreciation of the dollar against the euro during most of the year must be taken into account, and although there was a sharp appreciation of the US currency in the last quarter, the average exchange rate in 2008 exceeded that of the previous years by 8%. This appreciation of the euro reduced the operating income and expenses, having a moderately positive effect on profit before tax. With constant exchange rates, consolidated operating income (recurring) would have increased slightly.

Development of Euro / Dollar exchange rate



In 2008 the passenger revenue for the Iberia Group decreased by 2.5% in relation to 2007 due to the lower volume of traffic and the 1.1% decrease in the average revenue per RPK (or yield) with respect to 2007 for the network as a whole. The drop in yield was due mainly to the effect of the increase in the average stage length (12.6% in relation to 2007) and to the decrease in the value of the dollar against the euro. With constant exchange rates, the average revenue per RPK would have increased by 1.3% with relation to 2007. The Company managed to obtain an increase in yield in 2008, achieving 2.2% growth with respect to the last quarter of 2007.

The aggregate amount of other recurring operating income increased by 2.9%, with yet another year of strong progress in revenue from aeronautical maintenance services (up 8.7% on 2007). In accordance with the 2006-2008 Master Plan, Iberia has consolidated this business area, promoting the execution of higher value added work for other airlines, consisting mainly of engine and component inspections, and the outsourcing of jobs requiring a lower level of expertise.

Although the Company's cargo traffic was down by 5.6%, seriously affected by the economic crisis over the last months of the year, the Iberia Group's cargo revenue increased by 1.0% with respect to 2007. This was due mainly to an increase in unit revenue per tonne-kilometre (4.9%), despite being adversely affected by the negative impact of the depreciation of the dollar and by the increase in the average stage length.

The handling services at Spanish airports continued to adapt to a significantly more fragmented and competitive market since the beginning of March 2007, when the effective incorporation of new ramp-handling operators was completed. In addition, the sector was also adversely affected by the decrease in Spanish air traffic in 2008 (according to AENA data, the number of operations at the airports registered a decrease of 3.0% with respect to 2007).

In this difficult environment, Iberia performs third-party handling services at 36 airports, and in addition, since March 2007, the Company has participated in the unincorporated joint ventures (UTE) which were awarded public tenders in Barcelona, Lanzarote and Fuerteventura. In 2008 the Company continued to develop diverse initiatives to improve resource flexibility and productivity, safeguard the customer portfolio, increase process efficiency and provide new services at the airports, of particular note being the award of licenses for services to passengers with reduced mobility to the unincorporated joint ventures participated in by Iberia at the main airports, thereby stabilising its position in the new competitive market. In 2008 consolidated handling revenue decreased by 1.8% with respect to 2007, due partly to the effect of a non-uniform comparison since in the first two months of 2007, Iberia still provided service to the five airports (the three discussed and Almeria and Jerez de la Frontera) at which new licenses were not awarded.

In 2008 the Iberia Group's operating expenses increased by 4.0% with respect to 2007. Once the non-recurring items were excluded, which amounted to EUR 6.0 million in 2008 and EUR 81 million in 2007, operating expenses stood at EUR 5,529 million, 5.5% above the 2007, figure due mainly to the sharp increase and volatility of the price of fuel in 2008, the impact of which was partially offset by the cost-cutting measures included in the 2006-08 Master Plan together with the positive effect of the depreciation of the dollar against the euro.

JET CIF NWE – Development 2005 - 2008

In the first half of 2008, oil and refined product prices, as in the case of aviation kerosene, continued the upward trend of 2007 to reach all-time highs. According to the Jet CIF NWE index, the price of kerosene began the year fluctuating around USD 900 per metric tonne, and continued to rise until reaching more than USD 1,400 in July. From July onwards, unpredictably, the price of kerosene changed its trend, beginning a sharp decline which brought it down below USD 500 per tonne (a level it has not reached since the beginning of 2005). Despite falling sharply in the final months of 2008, the average market price of kerosene in dollars increased by 41% with respect to 2007.

The Iberia Group's fuel expense increased by 45.5% in 2008, to stand at EUR 1,666 million (30.1% of the total consolidated operating expenses), due to a sharp rise in the average price in dollars after hedges, partially offset by the depreciation of the dollar and by enhanced aircraft fuel consumption efficiency.

The other recurring operating expenses amounted to EUR 3,863 million, down EUR 230 million from 2007, which represents a considerable reduction of 5.6%. Recurring staff costs were down 4.4% in relation to 2007 due to a significant reduction in the Group's average number of employees (4.2%) and the containment of salary increases. It should be noted that aircraft lease costs decreased by 10.9% in 2008 due mainly to the fall in interest rates and the improved prices obtained in new operating leases. There was also a significant decrease in commercial expenses (down 17.4% on 2007).

The Iberia Group's unit operating cost increased to 8.36 euro cents per ASK in 2008, up 6.1% on 2007. Excluding the fuel expense, the unit cost was 5.84 euro cents per ASK, a decrease of 5.1% with respect to 2007 as a result of rigorous cost control.

In 2008 the productivity of resources at the Company continued to improve. The average aircraft utilisation stood at ten block hours per aircraft per day, up 4.3% on 2007. Iberia employee productivity (in terms of ASK per employee) increased by 3.9% with respect to 2007.

In 2008 the Iberia Group's profit from operations amounted to EUR 5 million compared with EUR 413 million in 2007.

The net financial balance stood at EUR 85 million in 2008, increasing by EUR 19 million with respect to 2007, although it was offset in part by the effect of the valuation of the derivatives, and to a lesser extent, by the exchange differences. Accordingly, in 2008, the aggregate financial profit amounted to EUR 49 million. The balance of the share of results of the Group's associates improved by 40% with respect to 2007 to stand at EUR 18 million of losses in 2008.

As a result of all the foregoing, the profit after tax of the Iberia Group amounted to EUR 32 million in 2008, the thirteenth consecutive year of profit.

At year-end, the consolidated balance sheet reflected the sound financial position of the Company with equity of EUR 1,564 million and a cash balance of EUR 2,351 million.

Corporate Culture

The tenets of Iberia's corporate culture form part of its corporate responsibility policy, and include the mission, vision and values shared by all the employees.

Iberia's mission is to offer air transport, airport and aircraft maintenance services that live up to the expectations of our customers and create economic and social value on a sustainable basis.

Iberia seeks to become the leading company in terms of customer satisfaction in its strategic markets (Latin America, Europe and Domestic), and to offer the optimal price/service quality relationship. Iberia wishes to offer its shareholders notable and sustained profitability and strives to attain the maximum professional development of all its employees.

Iberia endeavours to be recognised for its transparency and its firm social and environmental commitment. Accordingly, the Company is committed to entities that implement social cooperation projects and improve living conditions by promoting the involvement of its customers and suppliers and counting on the active participation of its employees. Also, Iberia pursues a global environmental protection policy that includes all its activities, both on the ground and in flight.

Iberia is committed to innovation, ongoing improvement and management excellence as key tools to create value and guarantee the future of the Company.

In recognition of the actions implemented by the Company in this field, in 2008 Iberia simultaneously joined the most prestigious stock market indexes; the select European Dow Jones Sustainability STOXX Index and the Dow Jones Sustainability Index World and the FTSE4Good IBEX. These indexes select the companies with the best practices in economic, social and environmental matters, of which only three are airlines.

The Corporate Responsibility Report provides ample information on these matters.

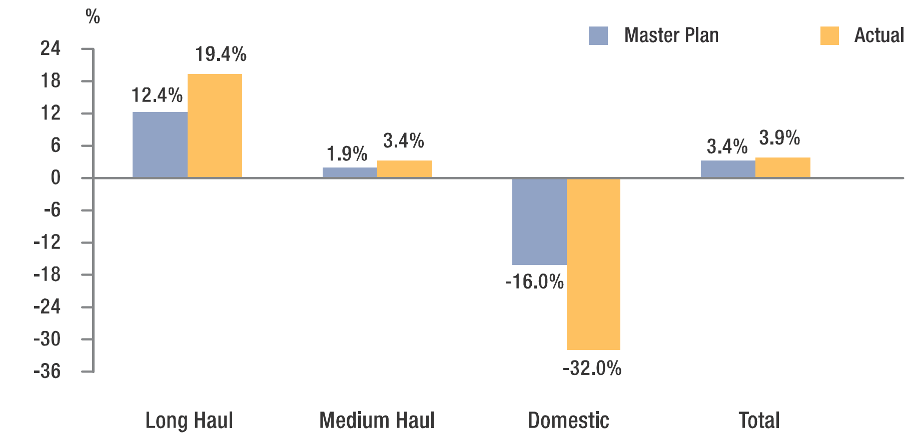
Fulfilment of the 2006-2008 Master Plan

Following the implementation of the 2006-2008 Master Plan and the evaluationof the measures put into practice, the conclusion reached is that the level of compliance with the main strategic objectives was very high. The network revision and optimisation process was completed and the total volume of revenue increased, clearly beyond initial projections. Operating costs were reduced as planned and the productivity of resources, in general terms, increased although flight crew productivity grew to a lesser extent.

One of the cornerstones of the 2006-2008 Master Plan was the revision and optimisation of the flight programme in order to strengthen network operations. The Company bolstered its activity at the Madrid-Barajas airport, operating out of the new Terminal 4 facilities from February 2006 onwards. Iberia performed a complex and extensive restructuring of the short and medium-haul programme from 2006 to 2008, making selective adjustments to European routes, and to a greater extent, to domestic connections while strengthening its hub connections. As a result, in 2008 the volume of capacity in the international medium-haul sector exceeded the number of ASKs (available seat-kilometres) in 2005 (base year of the Master Plan) by 3.4%, while capacity in connecting flights from Madrid to Europe rose by more than 45% over the three years taken as a whole.

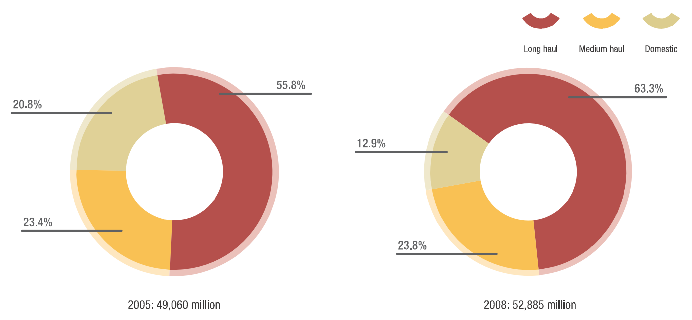
Also, Iberia significantly increased long-haul-flight capacity over the three-year period (up 19.4% on 2005), thereby exceeding the Master Plan's target for growth in this sector by seven percentage points. Furthermore, as a result of this expansion the Company consolidated its strategic position as the leading airline in connecting flights between Europe and Latin America, obtaining a market share of 19.2% in 2008, up 1.7 points on 2005. The cumulative increase in supply in the aggregate of all of the sectors was 3.9% with respect to 2005, slightly more than the growth planned.

Growth of supply (in ASK). Cumulative change 2008 / 2005



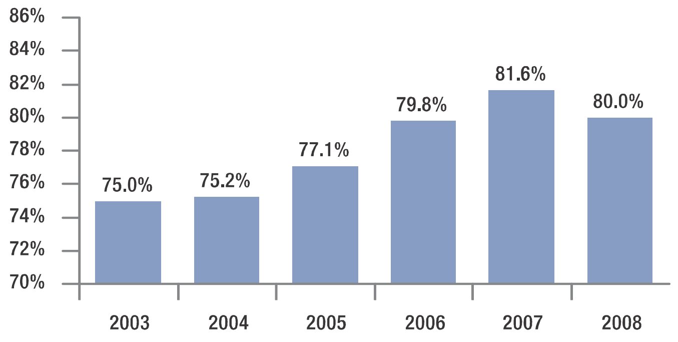
The relative weight of the long-haul sector increased as a result of the progress made in the network revision and optimisation process. Also, long-haul traffic represented 63.3% of total RPK (revenue passenger-kilometres) in 2008, 7.5 percentage points more than its weight in 2005.

Traffic (in RPK). Breakdown by sector



The load factors of the network taken as a whole were higher than the level recorded in 2005 in each of the three years of the Master Plan primarily as a result of the improvements in international flights, which enabled the Company to achieve leading positions amongst the European network carriers.

Development of the annual load factor. Total network



The increase in revenue and quality improvement formed the second strategic target of the 2006-2008 Master Plan. The Company invested heavily to improve the product and took various steps to increase the service level both on the ground and in flight, paying particular attention to its high-value passengers. In particular, mention should be made of the fact that the Business Plus Class was well received and valued highly by passengers. In 2008, the number of paying passengers travelling business class on long-haul flights was up 45% as compared with 2005, thereby improving the class mix (the number of total passengers in this sector rose by 19.5% over the three-year period). Furthermore, Iberia improved its European-Latin America market share of the Business traffic segment by 2.7 points compared to 2005.

Unit passenger revenue per ASK within the long-haul sector grew considerably over the last three years taken as a whole, exceeding the 2005 figure by 22.9% despite the appreciation of the euro against other currencies, which reduced this growth by 8.5 points. In 2008, unit revenue in the domestic sector was 10.3% more than the figure recorded in the base year of the Plan. As regards international medium-haul flights, unit revenue decreased by 2.8% with respect to 2005, since it was adversely affected by the growth in the average stage length (9.7%), the proliferation of low-cost carriers in the Spanish-European market and the aforementioned appreciation of the euro (which had an adverse effect of 3.5 points).

The 2006-2008 Master Plan also included an ambitious increase in revenue from maintenance services to other airlines. Total billing to other airlines (for technical assistance, lease and sale of material) amounted to EUR 309 million in 2008, outstripping 2005 income by more than 83%. During the last three years, Iberia's maintenance business has broadened its customer portfolio, obtained the relevant licences from manufacturers and entered into major agreements for its strategic development, thereby consolidating its profitability.

In the last three years, the Iberia Group has implemented a vast array of measures in order to improve the productivity of resources and reduce unit costs – the other two cornerstones of the 2006-2008 Master Plan.

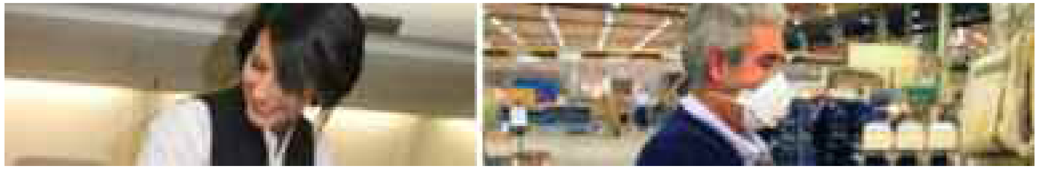
Iberia also met its fleet management objectives. From November 2008, it operated all its flights with just two families of aircraft (the Airbus A340 and A320), having retired (earlier than initially planned) the McDonnell-Douglas (MD) fleet. This measure helped to achieve the objective of reducing the age of the aircraft in service, the average age of which stood at seven years at the end of 2008.

In 2008 Iberia completed the second programme of cabin space reconfiguration affecting its entire short and medium-haul aircraft, which began in the second half of 2006. The fitting of latest-generation seats, which are more comfortable and have more available space, affords added comfort to our customers and optimises the layout of the cabins. A total of 66 Airbus aircraft were converted and 20 new aircraft equipped with the new configuration were added to the fleet (141 seats on the A319 aircraft, 171 on the A320 aircraft, and 200 on the A321 aircraft).

The fulfilment of the standardisation and aircraft age-reduction objectives was achieved together with a significant reduction in the unit cost of aircraft ownership (depreciation, lease and net finance cost), which in 2008 stood at 0.61 euro cents, a decrease of 24.7% with respect to 2005. Fuel consumption efficiency was also enhanced (measured in litres per ASK) by 9.4% over the three years taken as a whole.

Despite the early withdrawal from service of the MD aircraft, Iberia surpassed its global objectives for aircraft utilisation, which achieved an average of ten block hours per aircraft per day in 2008. This figure represents an all-time high for the Company and one of the highest amongst the network airlines with similar stage lengths.

For the purpose of improving staff productivity and optimising the cost structure, the 2006-2008 Master Plan envisaged a reduction of 9% in Iberia's workforce. The staff restructuring plan consisted of voluntary redundancies, mainly under the framework of collective redundancy procedures (72/2001 and 35/2005), and a redundancy scheme abroad. The average headcount at Iberia in 2008 amounted to 21,345 equivalent employees compared to 24,487 in 2005 and, therefore, represents an actual decrease of 12.8% in the three-year period taken as a whole, marking a clear improvement on the objectives of the Plan.



The productivity (in terms of ASK per equivalent employee) of the workforce of the Group's parent, including flight crew, was up by 3.9% in 2008, with a cumulative increase of 19.2% in the last three years. The productivity of Iberia's ground employees stood at 4,189 thousand ASK per employee in 2008, which is 21.1% more than the figure recorded in 2005. In 2008 a rigorous plan was initiated to improve the productivity of personnel from the Iberia Airport Services Division, which will be ongoing over the next few years.

In July 2008 the 17th Collective Labour Agreement covering Iberia ground employees (representing 74% of the Company's workforce) was signed, in force between January 1, 2008 and December 31, 2008. This new collective agreement lent continuity to the main agreements reached in the collective agreements signed in 2006 and 2007, and included new initiatives aimed at improving productivity and flexibility to facilitate management in the various areas of the Company. At the beginning of 2007 the 15th Collective Agreement of cabin crew members (CCMs) was entered into –in force until the end of 2007 and extended thereafter until December 2008– which enabled various productivity improvement initiatives to be put in place from summer 2007 onwards. The measures in relation to staff costs included in the collective agreements entered into meet the criteria established in the 2006-2008 Master Plan.

Also, an agreement was reached in January 2009 on the collective agreement with the technical crew which, after ratification through a technical crew vote, resulted in the achievement of the objectives of the Master Plan completed in 2008. This agreement will also ensure a new framework to face up to future challenges.

The implementation of rationalisation schemes for the other expenses also helped to meet the cost-cutting commitments. Particularly noteworthy is the decrease in net commercial expenses, which represented 2.6% of traffic revenue in 2008 compared to 4.3% in 2005. The unit operating cost (per ASK), excluding the cost of fuel, stood at 5.84 euro cents in 2008, which represents a reduction of 6% with respect to the 2005 cost (more than 13% when taking into consideration inflation for the period).

2009-2011 Strategic Plan

In 2008 Iberia prepared the Strategic Plan for the coming three years. The plan sets out the objectives that will enable the Company to consolidate its leadership against a difficult panorama. The macroeconomic backdrop is expected to be marked by a severe economic crisis which will enable the Company to consolidate its leadership against a difficult panorama. The macroeconomic backdrop is expected to be marked by a severe economic crisis which will give rise to a general slump in air traffic in 2009 and a slow and gradual recovery in the two years thereafter. The airline industry must also face the uncertain future of oil prices, strong competition across all markets and a foreseeable process of extensive industry consolidation.

The 2009-2011 Strategic Plan sets out specific initiatives and measures that will be put into effect by each business unit and management area of the Iberia Group, enabling the following strategic objectives to be met:

- A qualitative advance in improving customer service.
- Reinforcement of Iberia's leadership in the Europe-Latin America and Madrid-Europe markets and maintenance of its current position in the domestic market.
- Recovery of profitability levels, obtaining an average EBITDAR margin of more than 14% in the three-year period and 15-17% in 2011, and consolidation of the Group's financial soundness, achieving equity of EUR 2,040 million by 2011 year-end.
- Strengthening of the Company's considerable strategic positioning in a changing industry.

As the cornerstone of the Strategic Plan, Iberia will launch an Integral Customer Service Plan in line with its firm commitment to improve quality and focus on the customer. This Integral Plan includes specific measures that require the involvement of all of the Company's areas and employees and is centred on three initiatives:

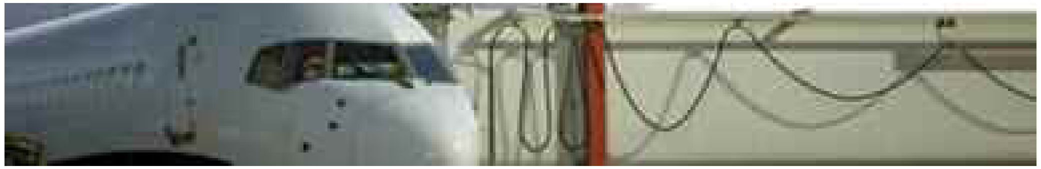
- Improvements to the product and service level throughout the entire customer relationship, from the decision to buy the ticket to the post-flight experience. The Company will invest EUR 150 million in 2009-2011, envisaging, inter alia, a revamp of the long-haul economy and business classes, redesign of the VIP lounges at key airports and separate boarding for business class customers or the reduction in waiting time at baggage claims in Terminal 4 at Barajas airport (in collaboration with the Spanish Airports and Aviation Authority in the last two cases).
- Complementary action plans to improve the attitude towards customer service.
- Revision of operational processes on the ground and in flight, customer-focused and taking into consideration the customer loyalty endeavours, together with an internal and external communication plan.

In addition to the significant improvement in the quality of customer service -an initiative shared by all departments- the 2009-2011 Strategic Plan also foresees the following principal measures for the Transport business:

- Shore up revenue, setting apart the value proposal. Best practices will be applied to revenue management, inter alia, the dynamic management by origin and destination according to network availability, optimisation of the hub and network, sales mix, group management and the promotion of Iberia Plus.
- Optimise the structure and size of the network, tailoring growth to demand. The Plan foresees an adjustment of 1.7% to the Company's capacity in 2009 and annual growth of approximately 4.2% over the following two years.
- Further operational efficiency, achieving increased productivity and efficiency.
- Manage the consolidation environment across the various fronts, positioning the Company right at the centre of a super alliance.

As regards the profitable Maintenance business, the primary objective of the Strategic Plan for the three-year period is to consolidate the position achieved over the last few years, through the following lines of action:

- Promotion of the customer service culture.
- Increased revenue and productivity and improved profitability across all production areas: engines (an increase in production capacity is planned), components, fuselage (overhaul of production centres) and maintenance at aircraft lines.
- Development of advanced management and logistic tools to buoy up business growth.
- Procurement of new business opportunities through agreements with other companies.



Lastly, in the case of the Handling business, the main challenge is to regain sustained profitability (cut short by the award of new handling licences from 2007 onwards). The 2009-2011 Master Plan establishes various ways to transform the dynamics of this business, with specific and diverse lines of action for each airport that may be summarised in the following five points:

- Significant increase in productivity, this being the central feature.
- Increased revenue through the implementation of new billable items and the adaptation of the pricing policy.
- Reduction of overheads.
- Additional measures to reduce the rise in the unit cost of personnel.
- Promotion of the customer service culture.

Service quality

Iberia considers service quality to be fundamental to its competitive edge and a commitment to both the customer and value. Therefore, the Company has invested considerable resources in improving its product. It has also equipped itself with the systems and procedures required to provide the adequate service level in each segment and continually assess service quality and satisfaction.

As discussed in the previous section, one of the cornerstones of the 2009-2011 Strategic Plan is to reinforce the focus on the customer and make significant headway in service quality. For this purpose, the Integral Customer Service Plan was designed which hinges on three main points: improvements to the product and service level, revision of the operational processes and the communication plans, and a structured plan to improve the attitude of its employees towards the customer through training programmes as well as staff selection processes.

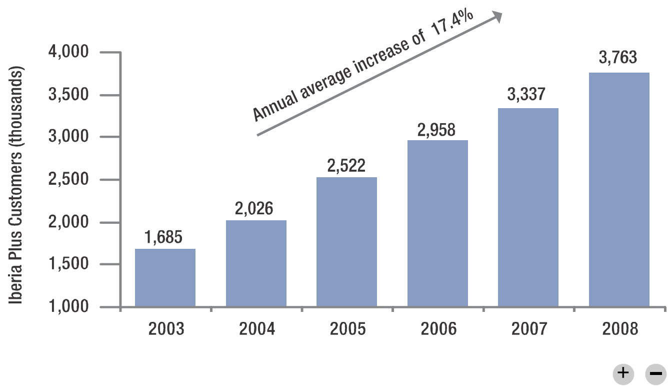
In 2008 Iberia continued to revamp its in-flight service and the services offered to its Business Plus passengers, seeking the best way to complement modern-seat comfort and the advanced communication and entertainment systems onboard its aircraft. Prestigious chefs and renowned companies worked alongside the Company to extend the variety and quality of the Spanish food and wine offered in-flight and in the VIP lounges.

Iberia also improved the service provided on its short and medium-haul flights. The reconfiguration of the passenger cabins of all the Airbus aircraft began mid-2006, fitting latest-generation seats, more comfortable than the current ones and less voluminous. At the end of August 2008 this plan was completed and a total of 86 aircraft fitted with the new seats were in service.

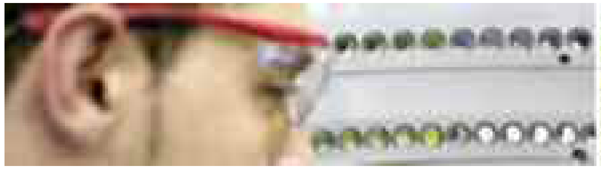
From December 1, 2008, Iberia ceased to market the central seats of the rows in its business class on all domestic flights; the middle seat is always free so that business class customers have more room and greater comfort. By doing so, the Company equipped its national routes with the business service it already provided on its flights with Europe, North Africa and the Middle East. Business class customers will also enjoy other benefits such as more Iberia Plus points with their journeys, check-in at separate desks or access to the VIP lounges.

Under its plan for ongoing quality improvement, Iberia implemented various commercial measures aimed at making the Madrid-Barcelona shuttle flights more attractive. As a result, from March, the business class catering of this product was completely revamped, also improving the service. Under the guidance of chef Sergi Arola, the Company prepared a proposal based on natural products found in the Mediterranean diet. With the frequent flyers of the Madrid-Barcelona shuttle service in mind, different dishes are offered according to the meal time and season. For example, in winter hot dishes are offered for all meals (breakfasts, snacks and dinners).

Iberia Plus, the Group's customer loyalty programme had 3.8 million members at the end of 2008, up 12.8% with respect to 2007 and, therefore, remaining one of the biggest frequent flyer schemes in Europe. The programme consists of the accumulation of points through the use of the card, which may be exchanged for flights or other services offered by companies associated with the programme. As a result of this programme and the possibilities offered through state of the art technologies, Iberia maintains close ties with its best customers, who represent one of its most valuable assets, and can pay particular attention to them. In recent years, Iberia has significantly increased the number of companies associated with the programme (87 associated companies at the end of 2008). In the last year, 19 new members joined, including most notably the World Hotels chain, Hotelcolor, Mapfre and Banco Popular e-com.



Thanks to the ongoing efforts of all the areas involved in this operation, the Company achieved a punctuality index (15 minute limit) of 83% for the network taken as a whole in the run up to November 2008, up 2.4 percentage points on the figure recorded in the same period in 2007 and, therefore, keeping Iberia at the forefront of other network airlines. However, in December the Company's operation was affected by general delays and cancellations due to the action taken by a portion of the technical crew and, consequently, cumulative punctuality in 2008 stood at 81.4%, an improvement of 0.6 percentage points as compared to 2007.



Innovation and Technology

For the Iberia Group, innovation permeates all of its business concepts: strategy, processes, services and products. Every year the Company manages dozens of projects aimed at improving service quality, technological progress in processes and resource savings. The great majority of such initiatives are recognised as innovative projects through the award of certifications or independent assessments made by various national and international official bodies.

For the past 12 years, the Company has been improving and innovating the functionality of Iberia.com, its commercial website, through which customers can reserve and purchase airline tickets. They may also check timetables, prices, flight arrivals and departures or information on weather, in real time, at the various destinations to which Iberia flies. The Company also offers other services through its website including, in particular, the online issue of boarding cards from any computer. In 2008, close to 3.5 million boarding cards were issued using the auto check-in online facility, which represents a daily average of 13,000 boarding cards.

In 2008 Iberia.com implemented new functions aimed at improving the service offered to its customers. Specifically, flight search options were included based on a customer's budget and for weekend breaks. A specific Fairs-Congresses" section was also included where special prices can be found. Tickets may also be purchased against Iberia Plus points to fly with other **one**world airlines British Airways and Qantas. Noteworthy amongst the existing functions is the development of a communication platform that enables the content of the website to be consulted through various types of mobile devices such as telephones or PDAs.

Iberia.com is available in seven different languages and has specific versions that cover substantially all the Company's destination countries. Sales of the air transport product (airline tickets and fees) amounted to EUR 532 million in 2008, up 7.5% on 2007. Agreements were entered into with other companies (inter alia, Avis, Lastminute and Viva Tours) to enable them to offer their products (hotels, car rental services, package deals, etc.) through the Iberia website.

In 2008 Iberia's Cargo Division led the implementation of the IATA's (International Air Transport Association) e-Freight project in Spain. The primary objective of this project is to eliminate the paper documentation system used in the management of air cargo and to replace it with electronic messages. Iberia was chosen as a result of its effective e-ticket roll out for passengers (a process that has now been completed) and the successful launch of the innovative electronic air waybill tool for the domestic area mid-2007 by the company (Iberia Cargo e-AWB). At the end of 2008, Iberia put this new air freight e-documentation system into effect on certain European routes and it is expected to be extended to the remaining routes in the coming months. The implementation of IATA's e-Freight system will afford a number of benefits to the various players in the freight area such as streamlined operational processes, cost savings and a reduction in the environmental impact.

Iberia's Maintenance and Engineering Division, together with other bodies and companies, is implementing a project to create a compressor blade workshop which, through the integration of consecutive automated processes, enables these parts to be fully repaired. Design of this R&D project, classified as Technological Development by the Spanish Ministry for Industry, began in 2007 and is expected to be completed in 2010, requiring a total investment of EUR 6 million.

Fleet renewal

The Company continued its plan to renew and standardise its short and medium-haul fleet with the aim of using more modern aircraft equipped with the best features that consume less fuel and are more environmentally friendly. In the first half of 2008 Iberia added three A319 aircraft to its fleet, which were sourced directly from the Airbus plant.

At the end of October, ahead of the initial schedule, the Company concluded the retirement of the McDonnell-Douglas fleet from service. In the last 19 months, a total of 30 aircraft were retired from service, namely, 18 MD87 aircraft and 12 MD88 aircraft. In the first few months of 2008, two B757 aircraft were also retired under the restructuring framework of the wet lease operation. Consequently, from November 2008 Iberia operated all its short and medium-haul flights with a single family of Airbus aircraft (using the A319, A320 and A321 models), with an average age of 6.7 years.

Also, from mid-2006 the Company operated its long-haul flights with a single type of aircraft, the Airbus A340. Therefore, the Company standardised the aircraft in both fleets (on short, medium- and long-haul flights) under the renewal process, thereby reducing maintenance costs and optimising the use of technical crew, while offering advantages vis-à-vis the operational management of the commercial programme.

At the end of 2008, following the addition of two aircraft in the first half of the year, Iberia's long-haul fleet consisted of 33 A340 aircraft (21 of the 300 version and 12 of the 600 version), three of which were operated under a wet lease. The short and medium-haul fleet totalled 86 Airbus aircraft (22 A319, 45 A320 and 19 A321).

The implementation of the fleet renewal and standardisation plan reduced the average age of the aircraft in service as a whole, which stood at seven years at the end of 2008. As a result, Iberia is currently one of the airlines with the most modern fleet in the global aviation industry.

Corporate transactions

On July 29, the Board of Directors of Iberia resolved to begin talks with British Airways on a potential merger between the two airlines through an exchange of shares. In relation to this transaction, Iberia acquired a strategic ownership interest in the share capital of **British Airways** in 2008, which represented 9.99% of British Airways' share capital at December 31. Both companies continue to work on the complex process of negotiating an agreement and planning the transaction.

On July 7, 2008, the Board of Directors of **Vueling** and **Clickair** -the latter being an investee of Iberia- approved a framework agreement for the integration of the two new generation airlines on the basis of a merger of equals, respecting the independence of the resulting company. The transaction, structured as a merger by absorption of Clickair by Vueling, was subject to clearance from the anti-trust authorities and compliance with other legal requirements.

On January 9, 2009 the European Commission's Competition Service authorised this merger. The legal formalities and commercial processes required to complete the transaction continue, which are basically to gain the approval on the merger project of the shareholders of Vueling and Clickair at their respective general meetings, and to file a request with the Spanish National Securities Market Commission for its approval of the prospectus for the issue of Vueling shares in relation to the share capital increase that will give rise to the entry of the new shareholders. Once the required authorisation has been granted, the merger is expected to be completed before the end of summer 2009.

Changes in the shareholder structure

In the first half of 2008, British Airways, through its subsidiary British Airways Holdings B.V., acquired 31 million Iberia shares, representing 3.25% of the share capital. At December 31, 2008, the majority shareholders of the Iberia Group's Parent were Caja de Ahorros y Monte de Piedad de Madrid (Caja Madrid), holding 22.99% of the share capital, and British Airways Holdings B.V. with an ownership interest of 13.15%.

Management Report

2. FINANCIAL AND OPERATIONAL PERFORMANCE

2.1. Business activity

The Consolidated Management Report for 2008 includes a more detailed account of Iberia's operational performance in the transport and other Company businesses.

2.1.1. Transport

Passenger transport

The growth of traffic in the air transport industry slowed in 2008 and decelerated sharply in the last four months of the year as a result of the rapid deterioration of the global economy. Thus, the number of revenue passenger-kilometres (RPK) on international flights of the companies in the International Air Transport Association (IATA) increased by 1.6% in 2008 compared with 7.4% in 2007), due to the 5.1% rise in the first half of the year. The monthly load factors of the IATA companies dropped notably from mid-2008 onwards and the gradual adjustment of supply proved insufficient.

Air traffic in Spain fell sharply throughout the year, affected by the negative performance of the economy and by the impact of the entry into service of new high-speed rail lines. According to data from Aeropuertos Españoles y Navegación Aérea (Aena), in 2008 the total number of passengers on domestic flights fell by 7.5% with respect to 2007 whereas passenger on international flights increased by only 0.3%.

In this difficult climate, Iberia concluded the flight-programme revision and optimisation designed in the 2006-2008 Master Plan, which boosted network operation. The Company continued to increase its capacity and optimise connections at its Madrid-Barajas hub, while also completing its plan of adjustments envisaged for point-to-point routes, which by and large affected domestic routes. In addition, Iberia made further adjustments to supply in the second half of 2008 to take into account the increased weakening of demand.

The following table shows the evolution of the main parameters of Iberia's passenger transport business for the total number of flights:

Passenger transport	2008	2007	% Change
ASK (millions)	66,098	66,454	(0.5)
RPK (millions)	52,885	54,229	(2.5)
Load factor (%) [a]	80.0	81.6	(1.6 p.)
Block hours	466,645	493,460	(5.4)
Passenger revenue / RPK (euro cents)	7.36	7.44	(1.1)
Passenger revenue / ASK (euro cents)	5.89	6.07	(3.0)
Passenger revenue (millions of euros)	3,891	4,034	(3.5)

(a) The difference between both years is expressed in percentage points.

The Company achieved a load factor of 80.0% in 2008, as compared with 81.6% in 2007 (which was a record for Iberia), far above the average figure achieved by the European network carriers.

In the network as a whole the volume of supply, measured according to the number of available seat-kilometres (ASK), was down 0.5% on 2007, due mainly to the restructuring of capacity in the domestic sector which led to a reduction of 2.5% in the volume of traffic, measured in RPK. The adverse trend in demand in 2008 and the consequent adjustment to supply performed by Iberia resulted in a 5.3% drop in supply and an 8.7% decrease in RPK in the last quarter of 2008.

Taking into account international flights, the Company increased its capacity by 2.7% in 2008, with traffic up 1.3% on 2007. The increased supply of intercontinental flights and flights to Central and Eastern Europe led to a 12.6% rise in the average stage length in the network as a whole, up to 2,273 kilometres in 2008.

Iberia's passenger aircraft production in terms of block hours was 5.2% lower than in 2007, and the number of hours of aircraft under wet lease agreements also fell by 12%.

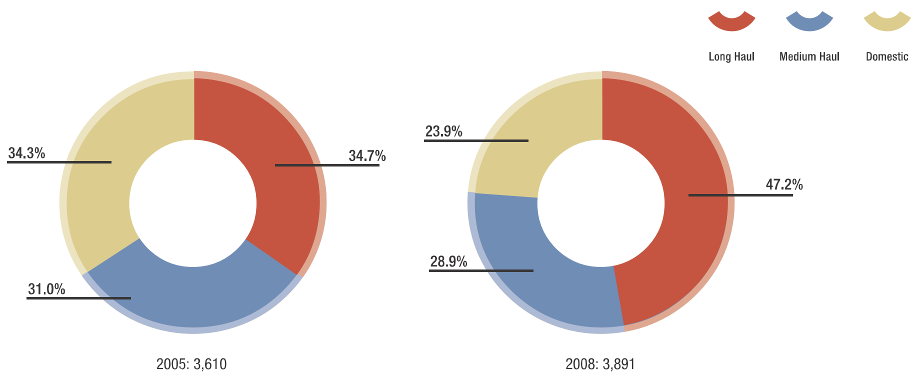
Iberia's passenger traffic revenue for the network taken as a whole stood at EUR 3,891 million in 2008, down 3.5% on 2007. Adversely affected by the increase in the average stage length and by the depreciation of the dollar against the euro, average revenue per RPK (yield) and average revenue per ASK dropped by 1.1% and 3.0%, respectively. Revenue per ASK was also affected by the decrease in the load factor. Had exchange rates remained constant, yield would have increased by 1.3% with respect to 2007 and revenue per ASK would have dropped by 0.7%. The year-on-year changes in yield and unit revenue showed an upward trend during 2008.

In 2008 the Iberia network carried 23.3 million passengers, attaining a total of 4.2 million customers on long-haul flights. Following the trend set in recent years, the relative weight of long-haul traffic in the network taken as a whole increased by almost two percentage points with respect to 2007, to stand at 63.3% (measured in RPK).

Long-haul traffic increased by 0.5% as compared with 2007. The volume of supply rose by 3.0% with the load factor standing at 85.2%, compared with 87.2% in 2007. The largest increase in business in relative terms was reported in North America (with a 6.4% rise in ASK and 4.4% in RPK), due mainly to the inclusion of Boston and Washington in the flight programme in May and June 2007, respectively.

Long-haul yield increased by 1.4% and average revenue per ASK decreased by 1.0% with respect to 2007 owing to the impact of the depreciation of the dollar against the euro. Had exchange rates remained constant, yield would have increased by 5.1% and revenue per ASK by 2.6%. Long-haul passenger revenue was up 2.0% on 2007, amounting to EUR 1,838 million in 2008 and accounted for 47.2% of entire network revenue (2.5 percentage points up on the relative weight in 2007 and up 12.5% on 2005).

Breakdown of revenue (in millions of euros)



The number of RPK on medium-haul international flights was up 3.4% on 2007, with an increase of 2.9% in the number of ASK leading to an increase of 0.3% in the load factor to 73.1%. The Company continued to increase the connections at its hub and to make selective adjustments to capacity on certain point-to-point connecting flights. Aggregate demand for medium-haul flights departing from or arriving at Madrid airport increased by 16.7% and the load factor improved by 0.4% to stand at 73.7%. Average revenue per RPK decreased by 2.8% with respect to the figure obtained in 2007 and average revenue per ASK dropped by 2.3% due to the increase in the average stage length (5.4%), the depreciation of the dollar and sterling against the euro and pressure from competitors on the prices of European routes. Had exchange rates remained stable, unit revenue per ASK would have remained practically the same (-0.3%). Revenue per passenger in the medium-haul business totalled EUR 1,124 million in 2008, up 0.5% on 2007.

In accordance with the Company's strategy of the network optimisation, Iberia reduced supply in the domestic market by 17.1% as compared with 2007. The load factor stood at 71.3% in 2008, 4.5% down on 2007 due to the steady weakening of demand as a result of the economic crisis and the impact of the competition from new high-speed train lines. However, as a result of the notable increase in yield –up 7.1% on 2007– the Company's average revenue per ASK rose by 0.7% on domestic flights and passenger revenue amounted to EUR 929 million in 2008.

Cargo transport

Iberia's revenue tonne-kilometres (RTK) from goods and mail exceeded EUR 1,156 million in 2008, down 5.6% on 2007, whereas the total number of available tonne-kilometres (ATK) increased by 0.7%. ATK in the second half of 2008 dropped by 10.6% in comparison with the like period of 2007 as a result of the slump in the world goods trade in the last few months of 2008.

The number of RTK decreased by 5.7% for long-haul flights (the Americas and South Africa), which had a weight of 84.4% of total network traffic in 2008. In the short and medium-haul sectors (including the domestic sector) the decrease in the volume of traffic with respect to 2007, measured in RTK, was 4.7%.

Cargo transport revenue decreased by 1.0% with respect to 2007, to stand at EUR 297 million, due to the decrease in the volume of traffic in the markets. Yield stood at 25.7 euro cents, an increase of 4.9% with respect to 2007 as a result of the endeavours made to increase unit revenue despite being adversely affected both by the increase in average cargo stage length and the fall in value of the dollar. With constant exchange rates, the increase in yield would have been 7.5%.

The main cargo transport aggregates were as follows:

Cargo transport	2008	2007	% Change
ATK (millions)	1,714.2	1,702.3	0.7
RTK (millions)	1,156.1	1,224.7	(5.6)
Load factor (%) [(a)]	67.4	71.9	(4.5 p.)
Cargo revenue / RTK (euro cents)	25.67	24.47	4.9
Cargo revenue (millions of euros)	297	300	(1.0)

(a) The difference between both years is expressed in percentage points.

2.1.2. Handling

In 2008 the Spanish handling industry was marked by the effect of increased competition (after the awarding of more licences and the entry of new operators in 2007) and by the economic crisis, which reduced the volume of operations, particularly from October onwards.

Iberia continued to operate as a ramp handling operator at 36 airports in 2008 under 21 licences it obtained in public tenders in the second half of 2006. The Company also maintained its presence at Barcelona, Lanzarote and Fuerteventura airports through unincorporated joint ventures (UTEs) that were the successful bidders for the licences at these airports. Iberia has a 32% ownership interest in the joint venture at El Prat airport to which it transferred 577 employees last year and a 30% holding in the joint ventures at the two Canary Island airports.

In 2008 the licenses for the provision of services to passengers with limited mobility or who require special attention were the subject of a call for tenders. Iberia Handling was awarded this license at the airports where it is the sole ramp handling operator. Also, the joint ventures formed by Iberia and other operators obtained the corresponding licenses for the airports of Madrid, Alicante and Palma de Mallorca.The provision of these services began mid-year.

In 2008 Iberia handled a total of 80 million passengers, representing a decrease of 8.3% with respect to 2007. The total weighted number of aircraft handled was 376,040 (excluding the production of the joint ventures in which Iberia has an ownership interest), down 6.8% on 2007, due to the provision of services in the first two months of 2007 in the five airports at which the licence was lost (Barcelona, Almeria, Jerez de la Frontera, Lanzarote and Fuerteventura) and the adjustments made for the presence of new operators and increased pressure from competitors in the market.

The volume of business with other airlines, which in terms of weighted aircraft handled represented 56.2% of total production, decreased by 2.2% with respect to 2007. Iberia maintained a higher share of the handling market than its competitors at all of the airports at which the Company operates, due to the addition to its client portfolio of Atlas Blue, TAM and Turkish Airlines at the beginning of the year and First Choice in March (when it became part of the TUI Group).

The operating income of the handling business amounted to EUR 491 million in 2008, down 14.4% on 2007, due both to the aforementioned decrease in activity and to the decrease in unit revenue.

2.1.3. Maintenance

Iberia Maintenance carries out integral maintenance services for the Company's own aircraft and for other airlines. In 2008 it carried out a total of 225 C and D inspections weighted by value, representing an increase of 4.3% with respect to 2007. The percentage of inspections carried out for other airlines was 59.7% (35% in 2007). In the area of engines, the weighted production of engines rose to 243, representing an increase of 30% with respect to 2007.

The notable increase in business from other airlines over the last three years, thanks to the significant diversification of the product portfolio and a range of competitive prices, has enabled Iberia to consolidate its maintenance business. Operating income from maintenance work for other airlines amounted to EUR 309 million in 2008, surpassing the 2007 figure by 7%.

Iberia Maintenance's customer portfolio includes practically all the Spanish airlines, where it is market leader, and numerous international airlines, aircraft lessors, cell and engine manufacturers and important bodies and institutions such as the Spanish Ministry of Defence.

Numerous commercial agreements were signed in 2008, the most noteworthy in terms of financial or strategic factors being the following:

- Long-term agreement with DHL Air and EAT whereby the company will perform the major inspection and maintenance of more than 80 Rolls Royce RB211-535 C37 engines. Iberia is the only maintenance centre in Europe and one of the few around the world that provides support for this kind of engine.
- Agreement with Dana Airlines and Aurora Airlines for the maintenance of engines and MD80-88 aircraft components.
- Contract with Air Europa for the maintenance of CFM56-7B engines for a fleet of 33 B737, resulting in the first maintenance job in the history of the company of a CFM56-7B engine.
- Cooperation agreement with EADS/CASA for the development of the new A330 Tankers.
- Contract with the North American company Precision Conversions to change the configuration of B757s from passenger to cargo.
- Contract with GE Aviation making Iberia Maintenance the Preferred Regional Centre for the maintenance of CFM56-5A engines.
- Agreement with SR Technics for the joint maintenance of CFM56-5C engines and the repair of components.

Iberia Maintenance entered into important strategic agreements in 2008 including most notably the creation of two joint ventures. In the international arena, Iberia and Singapore Technologies Aerospace Solutions Europe (STASEU), part of the important Singapore Technologies Aerospace (STA) group, set up a new company on an equal-footing basis -Madrid Aerospace Service– specialising in the inspection and repair of the landing gear of

A320, A330 and A340 Airbus aircraft, a market that is currently expanding. Iberia Maintenance also entered into an exclusive agreement with STASEU whereby the former will inspect and repair aeronautical components of 24 Airbus aircraft owned by SAS and Air Greenland. At national level an agreement was entered into with Gestair for the joint creation (also on an equal footing) of CorJet, which will enable Iberia to boost its activity of the maintenance of executive aircraft.

In 2008, Iberia Maintenance joined the Airbus Maintenance Training Network and became the first maintenance centre to enter into the agreement with the aeronautical manufacturer. During the year the Company also received civil aviation certification from Russia and Nigeria for maintenance of aircraft, engines and components and passed the audits for the renewal of the certificates of the aeronautical authorities of Chile, Canada, Nepal, Venezuela and Uruguay, and the FAA (Federal Aviation Administration). It also renewed, through audit, the IOSA (IATA Operational Safe Audit), ISO 9001:200 (Quality Management System) and ISO 14001:2004 (Environmental Management System, zone 1 and zone 2) certifications.

2.2. Resources

2.2.1. Fleet

At 2008 year-end, Iberia had a total of 119 passenger aircraft in operation, which included 33 long-haul aircraft and 86 short and medium-haul aircraft. The following table shows the composition of the fleet by aircraft type:

Aircraft type (a) (b)	Owned	Aircraft under finance lease	Aircraft under operating lease	Wet lease	Total operated
A340 / 300	6	1	11	3	21
A340 / 600			12		12
Long-haul	**6**	**1**	**23**	**3**	**33**
A319			22		22
A320	10	6	29		45
A321		4	15		19
Short and medium-haul	**10**	**10**	**66**		**86**
TOTAL	**16**	**11**	**89**	**3**	**119**

(a) Excluding inactive aircraft.
(b) Also, at December 31, 2008 Iberia had one Boeing B757 and one Airbus A320 leased to other companies.

At December 31, 2007 Iberia operated a total of 136 aircraft (not including a MD87 which was in the hangars waiting the granting of a Technical Acceptance Certificate of delivery for sale). The following list shows the detail of aircraft additions and retirements in 2008:

Additions

- 3 A319 under operating lease.
- 2 A320, under finance lease and a third under operating lease.
- 2 A340/300 under wet lease.

Retirements

- 2 A320 under operating lease.
- 2 B757 under wet lease.
- 9 MD87 owned.
- 11 MD88 owned.

Iberia, continuing with its plan for the renewal and standardisation of the short and medium-haul fleet, added three A319 aircraft directly from the Airbus factory under operating lease in the first half of 2008, designed to transport up to 141 passengers. Also, two A320, which had previously been leased to another company, were added to the aircraft in operation in April, one under finance lease and the other under operating lease. In October and December the company withdrew two A320 aircraft under operating lease from service.

Also, there were certain changes in the leases of some of the aircraft during the year. One A321 aircraft that at the start of 2008 was under operating lease, operated for ten months under wet lease. In the first half of the year, two A340/300 aircraft that were under operating lease began to be owned by the company. At the end of October 2008 one of these A340 aircraft moved to a finance lease.

In 2008 three A340/300 aircraft operated for the company under wet lease, which affords Iberia greater flexibility to adjust its capacity to the market situation. The number of wet lease block hours rose by 18.8% on the long-haul routes, which are operated using aircraft from the A340 family, a decrease of 56.2% on the short and medium-haul flights, which were operated by one A321 and, at the start of the year, by two B757 aircraft.

Under the aforementioned short and medium-haul aircraft renewal and standardisation plan, a total of 30 McDonnell-Douglas aircraft (18 MD87 and 12 MD88) were withdrawn from service between April 2007 and October 2008. In February 2007 Iberia entered into a contract with Tiger & Engine Support for the sale of all these aircraft, including the engines. Consequently, since November 2008 the company operates all its flights with two families of aircraft: the Airbus A340 for long haul flights, with an average age of 7.9 years, and the A320 (which includes the A319, A320 and A321) for the short and medium-haul flights, with an average age of 6.7 years.

Utilisation of the Company's operative aircraft reached 10 hours per aircraft per day, an improvement of 4.3% on 2007, thereby meeting one of the objectives of the 2006-2008 Master Plan.

Block hours / aircraft / day	2008	2007
Average short and medium-haul aircraft utilisation	8.4	8.2
Average long-haul aircraft utilisation	14.5	14.3
Average utilisation of own aircraft	**9.8**	**9.5**
Average utilisation of aircraft under wet lease [(a)]	13.4	10.7
Average utilisation of total aircraft	**10.0**	**9.6**

(a) In 2008 aircraft operating under wet lease contracts for Iberia included: three A340/300 all year, two B757 (one in January and the other until March) and one A321 from March to December.

2.2.2. Personnel

Headcount

Iberia's average workforce decreased by 4.3% with respect to 2007 to stand at 21,345 equivalent employees in 2008. At December 31, 2008, 38% of the total number of employees were women.

The following table shows the distribution of the workforce by business segment in the last two years:

	Ground		Flight		Total	
	2008	2007	2008	2007	2008	2007
Transport	3,090	3,178	5,567	5,638	8,657	8,816
Handling	7,769	8,493			7,769	8,493
Maintenance	3,767	3,806			3,767	3,806
Other (*)	1,152	1,185			1,152	1,185
Total Iberia	**15,778**	**16,662**	**5,567**	**5,638**	**21,345**	**22,300**
2008 / 2007 change (%)	(5.3)		(1.3)		(4.3)	

(*) Including Corporate and Systems Divisions.

The average ground staff workforce decreased by 5.3% with respect to 2007 to stand at 15,778 equivalent employees. Of these employees, 14,906 work in Spain and the remainder (5.5% of ground staff) are located in the other countries where the Company operates. In 2008 decreases were recorded in all the areas, mainly through voluntary redundancies taken in the framework of the collective redundancy procedures. Noteworthy was the reduction of 724 equivalent employees in the Airports Department (Handling), representing a decrease of 8.5% compared with 2007.

The average flight staff workforce totalled 5,567 equivalent employees in 2008, accounting for 26.1% of Iberia's employees. The average number of technical crew members decreased by 3.7% with respect to 2007, and that of the passenger cabin crew members by 0.2%. The reduction in the latter group was smaller because intercontinental flights, which require a greater number of passenger cabin crew, had the strongest growth within the Company network.

On November 27, 2007, the Directorate General of Employment authorised the extension of collective redundancy procedure 72/01 until December 31, 2010 for ground staff. Also, on the same date, it authorised collective redundancy procedure 35/05, to be applied specifically to employees working in the Handling area, until December 31, 2014. Finally, on July 21, 2008, the Ministry of Employment also authorised the extension of collective redundancy procedure 72/01 until December 31, 2010 for Iberia's passenger cabin crew members.

In 2008, 307 ground staff employees left the Company (1,092 in 2007), availing themselves of one of the early retirement methods addressed in the two collective redundancy procedures. A further 15 ground staff employees in Spain availed themselves of the National Employment Agreement in 2008 (36 in 2007). Iberia also developed a plan for ground staff abroad, and a further 17 employed abroad left the Company in 2008 (73 in 2007). Consequently, a total number of 339 ground staff employees departed in 2008.

In 2008, 123 passenger cabin crew members left the Company, availing themselves of one or other of the collective redundancy methods contained in procedure 72/01, in addition to the 260 employees who left the Company in 2007.

Productivity

The productivity of Iberia's total workforce, measured in terms of available seat-kilometres performed, went up to 3.10 million ASK per employee in 2008, an increase of 3.9% compared with 2007. In the case of ground staff, productivity increased by 5.0%, due mainly to the decrease in the number of equivalent employees over the past two years, especially within the Airport Services Division.

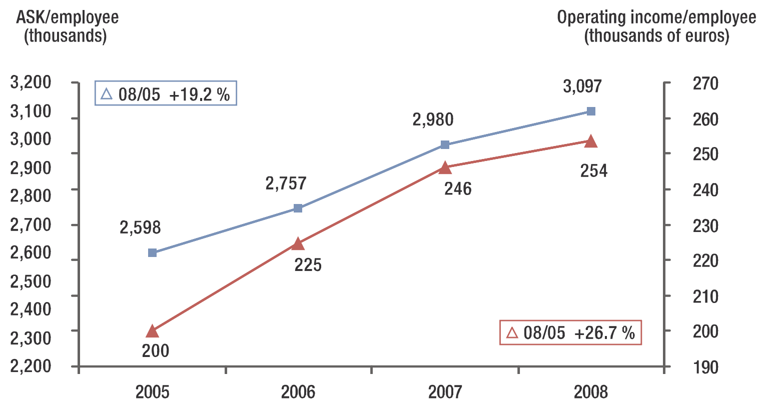
In 2008 the development of a plan to improve the productivity of the staff in this division was begun and will reach its peak in the coming years. In 2008, the productivity of Handling employees, measured in terms of total hours per weighted aircraft handled, improved by 3.1% with respect to 2007.

The following table shows the breakdown, by group, of workforce productivity:

Productivity of Iberia's employees	2008	2007	% Change
Total workforce (thousands of ASK per employee)	3,097	2,980	3.9
Ground workforce (thousands of ASK per employee)	4,189	3,988	5.0
Handling workforce (total hours / weighted aircraft)	32.7	33.8	(3.1)
Technical crews (block hours per crew member)	270.9	275.1	(1.6)
Auxiliary crews (block hours per crew member)	118.8	121.4	(2.1)

Productivity –measured in terms of ASK per employee– of Iberia's total workforce showed a cumulative increase of 19.2% over the last three years. The economic productivity of Iberia's workforce as a whole -measured in terms of operating income per employee- increased by 3.0% in 2008 with respect to 2007, and showed a cumulative increase of 26.7% over the last three years.

Productivity performance. Total Iberia workforce



Management Report

2.3. Company performance

From 2008 onwards, the individual financial statements of Iberia are to be presented in accordance with Royal Decree 1514/2007, approving the new Spanish National Chart of Accounts (NPGC). The changes in the NPGC mean a step forward in the process towards converging the accounting systems of European Union countries and a significant narrowing of the gap between these systems and the international IAS/IFRS accounting standards, on the basis of which the consolidated financial statements of the Iberia Group have been prepared since 2005. Since the date of transition to NPGC was January 1, 2008, the 2007 financial statements relate to the standards established in Royal Decree 1643/1990 (Spanish National Chart of Accounts of 1990).

2.3.1. Profit from operations

In a climate marked by the international financial crisis and the progressive deterioration of most developed countries' economies, Iberia's performance during 2008 was affected by the sharp increase in its fuel expenses, arising from a high average annual price, and by the downturn in traffic in the global airline industry, aggravated in Spain by the strong competition from new high-speed train lines.

In 2008, Iberia's loss from operations, including non-recurring items, amounted to EUR 4 million, compared with a profit of EUR 310 million in 2007. Excluding non-recurring items, the loss from operations totalled EUR 88 million in 2008, as compared with a profit from recurring operations of EUR 284 million obtained in 2007.

EBITDAR (profit from operations before depreciation and amortisation and aircraft leases) generated by Iberia was EUR 496 million in 2008, down 46.4% on 2007. The EBITDAR margin as a percentage of income from recurring operations stood at 9.2% in 2008, as compared with 16.8% in 2007.

Following are the consolidated income statements of Iberia for 2008 and 2007 with a breakdown of the most noteworthy operating income and expense items:

Millions of euros

Iberia	2008	2007	% Change
PROFIT (LOSS) FROM OPERATIONS	(4)	310	(101.2)
OPERATING INCOME	5,480	5,507	(0.5)
REVENUE	5,188	5,277	(1.7)
Passenger ticket revenue	4,218	4,325	(2.5)
Cargo revenue	309	306	1.0
Handling revenue	275	280	(1.8)
Technical assistance to airlines	297	274	8.7
Other income from services and sales	89	92	(4.3)
OTHER OPERATING INCOME (1)	292	231	26.7
Recurring	227	217	4.5
Non-recurring	65	13	n.m.
OPERATING EXPENSES	5,508	5,297	4.0
PROCUREMENTS	1,864	1,364	36.7
Aircraft fuel	1,666	1,151	44.8
Aircraft spare parts	160	173	(7.2)
Catering materials	21	23	(11.1)
Other procurements	17	17	1.5
STAFF COSTS	1,313	1,436	(8.6)
Of which: Non-recurring	1	64	(97.8)
DEPRECIATION AND AMORTISATION CHARGE	198	222	(10.6)
OTHER OPERATING EXPENSES	2,133	2,276	(6.3)
Aircraft leases	386	421	(8.2)
Other leases	75	75	0.4
Aircraft maintenance (subcontracts)	228	246	(7.3)
Of which: Non-recurring	-	10	n.a.
Commercial expenses	201	243	(17.2)
Traffic services	415	449	(7.6)
Navigation charges	258	274	(5.8)
In-flight services	72	73	(1.2)
Booking systems	137	145	(4.9)
Other expenses	361	352	2.7
Of which: Non-recurring	4	12	(65.9)
IMPAIRMENT LOSSES AND NET GAINS ON DISPOSAL OF NON-CURRENT ASSETS	24	100	(75.5)
PROFIT (LOSS) FROM RECURRING OPERATIONS	(88)	284	(131.0)
Operating income (recurring)	5,415	5,494	(1.4)
Operating expenses (recurring)	5,503	5,210	5.6
EBITDA	110	505	(78.2)
EBITDAR	496	926	(46.4)

n.m.: not meaningful; n.a.: not applicable

(1) Including excess provisions, in-house work on assets and other operating income.

Operating income

Iberia's operating income amounted to EUR 5,480 million in 2008, a slight drop (0.5%) compared with 2007 due mainly to the increasing weakness of air traffic in the markets and the appreciation of the euro against the dollar (an average annual increase of approximately 8%). Had the exchange rate remained stable, operating income would have risen by approximately 1.7% with respect to 2007.

Income from recurring operations stood at EUR 5,415 million in 2008, down 1.4% on 2007. Noteworthy is the steady increase in revenue from maintenance services, which exceeded the 2007 figure by EUR 24 million, despite being affected by the depreciation of the dollar.

In 2008 total passenger revenue fell by 2.5% with respect to 2007 to stand at EUR 4,218 million. The difference between the amount in the consolidated income statement and that included in "Key Data" and "Transport" (section 2.1.1.) arises from the fact that the latter is related to the actual production of each year, excluding accounting adjustments and revaluations, and also the revenue arising from the unused ticket recovery process, which is included in the figure in the income statement.

Passenger revenue from tickets effectively used amounted to EUR 3,891 million in 2008, down 3.5% on 2007. The main reasons for this decrease were the significant impact of the depreciation of several currencies, mainly the dollar against the euro, and the drop in the volume of traffic (2.5% measured in terms of RPK) as a result of falling market demand and the strategic restructuring plan for domestic sector capacity. If the change in exchange rates were excluded, passenger revenue from tickets effectively used would have dropped 1.2% as compared with 2007.

A more detailed analysis of passenger ticket revenue can be found in section 2.1.1. of this Management report.

Iberia's cargo revenue (including the billings for goods and mail transport, fuel and security charges or surcharges and excess baggage revenue) totalled EUR 309 million in 2008, up 1.0% on 2007, due mainly to the increase in average revenue per RPK (up 4.9% on 2007), which offset the decrease in the volume of cargo transported.

Revenue from ground handling services to other airlines' passengers and aircraft amounted to EUR 275 million, a decrease of 1.8% with respect to 2007 due to a lower level of activity (-2.2% in terms of the weighted number of aircraft handled). It should be borne in mind that the new licence framework affected ten months of 2007 and, logically, the whole of 2008, and therefore this evolution evidences the consolidation of Iberia's position in this business. "Handling Revenue" also includes the handling revenue arising from Iberia's ownership interest in handling joint ventures.

Revenue from maintenance services to other airlines amounted to EUR 297 million, up 8.7% on the figure for 2007, due to an increase in the volume of technical assistance services: engine inspections (particularly CFM56), components, C and D inspection and supplementary work. The depreciation of the dollar had an adverse effect on maintenance revenue in 2008 which, had the exchange rate remained constant, would have increased by almost 13%.

"Other income from services and sales" decreased by 4.3% with respect to 2007. The drop in revenue from terminals and other cargo services and particularly in revenue from in-flight sales, the management of which was outsourced, was partially offset by the increase in revenue from the use of the Amadeus booking system which amounted to EUR 55 million.

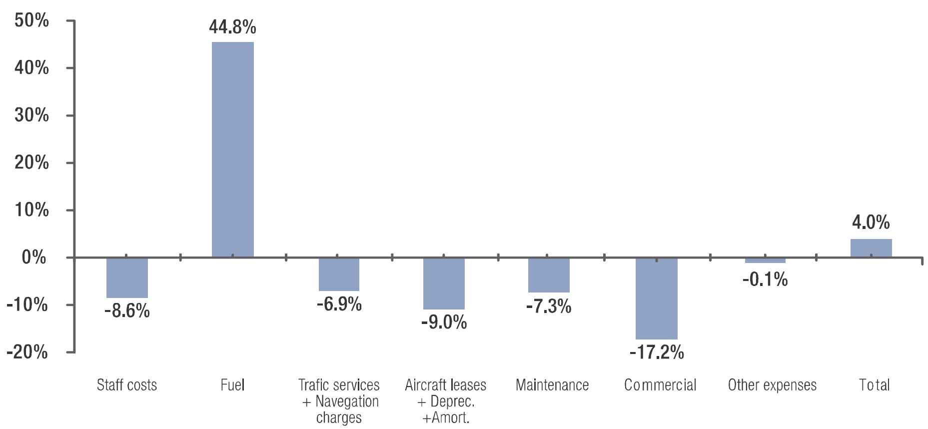
"Other Operating Income-Recurring" (fees, deferred income, income from the temporary transfer of employees to unincorporated joint ventures, rentals and other sundry income) increased by a total of 4.5% with respect to 2007 to reach EUR 227 million.

Non-recurring income totalling EUR 65 million was recognised in 2008 (compared with EUR 13 million in 2007), relating mainly to the release of various provisions and EUR 15 million obtained from the insurance for an Airbus A340.

Operating expenses

In 2008 Iberia's operating expenses rose by 4.0% with respect to 2007, to stand at EUR 5,508 million, due mainly to the sharp increase in the average fuel price. This impact was partially offset by the significant reduction (-7.3%) in other expenses achieved through the implementation of the strategic measures established in the 2006-2008 Master Plan and through the beneficial effect of the depreciation of the dollar against the euro. Except for fuel, all significant operating expenses decreased as compared with 2007.

Change in Iberia's operating expenses 2008/2007 (%)



Iberia's recurring operating expenses amounted to EUR 5,503 million in 2008, up 5.6% on 2007. Disregarding the fuel expense in the two years, the aggregate figure of the other recurring operating expenses fell by 5.5% with respect to 2007. Unit recurring operating expenses excluding fuel dropped by 5.0% to 5.80 euro cents per ASK and throughout 2008 stayed below the levels recorded in 2007.

Iberia's fuel expense increased by EUR 515 million as compared with 2007 and amounted to EUR 1,666 million in 2008. As a result of this increase, fuel now accounts for 30.3% of the Company's recurring operating expenses and for 33.6% of the recurring operating expenses of the Transport business.

The generally high price of oil and oil products during most of the year and their extreme volatility –which hindered risk management– account for this sharp increase in expenses (44.8%). In the first half of the year the price of aviation kerosene, which was already extremely high (around USD 900 per metric tonne), continued to rise, partly as a result of speculation, until in July it reached the record price of USD 1,450 per tonne. In the following months kerosene prices fell sharply due to the sudden economic downturn and the more negative outlook for the future, standing at under USD 500 per tonne at year-end.

The following table shows the detail of the items that were involved in this exceptional increase in the fuel expense in comparison with 2007:

Millions of euros

	Causes of the change in the fuel expenses				Total change 2008 / 2007
	Price (*)	Volume	Exchange rate (*)	Efficiency	
Iberia	732	(8)	(165)	(44)	515

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

The increase in the price of aviation kerosene in dollars after hedges led to a 63.6% rise in the fuel expense, which was partially offset by the positive effect of depreciation of the dollar and lower unit consumption due to more efficient aircraft. The unit fuel cost stood at 2.52 euro cents per ASK in 2008, up 45.6% on 2007.

In 2008 Iberia's staff costs totalled EUR 1,313 million, down 8.6% on 2007. Excluding the exceptional provisions recognised to update the provision for the extension of the collective redundancy procedure, which amounted to EUR 1.4 million in 2008 and EUR 64 million in 2007, recurring staff costs decreased by 4.4% with respect to 2007 mainly as a result of the reduction in the number of Company employees (4.3%). The average number of ground staff fell by 5.3% and flight crew employees (flight technicians and cabin crew) dropped by 1.3%. Staff costs decreased in all three groups.

Iberia's staff costs accounted for 23.8% of total recurring operating expenses in 2008, according to the following breakdown: wages, salaries and similar amounted to EUR 995 million, down 4.2% on 2007; and the aggregate amount of social security contributions and other employee benefit expenses totalled EUR 316 million, down 5.0%. Unit (recurring) staff costs fell by 3.9% with respect to 2007 to stand at 1.98 euro cents per ASK.

The depreciation and amortisation charge fell by 10.6% as compared with 2007 to stand at EUR 198 million. Of this amount, 64.8% related to the depreciation of aircraft, which was down 13.6% due to the reduction in the number of aircraft recognised in the balance sheet in the last two years, partially as a result of the withdrawal of the MD87/88 aircraft, which were finally eliminated from the Company's operating aircraft in the last quarter of 2008.

In 2008 the aircraft lease expense dropped by 8.2% in comparison with 2007, to stand at EUR 386 million. The cost of dry leases for passenger aircraft fell by 6.5% to EUR 324 million as a result of the lease of fewer aircraft, the obtainment of better prices and the depreciation of the dollar. Wet lease costs also fell by EUR 13 million (-28.7%) due to the restructuring of stable operations (not occasional) under this type of contract, which resulted in the operation of a smaller number of aircraft and block hours (12.0% less than in 2007). The aircraft lease unit cost was 0.58 euro cents per ASK, down 7.7% on 2007.

Aggregate aircraft maintenance expenses (which include external services and spare parts consumed) amounted to EUR 389 million in 2008, down 7.3% on 2007, which was due in part to the depreciation of the dollar. Excluding exceptional expenses recognised in 2007 (EUR 10 million relating to work associated with the return of aircraft), recurring maintenance expenses were reduced by 4.9%. Consumption of spare parts fell by 7.2% and recurring costs for outside services also decreased by 3.2% with respect to 2007. This decrease, which is related to improved productivity and more modern and uniform aircraft, has even greater value taking into account the increase in the volume of maintenance services provided to other airlines. The unit cost per ASK of the maintenance of the aircraft operated under Iberia's own transport business dropped by 5.9% with respect to 2007 to stand at 0.65 euro cents in 2008. Commercial expenses amounted to EUR 201 million in 2008, down 17.2% on 2007. The aggregate amount of the commissions, promotional expenses and development expenditure fell by 15.2% to EUR 177 million, whereas advertising expenses decreased by 29.6% to stand at EUR 24 million. As a result of the emphatic measures taken by the Company in recent years in this area of expenses, unit commercial costs have dropped considerably and in 2008 decreased by 16.8% with respect to 2007 to stand at 0.30 euro cents per ASK.

The traffic services cost decreased by 7.6% with respect to 2007 due to a drop in practically all the operating expenses included under this heading. Part of this drop can be accounted for by the lower number of takeoffs (15% fewer than in 2007) as a result of an extensive restructuring of the short and medium-haul programme and to the increasing relative weight of long-haul flights. Landing charges and expenses relating to boarding bridges and other airport services decreased by 5.1% with respect to 2007. The expenses arising from incidents (discontinued journeys, missed connecting flights and baggage delivery) dropped by 20.5% as a result of the improved quality of operations (except for the last few weeks of the year). The aggregate expense of the other items (aircraft dispatch, H fare types, aircraft cleaning services and crew stopover expenses, etc.) fell by 8.5% with respect to 2007.

In 2008 navigation charges decreased by 5.8% due to the reduction in the number of flights operated during the year and, to a lesser extent, to the depreciation of the dollar. The cost of in-flight navigation assistance services dropped by 5.1% with respect to 2007, to stand at EUR 210 million. Airport approach rates amounted to EUR 48 million, down 8.8% on 2007. The Spanish airport approach unit rates increased by 3% in 2008.

Booking system expenses dropped by 4.9% as compared with 2007, due in part to the lower volume of traffic. Taking into account the increased revenue from these systems, arising mainly from the new agreement entered into with Amadeus, the net cost of the booking systems fell by 12.6% in comparison with 2007. The aggregate cost of in-flight and catering services totalled EUR 92 million in 2008, down 3.6% on 2007.

"Other Expenses" amounted to EUR 361 million in 2008, which represents an average increase of 2.7% with respect to 2007 as a result of the increase in staff transport costs, other maintenance expenses (software applications, ground equipment, tools and facilities), computer programs, sundry services and taxes other than income tax, among other items. This amount also includes EUR 4 million of exceptional expenses (various provisions, fines and penalties) as compared with EUR 12 million of other non-recurring expenses recognised in 2007.

"Impairment losses and net gains on disposal of non-current assets" amounted to EUR 24 million in 2008 and arose substantially in full from the sale of aircraft. In 2007 the net gains from the disposal of assets totalled EUR 100 million and arose mainly from various transactions related to aircraft (approximately EUR 70 million) and from the sale of land owned by Iberia in La Muñoza industrial area (approximately EUR 25 million).

2.3.2. Other gains or losses

The detail of the other items included in Iberia's income statement is as follows:

Millions of euros

Iberia	2008	2007	% Change
PROFIT (LOSS) FROM OPERATIONS	**(4)**	**310**	**(101.2)**
FINANCIAL PROFIT	**30**	**138**	**(78.6)**
Finance income	137	224	(38.8)
Finance costs	(52)	(61)	(13.9)
Exchange losses	(1)	(3)	n.m.
Other income and expenses	(28)	1	n.m.
Impairment losses and net gains on disposal of financial instruments	(26)	(23)	n.m.
PROFIT BEFORE TAX	**26**	**448**	**(94.3)**
TAX	(1)	(125)	(99.2)
PROFIT FOR THE YEAR	**25**	**323**	**(92.3)**

n.m.: not meaningful.

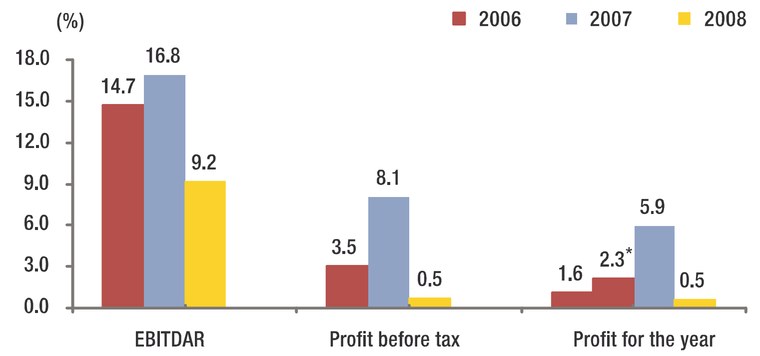
In 2008 net financial profit fell by 48% with respect to 2007 to stand at EUR 85 million. Finance income totalled EUR 137 million, arising mainly from interest on short-term deposits which rose significantly compared with 2007. However, total finance income dropped by 38.8% owing mainly to the recognition of EUR 97 million in 2007 relating to the gains obtained on the reimbursement of Shareholders' contributions and the sale of a portion of Iberia's ownership interest in Wam Acquisition. Finance costs dropped by 13.9% with respect to 2007 due mainly to the decrease in interest on loans and obligations under finance leases.

"Other Income and Expenses" reflects the change in the fair value of financial hedging instruments, which totalled a negative amount of EUR 28 million in 2008 relating mainly to impairment losses on fuel hedges considered to be ineffective (a negative amount of EUR 23 million).

"Impairment losses and net gains on disposal of financial instruments" includes changes in the provisions for investments in Group companies and associates, totalling a negative amount of EUR 26 million in 2008 relating mainly to the Company's ownership interest in the subsidiary Clickair.

Profit before tax totalled EUR 26 million in 2008, as compared with a profit of EUR 448 million in 2007. Profit after tax totalled EUR 25 million in 2008, as opposed to EUR 323 million in 2007.

Iberia Group´s margins (as a percentage of operating income)



* Profit for the year before tax adjustments

2.4. Balance sheet

The equity of Iberia amounted to EUR 1,525 million at December 31, 2008, down EUR 456 million on the figure for 2007, due mainly to the dividend charged to 2007 profit (EUR 158 million) and to the adjustments to the balance of reserve accounts as a result of the change in value of hedging instruments together with impairment losses on certain financial investments.

At December 31, 2008 the Company's balance sheet included EUR 64 million relating to 27,898,271 treasury shares representing 2.93% of the share capital with a total par value of EUR 22 million and an average acquisition price of EUR 2.31 per share.

The long-term provisions for contingencies and charges amounted to EUR 1,309 million at 2008 year-end, down 6.8% on 2007 due mainly to the provisions used for redundancy payments in 2008. The breakdown of the balance is as follows: EUR 74 million of provisions for major aircraft repairs; EUR 669 million of provisions for obligations to employees, which included the allowances for reserve flight crew members; and EUR 566 million of provisions for third-party liabilities, which include the provisions recorded for the restructuring of the workforce.

Interest-bearing current and non-current liabilities (debentures, bank borrowings and finance lease obligations) amounted to EUR 468 million at 2008 year-end, down EUR 55 million on 2007.

The cash balance (current financial assets plus cash and cash equivalents, excluding the measurement of hedging transactions) amounted to EUR 2,250 million at 2008 year-end, down EUR 684 million on 2007 year-end, due in part to the payment of dividends (charged to 2007 profit) and to the acquisition of British Airways shares.

Iberia's net indebtedness continued to be negative, i.e. the balance of the current financial asset accounts (excluding the measurement of hedges) exceeded the total balance of interest-bearing debt. Accordingly, net indebtedness stood at EUR -1,782 million at December 31, 2008, as compared with EUR -2,474 million recognised at 2007 year-end.

Adjusted net debt, including the conversion to debt of the operating lease instalments (excluding the effect of the measurement of hedges and taking into account the adjustment of interest on the loans to the Iberbus companies), amounted to EUR 1,034 million, up EUR 475 million on 2007.

"Non-Current Financial Assets" amounted to EUR 635 million at 2008 year-end and included most notably deposits for the acquisition of aircraft, loans to Iberbus and Iberlease 2004 Ltd., and the 9.99% ownership interest in British Airways, measured at fair value, which was acquired in 2008 and is related to corporate transactions.

2.5. Outlook

2.5.1. Growth forecast

The outlook for the growth of the world economy in 2009 has worsened in recent months in which the deleverage of the financial industry occurred and there was a loss of confidence among both manufacturers and consumers. The latest projections (January 2009) of the International Monetary Fund (IMF) suggest that world growth will slow to an average of 0.5% in 2009. Advanced economies' GDP will decrease in 2009, which is the first time that this has happened since the Second World War. The growth of emerging economies will decrease considerably although it will remain positive. However, the measures taken around the world to shore up the financial markets and encourage tax incentives and a relaxed monetary policy may curb the drop in growth.

The outlook for the Spanish economy has deteriorated radically in recent months with the economic forecast being revised downwards on several occasions. In January 2009, the European Commission forecast a 2% fall in Spanish GDP in 2009. The Eurozone is also expected to see negative growth. Latin America will not be immune to the economic crisis but many countries in the region are likely to recover more easily than at other times thanks to their strong economic policy during the last few years.

The forecast for the airline industry has also changed drastically. In view of the negative evolution of business and consumer confidence in recent months, a significant decrease in passenger and cargo traffic is anticipated. The latest forecasts of the International Air Transport Association (IATA) point to a 3% drop in passenger traffic and a 5% fall in cargo. This represents a decrease in global traffic (measured in revenue tonne-kilometres performed) of 3.6%, after growth of only 0.9% in 2008.

IATA has also forecast a 6.5% drop in industry revenue in an extremely difficult climate that will give rise to losses of around USD 2,500 million in 2009. The exception may be the United States where the low fuel hedges together with substantial reductions of capacity carried out in the past may lead to a return to profit, however small. In other regions air-lines have started to cut back capacity although in Europe they should consider the dan-ger of losing slots in congested airports if they are not used. On the other hand, a signifi-cant number of new aircraft are to be delivered in Asia and the Middle East. Consequently, traffic is expected to fall more sharply than capacity, leading to a drop in load factors and putting pressure on yield and profitability.

Against this adverse backdrop the expected transformation of the industry is likely to accelerate. Iberia, thanks to its financial strength and strategic positioning, faces the future with the capacity to manage the probable period of consolidation.

In July 2008 negotiations got underway with British Airways regarding a potential merger between the two companies through a share exchange. Both companies continue to work on the complex negotiation process.

An important event for European and US airlines was the entry into force on March 31, 2008 of the "Open Skies" agreement to liberalise international routes between the European Union (EU) and the United States (US). The agreement was due to come into force in 2008 but, due possibly to the fact that the airline industry has been hit hard by the economic crisis, airlines on both sides of the Atlantic have yet to avail themselves of the advantages it affords, perhaps waiting for total liberalisation of the airline market. A new round of negotiations will be held in May which aims to make progress in this area.

In this context, in August 2008 American Airlines, British Airways and Iberia signed a joint business agreement for flights between North Americ and Europe and requested immediate antitrust immunity from the United States Department of Transportation, of which the European authorities were informed. The companies are in the process of furnishing the information requested by the respective government authorities with a view to obtaining a favourable decision in the third quarter of 2009.

The Company will continue to be managed on the basis of three strategic lines: improving the quality of the service offered to customers, optimising revenue and increasing competitive efficiency.

The transport business will be affected by the global economic crisis and the impact it will have on demand. In line with the strategic optimisation of the network, the Company plans to reduce passenger transport supply by around 1.6% in 2009 (with respect to actual 2008 data), with long-haul flights growing by 0.8% and short and medium-haul flights decreasing by 5.2%. Cargo supply will increase by 1.5% and will continue to focus on America. In any event, Iberia has various options under the agreement with Airbus which, together with the aircraft operated under wet leases, afford it the flexibility to adjust capacity to the evolution of the market.

The Company has also drawn up an ambitious Integral Customer Service Plan to enhance the quality of the service provided. Investments and adjustments to the entire travel experience of customers will result in an improved product and level of service. Measures to be taken include the revamp of long-haul Tourist and Business class, the refurbishment of VIP lounges at key airports to incorporate the latest innovations in technology and service, separate boarding for Business passengers and shorter baggage collection times.

The new terminal at El Prat airport in Barcelona will come into service in the first half of 2009. The new building will be home to three airline alliances and represents a significant advance in the airport industry and Spanish aviation. Iberia will be present at the airport through its ownership interest in Clickair and, if the merger process is completed, through the new Vueling.

The global aircraft maintenance industry is likely to grow moderately over the next few years within the context of increasing globalisation and consolidation processes. The trend towards the outsourcing of these services by airlines is also expected to continue with manufacturers acquiring increasing importance. Iberia therefore expects its production and billings in maintenance services provided to other airlines, which were fully consolidated in 2008, to continue increasing through the diversification of products and the customer portfolio. The Company has started to build a maintenance hangar at El Prat-Barcelona airport which is expected to be completed by the end of 2009.

With regard to the handling business, Iberia will continue to implement measures aimed at optimising revenue, reducing overheads and above all substantially increasing employees' productivity in order to achieve the appropriate level of profitability after the impact of the second phase of the liberalisation of handling services brought in at Spanish airports in 2007.

2.5.2. Description of the main risks and uncertainties

Thanks to the objectives achieved in recent years, the Iberia Group is on a sound footing to face the considerable challenges of the future.

Spain is now in a recession of uncertain intensity and length. The deterioration of the economic situation has been brought about by internal and external factors: the end of a period of expansion has given rise to a series of macroeconomic imbalances and Spain has also suffered the impact of the international financial crisis on interest rates and credit restrictions. As a result, all the economic forecasts have been adjusted and recent estimates of the IMF estimate that Spanish GDP will drop by 1.7% in 2009 and by 0.1% in 2010.

Another important risk is the high volatility and uncertainty surrounding fuel prices. Airline profitability fell sharply in 2008 as the price of fuel rose from USD 90 per barrel in January to over USD 140 in July. In the last few months of 2008, the price per barrel of Brent crude plummeted to less than USD 40 although a large portion of airlines were unable to benefit from this fall. In view of the enormous volatility of the market it is extremely difficult to predict how oil prices will behave over the next few months. Iberia has implemented a complex structure of kerosene hedges for the coming quarters using various financial instruments to hedge around 50% of its expected annual consumption.

Another uncertainty is the exchange rate of the dollar since a possible appreciation would increase income but also expenses since around 45% of the Company’s costs and 25% of its income are linked to the US dollar.

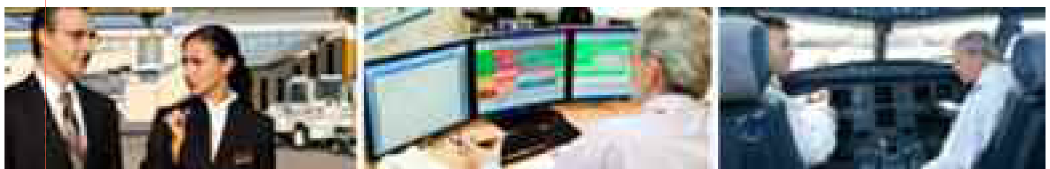
The Company adopts numerous measures to control and manage risks and has implemented systems to enable it to identify, assess, manage and mitigate the main risks that affect the various activities of the Company. In particular, Iberia uses a global management programme designed to control and reduce the potential impact of fluctuations in fuel prices, exchange rates and interest rates on the Group's earnings.

The Company will also have to face growing competition across all markets. In Spain the new high-speed rail network has become a clear competitor for the airline companies. The inauguration in February 2008 of the high-speed line (AVE) between the two main Spanish cities, Madrid and Barcelona, led to sharp fall in air traffic in this corridor. Previously, in December 2007, the corridors linking Madrid with Málaga and Valladolid came into operation. Other connections planned for 2009 will link Madrid with Valencia and Alicante and Madrid with Bilbao.

In Europe, the traditional airlines will continue to face competition from the expansion of low-cost carriers. In long-haul flights Iberia has increasing competition from South American airlines such as Mexicana de Aviación or Lan Chile, which are expanding their networks and the frequency of flights to and from Europe. However, rational behaviour and limited increases in capacity are expected from several airlines.

The trade union representatives of Iberia’s technical crew and Company management held long negotiations to establish the terms of the new collective labour agreement. A preliminary agreement was reached in the second half of January 2009, which envisages measures that will allow most of the objectives established for this group of employees in the 2006-2008 Master Plan, in terms of unit costs and productivity, to be achieved.

In July 2008, the 18th Collective Labour Agreement for Iberia's ground staff, applicable from January 1, to December 31, 2008, was signed. In 2008 management and the representatives of the cabin crew also agreed to extend until December 31, 2008 the 15th Collective Labour Agreement applicable to these employees.



3. MANAGEMENT OF NON-OPERATING RISKS

To control and limit the potential adverse effect of fluctuations in exchange rates, interest rates, and fuel prices on the Company's earnings, Iberia has a global management programme for its non-operating risks.

To achieve this objective, Iberia uses a VaR (Value at Risk) model to conduct statistical assessments of the possible impact of these market variables on its earnings, and defines the maximum volatility targets and the hedging programmes required to attain them.

To this end, Iberia arranges derivatives so as to fully or partially neutralise the fluctuations in prices, seeking highly effective hedges in line with the risk management strategy initially documented for each hedging relationship and with the methods established in International Accounting Standards (IASs) and the new Spanish National Chart of Accounts for hedge accounting.

The following three sections describe the Company's aforementioned hedging programme.

3.1. Foreign currency risk

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

- **Cash flows**

The Company took a short dollar-position of around USD 1,870 million in 2008, since US dollar revenue (21% of the total) was lower than expenses in US dollars (44% of the total).

Management Report

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

- Up to 50% by strategic hedging of up to a five-year term, by means of swaps of aircraft lease income denominated in dollars to euros.
- The remaining percentage is managed through tactical transactions with a time horizon of between one and three years, which can be adapted to market trends and which are also associated with the Company's actual flows of US dollar payments.

At December 31, 2008, Iberia had hedged 90% of its US dollar cash-flow positions for 2009 and 50% of the 2010 position.

- **Balance sheet**

The Company has assets denominated in US dollars amounting to USD 521 million, including most notably the loans granted to the Iberbus companies, the advances paid to aircraft and engine suppliers, the equities of A320 aircraft and guarantees. It also has a liability position in dollars amounting to USD 349 million which, together with arranged swaps, enables the Company to neutralise the effect of the translation differences.

- **Aircraft additions**

In order to limit the volatility of currency markets and the impact thereof on the financing or acquisition of new aircraft, the Company hedges the foreign currency risk relating to aircraft financing/acquisition/additions through forward purchase transactions and option structures that make it possible to assure a certain level or range. The addition of the new aircraft planned for 2009 gave rise to a short position of USD 80 million at 2008 year-end, 19% of which was hedged.

3.2. Interest rate risk

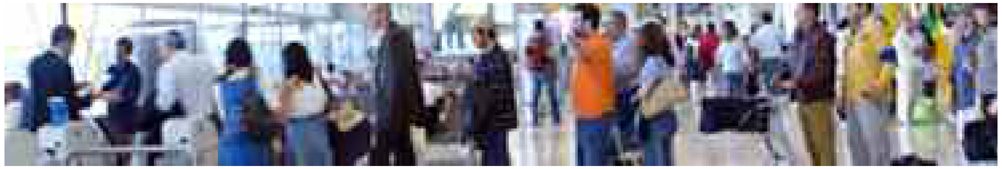
Although Iberia has negative net debt in its balance sheet, if the notional debt relating to operating lease payments (multiplying by eight the aircraft lease payments) is included, the adjusted total net debt amounts to EUR 1,034 million in its individual financial statements. At December 31, 2008 the Company maintained 58% of the adjusted gross debt at a fixed interest rate, 6% at a floating interest rate with protection and the remaining 36% at a floating interest rate.

Sensitivity to a 1% rise in euro interest rates is positive by EUR 17.5 million, due to the Company’s cash position. However, sensitivity to a 1% rise in dollar interest rates is negative by EUR 7.9 million.

Liquidity risk

At December 31, 2008 Iberia maintained an equivalent cash position amounting to EUR 2,250 million (cash plus current financial assets, excluding the measurement of hedges) in its individual financial statements, which is invested in highly liquid short-term instruments, debt repos, Eurodeposits, and commercial paper transacted through leading Spanish banks, in accordance with the prevailing risk policy. The portfolio matures at a maximum of twelve months.

In addition to the current financial assets and the cash position, the Company has undrawn credit facilities amounting to EUR 195 million that guarantee its liquidity requirements **.**



3.3. Fuel price risk

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

The Company has directly hedged the price of kerosene using a combination of financial tools such as swaps and zero-cost options.

Fuel prices were extraordinarily volatile in 2008, varying far more than usual. In the first half of the year prices rose, reaching record levels of over USD 140 per barrel (50% more than the highs reached in 2007), to then sink to under USD 50 per barrel in the last five months of the year due to the economic and financial crisis. The hedges of the price of fuel covered around 75% of the volume consumed over the year, thereby largely limiting the volatility of cash flows due to fuel.

Iberia consumes almost two million metric tonnes per year and this volume is expected to be maintained in 2009. At December 31, 2008 the Company had hedged approximately 50% of its fuel position which, depending on the evolution of fuel prices in 2009, may have a positive or negative impact on the Group's income statement.

Note 8 to the accompanying financial statements includes a sensitivity analysis of the hedges.

4. ENVIRONMENTAL RESPONSIBILITY

In 2008 the Iberia Group continued to implement measures aimed at the ongoing improvement of its management of environmental issues, as an essential element of its Corporate Responsibility Policy.

As regards flight operations, the reduction of the average age of the fleet through the renewal of aircraft (mainly the McDonnell-Douglas aircraft), the adoption of new operational measures, and the improvements obtained in flight programming and the load factor enabled Iberia, for yet another year, to reduce sound emissions and emissions affecting climate change. These improvements will allow the company to successfully meet the requirements of future European legislation, which comes into force in 2012, to limit CO_2 emissions in the aviation industry, and which was included in an EU directive approved last November.

In relation to ground operations, in 2008 significant environmental improvements were achieved through the Environmental Management Systems ISO 14001/AENOR, for which Iberia was awarded certificates in the areas of Airports and Aircraft Maintenance.

Iberia also participates in various work groups which, at both national and international level, analyse, promote and inform on the best environmental practices in the sector.

Also, in 2008 Iberia was simultaneously admitted to the most significant sustainability indexes in the world, the Dow Jones Sustainability Index (World), the Dow Jones Sustainability Index (European) and the FTSE4Good (Ibex). They all acknowledge the best environmental, social and economic practices at international level obtained through an exhaustive analysis amongst a group of large companies. Iberia achieved the maximum score in categories such as the local air quality.

Iberia's Corporate Responsibility Report provides more detailed information on the Company's Sustainability Management.

5. ANNUAL CORPORATE GOVERNANCE REPORT

Pursuant to the amendments to Article 49 of the Spanish Commercial Code and to Article 202 of the Consolidated Spanish Companies Law under Law 16/2007, of July 4, on the reform and adaptation of Spanish company and commercial law on accounting matters for its international harmonisation based on European Union legislation, the companies that have issued securities admitted to listing on a regulated European Union stock market must include a Corporate Governance Report in a separate section of their Management Reports.

The Corporate Governance Report of Iberia, Líneas Aéreas de España, S.A. for 2008 is included in section six of the Company's Consolidated Management Report for the year.