Europe: Facing the LCC Challenge

European Transport Conference

Merrill Lynch

9 & 10 March 2004

Focused Strategy in Key Growing Markets

Long Haul

“Maintaining current leadership in Europe to Latin America routes”

Improve product offering

- **frequencies**
- **connectivity**

Daily flights to all Latin American capitals, even 2 in most relevant destinations

Europe

“Strengthening market presence”

Feed the Europe to Latin American routes

Increase in frequencies and direct flights rather than from new markets

Spain

“Focusing on yield reinforcement”

Selective increase in frequencies

Increase in aircraft capacity

Continue leveraging on regional flights with Air Nostrum

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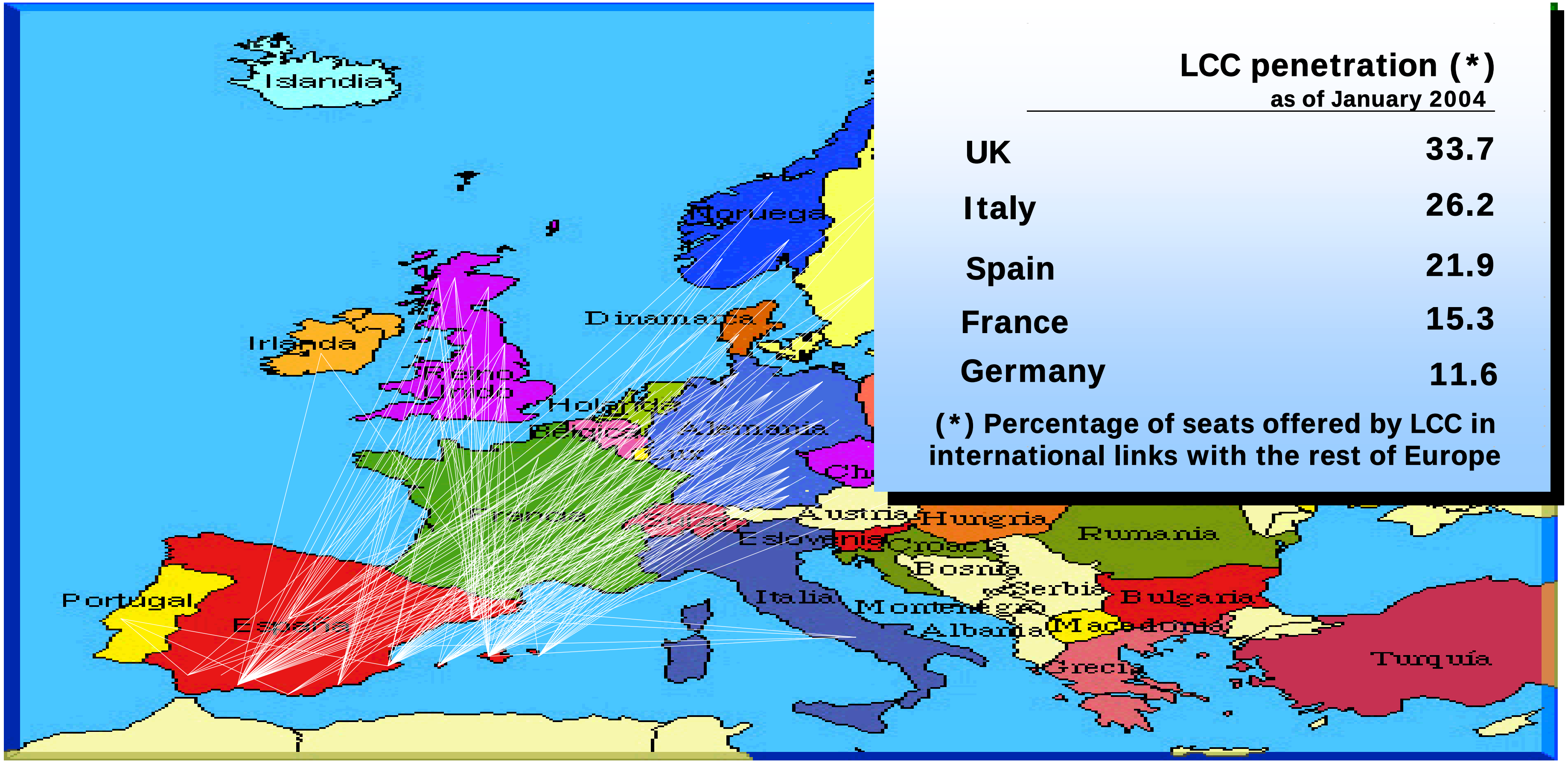
The LCC´s are already in the Spain-Europe market

Spain has high exposure to LCC´s: third market in Europe after the UK and Italy (First if charter activity is included)



LCC penetration (*) as of January 2004	
UK	33.7
Italy	26.2
Spain	21.9
France	15.3
Germany	11.6

(*) Percentage of seats offered by LCC in international links with the rest of Europe

Source: OAG MAX Jan 04

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LCC´s are capturing Traffic mostly from Former Charter Activity

From 2001 to 2003 Iberia has gained 0.3 percentage points of market share in the total traffic between Spain and Europe

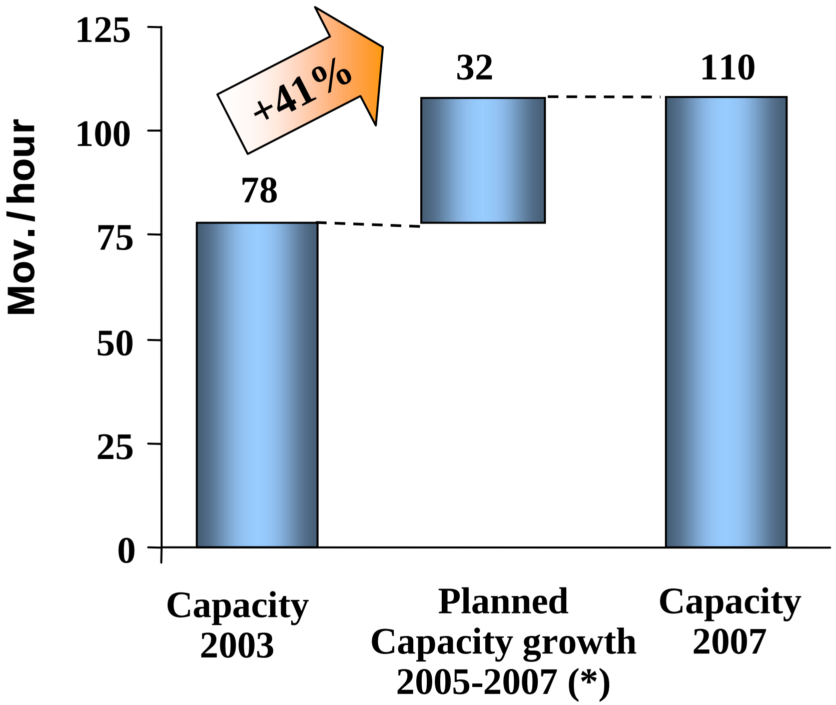
In the same period Low Cost Carriers have increased their market share by 8.1 percentage points

Charter carriers have reduced market share by 7.1 percentage points

The Expansion in Madrid and Barcelona Will Allow Iberia's Growth

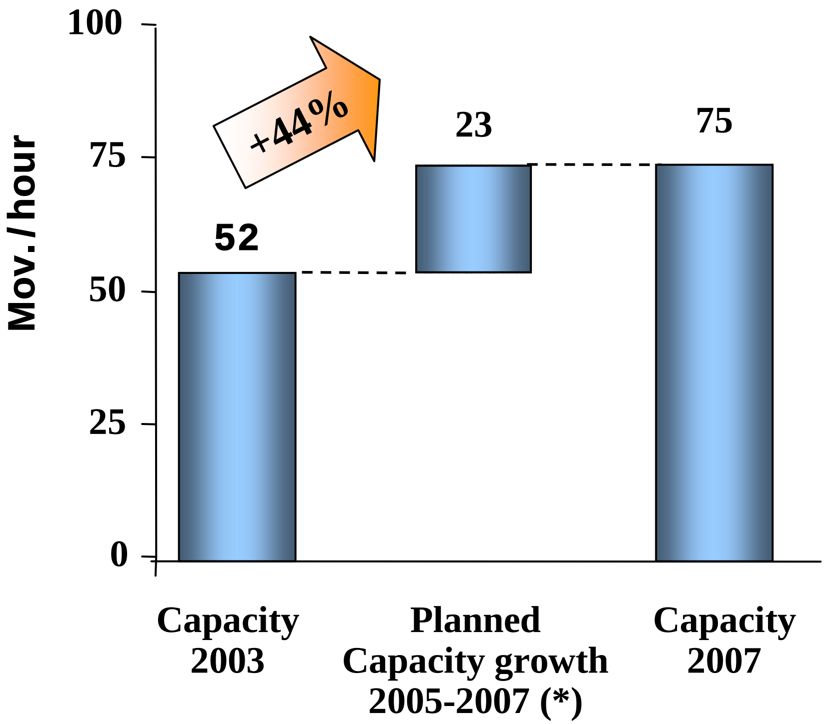
Madrid and Barcelona are among the fastest growing airports in Europe

Madrid expansion to 2007



2005	**2 new runways**
	1 new terminal

Barcelona expansion to 2007



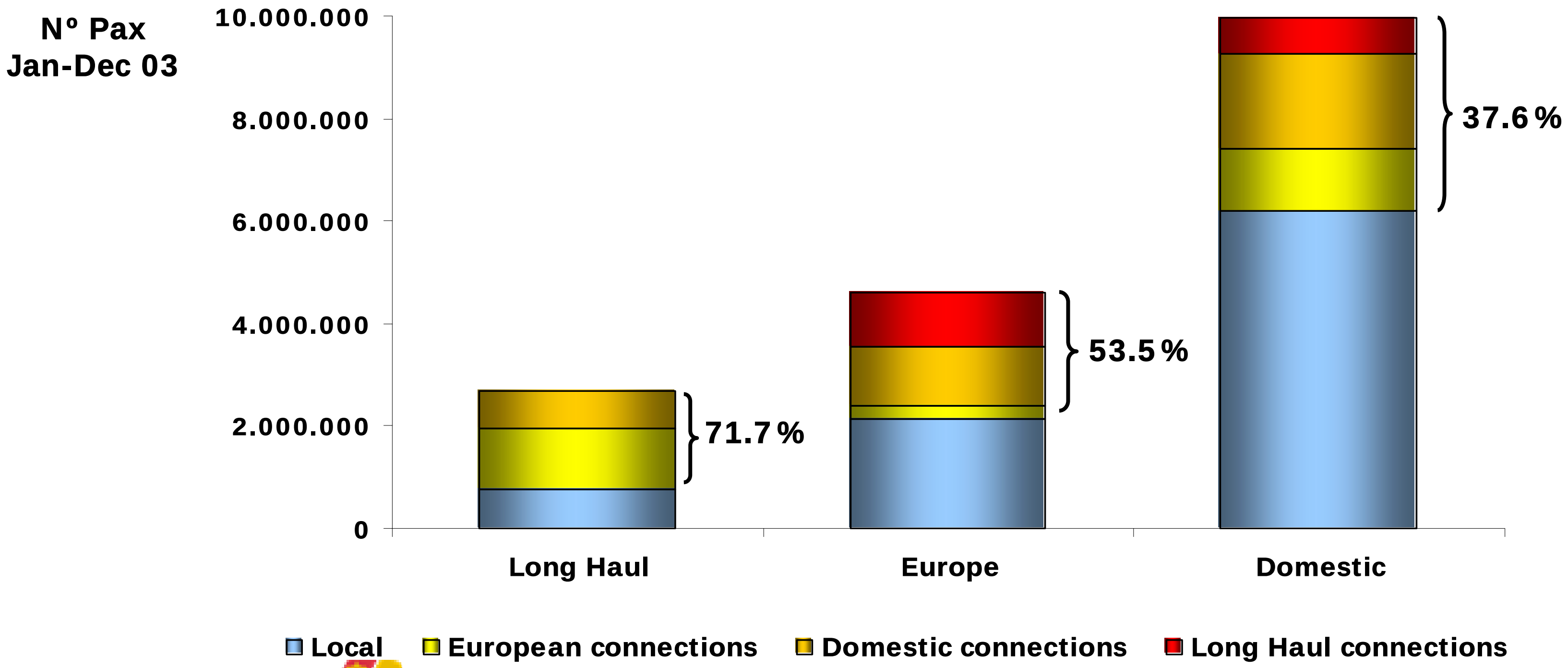
2005	**1 new runway**
	1 new terminal

(*) IB forecast

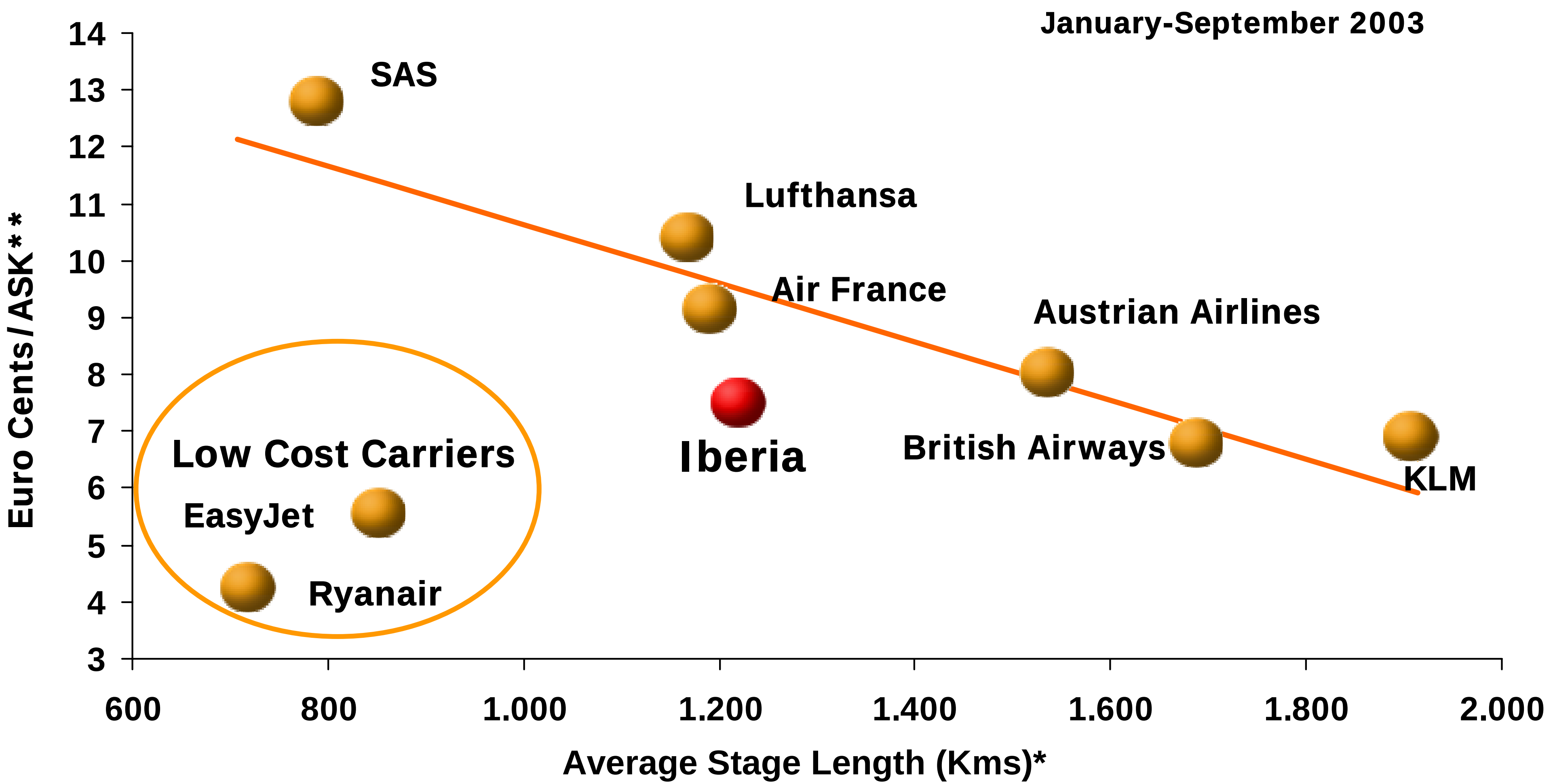
Network Carrier Advantages

- Hub-and-spoke economies of scale
- Established customer base
- Product differentiation

Iberia: Connectivity by sector



Unit Costs Significantly Below Industry Average



Date for period January - September 2003, except Ryanair and Easyjet fiscal year 2003.

* Source: AEA

**Operating costs less 33% of Operating Leases less other non-airline revenues

Director Plan 2003-2005

Vision of the Director Plan

- Maintain our leadership position in the domestic and Europe-Latin America market

  Enhancing business class and maintaining connecting traffic

- Develop competitive service and prices in Domestic and European point-to-point routes

  Redefining the service model in tourist class: Unbundling the product

- Maintain a competitive cost base even with Low Cost Carriers

- Maximise the value of the different airline related businesses

Maintain the leadership in profitability among the European airlines

Shareholder Value Creation

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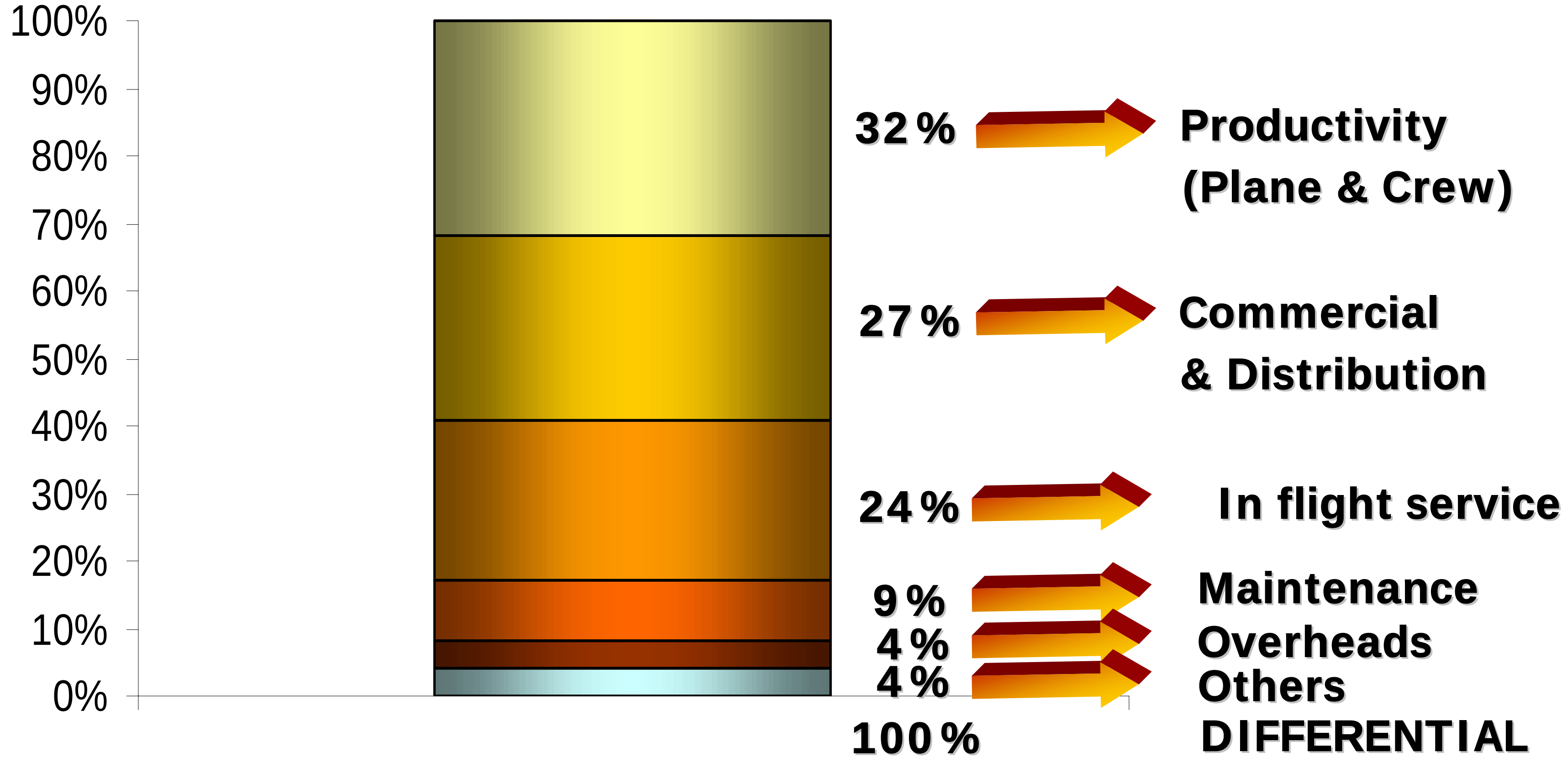
Cost Differential Iberia-Low Cost Carriers

Areas Identified → **Action plan under way** → **Gap narrowing**



The Director Plan will narrow this differencial by 60% in 3 years

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Adapting the Business Model of Iberia. New Products

- The short / medium haul economy product will be transformed: Unbundling the product
- The proposal offered to business traveller will continue to be enhanced

Modifications to Service Model

	Economy	Business
Short + Medium Haul	Migration to a "pay as you go" model •Simplification in 2003 (1st phase) •Introduction of pay-as-you-go in 2004	Improvement of passenger services •Fast track services •Quality meals •Personalised passenger treatment (CRM)
Long Haul	No change	Introduction of "New Business Class" •Entertainment on board •Communications •Flat Seats •Personalised passenger treatment (CRM)

Redeployment of resources

Asset Utilisation

35-45 MM/€

- Improvement of 0.8 Block Hours/ Day in medium haul aircraft through optimisation of slots and night aircraft utilisation

- Optimisation of short/medium haul fleet : Increase number of seats per aircraft by 5%

Additional measures

- Accelerate the phase out of B747-200
- Utilise financial tools will add flexibility in fleet incorporation
- Optimisation of A 340-300. Change of crew rest zone adding more seats

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Personnel Productivity

65-75 MM/€

Productivity improvement and reduction of unit costs

Director Plan targets:

- **Ground Staff** Cost/ASK: ↓ 10-13%
- **Pilots** Cost/Block Hour: ↓ 4-8%
- **Flight attendants** Cost/Block Hour : ↓ 10-15%

Some measures:

- Reduction of flight attendants for short and medium flights
- Reorganisation of regional offices
- Crew multilicences

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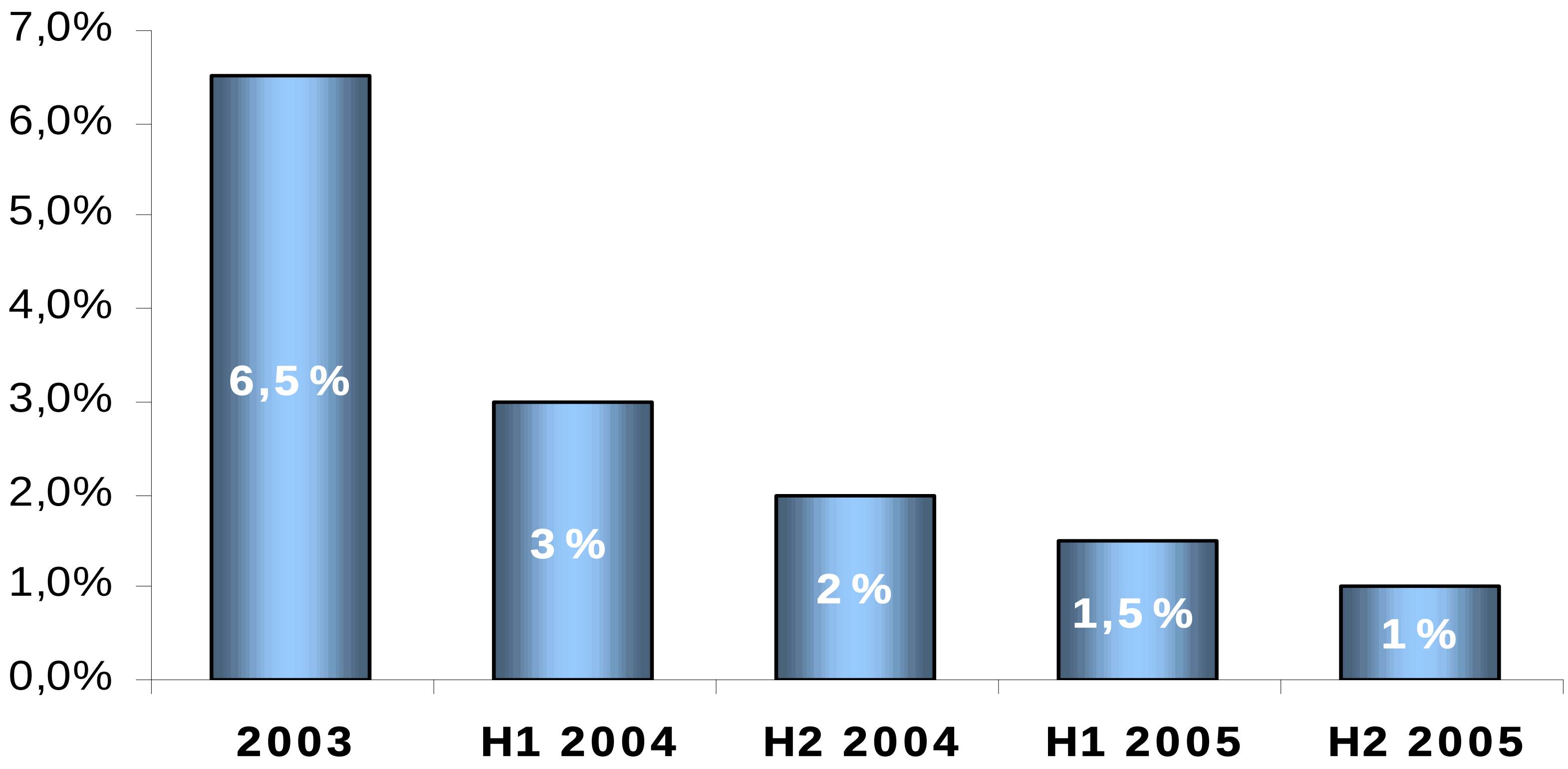
Commercial and Distribution Costs

100-110 MM/€

Reduction in distribution costs

- New role of Travel Agencies
- New role of direct channels
- Increase corporate agreements under management fee
- Implement program for small companies

Reduction of Basic Travel Agencies' Commissions in Spain



Other Costs

110-120 MM/€

Improvement in maintenance

- Improve productivity
- New fleet
- Purchasing policy
- Increase third party revenues

Reduction in other costs

- Reduction in global purchasing costs
- Overhead reduction

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Reducing Costs

	Impact in 2005 MM/ Euro Director Plan
Asset utilisation	35-45
Personnel costs	65-75
Commercial costs	100-110
Service on board	40-50
Other costs	110-120
	350-400

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Note: Targets of cost reductions over base case 2005

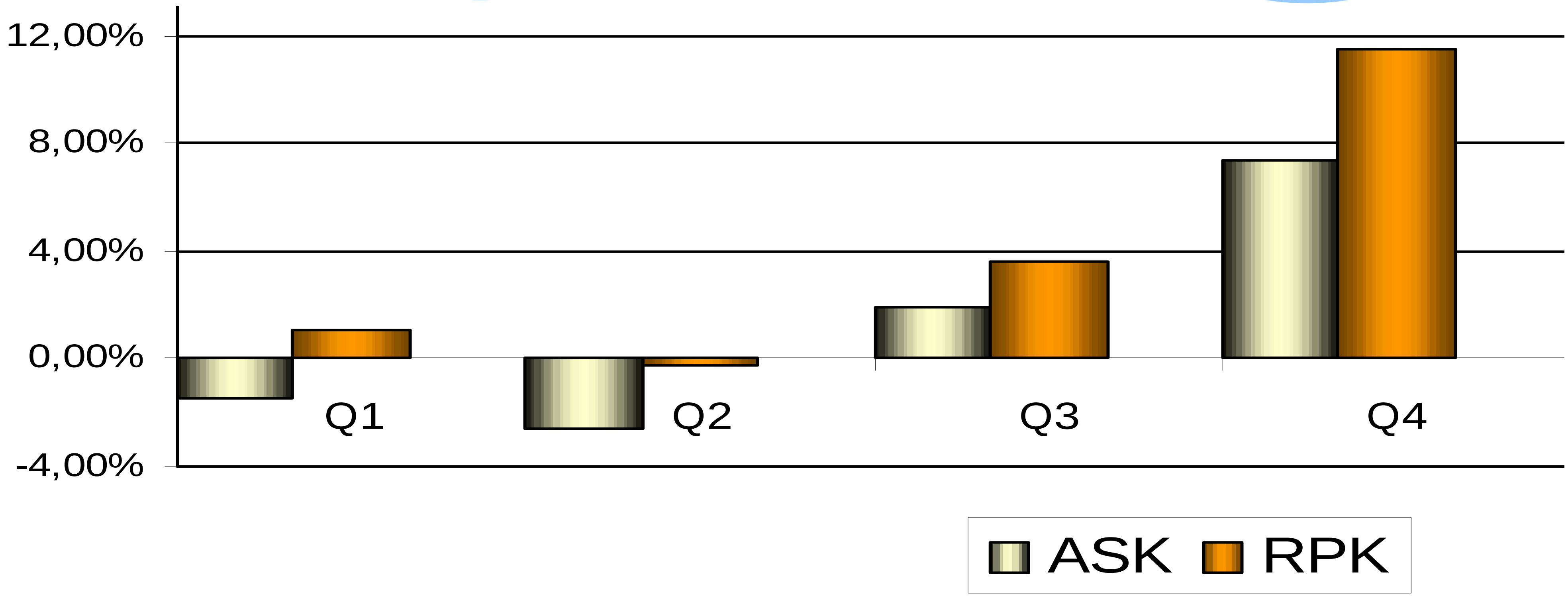
Our Objectives

Unit Cost	2005/02 ↓ 10-12%
EBITDAR margin	≃ 19%
ROE	≃15%

Year 2003

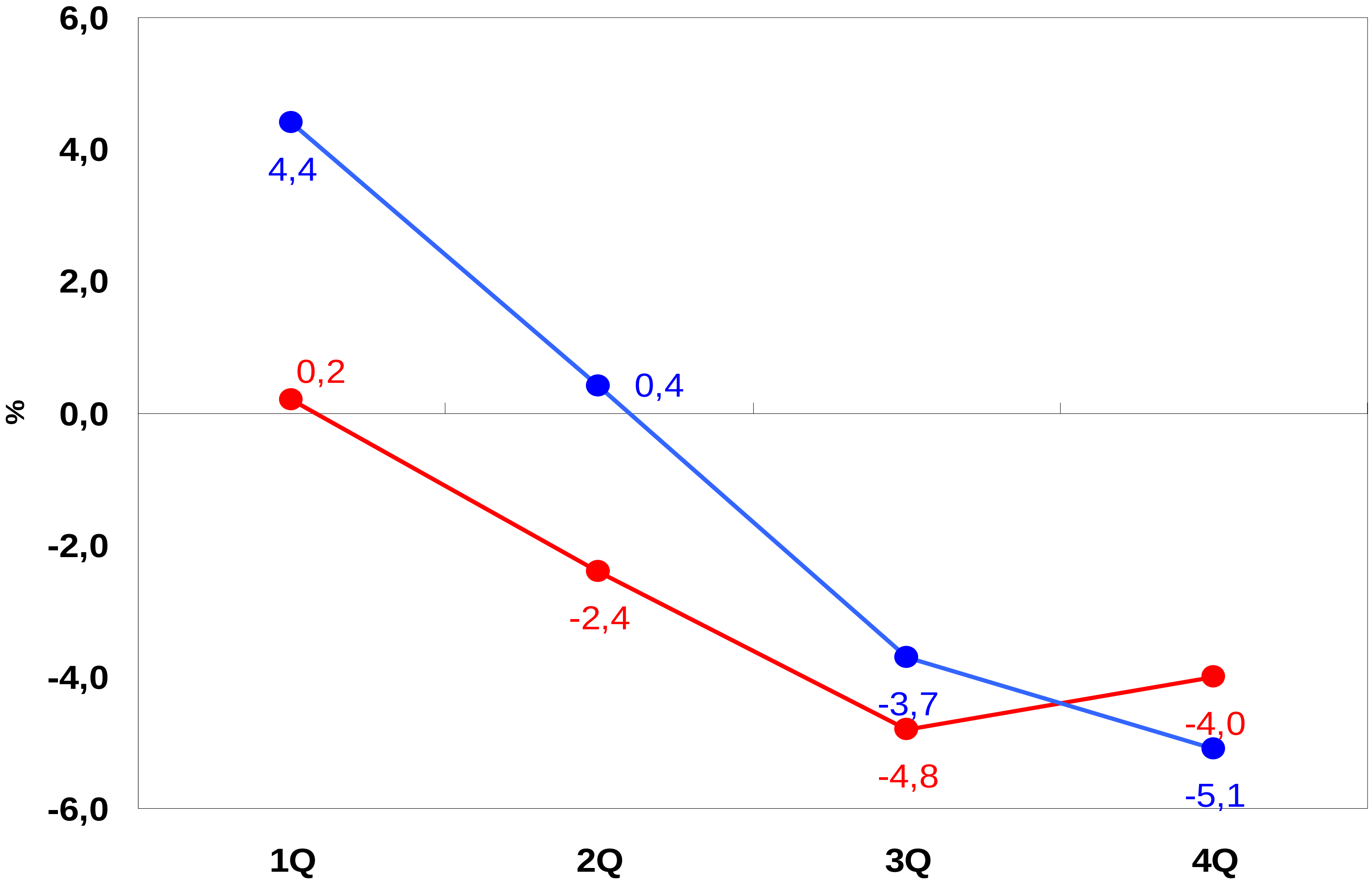
Capacity Adjustment

Load factor	+1,9	+1,8	+1,4	+2,7



Load Factor 2003: 75 % Historical Record

Unit Cost and Revenue Evolution 03/02



- **% 03/02 Unit Revenue**
- **% 03/02 Unit Cost**

Positive Results

	2003
Revenues	4,619.3
Ebitdar	700.7
Ebitdar Margin	15.2%
EBIT	160.7
Ordinary Results	183.6
Net Income	143.6

Data in million €

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Director Plan: Measures already in place

Reduction of travel agencies´commissions	January 2004
Agreement with maintenance staff, allowing more flexibility and productivity	December 2003
New on board service model:	1st phase July 2003 2nd phase March 2004
Restructuring of foreign offices	2003-2004
Improvement of ground and flight staff productivity	2004-2005

Traffic Statistics January 04

	ASK	RPK	L.F.
Domestic	1.4%	5.3%	2.4 p.p.
Europe	3.9%	8.3%	2.2 p.p.
Long Haul	12.5%	13.3%	0.6 p.p.
Total	7.6%	10.6%	1.9 p.p.