

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Türk Hava Yolları Anonim Ortaklığı

1. We have audited the accompanying balance sheets of Türk Hava Yolları Anonim Ortaklığı (the "Company") as at December 31, 2003 and the related statement of income, shareholders' equity and cash flow for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
3. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and the result of its operation and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

4. Without qualifying our opinion, we would like to draw attention to following matter:

In our report dated 7 May 2003 for the financial statements as of 31 December 2002, it was mentioned that the Company did not apply SFAS 144 “Accounting for the Impairment or Disposal of Long-Lived Assets”, since it was not yet certain as of 2001 report date, whether the decline in market prices of some of the Company’s aircrafts, which occurred as a result of the terrorist attack in the United States on 11 September 2001, was permanent or temporary. Because market prices of used aircraft had not recovered as of 31 December 2002 and the Company’s management was of the opinion that the decline in market prices was permanent, the Company has recorded the total impairment in 2002, including the amount that should be recorded in 2001 as an expense. While preparing its 2003 financial statements, in order to make statements of income for the year ended 31 December 2003 and 2002 comparable, the Management of the Company has restated its 2002 financial statements by adjusting its 2002 opening balance sheet.

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

İstanbul, April 9, 2004

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT DECEMBER 31, 2003 AND 2002

<u>ASSETS</u>	<u>Note</u>	December 31, 2003 <u>US \$ 000</u>	December 31, 2002 <u>US \$ 000</u>
Cash and Cash Equivalents	5	472,700	217,192
Investments Held to Maturity (Net)	6	-	2,355
Accounts Receivable (Net)	7	84,638	74,683
Due from Related Parties (Short Term)	8	85	687
Inventories	9	30,529	29,986
Prepaid Taxes	22	-	5,221
Other Receivables and Current Assets	10	37,169	32,383
TOTAL CURRENT ASSETS		625,121	362,507
Due from Related Parties (Long Term)	8	37,507	23,004
Long Term Advances Given	11	7,319	15,196
Investments at Equity	12	5,092	2,348
Available For Sale Investments (Net)	12	10,615	8,805
Fixed Assets (Net)	13	1,357,815	1,470,930
Other Long Term Receivables and Assets	14	9,536	9,467
TOTAL LONG TERM ASSETS		1,427,884	1,529,750
TOTAL ASSETS		2,053,005	1,892,257

The accompanying notes form an integral part of these financial statements.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT DECEMBER 31, 2003 AND 2002

<u>LIABILITIES</u>	<u>Note</u>	December 31, 2003 <u>US \$ 000</u>	December 31, 2002 <u>US \$ 000</u>
Bank Loans	15	-	455
Short Term Capital Lease Obligations	16	174,602	183,820
Accounts Payable		129,648	94,884
Due to Related Parties	17	3,847	3,286
Other Payables and Liabilities	18	35,102	28,944
Deposits and Advances Received	19	40,007	32,509
Passenger Flight Liabilities	20	71,455	51,001
Other Accrued Liabilities	21	46,631	39,950
Corporate Tax Payable	22	13,800	-
TOTAL SHORT TERM LIABILITIES		<u>515,092</u>	<u>434,849</u>
Long Term Capital Lease Obligations	16	860,729	1,027,871
Long Term Trade Payables		-	74
Manufacturers' Credits (Net)	23	3,045	4,308
Deferred Tax Liability	22	73,596	2,109
Retirement Pay Provision	24	56,342	46,939
Other Long Term Liabilities	18	2,732	3,742
TOTAL LONG TERM LIABILITIES		<u>996,444</u>	<u>1,085,043</u>
Capital	25	775,381	775,381
Reserves	25	55,327	55,327
Accumulated Loss		(289,239)	(458,343)
TOTAL SHAREHOLDERS' EQUITY		<u>541,469</u>	<u>372,365</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>2,053,005</u>	<u>1,892,257</u>

The accompanying notes form an integral part of these financial statements.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

	Note	December 31, 2003 <u>US\$ 000</u>	(As Restated) December 31, 2002 <u>US\$ 000</u>
Operating Revenues	29	1,655,206	1,517,620
Operating Expenses	30	(1,384,655)	(1,272,013)
OPERATING PROFIT		<u>270,680</u>	<u>245,607</u>
Income from Other Operations	32	24,242	23,569
Loss from Other Operations	33	(7,348)	(4,414)
PROFIT BEFORE FINANCIAL INCOME/ (EXPENSE), AND TAXATION		<u>287,574</u>	<u>264,762</u>
Financial Income / (Expense) (Net of Translation Gain)	31	9,246	(82,389)
PROFIT BEFORE TAXATION		<u>296,820</u>	<u>182,373</u>
Taxation	22	(127,716)	(43,106)
NET PROFIT FOR THE YEAR		<u>169,104</u>	<u>139,267</u>
Earnings per Share (US\$)	4.16	0.0010	0.0008

The accompanying notes form an integral part of these financial statements.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002**

	<u>Capital</u> <u>US\$ 000</u>	<u>Reserves</u> <u>US\$ 000</u>	<u>Accumulated</u> <u>Loss</u> <u>US\$ 000</u>
Balance at 31 December 2001 (as previously reported)	775,381	55,327	(500,733)
To record impairment on fixed assets as of 31 December 2001 (after tax effect)	-	-	(97,387)
Other (after tax effect) (Note 21)	-	-	510
Balance at 31 December 2001 (As Restated)	<u>775,381</u>	<u>55,327</u>	<u>(597,610)</u>
Profit for the year (As restated)	-	-	139,267
Balance at 31 December 2002 (As Restated)	<u>775,381</u>	<u>55,327</u>	<u>(458,343)</u>
Profit for the year	-	-	169,104
Balance at 31 December 2003	<u>775,381</u>	<u>55,327</u>	<u>(289,239)</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

STATEMENTS OF CHANGES IN CASH FLOW FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002

	December 31, 2003 US\$ 000	(As Restated) December 31, 2002 US\$ 000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Profit before Taxation	296,820	182,373
Adjustments to reconcile net profit for the year to net cash provided by operating activities:		
Depreciation and Amortization	137,975	149,432
Provision for Employee Termination Benefit	21,701	10,722
Interest Income	(26,346)	(15,058)
Gain on Fixed Asset Sales	(568)	(5,562)
Impairment Loss	5,789	23,460
Gain from Equity Investment	(2,744)	(1,256)
Interest Expense	41,894	53,592
Provision for Diminution in Value of Equity Investments and Marketable Securities	(5,188)	6,594
Movement in Manufacturers' Credit	(1,264)	(1,264)
Amortization of Deferred Income from USAŞ Share Transfer	(1,366)	(1,247)
Adjustments to the Opening Balance of Fixed Assets	397	-
Translation Loss on Deferred Taxes	361	2,867
Increase in Provision for Doubtful Receivable	659	2,962
Operating Profit Before Working Capital Changes	468,120	407,615
(Increase)/Decrease in Trade Receivables	(10,614)	(17,089)
(Increase)/Decrease in Due From Related Parties	(13,901)	(6,825)
(Increase)/Decrease in Inventories	(543)	(3,732)
(Increase)/Decrease in Prepayments & Other Assets	(4,786)	(4,884)
(Increase)/Decrease in Other Long Term Assets	(69)	353
(Increase)/Decrease in Short Term and Long Term Advances Given	7,877	12,846
Increase/(Decrease) in Trade Payables	34,764	(57,010)
Increase/(Decrease) in Due to Related Parties	561	3,228
Increase/(Decrease) in Other Payables & Accrued Expenses	12,721	30,761
Increase/(Decrease) in Advances Received	7,498	26,044
Increase/(Decrease) in Advance Ticket Sales	20,454	15,011
Increase/(Decrease) in Other Long Term Trade Payables	(74)	(58)
Cash Generated from Operations	522,008	406,260
Retirement Benefits Paid	(12,298)	(2,107)
Interest Paid	(41,894)	(51,142)
Corporation Tax Paid	(37,569)	(25,042)
Net Cash Provided by Operating Activities	430,247	327,969
CASH FLOWS FROM INVESTING ACTIVITIES		
Changes in Marketable Securities	2,355	(2,038)
Proceeds from Sale of Financial Assets	3,853	-
Cash Proceeds from Sale of Fixed Assets	11,371	41,283
Interest Received	26,346	15,057
Purchases of Fixed Assets	(41,849)	(60,418)
Net Cash Provided by / (Used in) Investing Activities	2,076	(6,116)
CASH FLOWS FROM FINANCING ACTIVITIES		
Leased Paid Out	(176,360)	(169,751)
Payment of Loans	(455)	(319)
Net Cash used in Financing Activities	(176,815)	(170,070)
NET INCREASE IN CASH AND CASH EQUIVALENTS	255,508	151,783
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF YEAR	217,192	65,409
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	472,700	217,192

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 December 31, 2003, the shareholders and their respective shareholdings in the Company were as follows:

Turkish Republic Privatization Administration	% 98.17
Other	% 1.83
	<hr/> <u>% 100</u>

The total number of employees working for the Company as of December 31, 2003 is 10,239. The average number of employees working for the Company in 2003 and 2002 is 10,683 and 11,084.

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 Dollars :

Remeasurement of the local currency denominated financial statements into US Dollars 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 Dollars.

SFAS 52 defines a highly inflationary economy as one that has cumulative inflation of approximately 100% or more over a three-year period. Such cumulative rates in Turkey exceeded 181% for the three years ended December 31, 2003 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 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 Dollars 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 annual change in the TL exchange rate against the US Dollar can be compared with the rates of general price inflation in Turkey according to the Wholesale Price Index ("WPI") as set out below:

<u>Year:</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Currency Deflation US \$	%(14.6)	%13.5	%114.3	%24.4	%72.7
WPI Inflation	%13.9	%30.8	%88.6	%32.7	%62.9

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. The activities of the Company's equity investments are also related to the airline business.

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 is attributed to the 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 is furnished. Tickets sold but not yet used are recorded as advance ticket sales.

The Company develops estimations using historical statistics and data to estimate unredeemed tickets. Total unredeemed tickets of 24.930 Million US\$ (approximately) were recognized as operating revenue in 2003.

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

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

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

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 investments portfolio in accordance with SFAS 115 (Accounting for Certain Investments in Debt and Equity Securities) as follows:

Investments Held for Trading:

Securities held for trading are those acquired principally for the purpose of generating profit from short-term fluctuations in their price or dealer's margin. 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 included 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 securities are those that the investment ratio is less than %20 and are not held for trading. Subsequent to acquisition, available for sale securities are valued at their fair value if reliably measurable. Otherwise, they are accounted for at cost. Gains or losses on available for sale securities are included in net profit or loss for the period in which they arise.

Investments At Equity:

Securities that the investment ratio is %50 and the Company is not in a position to exercise joint control are valued at equity.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

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

4.4. Fixed Assets

The Company applies the provisions of SFAS 144 “Accounting for the 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 used. 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 expense except certain aircraft as explained below.

Depreciation is provided at historical cost amounts of fixed assets 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 depreciable lives and residual values used for the principal depreciable asset classifications are as follows:

	<u>Useful Life</u>	<u>Residual Value</u>
Land	-	-
Buildings	25-50	-
Aircraft	15-20	10-30 %
Engines	15	30 %
Rotable Assets	5-8-10	-
Repairables	2-3	-
Simulator	10	-
Machinery and Equipment	7	-
Furniture and Fixture	5	-
Vehicles	5-7	-
Other Equipment	5	-

4.5. Manufacturers' Credits

Manufacturers' credits are received against acquisition and/or lease of aircraft and engines. The Company reduced these credits from the cost of the owned or financial leased assets and amortized them over the related asset’s remaining useful life. Manufacturers’ credit 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 recognised 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

Provision is made in the financial statements for the Company’s estimated liability to Turkish corporation tax on its results for the year. The charge for current tax is based on the results for the year 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 income in the period that includes the enactment date.

In accordance with SFAS 109, the Company does not recognize any deferred tax liability or assets for differences related to assets and liabilities that, under FASB Statement No. 52 Foreign Currency Translation, are remeasured from the local currency into the functional currency using historical exchange rates and that result from (1) changes in exchange rates or (2) indexing for tax purposes.

Further, the Company’s deferred tax assets and liabilities have been remeasured into US Dollars in accordance with the provisions of SFAS No: 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.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

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

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. 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 according to SFAS 106 "Employer's Accounting for Postretirement Benefits Other Than Pensions". The interest rate included in employee retirement expense is shown in the financial result as interest expense.

4.10. Related Parties

The shareholders of the Company and the companies related to those companies, their directors and key management personnel and any companies to which they are known to be related, 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 capital/finance leases or operating leases. Assets held under finance leases are recognized as assets of the Company at their fair value at the date of acquisition. The corresponding liability is included in the balance sheet as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the income statement over the term of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period. 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, judgment 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.

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 (cont'd)

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, securities, accounts receivable, due from related parties and 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.

Financial assets, except Sun Express, Uçak Servis 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 Servis A.Ş. and France Telekom shares are classified as available for sale investments and changes in fair value relating available for sale investments are reported 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 interest-bearing bank loans, accounts and other payables, due to related parties and finance lease obligations. Interest-bearing loans denominated in foreign currencies are translated at the year-end exchange rates. Finance charges are accounted for on accrual basis and are traced under other accrued expenses 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 presented 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.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

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

4.13. Financial Instruments (cont'd)

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 Dollar or linked to these currencies and the major part of its expenses is denominated in US Dollars and Turkish Lira.

- Interest Risk

Most of the interest rates related to leasing transactions are based on LIBOR; therefore the Company is exposed to interest rate fluctuations on international market. The Company does not have any 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. These investments fluctuated based on the market conditions.

- 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.

The Company also benefits the difference between the collection and the payment period to its counter parties.

4.14. Offsetting

Financial assets and liabilities are offset and the net amount reported 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 Generally Accepted Accounting Principles 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 estimates.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

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

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.

The weighted average number of shares outstanding and calculation of Earnings Per Share as at December 31, 2003 and 2002 are as follows:

	December 31, 2003	December 31, 2002
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 December 31, (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)	169,104	139,267
Basic Earnings per Share (US\$)	0.0010	0.0008

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	December 31, 2003	December 31, 2002
	<u>US\$ 000</u>	<u>US\$ 000</u>
Cash	125	75
Cheques Received	39	169
Banks	467,135	214,488
Other Liquid Assets	5,401	2,460
	<u>472,700</u>	<u>217,192</u>

Foreign currency bank balances are US\$ 464,872,331 as at December 31, 2003.

Time Deposits:

<u>Amount</u>	<u>Currency</u>	<u>Opening Date</u>	<u>Interest rate</u>	<u>Maturity</u>	December 31, 2003 <u>US\$ 000</u>
2,400,000	TL Million	31.12.2003	19.78%	02.01.2004	1,719
		18.08.2003-	2.41%-	02.01.2004-	
205,300,000	US\$	31.12.2003	3.83%	23.02.2004	205,300
		25.08.2003-	2.81%-	02.01.2004-	
181,500,000	EUR	31.12.2003	3.69%	23.02.2004	226,911
					<u>433,930</u>

Time Deposits:

<u>Amount</u>	<u>Currency</u>	<u>Opening Date</u>	<u>Interest rate</u>	<u>Maturity</u>	December 31, 2002 <u>US\$ 000</u>
		29.11.2002-	1.6%-	02.01.2003-	
165,750,000	US\$	31.12.2002	3.0 %	16.01.2003	165,750
22,700,000	EUR	30.12.2002	3.2 %	02.01.2003	23,659
					<u>189,409</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

6. INVESTMENTS HELD TO MATURITY (NET)

Investments Held to Maturity consist of the following:

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Repurchase Agreements	-	2,355
	<u>-</u>	<u>2,355</u>

7. ACCOUNTS RECEIVABLE (NET)

Accounts receivable consist of the following:

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Trade Receivables	98,683	88,487
Discount on Receivables	(241)	(659)
Provision for Doubtful Receivables	(13,804)	(13,145)
	<u>84,638</u>	<u>74,683</u>

8. DUE FROM RELATED PARTIES

Short-term due from related parties consists of the following:

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Güneş Ekspres Havacılık A.Ş. (SUN EXPRESS)	75	616
Uçak Servisi A.Ş. (USAŞ)	10	5
THY SRL	-	66
Due from Related Parties- Short Term	<u>85</u>	<u>687</u>

Long-term due from related parties consists of the following:

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Turkish Republic Privatization Administration(*) (***)	10,214	6,265
Turban Turizm A.Ş. (**) (***)	27,293	16,739
Due from Related Parties- Long Term	<u>37,507</u>	<u>23,004</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

8. DUE FROM RELATED PARTIES (cont'd)

(*) The interest rate applied to the receivable from Turkish Republic Privatization Administration is 40%. The balance of the account is reclassified from "Short Term Receivables from Related Parties" to "Long Term Receivables from Related Parties" as of 31 December 2003, since the maturity of the receivable is not determined yet.

(**) The receivable from the sale of equity participation is related to the sale of shares in Kıbrıs Türk Hava Yolları to Turban Turizm A.Ş. (Turban) on December 31, 2000. THY has converted its receivable about this sale into Turkish Lira and applied interest at a rate of 40% commencing from December 2002. The balance of the account is reclassified from "Other Short Term Receivables" to "Other Long Term receivables" as of 31 December 2003, since the maturity of the receivable is not determined yet. Turban is considered to be related party as it is participation of Turkish Republic Privatization Administration.

(***) Interest at a rate of 40% is applied to the receivables from Turkish Republic Privatization Administration and Turban as to be valid for one year commencing from December 2002 based on the article sent by the Turkish Republic Privatization Administration to THY on 17 February 2003. Although this duration has expired in December 2003, same interest rate is still being applied after this date since a new interest rate is not determined by the two sides.

9. INVENTORIES

Inventories consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Spare Parts, Flight Equipment	24,045	25,150
Other Inventories	6,484	4,836
	<u>30,529</u>	<u>29,986</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

10. OTHER RECEIVABLES AND CURRENT ASSETS

Other receivables and current assets consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
VAT Receivable	79	54
Tax to be Refunded	1,968	1,755
Third Party Maintenance Service Income Accrual	8,881	2,057
Receivable due to Cancellation of A Type Handling License	-	7,089
Prepaid Operating Lease Expenses	2,194	3,494
Prepaid Sales Commissions	5,779	2,971
Deposits Given related to the Outstanding Litigations	1,363	2,340
Prepaid Rent	282	406
Other Prepaid Expenses	2,710	1,409
Receivables from Aircraft Manufacturers	-	702
Receivables from personnel	386	360
Business Advances	96	193
Restriction on Transfer of funds from Banks(*)	11,944	8,167
Receivables from SITA Deposit Certificates	109	123
Other Receivables	1,378	1,263
	<u>37,169</u>	<u>32,383</u>

*The restriction on transfer of funds from banks is related to funds held at banks in Iran, Libya, Egypt and Uzbekistan and are classified in other receivables 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.

11. LONG TERM ADVANCES GIVEN

Advances given consist of the following

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Pre-delivery Payments for Aircraft	4,753	4,399
Deposits Given for Operational Leases	1,030	9,506
Other Deposits Given	1,536	1,291
Total Long Term Advances Given	<u>7,319</u>	<u>15,196</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

12. FINANCIAL ASSETS

Investments accounted for using the equity method is as follows:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Güneş Ekspres Havacılık A.Ş. (Sun Express)	5,092	2,348

Other financial assets available for sale are as follows:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Qualifier Ground Services Ltd.	-	39
Emek İnşaat ve İşletme A.Ş.	7	7
Sita Inc	785	785
Diminution in Value of Sita Inc. Shares	-	(557)
France Telekom Shares	8,723	8,723
Diminution in Value of France Telekom. Shares	(2,982)	(5,099)
Uçak Servisi A.Ş. (USAŞ)	4,082	6,237
Diminution in Value of USAŞ	-	(1,330)
	<u>10,615</u>	<u>8,805</u>

Tender for the catering service was won by Uçak Servis A.Ş. (USAŞ) and service agreement was signed in 1 January 2002. Based on share transfer agreement made between USAŞ's main partner Gate Gourmet Holding A.G. (GGH) and the Company, USAŞ will transfer its group B free shares corresponding to 15% of its total capital to the Company. According to agreement, ownership of first %10 shares was transferred in June 21, 2002, and % 1.25 shares was transferred on January 2, 2003; it will be completed to % 15 by transferring the ownership of % 1.25 share in the years 2004, 2005 and 2006. Consequently, 641 million shares corresponding to first 11.25% share of USAŞ's capital, which was transferred to the Company, was recorded to "Financial Assets" and "Deferred income" accounts from market value of US\$ 6,710,877. "Deferred income" amount will be amortized to income during 5 years catering service agreement on a straight-line basis. The Company has sold 342 Million units of its owned USAŞ shares in İstanbul Stock Exchange Market in 2003.

Details of the Company's financial assets at December 31, 2003 are as follows :

<u>Name of the Company</u>	<u>Place of Incorporation and Operation</u>	<u>Proportion of Ownership Interest</u>	<u>Proportion of Voting Power Held</u>	<u>Principal Activity</u>
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'	None	Information & Telecommunication Services
Uçak Servis A.Ş (USAŞ)	Turkey	5.25%	5.25%	Catering
France Telecom	France	Less than 0.1%	None	Telecommunication

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

13. FIXED ASSETS (NET)

	Land & Building	Technical Equipment, Simulator 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
Acquisition Cost											
Opening Balance January 1, 2003	58,993	125,603	123,316	235,425	158,386	623	702,346	1,781,661	26,551	1,808,212	2,510,558
Adjustments to the Opening Balance(*)	8,226	(17,272)	3,542	(967)	-	(587)	(7,058)	-	-	-	(7,058)
Adjusted Opening Balance	67,219	108,331	126,858	234,458	158,386	36	695,288	1,781,661	26,551	1,808,212	2,503,500
Additions	56	2,048	3,812	-	28,218	7,715	41,849	-	-	-	41,849
Disposals	(416)	(1,189)	(1,090)	(19,675)	(63,253)	(7,721)	(93,344)	-	-	-	(93,344)
Closing Balance December 31, 2003	66,859	109,190	129,580	214,783	123,351	30	643,793	1,781,661	26,551	1,808,212	2,452,005
Accumulated Depreciation											
Opening Balance January 1, 2003	6,624	96,893	106,079	143,540	89,447	-	442,583	424,997	18,000	442,997	885,580
Adjustments to the Opening Balance(*)	9,950	(16,071)	153	(693)	-	-	(6,661)	-	-	-	(6,661)
Adjusted Opening Balance	16,574	80,822	106,232	142,847	89,447	-	435,922	424,997	18,000	442,997	878,919
Charge for the year	1,110	7,398	7,497	5,494	32,448	-	53,947	82,272	1,756	84,028	137,975
Disposals	(139)	(1,178)	(264)	(17,708)	(63,252)	-	(82,541)	-	-	-	(82,541)
Closing Balance December 31, 2003	17,545	87,042	113,465	130,633	58,643	-	407,328	507,269	19,756	527,025	934,353
Accumulated Impairment	-	-	-	15,221	-	-	15,221	144,616	-	144,616	159,837
NBV at December 31, 2003	49,314	22,148	16,115	68,929	64,708	30	221,244	1,129,776	6,795	1,136,571	1,357,815
NBV at December 31, 2002	52,369	28,710	17,237	91,885	68,939	623	259,763	1,202,616	8,551	1,211,167	1,470,930

(*) The Company has formed a different data base compared with prior years on the fixed assets that are subject to indexation. The indexation difference of this application is US \$ 397,000 , and since the amount is immaterial, it is recorded as expense for current period.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

14. OTHER LONG TERM RECEIVABLES AND ASSETS

Other receivables and long-term assets consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Prepaid Aircraft Financing Expense	2,276	2,245
Prepaid Eximbank USA Guarantee and Exposure Fee	5,801	5,608
Due From Personnel	932	974
Receivables from SITA Deposit Certificate	463	572
Other Receivables	64	68
	<u>9,536</u>	<u>9,467</u>

15. BANK LOANS

Bank Loans consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Current maturities of long term bank loans	-	455
	<u>-</u>	<u>455</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

16. CAPITAL LEASE OBLIGATIONS

The future lease rental payments under financial leases are:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Not later than one year	204,351	223,258
Between 1 & 2 years	171,024	199,845
Between 2 & 5 years	307,614	337,927
Over 5 years	457,173	603,992
	<u>1,140,162</u>	<u>1,365,022</u>
Less: Future interest expense	<u>(104,831)</u>	<u>(153,331)</u>
Present value of future lease rentals shown in Financial Statements	<u>1,035,331</u>	<u>1,211,691</u>
Represented by :		
Current Liabilities	174,602	183,820
Long Term Liabilities	860,729	1,027,871
	<u>1,035,331</u>	<u>1,211,691</u>
Interest Range		
Floating rate obligations	180,936	217,709
Fixed rate obligations	854,395	993,982
	<u>1,035,331</u>	<u>1,211,691</u>

As of December 31, 2003, the US\$ denominated lease obligations' interest rates are between 6.25% and 7.68% for the fixed rated obligations, and Libor plus a margin ranging %0.02 and %3 for the variable rated obligations.

17. DUE TO RELATED PARTIES

Due to related parties consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Sun Express	173	69
Uçak Servisi A.Ş (USAŞ)	3,674	3,217
	<u>3,847</u>	<u>3,286</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

18. OTHER PAYABLES AND LIABILITIES

Other short term payables and liabilities consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Taxes and Dues Payable	12,940	11,970
Social Security Deductions Payable	7,471	4,756
Payable to Personnel	1,438	131
DHMI Protocol Payable	11,448	11,315
Discount on DHMI Protocol Payable	(930)	(1,062)
Deferred Income from USAŞ		1,248
Share Transfer (Note 12)	1,366	
Deferred Income	141	319
Other Liabilities	1,228	267
	<u>35,102</u>	<u>28,944</u>

Other long term payables and liabilities consist of the following:

Deferred Income from USAŞ		
Share Transfer (Note 12)	2,732	3,742
	<u>2,732</u>	<u>3,742</u>

19. DEPOSITS AND ADVANCES RECEIVED

Advances received consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Deposits and Guarantees Received	11,258	9,892
Advances Received for Mileage Credit Sales	18,245	12,991
Deposit received From Turkish Republic		
Religious Affairs	9,056	6,903
Order Advances Received	1,448	2,723
	<u>40,007</u>	<u>32,509</u>

20. PASSENGER FLIGHT LIABILITIES

	December 31 2003 <u>US\$ 000</u>	December 31 2002 <u>US\$ 000</u>
Advance Ticket Sales	57,762	41,500
Provision for Mile Liability resulting from Sales of Mileage	13,693	9,501
	<u>71,455</u>	<u>51,001</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

21. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Sales Incentive Accrual	3,062	10,210
Fuel Oil Privilege Expense Accrual	6,876	3,937
Expense Accruals Related with Rejected Passengers	520	-
Accrued Salaries	15,121	8,695
Accrued Maintenance Costs	8,307	7,669
Accrued Frequent Flyer Liability	8,200	7,249
Provision for Legal Claims	3,657	2,130
Other Liabilities	888	60
	<u>46,631</u>	<u>39,950</u>

During preparation of the financial statements as of 31 December 2003, the Company decided to cancel the unfunded internal insurance risk provision that was provided due to the Company is one of the state owned economic enterprises. Provision amount of US\$ 510,000 related to period before 2002, was restated by adjusting opening balance sheet of 2002 and hence accompanying financial statements as of 31 December 2002 and 2001 has been presented as restated.

22. INCOME TAXES PAYABLE

Corporate Tax Payable/ (Prepaid Taxes) is as follows:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Corporate Tax Payable	56,590	19,821
Prepaid Taxes and Funds	(42,790)	(25,042)
	<u>13,800</u>	<u>(5,221)</u>

Major Components of Tax Expense:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Current Tax Expense	56,590	19,821
Deferred Tax Expense	71,126	23,285
Tax Expense	<u>127,716</u>	<u>43,106</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

22. INCOME TAXES PAYABLE (cont'd)

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 year.

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.

The effective rates of tax are as follows:

- In 2002 and prior years: 33%, being 30% corporate tax plus a 10% surcharge of funds contribution on corporate tax.
- 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 2 January 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 24 April 2003, and to 33% for 2004.

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 within 15 April following the close of the accounting year to which they relate. 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 24 April 2003 for all companies. Undistributed dividends incorporated in share capital are not subject to income withholding taxes.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

22. INCOME TAXES PAYABLE (Cont'd)

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 24 April 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.

Inflation Adjusted Tax Calculation:

Law No. 5024 published in the Official Gazette No. 25332 on 30 December 2003 requires the application of inflation accounting in Turkey in 2004 and future years, if the actual rate of inflation meets certain thresholds. The requirement of Ministry of Finance to apply inflation accounting from 2004 onwards includes a requirement to calculate an inflation-adjusted statutory balance sheet for 31 December 2003, which will form the starting point for the new inflation accounting, and in which the uplifts from the former book values are a tax-exempt gain.

Deferred Tax:

The Company recognizes deferred tax assets and liabilities based upon temporary differences arising 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.

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

22. INCOME TAXES PAYABLE (cont'd)

Temporary Differences: Deferred Tax Assets / (Liabilities)

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Allowance for Unrecoverable		
Bank Accounts	870	1,083
Adjustment to Prepaid Expense	-	-
Provision for Doubtful Receivables	268	414
Accounting for Short Term Lease Liability	39,194	44,727
Provision for Advance Ticket Sales	(12,818)	(9,205)
Accrued Liabilities	7,322	6,473
Useful Life and Leasing Adjustment on		
Fixed Asset	(384,317)	(399,685)
Accounting for Long Term Lease Liability	258,219	339,197
Adjustments to Long Term Assets	(1,426)	(1,407)
Provision for Retirement Pay	16,902	15,490
Adjustment to Manufacturers' Credit	914	1,421
Income Arising From Cancellation of	-	
A Type Handling License		(3,675)
Deferred Income	1,358	1,647
Discount on Receivables	72	218
Discount on Payables	(279)	(351)
Diminishing in Value of Marketable		
Securities and Financial Assets	798	1,544
Interest Accrual on Bank Accounts	(673)	-
Deferred Tax Liability/ Asset	<u>(73,596)</u>	<u>(2,109)</u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

22. INCOME TAXES PAYABLE (cont'd)

Movement in deferred tax liability per balance sheet can be reconciled with net deferred tax expense per income statement as follows:

	2003 <u>TL 000,000</u>	2002 <u>TL 000,000</u>
Deferred Tax Expense Related to the Origination and Reversal of Temporary Differences	73,371	37,402
Deferred Tax Benefit Resulting from Change in Effective Tax Rate	<u>(224)</u>	<u>(14,117)</u>
Net Deferred Tax Expense	71,126	23,285
Translation Loss on Deferred Tax Asset / (Liabilities)	<u>361</u>	<u>2,867</u>
Change in Net Deferred Tax	<u><u>71,487</u></u>	<u><u>26,152</u></u>

The reconciliation from the expected to the disclosed tax expense are as follows:

	2003 <u>US \$ 000</u>	2002 <u>US \$ 000</u>
Profit before taxation	296,820	182,373
Expected tax at 30% for 2003 and 33% 2002	89,046	60,183
Reconciling Items:		
Tax exempt income	(671)	-
Investment incentives used	(747)	(12,518)
Non deductible expenses	3,740	13,134
Accumulated losses	-	(941)
Translation (gains) / losses not (taxable) / deductible	36,572	(2,635)
Deferred tax benefit resulting from change in effective tax rate	<u>(224)</u>	<u>(14,117)</u>
Actual Tax Expense	<u><u>127,716</u></u>	<u><u>43,106</u></u>

TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

NOTES TO THE FINANCIAL STATEMENTS

23. MANUFACTURERS' CREDIT (NET)

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

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Gross Manufacturer's Credit	12,634	12,634
Accumulated Amortization	(9,589)	(8,326)
	<u>3,045</u>	<u>4,308</u>

24. RETIREMENT PAY PROVISION

Accounting Policy for retirement pay provision.

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 1,389,950,000 (US\$ 996) as at December 31, 2003 at historic money values. 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 made 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:

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Current Service Cost	18,919	10,722
Interest Cost	2,782	2,450
	<u>21,701</u>	<u>13,172</u>

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

	December 31, 2003 US\$ 000	December 31, 2002 US\$ 000
Provision at the beginning of the period	46,939	35,874
Expense in the income statement	21,701	13,172
Payments to retiring employees	(12,298)	(2,107)
Provision at the end of the period	<u>56,342</u>	<u>46,939</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

25. CAPITAL

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

			December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
	<u>Class</u>	<u>%</u>		
Turkish Republic Privatization Administration(*)	A,B,C	98.17	761,192	761,192
Others	A	1.83	14,189	14,189
			<u>775,381</u>	<u>775,381</u>
Nominal Capital (Historic) Million TL			<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 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 December 31, 2003, the Company's issued and paid-in share capital consists of 104,999,999,999 class A shares, 70,000,000,000 class B shares and 1 class C share, all with a par value of 1,000 TL each. Class A shares are ordinary shares, Class B shares are issued to name. The Class C share, which belongs to the Privatization Administration (P.A.), is a unique share with a par value of 1,000 TL 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:

- To suggest a change in the Main Agreement
- Increase or decrease in the share capital
- Registration of the transfer of the shares issued to name in the 'Register of the Company'
- To determine the bases of personnel regulations especially about terminating
- To appoint the independent auditing firm

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NOTES TO THE FINANCIAL STATEMENTS

25. CAPITAL (cont'd)

- f) To determine the wages and bonuses of the top management
- g) Suggestion of profit distribution
- h) To determine the form of document indicating representation authority that takes part in the article 30th of the Main Agreement
- i) To make decisions on strategy and investment decisions of the Company
- j) To make decisions about establishing a new company or companies, to participate to the established ones or merge with them, to buy a company

Main Agreement Temporary Article 4: The Company's members of the Board of Directors, auditors and general manager are assigned by an instruction of the Turkish Republic Privatization Administration and the approval of the Prime Ministry until the Company's shares held by Turkish State are below 50%.

26. CONTINGENT LIABILITIES

a) Guarantees given:

	December 31, 2003 <u>US\$ 000</u>	December 31, 2002 <u>US\$ 000</u>
Letters of Guarantee Given	30,886	37,475

b) Purchase Commitments:

The Company has an optional 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 report date, the duration to use this option has expired, and the Company's management expects to use the deposit while buying new aircrafts.

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NOTES TO THE FINANCIAL STATEMENTS

26. CONTINGENT LIABILITIES

c) Letter of Comfort:

	<u>December 31,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
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\$ 62,921,334 Million as of 31 December 2003 and THY amortizes these buildings based on their useful lives which is 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.

There were informal claims from DHMI that THY should start paying rent for the buildings after 10 years from the date of construction. The latest claim was made by DHMI 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 DHMI 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\$ 56,341,948 (see note 24). The Company's total liability for retirement pay would be US\$ 84,048,535 as of December 31, 2003, on an undiscounted basis if all the employees had been terminated as at that date.

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NOTES TO THE FINANCIAL STATEMENTS

27. OPERATING LEASE COMMITMENTS

Commitments for future operating leases are as follows:

	December 31, 2003 <u>US\$ 000</u>
Aircraft Lease Payable	
Not later than one year	30,179
Between 1 & 2 years	18,553
Between 2 & 5 years	1,062
	<u>49,794</u>

28. 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 at December 31, 2003, has decreased from Euro 22.65 at December 31, 2003 to Euro 21.23 at April 5, 2004, hence the total market value of these securities decreased by US\$ 796,813 compared to December 31, 2003.
- Market price of 299,250,000 USA\$ securities, which is traded in Istanbul Stock Exchange, and included in the financial investments available for sale as of December 31, 2003, has decreased from TL 19,042 at December 31, 2003 to TL 18,556 at April 5, 2004, hence the total market value of these securities decreased by US\$ 104,193 as of April 5, 2004.
- On January 2003 the statutory maximum amount of retirement and severance payable in respect of each year of employment is increased from US\$ 996 to US\$ 1,064.

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NOTES TO THE FINANCIAL STATEMENTS

29. SEGMENTAL INFORMATION

Analysis of Traffic Revenue:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Scheduled Services		
- Passenger	1,295,460	1,212,626
- Cargo and mail	150,045	149,381
	<u>1,445,505</u>	<u>1,362,007</u>
Non-scheduled Services	29,459	25,430
Other Revenue	180,242	130,183
Total Revenue	<u>1,655,206</u>	<u>1,517,620</u>

Geographical analysis of scheduled services traffic revenue is as follows:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
International		
- Europe	623,649	587,406
- Middle East	132,512	124,318
- South Africa	3,766	16,087
- North Africa	35,081	32,666
- North America	90,523	91,194
- Far East	220,524	225,256
	<u>1,106,055</u>	<u>1,076,927</u>
Domestic	<u>339,450</u>	<u>285,080</u>
Total Scheduled Services Traffic Revenue	<u>1,445,505</u>	<u>1,362,007</u>

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NOTES TO THE FINANCIAL STATEMENTS

30. OPERATING EXPENSE

Operating expenses consist of the following:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Fuel Oil	226,346	192,455
Maintenance Expenses	55,641	46,687
Passenger Service Expenses	93,296	82,365
Landing and Navigation Expenses	138,004	119,476
Handling and Station Expenses	101,342	98,942
Staff Expenses	326,661	268,004
Marketing and Selling Expenses	184,830	185,212
General Operations	31,919	30,030
General Administrative Expenses	20,839	20,125
Hull Insurance	17,506	16,348
Depreciation Expenses	137,975	149,432
Operating Lease Expenses	44,252	39,362
Impairment Loss	5,789	23,460
Other Operations Expenses	126	115
	<u>1,384,526</u>	<u>1,272,013</u>

31. FINANCIAL INCOME / (EXPENSE) (NET)

Financial expenses consist of the following:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Interest Income	26,346	15,058
Investment Income at Equity	2,744	1,256
Decrease in Impairment Loss Provision of Financial Assets Available for Sale	5,188	-
Foreign Exchange Gains	332,797	109,439
Discount Income	2,108	1,062
Financial Income	<u>369,183</u>	<u>126,815</u>
Foreign Exchange Losses	(146,709)	(312,628)
Interest Expense	(3,223)	(166)
Capital Lease Interest Expense	(35,889)	(50,976)
Retirement Pay Interest Cost	(2,782)	(2,450)
Diminution in Value of Financial Assets	-	(6,594)
Discount Expense	(1,243)	(168)
Financial Expense	<u>(189,846)</u>	<u>(372,982)</u>
Translation Loss / (Gain)	(170,091)	163,778
Finance Income / (Expense) (Net)	<u>9,246</u>	<u>(82,389)</u>

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NOTES TO THE FINANCIAL STATEMENTS

32. INCOME FROM OTHER OPERATIONS

Income from other operations consists of the following:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Commission Income	609	1,710
Dividend Income	2,045	164
Insurance Claims Received	2,873	689
Gain from Sale of Fixed Assets	568	5,562
Credit notes received	5,002	1,895
Prior Year Revenue	1,063	3,472
Manufacturer's Credit Income	1,179	678
No charge Materials Income	994	615
Reversal of Unnecessary Provision	3,721	1,891
Income from Cancelled A Type Handling License	-	4,749
Other	6,188	2,144
	<u>24,242</u>	<u>23,569</u>

33. LOSS FROM OTHER OPERATIONS

Losses from other operations consist of the following:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Penalty Expenses	3	32
Provision Expenses	5,257	1,792
Other Expenses	2,088	2,590
	<u>7,348</u>	<u>4,414</u>

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NOTES TO THE FINANCIAL STATEMENTS

34. 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.

Transaction with related parties are as follows:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Services given to SUN EXPRESS	920	1,224
Services given to USAŞ	132	130
	<u>1,052</u>	<u>1,354</u>

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Services taken from SUN EXPRESS	228	307
Services taken from USAŞ	39,670	31,829
	<u>39,898</u>	<u>32,136</u>

Dividend income received from investments is as follows:

	2003 <u>US\$ 000</u>	2002 <u>US\$ 000</u>
Uçak Servisi A.Ş.	1,111	163
Emek İnşaat and İşl. A.Ş.	1	1
	<u>1,112</u>	<u>164</u>

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FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2003