

**TÜRK HAVA YOLLARI  
ANONİM ORTAKLIĞI**

US GAAP FINANCIAL STATEMENTS  
FOR THE SIX MONTH PERIOD ENDED  
JUNE 30, 2004

## **INDEPENDENT AUDITORS' REVIEW REPORT**

To the Board of Directors of  
Türk Hava Yolları Anonim Ortaklığı

1. We have reviewed the accompanying balance sheet of Türk Hava Yolları A.O. (“the Company”) as of June 30, 2004 and the related statements of income, changes in shareholders' equity and cash flows for the six month period then ended. These financial statements are the responsibility of the Company’s management.
2. We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.
3. Based on our limited scope review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with Generally Accepted Accounting Principles in United States of America.
4. The impairment reserve on finance leased assets, were not taken into consideration in the calculation of deferred tax liability as of December 31, 2003. Accordingly, during the preparation of financial statements as of June 30, 2004, the Company has restated its 2004 opening balance sheet by decreasing deferred tax liability and accumulated losses as of December 31, 2003 by US \$ 43,346 thousand.

**DENETİM SERBEST MALİ MÜŞAVİRLİK A.Ş.**  
Member of **DELOITTE TOUCHE TOHMATSU**

İstanbul, September 23, 2004

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT JUNE 30, 2004 AND DECEMBER 31, 2003

<u>ASSETS</u>	<u>Note</u>	June 30, 2004 <u>US \$ 000</u>	December 31,2003 (As Restated) <u>US \$ 000</u>
Cash and Cash Equivalents	5	462,698	472,700
Accounts Receivable (Net)	6	124,431	84,638
Due from Related Parties	7	38,687	85
Inventories	8	38,009	30,529
Short Term Deferred Tax Assets	21	34,766	34,754
Other Receivables and Current Assets	9	47,540	37,169
<b>TOTAL CURRENT ASSETS</b>		<b>746,131</b>	<b>659,875</b>
Due from Related Parties (Long Term)	7	-	37,507
Long Term Advances Given	10	7,211	7,319
Investments At Equity	11	6,819	5,092
Financial Assets Available For Sale (Net)	11	10,022	10,615
Fixed Assets (Net)	12	1,300,351	1,357,815
Other Long Term Receivables and Assets	13	8,458	9,536
<b>TOTAL NON-CURRENT ASSETS</b>		<b>1,332,861</b>	<b>1,427,884</b>
<b>TOTAL ASSETS</b>		<b>2,078,992</b>	<b>2,087,759</b>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT JUNE 30, 2004 AND DECEMBER 31, 2003

<u>LIABILITIES</u>	<u>Note</u>	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 (As Restated) <u>US \$ 000</u>
Bank Borrowings	14	4,810	-
Short Term Portion of Finance Lease Obligations	15	146,814	174,602
Accounts Payable		143,590	128,930
Due to Related Parties	16	4,781	3,847
Other Short Term Payables	17	21,651	35,102
Deposits and Advances Received	18	19,949	40,007
Passenger Flight Liabilities	19	149,280	71,455
Other Accrued Liabilities	20	45,552	47,349
Provision for Corporate Tax	21	5,272	13,800
<b>TOTAL CURRENT LIABILITIES</b>		<u>541,699</u>	<u>515,092</u>
Long Term Portion of Finance Lease Obligations	15	787,714	860,729
Manufacturers' Credit (Net)	22	2,413	3,045
Long Term Deferred Tax Liabilities	21	74,958	65,004
Retirement Pay Liability	23	59,396	56,342
Other Long Term Payables	17	2,534	2,732
<b>TOTAL NON-CURRENT LIABILITIES</b>		<u>927,015</u>	<u>987,852</u>
Share Capital	24	775,381	775,381
Share Premium	24	55,327	55,327
Accumulated Losses		(220,430)	(245,893)
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<u>610,278</u>	<u>584,815</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<u>2,078,992</u>	<u>2,087,759</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## STATEMENTS OF INCOME FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2004 AND 2003

	Note	June 30, 2004 US \$ 000	June 30, 2003 US \$ 000
Operating Revenues	28	835,259	693,201
Operating Expenses	29	<u>(780,002)</u>	<u>(638,289)</u>
OPERATING PROFIT		55,257	54,912
Income from Other Operations	31	14,364	17,638
Loss from Other Operations	32	<u>(4,026)</u>	<u>(4,396)</u>
INCOME BEFORE FINANCIAL EXPENSE AND TAXATION		65,595	68,154
Financial Expenses (Net) (Net of Translation Gains and Losses)	30	<u>(20,820)</u>	<u>(21,340)</u>
INCOME BEFORE TAXATION		44,775	46,814
Taxation Charge	21	(19,312)	(9,552)
NET PROFIT FOR THE PERIOD		<u>25,463</u>	<u>37,262</u>
Basic Earnings per Share (US \$ in Full)	4.16	0.0001	0.0002

## TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

### STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2004 AND 2003

	Share Capital US \$ 000	Share Premium US \$ 000	Accumulated Losses US \$ 000	Total US \$ 000
Balances at December 31, 2002	775,381	55,327	(459,650)	371,058
Profit For The Period	-	-	37,262	37,262
Balances at June 30, 2003	<u>775,381</u>	<u>55,327</u>	<u>(422,388)</u>	<u>408,320</u>
Balances at December 31, 2003 (As Previously Reported)	775,381	55,327	(289,239)	541,469
Effect of Change in Deferred Tax Liability Arising From Tangible Fixed Assets (see note 2)	-	-	43,346	43,346
Balances at December 31, 2003 (As Restated)	<u>775,381</u>	<u>55,327</u>	<u>(245,893)</u>	<u>584,815</u>
Profit For The Period	-	-	25,463	25,463
Balances at June 30, 2004	<u>775,381</u>	<u>55,327</u>	<u>(220,430)</u>	<u>610,278</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## STATEMENTS OF CASH FLOWS

FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2004 AND 2003

	June 30, 2004 US \$ 000	June 30, 2003 (As Restated) US \$ 000
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Profit Prior to Taxation	44,775	46,814
Adjustments to reconcile net profit for the period to net cash provided by operating activities:		
Depreciation	67,753	71,164
Provision for Employee Termination Benefits	6,373	13,410
Interest Income	(11,887)	(10,052)
Gain on Fixed Asset Sales	(552)	(53)
Translation Gain / (Loss) on Deferred Tax Liability / (Assets)	(1,834)	316
Impairment Loss / (Gain)	18,353	(251)
(Income) / Loss from Financial Investment Accounted Per Equity Method	(1,727)	2,348
Interest Expense	17,036	18,730
Provision for Diminution in Value of Financial Assets Available For Sale	1,568	(1,916)
Movement in Manufacturers' Credit	(632)	28
Amortization of deferred income from USAŞ share transfer	(845)	(683)
Increase/(Decrease) in Provision for Doubtful Receivable	(2,975)	1,168
Operating Profit Before Working Capital Changes	135,406	141,023
(Increase) / Decrease in Trade Receivables	(36,818)	(32,414)
(Increase) / Decrease in Due From Related Parties	(1,095)	(2,159)
(Increase) / Decrease in Inventories	(7,480)	(1,450)
(Increase) / Decrease in Other Receivables and Short Term Assets	(10,371)	(170)
(Increase) / Decrease in Other Long Term Receivables and Assets	1,078	(6,960)
(Increase) / Decrease in Long Term Advances Given	108	6,121
Increase / (Decrease) in Trade Payables	14,660	17,515
Increase / (Decrease) in Due to Related Parties	934	1,977
Increase / (Decrease) in Other Payables and Accrued Expenses	(15,571)	13,920
Increase / (Decrease) in Deposits and Advances Received	(20,058)	(17,938)
Increase / (Decrease) in Passenger Flight Liabilities	77,825	58,760
Increase / (Decrease) in Other Long Term Payables	-	(74)
Cash Generated from Operations	138,618	178,151
Retirement Benefits Paid	(3,319)	(5,024)
Interest Paid	(17,806)	(20,056)
Income Taxes Paid	(16,064)	-
Net Cash Provided by Operating Activities	101,429	153,071
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Changes in Marketable Securities	-	2,355
Cash Outflows from Purchase of Financial Assets	(5)	
Cash Proceeds from Fixed Assets Sales	8,011	756
Interest Received	11,887	10,052
Acquisition of Fixed Assets	(36,101)	(10,181)
Net Cash Provided by / (Used in) Investing Activities	(16,208)	2,982
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal Payment of Finance Leases	(100,033)	(85,310)
Principal Payment of Bank Borrowings	4,810	(455)
Net Cash used in Financing Activities	(95,223)	(85,765)
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	(10,002)	70,288
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF PERIOD	472,700	217,192
CASH AND CASH EQUIVALENTS AT THE END OF PERIOD	462,698	287,480

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 1. THE COMPANY'S OPERATIONS

Türk Hava Yolları A.O. ("the Company" or "THY") was incorporated in Turkey in 1933. The principal activity of the Company is domestic and international air transportation of passengers and cargo.

As of June 30, 2004, the shareholders and their respective shareholdings in the Company were as follows:

Turkish Republic Prime Ministry Privatization Administration	98.17 %
Others	1.83 %
Total	<u>100.00 %</u>

The total number of employees working for the Company as of June 30, 2004 is 10,142. (December 31, 2003: 10,239). The average number of employees working for the Company for the periods ended June 30, 2004 and December 31, 2003 is 10,242 and 10,683, respectively.

### 2. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The Company maintains its books of account and prepares its statutory financial statements ("Statutory Financial Statements") in accordance with accounting principles in the Turkish Commercial Code (the "TCC") and tax legislation (collectively, "Turkish Practices"). The accompanying financial statements are based on these statutory records, with adjustments and reclassifications for the purpose of fair presentation in accordance with Accounting Principles Generally Accepted in the United States of America ("US GAAP").

Principles of translation of financial statements into US \$ :

Remeasurement of the local currency denominated financial statements into US\$ has been performed in accordance with the provisions of SFAS No 52 "Foreign Currency Translation", as they relate to hyperinflationary economies. The objective of this remeasurement process is to produce the same results that would have been reported if the accounting records had been kept in US \$.

SFAS 52 defines a hyperinflationary economy as one that has cumulative inflation of approximately 100% or more over a three-year period. Such cumulative rates in Turkey is 110 % for the three years ended June 30, 2004 based on the wholesale price index announced by the Turkish State Institute of Statistics.

Non-monetary assets and liabilities and revenues and expenses related to non-monetary items have been translated to US \$ at historical exchange rates prevailing on the transaction date. Monetary assets and liabilities have been translated at the exchange rates prevailing at balance sheet dates. All exchange gains and losses arising from remeasurement of monetary assets and liabilities that are not denominated in US \$ have been included in the determination of net income as "Translation gain or loss".

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 2. BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (cont'd)

The comparison of the periodical change of the value of TL against the US Dollar with the Turkish countrywide Wholesale Price Index (“WPI”) is set out below:

<u>Periods:</u>	<u>June 2004</u>	<u>December</u>			
		<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Currency Devaluation US \$	%6.5	%(14.6)	%13.5	%114.3	%24.4
WPI	%8.1	%13.9	%30.8	%88.6	%32.7

#### Prior year adjustments

The Company’s December 31, 2003 financial statements included deferred tax liability of US \$ 384,317 thousand related to fixed assets, however during the preparation of the financial statements as of June 30, 2004, it was realized that the impairment reserve on finance leased assets as of December 31, 2003, were not taken into consideration in the calculation of deferred tax liability. Accordingly, the Company has restated its 2004 opening balance sheet by decreasing deferred tax liability and accumulated losses as of December 31, 2003 by US \$ 43,346 thousand.

### 3. SEGMENTAL REPORTING

#### 3.1 Business Segments

The Company operates predominantly in one industry segment, its primary business being the air transportation of passengers and cargo within, to or from Turkey.

#### 3.2 Geographical Segments

The analysis of turnover is based on the destinations that THY serves. All passenger fare and cargo revenue within Turkey is attributed to the revenue from domestic services. Turnover from both scheduled and non-scheduled international flight revenues are attributed to flight destination’s geographical area.

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed in the preparation of the accompanying financial statements are as follows:

#### 4.1. Revenue Recognition and Commission Expenses

Passenger fares and cargo revenues are recorded as operating revenue when the transportation service is provided. Tickets sold but not yet used are recorded as passenger flight liabilities.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### 4.1. Revenue Recognition and Commission Expenses (cont'd)

The Company develops estimations using historical statistics and data for unredeemed tickets. Total estimated unredeemed tickets were recognized as operating revenue as of June 30, 2004.

Commissions to agencies relating to the passenger revenue are recognized as expense when the transportation service is provided. Commissions on tickets sold in advance are recorded as prepaid expenses in the current assets.

#### 4.2. Inventory Valuation

Inventories are valued at the lower of cost or net realizable value using the moving weighted average method.

#### 4.3 Financial Investments

The Company designates its investment portfolio in accordance with SFAS 115 (“Accounting for Certain Investments in Debt and Equity Securities”) as follows:

##### *Securities Held for Trading:*

Securities held for trading are those acquired principally for the purpose of generating profit from short-term fluctuations in their price. Subsequent to initial recognition, held for trading securities are valued at their fair value if reliably measured. Gains or losses on held for trading securities are recognized in net profit or loss for the period in which they arise.

##### *Investments Held to Maturity:*

Held-to-maturity investments are securities with fixed or determinable payments and fixed maturity that the Company has the positive intent and ability to hold to maturity.

##### *Investments Available for Sale*

Available-for-sale investments are those that the ownership rate is less than 20% and are not held for trading. Subsequent to acquisition, available for sale investments which are traded at stock markets are valued at market rate. Otherwise, they are accounted at cost. Gains or losses on available for sale investments are recognized in net profit or loss for the period in which they arise.

##### *Investments At Equity:*

Investment that the ownership rate is 50% and the Company is not in a position to exercise joint control are carried at equity.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### 4.4. Tangible and Intangible Assets

Fixed assets are recorded at historical costs at the acquisition date. The Company makes an assessment for its fixed assets at the balance sheet date in accordance with SFAS 144 (“Accounting for Impairment or Disposal of Long Lived Assets”). Tangible and intangible fixed assets are carried at historical cost as adjusted for their recoverable values; when the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. Recoverable amount is determined as higher of asset’s net selling price or its value in use. Net selling price is determined based on the Company’s management estimation developed from the International Aircraft Price Guide. The decrease in carrying amount is recorded as impairment loss under operating expenses.

Depreciation is provided on a straight-line basis for all categories of property, plant and equipment, except for rotables and repairables, which are depreciated on a group basis. The useful lives and residual values used for the depreciable assets are as follows:

	<u>Useful Life</u>	<u>Residual Value</u>
Land	-	-
Buildings	25-50	-
Aircraft	15	30%
Engines	15	30%
Rotable Assets	5-8-10	-
Repairables	2-3	-
Simulator	10	-
Machinery and Equipment	3-5-7-10	-
Furniture and Fixtures	3-4-5	-
Motor Vehicles	4-5-7	-
Other Equipment	5	-

#### 4.5. Manufacturers' Credits

Manufacturers' credits are received against acquisition and/or lease of aircraft and engines. The Company records these credits as a reduction to the cost of the owned or financial leased assets and amortizes them over the related asset’s remaining useful life. Manufacturers’ credits related to operational leases are recorded as deferred revenue and amortized over the lease term.

#### 4.6. Maintenance and Repair Costs

Regular maintenance and repair costs for owned and leased flight equipment are charged to operating expense as incurred. Heavy maintenance checks for owned and finance leased aircraft are expensed as incurred and delivery maintenance checks of operational leased aircraft are accrued on a periodical basis.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)
- 4.7. Frequent Flyer Program

THY provides a frequent flyer program which is called Miles and Miles in the form of free travel award to its members on accumulated mileage. The estimated cost of providing free travel, using the incremental cost method as adjusted for estimated redemption rates, is recognized as a liability and charged to operations as program members accumulate mileage.

THY also sells mileage credits to participating partners in the “Shop and Miles” program. A portion of such revenue is deferred and amortized as transportation is provided.

- 4.8. Taxation and deferred taxes

Provision is made in the financial statements for the Company’s estimated liability to Turkish corporation tax on its results for the period. The charge for current tax is based on the results for the period as adjusted for items, which are non-assessable or disallowed.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of income in the period that includes the enactment date.

In accordance with SFAS 109 (“Accounting for Income Tax”), the Company does not recognize any deferred tax liability or assets for differences related to assets and liabilities that, under SFAS 52 Foreign Currency Translation, are remeasured from the local currency into the functional currency using historical exchange rates.

Further, the Company’s deferred tax assets and liabilities have been remeasured into US \$ in accordance with the provisions of SFAS 109 and the translation gains and losses that result from such remeasurement have been included within the tax provision line in the financial statements.

Deferred tax is charged or credited in the statement of income.

Prepaid corporation taxes and corporation tax liabilities are offset as they relate to income taxes levied by the same taxation authority. Deferred income tax assets and liabilities are also offset.

- 4.9. Employee Retirement and Termination Indemnities

Employee retirement and termination benefits as required by Turkish Labor Law are recognized in the accompanying financial statements as earned. According to SFAS 106 (“Employers' Accounting for Postretirement Benefits other than Pensions”) future retirement payments are discounted to their present value at the balance sheet date at an interest rate determined by the net of an expected inflation rate and an appropriate discount rate. The interest rate included in employee retirement expense is shown in the financial result as interest expense.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### 4.10. Related Parties

The shareholders, key management personnel and board members of the Company, in each case together with their families and companies controlled by or affiliated with them, are considered and referred to as related parties in the accompanying financial statements.

#### 4.11. Foreign currency transactions

In the statutory accounts of the Company, transactions in foreign currencies (currencies other than Turkish Lira) are translated into Turkish Lira at the rates of exchange ruling at the transaction dates. Assets and liabilities denominated in foreign currencies are translated at the exchange rate ruling at the balance sheet date. Gains and losses arising on settlement and translation of foreign currency items are included in the statements of income.

#### 4.12. Leases

The Company leases aircraft, simulator, computer equipment and vehicles in the form of either finance leases or operating leases. Finance leases are reflected in the Company's assets by recording finance leased assets and liabilities equal to the present value of the lease payments. The finance leased assets are depreciated over their useful lives. Operating leases are accounted for as operating expense when incurred.

#### 4.13. Financial Instruments

##### Financial Assets

Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable willing parties in an arms length transaction. Market value is the amount obtainable from the sale or payable on the acquisition, of a financial instrument in an active market, if one exists.

The estimated fair values of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to develop the estimated fair value. Accordingly, the estimates presented here in may not necessarily be indicative of the amounts the Company could realize in a current market exchange.

Balances with banks, receivables, contingent liabilities like letters of guarantee, letters of credit are important financial instruments which would have negative effects on the financial structure of the Company if the other party failed to comply with the terms and conditions of the agreement.

The fair values of certain financial assets carried at cost are considered to be representative of carrying values due to their short-term nature.

The Company's principal financial assets are cash and cash equivalents, accounts receivable, due from related parties and available for sale financial assets.

Book values of trade receivables and due from related parties along with the related allowances for uncollectibility are estimated to be their fair value except receivables discounted to their present value when they hold significant credit periods.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### 4.13. Financial Instruments (cont'd)

Financial assets, except for Sun Express, Uçak Servisi A.Ş. and France Telekom where the Company is not in a position to exercise significant influence or joint control, are stated at cost as their fair value can not be reliably measured.

Sun Express is accounted for using the equity method as the Company exercises a significant influence. Uçak Servisi A.Ş. and France Telekom shares are classified as available for sale investments and changes in fair value relating available for sale investments are recognized in net profit or loss.

#### Financial Liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into. Significant financial liabilities include accounts and other payables, due to related parties and finance lease obligations.

Financial expenses are accounted for on an accrual basis and are traced under related financial liability account to the extent that they are not settled in the period in which they arise. Accounts and other payables and due to related parties are recorded at their nominal value, which approximates their fair value.

#### Credit Risk

The Company's credit risk is primarily attributable to its trade receivables. The amounts disclosed in the balance sheet are net of allowances for doubtful receivables, estimated by the Company's management based on prior experience and the current economic environment.

The Company has no significant concentration of credit risk, with exposure spread over a large number of counter parties and customers.

#### Price Risk

- Currency Risk:

The Company is exposed to exchange rate fluctuations between foreign currencies and Turkish Lira due to the nature of its business. The major part of the Company's ticket income is in Euro and US \$ or linked to these currencies and the major part of its expenses is denominated in US \$ and Turkish Lira.

- Interest Risk:

Part of the interest rates related to leasing transactions are based on LIBOR; therefore the Company is exposed to interest rate fluctuations on international markets. The Company does not have hedging transactions to limit currency and interest rate risks.

- Market Risk:

The Company invests in government bonds acquired under reverse repurchase agreements made for short periods or deposits to banks on a daily basis. Fair values of these investments fluctuate based on market conditions.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

- Liquidity Risk

Usually, tickets are sold in advance and transportation is provided later. Therefore the Company takes advantage of collecting revenue in advance and incurring transportation cost later.

#### 4.14 Offsetting

Financial assets and liabilities are offset and the net amount recognized in the balance sheet when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

#### 4.15 Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimations.

#### 4.16. Earnings per Share

SFAS 128 “Earnings per Share” requires disclosure of basic earnings per share and diluted earnings per share (if applicable) for companies whose shares are publicly traded or which are in the process of issuing shares in a public market.

There were no dilutive equity instruments outstanding which would require the calculation of a separate diluted earnings per share.

A summary of the weighted average number of shares outstanding during 30 June 2004 and 2003 and the basic earnings per share calculation is as follows:

	2004	2003
Number of Shares outstanding at January 1, (in full)	175,000,000,000	175,000,000,000
Bonus shares issued (by transfer of the Revaluation fund) (in full)	-	-
New shares issued (cash increase) (in full)	-	-
Number of Shares outstanding at June, 30 (in full)	175,000,000,000	175,000,000,000
Weighted average number of shares outstanding during the period (in full)	175,000,000,000	175,000,000,000
Net Profit (US \$ 000)	25,463	37,262
Profit per Share (US \$ Full)	0.0001	0.0002

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Cash	218	125
Cheques Received	75	39
Banks	461,016	467,135
Other Liquid Assets	1,389	5,401
	<u>462,698</u>	<u>472,700</u>

Foreign currency bank balances are US \$ 442,763,225 at June 30, 2004 (December 31, 2003: US \$ 464,872,331).

#### Time Deposits:

<u>Amount</u>	<u>Currency</u>	<u>Opening Date</u>	<u>Interest Rate%</u>	<u>Maturity</u>	June 30, 2004 <u>US \$ 000</u>
25,000,000	TL Million	28.06.2004- 30.06.2004	18.04%-18.45%	01.07.2004- 12.07.2004	16,825
77,300,000	US \$	04.06.2004- 30.06.2004	0.84%-2.85%	01.07.2004- 23.07.2004	77,300
271,550,000	EURO	28.05.2004- 30.06.2004	2.85%-3.43%	05.07.2004- 22.10.2004	330,205
					<u>424,330</u>
					December 31, 2003 <u>US \$ 000</u>
2,400,000	TL Million	31.12.2003	19.78%	02.01.2004	1,719
205,300,000	US \$	18.08.2003- 31.12.2003	2.41%-3.83%	02.01.2004- 23.02.2004	205,300
181,500,000	EURO	25.08.2003- 31.12.2003	2.81%-3.69%	02.01.2004- 23.02.2004	226,911
					<u>433,930</u>

### 6. ACCOUNTS RECEIVABLE (NET)

Accounts receivable consists of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Trade Receivables	135,578	98,683
Discount on Receivables	(318)	(241)
Provision for Doubtful Receivables	(10,829)	(13,804)
	<u>124,431</u>	<u>84,638</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 7. DUE FROM RELATED PARTIES

Short term due from related parties consists of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Güneş Ekpress Havacılık A.Ş. (Sun Express)	822	75
Uçak Servisi A.Ş. (USAŞ)	-	10
Turban Turizm A.Ş.(Turban)*	27,558	-
Turkish Republic Prime Ministry Privatization Administration(*)	10,307	-
Due from Related Parties - Short Term	<u>38,687</u>	<u>85</u>

Long term due from related parties consists of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Turkish Republic Prime Ministry Privatization Administration (*)	-	10,214
Turban Turizm A.Ş. (*)	-	27,293
Due from Related Parties - Long Term	<u>-</u>	<u>37,507</u>

(\*) Interest at a rate of 40.16% is applied to the receivables from Turkish Republic Prime Ministry Privatization Administration and Turban as to be valid for one year commencing from December 2002 based on the article sent by the Turkish Republic Prime Ministry Privatization Administration to THY on February 17, 2003. Interest rate has been changed to 23.35% after December 2003 based on the letter sent on May 31, 2004. Since the receivable from Turkish Republic Prime Ministry Privatization Administration and Turban has been paid to the Company on July 16 and July 27, 2004 respectively; related balances are classified as "Due from Related Parties – Short Term".

### 8. INVENTORIES

Inventories consist of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Spare Parts, Flight Equipment	30,907	24,045
Other Inventories	7,102	6,484
	<u>38,009</u>	<u>30,529</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 9. OTHER RECEIVABLES AND CURRENT ASSETS

Other receivables and current assets consist of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
VAT Deductable	376	79
Tax to be Refunded	2,121	1,968
Third Party Maintenance Service Income Accrual	7,213	8,881
Prepaid Operating Lease Expenses	1,656	2,194
Prepaid Sales Commissions	12,129	5,779
Deposits Given Related to the Outstanding Litigation	-	1,363
Prepaid Rent Expenses	346	282
Other Prepaid Expenses	2,454	2,710
Receivables from Personnel	616	386
Business Advances	182	96
Restriction on Transfer of funds from Banks (*)	18,245	11,944
Receivable from SITA Deposit Certificates	109	109
Special Expense Deduction Receivable from Tax Office	188	4
Interline Passenger Income Accrual	661	197
Other Receivables	1,244	1,177
	<u>47,540</u>	<u>37,169</u>

(\*) The restriction on transfer of funds from banks is related to funds held at banks in Iran, Libya, Egypt, Syria, Algeria and New Delhi and are classified in other receivables and current assets as they can be transferred to Turkey or used for payment of expenses in related sales bureaus within a period more than 3 months but less than a year.

### 10. LONG TERM ADVANCES GIVEN

Long term advances given consist of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Pre-delivery Payments for Aircraft	4,777	4,753
Deposits Given for Operational Leases	1,030	1,030
Other Deposits Given	1,404	1,536
	<u>7,211</u>	<u>7,319</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 11. FINANCIAL ASSETS

The investment accounted for using the equity method is as follows:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Güneş Ekspres Havacılık A.Ş. (Sun Express)	6,819	5,092

Financial assets available for sale are as follows:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Emek İnşaat ve İşletme A.Ş.	12	7
Sita Inc.	785	785
France Telecom Shares	8,723	8,723
Diminution in Value of France Telekom Shares	(3,487)	(2,982)
Uçak Servisi A.Ş. (USAŞ)	4,099	4,082
Diminution in Value of USAŞ Shares	(110)	-
	<u>10,022</u>	<u>10,615</u>

Tender for the catering service was won by Uçak Servisi A.Ş. (USAŞ) and service agreement was signed on January 1, 2002. Based on share transfer agreement made between USAŞ's main shareholder Gate Gourmet Holding A.G. (GGH) and the Company, USAŞ will transfer its group B free shares corresponding to 15% of its total share capital to the Company. According to the agreement, ownership of first 10% of shares was transferred on June 21, 2002, 1.25% of shares was transferred on January 2, 2003 and 1,25% of shares were transferred on January 2, 2004 and it will be completed to 15% by transferring the ownership of each 1.25% share in the years 2005 and 2006. Consequently, 712,5 million shares corresponding to first 12.5% of share of USAŞ's share capital, which was transferred to the Company, was recorded to "Financial Assets" and "Deferred income" accounts at market value of US \$ 10,611,257. "Deferred income" amount will be amortized to income during 5 years catering service agreement on a straight-line basis. The Company has sold 6% of USAŞ shares (342 Million shares) in İstanbul Stock Exchange Market in 2003.

Details of the Company's long-term financial assets at June 30, 2004 are as follows:

Name of the Company	Place of Incorporation And Operation	Proportion of Ownership Interest	Proportion of Voting Power Held	Principal Activity
Güneş Ekspres Havacılık A.Ş. (Sun Express)	Turkey	50 %	50 %	Air Transportation
Emek İnşaat ve İşletme A.Ş.	Turkey	0.3 %	0.3%	Construction
Sita Inc.	Holland	Less than 0.1%	Less than 0.1%	Information & Telecommunication Services
Uçak Servisi A.Ş. (USAŞ)	Turkey	6.5%	6.5%	Catering
France Telecom	France	Less than 0.1%	Less than 0.1%	Telecommunication

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 12. FIXED ASSETS (NET)

	Land & Building	Technical Equipments, Simulators and Vehicles	Other Equipment, Fixtures and Software	Aircraft and Spare Engines	Rotables and Repairable Spare Parts	Construction in Progress	Total Owned Assets	Leased Aircraft	Other Leased Fixed Assets & Simulator	Total Leased Fixed Assets	Total
<b>Acquisition Cost</b>											
Opening balance January 1, 2004	66,859	109,190	129,580	214,783	123,351	30	643,793	1,781,676	26,559	1,808,235	2,452,028
Additions	-	371	477	-	32,122	3,131	36,101	-	-	-	36,101
Disposals	(131)	(1,103)	(2,024)	-	(9,807)	(3,099)	(16,164)	(5,320)	-	(5,320)	(21,484)
Closing balance June 30, 2004	66,728	108,458	128,033	214,783	145,666	62	663,730	1,776,356	26,559	1,802,915	2,466,645
<b>Accumulated Depreciation</b>											
Opening balance January 1, 2004	17,545	87,042	113,465	130,633	58,644	-	407,329	507,292	19,763	527,055	934,384
Current period depreciation	550	3,259	2,962	1,412	18,555	-	26,738	40,135	880	41,015	67,753
Disposal	(47)	(1,101)	(1,921)	-	(9,807)	-	(12,876)	(1,157)	-	(1,157)	(14,033)
Closing balance June 30, 2004	18,048	89,200	114,506	132,045	67,392	-	421,191	546,270	20,643	566,913	988,104
Accumulated Impairment	-	-	-	20,501	-	-	20,501	157,689	-	157,689	178,190
<b>June 30, 2004 Net Book Value</b>	<b>48,680</b>	<b>19,258</b>	<b>13,527</b>	<b>62,237</b>	<b>78,274</b>	<b>62</b>	<b>222,038</b>	<b>1,072,397</b>	<b>5,916</b>	<b>1,078,313</b>	<b>1,300,351</b>
<b>December 31, 2003 Net Book Value</b>	<b>49,314</b>	<b>22,148</b>	<b>16,115</b>	<b>68,929</b>	<b>64,708</b>	<b>30</b>	<b>221,244</b>	<b>1,129,776</b>	<b>6,795</b>	<b>1,136,571</b>	<b>1,357,815</b>

### 13. OTHER LONG TERM RECEIVABLES AND ASSETS

Other long term receivables and assets consist of the following:

	June 30, 2004 US \$ 000	December 31, 2003 US \$ 000
Prepaid Aircraft Financing Expense	1,973	2,276
Prepaid Eximbank USA Guarantee and Exposure Fee	5,080	5,801
Due from Personnel	886	932
Receivables from SITA Deposit Certificate	457	463
Other Receivables	62	64
	<u>8,458</u>	<u>9,536</u>

### 14. BANK BORROWINGS

Bank borrowings of US \$ 4,810 thousand consists of overnight interest free borrowings for the purposes of settlement of tax and social security premium payments.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 15. FINANCE LEASE OBLIGATIONS

The future lease rental payments under finance leases are:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Not later than one year	175,782	204,351
Between 1 - 2 years	173,882	171,024
Between 2 - 5 years	289,006	307,614
Over 5 years	396,519	457,173
	<u>1,035,189</u>	<u>1,140,162</u>
Less: Future interest expense	(100,661)	(104,831)
Present value of future rentals shown in the balance sheets	<u>934,528</u>	<u>1,035,331</u>
Represented by :		
Current Liabilities	146,814	174,602
Long Term Liabilities	787,714	860,729
	<u>934,528</u>	<u>1,035,331</u>
Interest Range		
Floating rate obligations	693,094	767,597
Fixed rate obligations	241,434	267,734
	<u>934,528</u>	<u>1,035,331</u>

As of June 30, 2004, the US\$ denominated lease obligations' interest rates are between 5.96% and 8.00% for the fixed rate obligations, and LIBOR plus a margin ranging between 0.02% and 3.00% for the floating rate obligations.

### 16. DUE TO RELATED PARTIES

Due to related parties consist of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Sun Express	366	173
Uçak Servisi A.Ş. (USAŞ)	4,415	3,674
	<u>4,781</u>	<u>3,847</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 17. OTHER SHORT TERM AND LONG TERM PAYABLES

Other short term payables consist of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Taxes and Funds Payable	13,565	12,940
Social Security Premiums Payable	5,729	7,471
Payable to Personnel	193	1,438
State Airport Administration (“DHMI”) Protocol Payable	-	11,448
Discount on DHMI Protocol Payable	-	(930)
Deferred Income from USAŞ Share Transfer (Note 11)	1,689	1,366
Deferred Income	36	141
Other Liabilities	439	1,228
	<u>21,651</u>	<u>35,102</u>

Other Long term payables consist of the following:

Deferred Income from USAŞ Share Transfer (Note 11)	2,534	2,732
	<u>2,534</u>	<u>2,732</u>

### 18. DEPOSITS AND ADVANCES RECEIVED

Advances received consists of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Deposits and Guarantees Received	8,996	11,258
Advances Received for Mileage Credit Sales	8,269	18,245
Deposit Received from Turkish Republic Religious Affairs	205	9,056
Order Advances Received	2,479	1,448
	<u>19,949</u>	<u>40,007</u>

### 19. PASSENGER FLIGHT LIABILITIES

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Flight Liability - Advanced Ticket Sales	135,459	57,762
Flight Liability Resulting from Sales of Mileage	13,821	13,693
	<u>149,280</u>	<u>71,455</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 20. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Sales Incentive Premium Accrual	1,829	3,062
Fuel Oil Privilege Expense Accrual	7,472	6,876
Rejected Passengers Expense Accrual	966	520
DHMİ Expense Accrual	3,578	26
Accrued Salaries	10,764	15,121
Accrued Maintenance Costs	9,869	8,307
Accrued Frequent Flyer Liability	5,793	8,200
Provision for Legal Claims	2,881	3,657
Rent Accrual for RJ Aircraft that will be Returned	2,043	718
Other Liabilities	357	862
	<u>45,552</u>	<u>47,349</u>

### 21. TAXATION

Corporate Tax Payable is as follows:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Corporate Tax Payable	7,536	56,590
Prepaid Taxes and Funds	(2,264)	(42,790)
	<u>5,272</u>	<u>13,800</u>

Major components of tax charge consist of the following:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Current Tax Charge	7,536	280
Deferred Tax Charge	11,776	9,272
Tax Charge	<u>19,312</u>	<u>9,552</u>

#### *Corporate Tax:*

The Company is subject to Turkish corporate taxes. Provision is made in the accompanying financial statements for the estimated tax liabilities based on the Company's financial results for the period.

Corporate tax is applied on taxable corporate income, which is calculated from the statutory accounting profit by adding back non-deductible expenses, and by deducting dividends received from resident companies, other exempt income and investment incentives utilized.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (Cont'd)

The effective tax rates are as follows:

- In 2002 and prior years: 33%, being 30% corporate tax plus a 10% fund.
- In 2003: 30% (10% fund contribution was abolished.)
- In 2004: 33% (the corporate tax rate was increased from 30% to 33% by Law No. 5035 published in the Official Gazette on January 2, 2004)

In Turkey, advance tax returns are filed on a quarterly basis. The advance corporate income tax rate was increased from 25% to 30%, effective from April 24, 2003, and to 33% for 2004.

Tax losses can be carried forward for offsetting against future taxable income for up to 5 years. However, losses cannot be carried back for offsetting against profits from previous periods.

In Turkey, there is no procedure for a final and definitive agreement on tax assessments. Companies file their tax returns until 15 April following the close of the accounting period to which they relate. The tax authorities may, however, examine such returns and the underlying accounting records and may revise assessments within five years.

#### *Income withholding tax:*

In addition to corporate taxes, companies should also calculate income withholding taxes and funds surcharge on any dividends distributed, except for companies receiving dividends that are resident companies in Turkey and Turkish branches of foreign companies. The rate of income withholding tax is 10% starting from April 24, 2003 for all companies. Undistributed dividends incorporated in share capital are not subject to income withholding taxes.

Income withholding tax was also calculated in 2002 and prior years on various types of income and gains exempt from corporation tax, whether distributed or not. Such withholding tax has been removed in general. However, 19.8% withholding tax is still applied to investment allowances relating to investment incentive certificates obtained prior to April 23, 2003. Such allowances may be used to relieve corporation tax liability until the profits reach the calculated level of exemption. If companies fail to make a profit or incur losses, any allowance outstanding may be carried forward to following years so as to be deducted from taxable income of subsequent profitable years.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (Cont'd)

#### *Inflation Adjusted Tax Calculation:*

For 2003 and previous years, fixed assets and the related depreciation were revalued annually. Law No. 5024 published in the Official Gazette No. 25332 on December 30, 2003 requires the application of inflation accounting in Turkey in 2004 and future years, if the actual rate of inflation meets certain thresholds. Application of the new principles is optional in the first quarterly advance tax return in 2004, however the application is obligatory in the case of realization of the stated conditions in second quarter ending June 30, 2004. Because stated conditions has been met for the six month period ended June 30, 2004, the Company has adjusted its statutory records according to this law.

#### *Deferred Tax:*

The Company recognizes deferred tax assets and liabilities based upon temporary differences arising from the differences between its financial statements as reported for US GAAP purposes and its statutory tax financial statements. These differences usually result in the recognition of revenue and expenses in different reporting periods for US GAAP and tax purposes and are calculated over accounts like retirement pay provision and provision for doubtful receivables.

#### Temporary Differences: Deferred Tax Assets / (Liabilities)

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Allowance for Unrecoverable		
Bank Accounts	-	870
Prepaid Expenses	234	-
Provision for Doubtful Receivables	510	268
Short Term Lease Obligation	37,998	39,194
Provision for Advance Ticket Sales	(14,201)	(12,818)
Accrued Liabilities	9,809	7,322
Discount on Receivables	105	72
Discount on Payables	-	(279)
Diminution in Value of Financial Assets	483	798
Interest Accrual on Bank Accounts	(172)	(673)
Short Term Deferred Tax Asset	<u>34,766</u>	<u>34,754</u>
Useful Life and Leasing Adjustment on Fixed		
Assets	(355,843)	(340,971)
Long Term Finance Lease Obligations	259,946	258,219
Long Term Assets	(876)	(1,426)
Retirement Pay Provision	19,601	16,902
Manufacturers' Credit	796	914
Deferred Income	1,418	1,358
Long Term Deferred Tax Liability	<u>(74,958)</u>	<u>(65,004)</u>
Total Deferred Tax Liability	<u>(40,192)</u>	<u>(30,250)</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (cont'd)

Movement in Deferred Tax Liability per balance sheet can be reconciled with Net Deferred Tax Benefit/(Charge) per Income Statement as follows:

	2004 <u>US \$ 000</u>
Deferred Tax Charge Related to the Origination and Reversal of Temporary Differences	(8,935)
Deferred Tax Charge Resulting from Change in Effective Tax Rate	<u>(2,841)</u>
Net Deferred Tax Charge	(11,776)
Translation Gain on Deferred Tax Liabilities	<u>1,834</u>
Change in Net Deferred Tax	<u>(9,942)</u>

The reconciliation from the expected to the disclosed tax charge is as follows:

	2004 <u>US \$ 000</u>	2003 <u>US \$ 000</u>
Profit before taxation	44,775	46,814
Expected tax (at 2004: 33%, 2003:30%)	14,778	14,044
Reconciling Items:		
Effect of Investment Incentives	(399)	(144)
Non deductible expenses	2,428	2,523
Translation Gains non Taxable	(334)	(6,679)
Deferred Tax Expense / (Benefit) Resulting From Change in Effective Tax Rate	<u>2,841</u>	<u>(192)</u>
Actual Tax Expense	<u>19,312</u>	<u>9,552</u>

### 22. MANUFACTURERS' CREDIT (Net)

Unearned income from manufacturer's credits consists of the following:

	June 30, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Gross Manufacturer's Credit	12,634	12,634
Accumulated Amortization (-)	<u>(10,221)</u>	<u>(9,589)</u>
	<u>2,413</u>	<u>3,045</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 23. RETIREMENT PAY LIABILITY

Under Turkish Labor Law, employees are entitled to receive a lump sum payment when their employment is terminated without due cause or when they retire, complete 25 years of service (20 years for women), or called up for military service or die. The amount payable consists of one month's gross salary per year of service. The gross salary is that at the date of termination, but subject to a limit of TL 1,485,430,000 (US \$ 1,000) as at June 30, 2004. The number of years' service required before retirement is rising according to a sliding scale based on new legislation enacted in 1999. The system described above can be classified as an unfunded defined benefit system. The total provision presented in the financial statements represents the estimated present value of the vested benefit obligation.

Amounts recognized in the income statement regarding to provision for termination benefit are as follows:

	2004 <u>US \$ 000</u>	2003 <u>US \$ 000</u>
Current Service Cost	4,704	2,820
Interest Cost	1,669	3,565
	<u>6,373</u>	<u>6,385</u>

Movements in the provision for termination benefit in the balance sheet are as follows:

	2004 <u>US \$ 000</u>
Provision at January 1	56,342
Charge for the Period	6,373
Payments During the Period	(3,319)
Provision at June 30	<u>59,396</u>

The estimated value of the vested benefit obligation is discounted with an approximate rate of 6 % per annum after considering the effect of increase in eligible pay and its limit.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 24. SHARE CAPITAL

The Company's share capital was held in each period as follows:

	<u>Class</u>	<u>%</u>	<u>June 30, 2004</u> <u>US \$ 000</u>	<u>December 31, 2003</u> <u>US \$ 000</u>
Turkish Republic Prime Ministry Privatization Administration	A,C	98.17	761,192	761,192
Others	A	1.83	14,189	14,189
			<u>775,381</u>	<u>775,381</u>
Share Capital (TL Million)			<u>175,000,000</u>	<u>175,000,000</u>

(\*) 1,644 shares belonging to various private shareholders were not taken into consideration when THY was taken in to the privatization program in 1984. Subsequently, these shares were registered under the Turkish Republic Prime Ministry Privatization Administration according to THY's articles of association which was approved by decision of the Turkish Republic High Planning Board on October 30, 1990.

As at June 30, 2004, the Company's issued and paid-in share capital consists of 174,999,999,999 Class A shares and 1 Class C share, all with a par value of TL 1,000 each. These shares are issued to name. The Class C share, which belongs to the Turkish Republic Prime Ministry Privatization Administration, is a unique share with a par value of TL 1,000 with the following privileges:

Main Agreement Article 7: The Directors elected to represent C shareholders should have an affirmative vote for recording of transfer of ordinary shares on the share register.

Main Agreement Article 10: The Board of Directors of the Company consists of seven members of which one member has to be nominated by the class C shareholder.

Main Agreement Article 14: The following Board of Directors' decisions are subject to the class C Shareholder's affirmative vote:

- As explained in Article 3.1 of the Main Agreement, taking decisions that will negatively effect the Company's mission
- To suggest a change in the Main Agreement at General Assembly
- To increase the share capital
- Registration of the transfer of the shares issued to name in the 'Register of the Company'
- To make decisions or taking actions which will put the Company under direct or indirect commitment for more than 5% of total assets for each agreement in the latest annual financial statements prepared for Turkish Capital Market Board (this statement will be valid until the Company's shares held by Turkish State are below 20%)
- To make decisions about to merging with another companies and liquidation.

### 24. SHARE CAPITAL (cont'd)

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

g) To make decisions to close flight routes or significantly decrease number of flights except routes that cannot recover even its operational expenses under market conditions.

Main Agreement Temporary Article 1: The Company's chairman of the Board of Directors, members of the Board of Directors, auditors and general manager who meet the conditions mentioned in law numbered 4046, are to be selected from candidates suggested by A group shareholders, then assigned by a nomination of the Turkish Republic Privatization Administration and the approval of the Prime Minister or authorized minister, until the Company's shares held by Turkish State are below 50%. The article 315 of Turkish Commercial Code is applied for the members representing non-public membership.

### 25. CONTINGENT LIABILITIES

a) Guarantees Given:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Guarantee Letters Given	24,418	24,371

b) Purchase Commitments:

The Company has an option to purchase aircraft with total value of approximately US \$ 1.2 Billion. THY paid a deposit of US \$ 5.2 Million in order to secure the option until December 2000. As of the report date, the duration to use this option has expired, and the Company's management expects to use the deposit while buying new aircrafts.

c) Letter of Comfort:

	June 30, 2004	December 31, 2003
Letter of Comfort	US \$ 2,900,000	US \$ 2,900,000
Given to Sun Express	EURO 2,556,459	EURO 2,556,459

d) Land and buildings built on State Airports Administration ("DHMI") lands, and their legal structure:

The majority of THY's airport and terminal buildings, repair and maintenance centers, data processing centers, and training facilities are located on the land leased from the State Airports Administration (DHMI). The buildings and facilities on these leased lands have been constructed by THY and are recorded as fixed assets of the Company. However the land on which all these buildings were built is not registered as THY's property. The title of the property on which all these buildings were built belongs to the Ministry of Finance and allocated to DHMI for its use. The Company pays rent to DHMI for the land. The rent agreements made with DHMI are valid for one year. The agreements are renewed automatically at the beginning of each year if there is not any disapproval from any sides. The net book value of these buildings are US \$ 41,343,319 as of June 30, 2004 and THY amortizes these buildings based on their useful lives of 50 years. It is possible for THY to amortize related buildings in a period less than 50 years in case, DHMI does not renew the rent agreement.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 25. CONTINGENT LIABILITIES (con't)

There were informal claims from DHMİ that THY should start paying rent for the buildings after 10 years from the date of construction. The latest claim was made by DHMİ in 1996 for one building and no further claim was made for other buildings built by THY on this land. The Company's management believes that they do not need to pay rent for buildings built on DHMİ land with THY financing. The authority to resolve this conflict rests with the Ministry of Transportation. In the event the dispute is resolved against THY, it may cause THY to pay rent for the airport facilities in the future.

e) The Company discounted its retirement pay provision to US \$ 59,396,403 (see note 23). The Company's total undiscounted liability for retirement pay would be US \$ 96,549,100 as of June 30, 2004, if all employees had been dismissed as at that date.

f) Eight RJ 70/100 aircraft were grounded on May 2004 due to corrosion identified on two RJ 100 aircraft during delivery maintenance check, were also identified in other RJ 70/100 aircraft in the fleet. On July 2004, six of these aircraft, which have further lease periods, were given back to service as a result of written approval of air worthiness by Civil Aviation Directorate of Turkey.

According to conditions of the lease agreements, at the end of the lease period, the Company has to deliver the aircraft in air worthy condition and related maintenance checks were completed. A provision amount of US \$ 3,439,000 related to these maintenance checks including treatment for corrosion has been provided in the accompanying financial statements.

According to the Company's management, cost of corrosion treatment should be paid by manufacturer, because corrosion identified in the aircraft was caused by manufacturer's error. However, manufacturer is of the opinion that corrosion was caused by improper operating of the aircraft. The matter has been brought in to legal process through British Courts in accordance with conditions of the lease agreement and discussions among the Company, lessor and manufacturer have been continuing. If legal process or discussions among related parties results in favor of the Company, provision for corrosion treatment will be reversed and recognized as income.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 26. OPERATING LEASE COMMITMENTS

Commitments for future operating leases are as follows:

	June 30, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Not later than one year	30,938	30,179
Between 1 and 2 years	10,830	18,553
Between 2 and 5 years	1,544	1,062
	<u>43,312</u>	<u>49,794</u>

### 27. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

- Market price of 202,735 France Telecom securities, which is quoted at the Paris Stock Exchange, included in the financial investments available for sale as of June 30, 2004, has decreased from Euro 21.24 at June 30, 2004 to Euro 20.47 at September 21, 2004. Hence, the total market value of these securities decreased by US \$ 189,825.
- Market price of 370,500,000 USAŞ securities, which is traded in İstanbul Stock Exchange Market, and included in the financial investments available for sale as of June 30, 2004, has increased from TL 15,999 at June 30, 2004 to TL 18,000 at September 21, 2004. Hence, the total market value of these securities increased by US \$ 498,934.
- As of 1 July 2004 retirement pay ceiling has been increased from US \$ 1,000 to US \$ 1,060.
- The Company's Board of Directors on their meeting dated 20 July 2004, has decided to purchase five A330-200 aircraft to satisfy the Company's need for five wide body - long range aircraft and twelve A321-200, nineteen A320-200 and fifteen B737-800 aircraft to satisfy the Company's need for fourtysix medium range aircraft. As a result of this decision, the Company has signed a purchase agreement with Airbus to purchase five A330-200, twelve A321-200 and nineteen A320-200 on September 5, 2004.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 28. OPERATING REVENUES

Operating Revenues are as follows:

	June 30, 2004 <u>US \$ 000</u>	June 30, 2003 <u>US \$ 000</u>
Scheduled Services		
- Passenger	653,160	522,690
- Cargo and mail	80,641	77,475
	<u>733,801</u>	<u>600,165</u>
Non-scheduled Services	10,085	8,857
Other Revenue	91,373	84,179
Total Revenue	<u>835,259</u>	<u>693,201</u>

Geographical analysis of scheduled services traffic revenue is as follows:

	June 30, 2004 <u>US \$ 000</u>	June 30, 2003 <u>US \$ 000</u>
International		
- Europe	288,896	249,237
- Middle East	85,708	69,803
- South Africa	-	3,788
- North Africa	19,963	28,623
- North America	41,784	29,357
- Far East	126,885	81,870
	<u>563,236</u>	<u>462,678</u>
Domestic	170,565	137,487
Total Scheduled Service Traffic Revenue	<u>733,801</u>	<u>600,165</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 29. OPERATING EXPENSE

Operating expenses consist of the following:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Fuel Oil Expenses	137,264	103,181
Maintenance Expenses	29,131	33,888
Passenger Service and Catering Expenses	45,236	40,084
Landing and Navigation Expenses	72,404	61,331
Handling and Station Expenses	55,857	45,995
Staff Expenses	195,503	143,026
Marketing and Selling Expenses	103,827	81,528
General Operations	20,877	15,733
General Administrative Expenses	5,192	5,470
Insurance Expenses	10,324	8,267
Depreciation Expenses	67,753	71,164
Operating Lease Expenses	15,227	24,243
Impairment Loss	18,353	342
Other Expenses	3,054	4,037
	<u>780,002</u>	<u>638,289</u>

### 30. FINANCIAL EXPENSE (NET)

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Interest Income	11,887	10,052
Income from Investment Accounted from Equity Method	1,727	-
Foreign Exchange Gains	88,300	209,662
Discount Income	20	776
Financial Income	<u>101,934</u>	<u>220,490</u>
Foreign Exchange Losses	(136,875)	(81,493)
Expense from Investment Accounted from Equity Method	-	(2,348)
Interest Expenses- Third Parties	(2,154)	(6)
Finance Lease Interest Expense	(14,882)	(18,724)
Retirement Pay Interest Cost	(1,669)	(3,565)
Diminution in Value of Financial Assets	(1,569)	(578)
Discounting Expense	(986)	(1,328)
Financial Expense	<u>(158,135)</u>	<u>(108,042)</u>
Translation Gain / (Loss)	35,381	(133,788)
Financial Expense (Net)	<u>(20,820)</u>	<u>(21,340)</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 31. INCOME FROM OTHER OPERATIONS

Income from other operations consists of the following:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Commission Income	69	191
Dividend Income	193	2,070
Insurance Claims Received	112	1,299
Gain from Sale of Fixed Assets	552	32
Discounts Received From Spare Parts Suppliers	3,407	2,977
Manufacturer's Credit Income	676	1,123
Free of Cost Materials Income	479	513
Reversal of Unnecassry Provision	5,123	5,787
Other	3,753	3,646
	<u>14,364</u>	<u>17,638</u>

### 32. LOSS FROM OTHER OPERATIONS

Losses from other operations consist of the following:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Penalty Expenses	-	979
Provision Expenses	1,218	3,072
Rent Expense of RJ 70/100 Aircraft For The Non-Operating Period	1,157	-
Rent Expense of RJ 70/100 Aircraft To Be Returned	1,364	-
Other Expenses	287	345
	<u>4,026</u>	<u>4,396</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 33. TRANSACTIONS WITH RELATED PARTIES

For the purposes of the accompanying financial statements, the Company's shareholders and the Company's equity participations are referred to as related parties.

Transactions with related parties are as follows:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Services given to Sun Express	1,186	595
Services given to USAŞ	78	59
	<u>1,264</u>	<u>654</u>
Services taken from Sun Express	993	78
Services taken from USAŞ	20,477	16,281
	<u>21,470</u>	<u>16,359</u>

Dividend income from equity investments are as follows:

	June 30, 2004	June 30, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Uçak Servisi A.Ş.	-	1,111
Emek İnşaat ve İşletim A.Ş.	194	1
	<u>194</u>	<u>1,112</u>