



**INTERNATIONAL CONSOLIDATED
AIRLINES GROUP, S.A.**

Special Report on the issue of bonds that are convertible
and/or swappable in shares in the cases established by
articles 414, 417 and 511 of the Spanish Companies Act



Free translation of the auditor's special report on the issue of bonds that are convertible and/or swappable in shares in the cases established by articles 414, 417 and 511 of the Spanish Companies Act originally issued in Spanish. In the event of a discrepancy, the Spanish language version prevails.

SPECIAL REPORT ON THE ISSUE OF BONDS THAT ARE CONVERTIBLE AND/OR SWAPPABLE IN SHARES IN THE CASES ESTABLISHED BY ARTICLES 414, 417 AND 511 OF THE SPANISH COMPANIES ACT

To the General Shareholders' Meeting of International Consolidated Airlines Group, S.A.:

For the purposes of Articles 414, 417 and 511 of the Spanish Companies Act, and in accordance with the mandate received from International Consolidated Airlines Group, S.A. (hereinafter "IAG" or "the Company"), due to the designation by the Madrid Mercantile Registrar, Mr. Manuel Álvarez Gómez under case file number 460/15, we hereby issue this Special Report on the directors' proposal to issue bonds convertible into new shares and/or swappable for existing shares in IAG, excluding any preferential subscription right, under the authorisation of and, therefore, the delegation by, of IAG Ordinary General Shareholders' Meeting held on 18 June 2015.

1. Background and purpose of our work

IAG is a Spanish company, registered in Madrid and incorporated on 8 April 2010. IAG's shares are traded on the main stock market in London as well as in Madrid, Barcelona, Bilbao and Valencia in the Spanish Continuous Market (SIBE).

In accordance with the information and documentation received, IAG's Board of Directors, based on the authorisation conferred by shareholders at a General Meeting held on 18 June 2015, on 29 October 2015 adopted, simultaneously to the approval of the Directors' Report attached here to, a resolution to issue bonds that may be converted into new shares or swapped for existing shares in IAG. This action was simultaneous to the approval of the Directors' Report attached hereto. The maximum nominal amount of the issue is one thousand million euro (EUR 1,000,000,000), and an incomplete subscription process is expected, excluding preferential subscription rights. The issue will comprise a first tranche totalling a maximum amount of six hundred and twenty-five million euro (EUR 625,000,000) and maturing in five years and a second tranche totalling a maximum amount of six hundred and twenty-five million euro (EUR 625,000,000) and maturing in seven years (hereinafter the "Bonds").

By virtue of this delegation of authority, the Directors of IAG have prepared the Directors' Report, attached hereto as an Appendix, accompanied by a certificate of resolutions adopted by the Board of Directors dated 29 October 2015 (hereinafter the "Directors' Report") that provides justification for the proposal and the rate of conversion into shares of the bonds to be issued. In accordance with the information provided to us, the issue will take place under the terms and conditions established in the Directors' Report that was previously approved by the Board of Directors.

The purpose of our work is not the certification of the price of the issue or the conversion of the Bonds. The objectives of our work are exclusively the following:

- Determine, through the application of the procedures established by the Technical Rule governing Special Reports on the issue of convertible bonds in the cases covered by Article 414 of the Spanish Companies Act, whether the Report prepared by the Directors of IAG attached hereto contains the information required by the aforementioned Rule that includes an explanation of the bases and types of conversion relating to the Bonds.

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- Issue a technical opinion, as independent experts, on the reasonableness of the information set out in the IAG Directors' Report relating to the issue of the convertible Bonds, excluding any preferential subscription right and on the adequacy of the conversion rate of the Bonds and, if appropriate, the adjustment formulae to offset any potential dilution of the stake held by shareholders, all in accordance with the provisions of Article 417 of the Spanish Companies Act.

The accounting information used in this report has been taken from the consolidated annual accounts of International Consolidated Airlines Group, S.A. and subsidiaries (hereinafter “the Group” or “the IAG Group”) for the year ended 31 December 2014, audited by Ernst & Young, S.L., which issued a favourable audit opinion on 4 March 2015 and the summarized consolidated interim financial statements for the six month period ended 30 June 2015, on which Ernst & Young, S.L. issued a limited review report dated 30 July 2015 in which they expressed a conclusion without exceptions.

2. Procedures applied during the course of our work

Our work has consisted of the application of the following procedures, as applicable in accordance with the Technical Rule on the Preparation of the Special Report on the issue of convertible bonds in cases covered by Article 414 of the Spanish Companies Act and any supplementary procedures that we considered necessary to comply with the provisions of Articles 417 and 511 of the Spanish Companies Act.

- a) Obtain the notification, and the relevant appointment, of the Madrid Mercantile Registrar Mr. Manuel Alvarez Gomez on 18 August 2015 of our designation as Auditor for the purposes of Articles 414, 417 and 511 of the Spanish Companies Act with respect to case file 460/15 concerning IAG.
- b) Obtain the resolution adopted on 29 October 2015 by IAG's Board of Directors relating to the issue of bonds convertible into new shares and/or swappable for existing shares in the Company.
- c) Obtain the resolution adopted by shareholders of IAG at a General Meeting held on 18 June 2015 regarding the delegation of the authority to IAG's Board of Directors to issue convertible bonds and to exclude the preferential subscription right.
- d) Obtain the report dated 29 October 2015 prepared by IAG's Directors explaining the bases and types of conversion, attached hereto as an Appendix.
- e) Obtain the audit report and the consolidated annual accounts for the IAG Group for the year ended 31 December 2014, and the limited review report and the summarized consolidated interim financial statements for the six month period ended 30 June 2015.
- f) Verify that the report prepared by the Directors relating to the proposal to issue bonds convertible into new shares and/or swappable for existing shares contains the information considered necessary and sufficient, in accordance with the provisions of Articles 401 to 413 of the Spanish Companies Act, for an adequate interpretation and understanding on the part of the recipients of the report, including any significant subsequent events that could affect the proposed bond issue.
- g) Obtain and analyse the financial information used by the Directors of IAG to determine the bases and types of the conversion of the bonds and compare them with other alternative valuation methods (Discounted cash flows, comparable listed company multiples and analysis of recent analysts' reports on IAG's shares)
- h) Verify, based on the Directors' Report, that the price of the issue of the convertible bonds is not lower than their nominal value and that the price of the bonds convertible into shares is not lower than the nominal value of the shares into which they will be converted, or lower than the net equity value reflected in the latest audited consolidated annual accounts for the IAG Group, or than which results from the summarized consolidated interim financial statements for the six month period ended 30 June 2015.
- i) Evaluate the reasonableness of the information set out in the Directors' Report to justify the proposal regarding the issue of the Bonds and the reasons and documentation that justify the suppression of the Preferential Subscription Right.



- j) Verify that the accounting information set out in the Directors' Report matches the information in IAG's consolidated annual accounts for 2014.
- k) Obtain information from the Company's auditor regarding any significant events or factors concerning the financial situation of the Company and IAG Group that became known after the issue of the latest audit report provided to us.
- l) Analyse significant subsequent events that occurred after the preparation of the 2014 consolidated annual accounts for IAG Group, including any Relevant Events reported to the National Stock Market Commission (CNMV) up to the date of this report.
- m) Meet with IAG management to obtain information regarding the financial development of the IAG Group as from 30 June 2015, date to which the regularly published financial information refers, to the date of our report, which could significantly affect the equity value of the IAG Group and evaluation thereof, as well as to obtain management's financial projections for coming years and discussion of the main hypotheses and their impact on our work.
- n) Analyse the available minutes of the Board of Directors' meetings and General Shareholders' Meeting held during 2015 and up to the date of this report.
- o) Request previous agreements between shareholders or other third parties that could be related to the IAG share valuation.
- p) Meet with executives of IAG for the purpose of obtaining information relating to matters raised during the course of our work, and any other issues that could significantly affect the value of the Group or which could be of interest for the purpose of our work.
- q) Analyse the performance of the listed price of the Company's shares and determine the average listed price of those shares over the course of the latest representative period prior to the date of this special report (the last quarter) and the latest listed price prior to that date, taking into account the frequency and volume of trading in the periods being analysed.
- r) Determine the theoretical value of the preferential subscription rights to be suppressed, calculated with reference to the Company's average share price for the latest representative period and the latest listed value for the Company prior to the date of the Special Report and to the Group's theoretical equity value.
- s) Analyse the adequacy of the conversion rate and the adjustment formulae to offset any potential dilution of the stake held by shareholders.
- t) Obtain a letter of representation from IAG management confirming, among other things, that we have been provided with all the information necessary to prepare our Special Report, that they have made available to us all hypotheses, data and relevant information, and that there have been no subsequent events up until the date of said Special Report that have not been reported to us and which could have a significant effect on the conclusions of our work.

3. Evaluation of the conversion ratio and the adjustment formulae

The Directors' Report which is attached as an Appendix hereto, is issued in relation to the resolution approving two issues (respectively "Issue 1" and "Issue 2", individually "an Issue", and jointly "the Issues"), of bonds convertible into new shares and/ or swappable into existing shares in the Company, for an overall maximum nominal amount of EUR 1,000,000,000, where:

- (i) EUR 625,000,000 is the maximum nominal amount of Issue 1 and EUR 375,000,000 the minimum nominal amount of Issue 1, maturing at five (5) years; and
- (ii) EUR 625,000,000 is the maximum nominal amount of Issue 2 and EUR 375,000,000 the minimum nominal amount of Issue 2, maturing at seven (7) years.



Without prejudice to the limits mentioned above, the overall principal of the bonds issued under the Issues may in no event exceed EUR 1,000,000,000.

Therefore if the amount issued under either Issue exceeds EUR 500,000,000, the other Issue shall be for a maximum amount of EUR 500,000,000 less the amount issued for the first Issue which exceeds EUR 500,000,000 and taking into account that in any event the minimum issue amount in both Issues is EUR 375,000,000.

The report prepared by the Directors proposes that the conversion rate and the interest rate payable annually as the coupon on the bonds convertible into new shares and / or swappable for existing shares in IAG are fixed over the entire life of the issue for each tranche.

This rate of conversion or swap will be determined based on market conditions at the time the bond issue is launched and using habitual demand prospecting procedures. For these purposes, taking into account an interest rate payable as the maximum coupon of 0.875% for Issue 1 and 1.25% for Issue 2, the conversion price will be set based on the listed price for IAG shares at the date the issue is carried out with a premium of not less than 47.5% for Issue 1 and 40% for Issue 2, of that value. In any event, it is established that the result of dividing the amount of the issue by the conversion price (which will be a minimum of EUR 9.8036 for both tranches) may not exceed the 102,003,865.95 shares.

In the case of a listed company, the fair value is understood as the market value and this is assumed, unless otherwise evidenced, to be linked to their share price. The share price at 28 October 2015 was EUR 8.44 and the average share price for the three month period ended 28 October 2015 was EUR 7.81.

The minimum conversion price proposed by the directors exceeds the consolidated net equity value of the IAG shares currently outstanding, which amounts to EUR 1.71 per share at 31 December 2014, according to the audited consolidated annual accounts for 2014 for the IAG Group. Similarly, that minimum conversion price is higher than that which would result from using the unaudited consolidated net equity value at 30 June 2015, date to which the latest regular public financial information sent to the National Securities Market Commission refers, on which the auditor issued a limited review report without exceptions. That price amounts to EUR 2.34 per share.

The minimum conversion price agreed in the Directors' Report does not give rise to any theoretical dilution effect on the listed price of the shares in the three month period ended 28 October 2015 and at 28 October 2015 or on the audited theoretical book value at 31 December 2014.

4. Relevant issues and specific difficulties to consider with respect to the interpretation of our work

Both the interpretation of the requirements of Articles 414 and 417 of the Spanish Companies Act and the opinions expressed in this report include, in addition to objective factors, subjective factors that involve judgements and, therefore, it is not possible to ensure that third parties would necessarily agree with the interpretations and judgements expressed in this report.

The information necessary to carry out our work has been provided by the management of IAG or has been obtained from public sources.

Our work has not included the verification of such information using external evidence, notwithstanding the fact that to the extent possible we have verified that the information presented is consistent with other information obtained during the course of our work.

Our report does not include an analysis of any change that could arise with respect to the conversion price between the date of this Special Report and the subscription date, or the possible theoretical dilution that could differ from that being reviewed in this report.

We do not have the obligation to update our report due to events that may take place after the date it is issued. The content of this report should be understood to refer to all of the information received regarding the events taking place prior to the date it was prepared.



We assume that all the authorisations and filing obligations that may be necessary to effectively carry out the transaction, and which could affect our work, will be obtained without any adverse effect on the aim of the transaction being analysed by us.

Finally, it is important to emphasise that our work is independent in nature and therefore does not constitute any recommendation to the management of IAG, Company shareholders or third parties with respect to the position they should take in the bond issue operation.

5. Conclusion

In accordance with the work performed, with the scope described in the preceding paragraphs, and subject to relevant aspects to be taken into consideration when interpreting the results of our work, and with the sole objective of complying with the requirements established in Articles 414 and 417 of the Spanish Companies Act, in our professional opinion:

- the accompanying Report of the Directors of IAG regarding the resolution concerning the issue of bonds that are convertible into new shares and/or swappable for existing shares in IAG, with no preferential subscription right, contains the information required by the Technical Rule governing the preparation of special reports on the issue of Convertible Bonds stipulated by Article 414 of the Spanish Companies Act and the information set out in that Directors' Report is reasonable as it is adequately documented and presented, and
- the ratio for the conversion of the bonds to IAG shares excluding the preferential subscription right and the proposed adjustment formulae to offset any possible dilution of the stake held by shareholders are appropriate.

This Special Report has been prepared solely for the purposes established by Article 414, 417 and 511 of the Spanish Companies Act and should not be used for any other purpose.

PricewaterhouseCoopers Auditores, S.L.

Originally signed by Raúl Llorente Adrián

29 October 2015