

**TÜRK HAVA YOLLARI  
ANONİM ORTAKLIĞI**

US GAAP FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
DECEMBER 31, 2004

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Türk Hava Yolları Anonim Ortaklığı

1. We have audited the accompanying balance sheet of Türk Hava Yolları Anonim Ortaklığı (“the Company”) as of December 31, 2004, and the related statements of income, shareholders’ equity, and cash flows 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 audit provides 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, 2004, and the results of its operations and its cash flows for the year then ended in conformity with Accounting Principles Generally Accepted in the 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 December 31, 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, 13 May 2005

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT DECEMBER 31, 2004 AND 2003

<u>ASSETS</u>	<u>Note</u>	December 31, 2004	December 31, 2003
		<u>US \$ 000</u>	(As Restated) <u>US \$ 000</u>
Cash and Cash Equivalents	5	272,437	472,700
Accounts Receivable (Net)	6	118,162	84,638
Due from Related Parties (Short-Term)	7	606	85
Inventories	8	42,718	30,529
Prepaid Taxes	21	38,228	-
Short Term Deferred Tax Assets	21	37,745	34,754
Other Receivables and Current Assets	9	26,355	37,169
<b>TOTAL CURRENT ASSETS</b>		<b>536,251</b>	<b>659,875</b>
Due from Related Parties (Long-Term)	7	-	37,507
Investments At Equity	10	12,448	5,092
Financial Assets Available For Sale (Net)	10	18,766	10,615
Fixed Assets (Net)	11	1,281,130	1,357,815
Advances Given For Aircraft	12	295,739	5,783
Other Long Term Receivables and Assets	13	9,945	11,072
<b>TOTAL NON-CURRENT ASSETS</b>		<b>1,618,028</b>	<b>1,427,884</b>
<b>TOTAL ASSETS</b>		<b>2,154,279</b>	<b>2,087,759</b>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

BALANCE SHEETS AS AT DECEMBER 31, 2004 AND 2003

<u>LIABILITIES</u>	<u>Note</u>	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 (As Restated) <u>US \$ 000</u>
Bank Borrowings	14	210	-
Short Term Portion of Finance Lease Obligations	15	151,041	174,602
Accounts Payable		147,520	128,930
Due to Related Parties	16	4,849	3,847
Other Short Term Payables	17	27,492	35,102
Deposits and Advances Received	18	28,963	40,007
Passenger Flight Liabilities	19	122,742	71,455
Other Accrued Liabilities	20	43,592	47,349
Provision for Corporate Tax	21	-	13,800
<b>TOTAL CURRENT LIABILITIES</b>		<b>526,409</b>	<b>515,092</b>
Long Term Portion of Finance Lease Obligations	15	713,605	860,729
Manufacturers' Credit (Net)	22	1,785	3,045
Long Term Deferred Tax Liabilities	21	76,399	65,004
Retirement Pay Liability	23	74,344	56,342
Other Long Term Payables	17	1,866	2,732
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>867,999</b>	<b>987,852</b>
Share Capital	24	775,381	775,381
Share Premium	24	55,327	55,327
Accumulated Losses		(70,837)	(245,893)
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>759,871</b>	<b>584,815</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>2,154,279</b>	<b>2,087,759</b>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

		December 31, 2004	December 31, 2003
	Note	US \$ 000	(As Restated) US \$ 000
Operating Revenues	28	1,872,665	1,655,206
Operating Expenses	29	<u>(1,725,553)</u>	<u>(1,384,526)</u>
OPERATING PROFIT		147,112	270,680
Income from Other Operations	31	26,484	24,242
Loss from Other Operations	32	<u>(10,941)</u>	<u>(7,348)</u>
INCOME BEFORE FINANCIAL INCOME AND TAXATION		162,655	287,574
Financial Income (Net) (Net of Translation Gains and Losses)	30	<u>19,594</u>	<u>9,246</u>
INCOME BEFORE TAXATION		182,249	296,820
Taxation Charge	21	(7,193)	(84,370)
NET PROFIT FOR THE YEAR		<u>175,056</u>	<u>212,450</u>
Basic Earnings per Share (US \$ in Full)	4.16	0.0010	0.0012

## TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

### STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	Share Capital <u>US \$ 000</u>	Share Premium <u>US \$ 000</u>	Accumulated Losses <u>US \$ 000</u>	Total <u>US \$ 000</u>
Balances at December 31, 2002	775,381	55,327	(458,343)	372,365
Profit For The Year (As Previously Reported)	-	-	169,104	169,104
Balances at December 31, 2003 (As Previously Reported)	<u>775,381</u>	<u>55,327</u>	<u>(289,239)</u>	<u>541,469</u>
Effect of Change in Deferred Tax Liability Arising From Tangible Fixed Assets (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 Year	-	-	175,056	175,056
Balances at December 31, 2004	<u><u>775,381</u></u>	<u><u>55,327</u></u>	<u><u>(70,837)</u></u>	<u><u>759,871</u></u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	December 31, 2004	December 31, 2003 (As Restated)
	US \$ 000	US \$ 000
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Profit Prior to Taxation	182,249	296,820
Adjustments to reconcile net profit for the period to net cash provided by operating activities:		
Depreciation	137,899	137,975
Provision for Employee Termination Benefits	22,724	21,701
Interest Income	(28,207)	(26,346)
Gain on Fixed Asset Sales	(606)	(568)
Translation Loss on Deferred Tax Liability	1,211	361
Impairment Loss	12,241	5,789
Income from Financial Investment Accounted per Equity Method	(10,244)	(2,744)
Interest Expense	34,175	39,112
Provision for Diminution in Value of Financial Assets Available For Sale	(7,176)	(5,188)
Movement in Manufacturers' Credit	(1,260)	(1,264)
Amortization of Deferred Income From USAŞ Share Transfer	(1,866)	(1,366)
Tangible Fixed Asset Opening Adjustment	-	397
(Decrease) / Increase in Provision for Doubtful Receivables	(1,386)	659
Operating Profit Before Working Capital Changes	339,754	465,338
(Increase) / Decrease in Trade Receivables	(32,138)	(10,614)
(Increase) / Decrease in Due From Related Parties	36,986	(13,901)
(Increase) / Decrease in Inventories	(12,189)	(543)
(Increase) / Decrease in Other Receivables and Short Term Assets	10,814	(4,786)
(Increase) / Decrease in Other Long Term Receivables and Assets	1,127	(69)
Increase / (Decrease) in Trade Payables	18,590	34,764
Increase / (Decrease) in Due to Related Parties	1,002	561
Increase / (Decrease) in Other Payables and Accrued Expenses	(11,337)	12,721
Increase / (Decrease) in Deposits and Advances Received	(11,044)	7,498
Increase / (Decrease) in Passenger Flight Liabilities	51,287	20,454
Increase / (Decrease) in Other Long Term Trade Payables	-	(74)
Cash Generated from Operations	392,852	511,349
Retirement Benefits Paid	(4,722)	(12,298)
Interest Paid	(34,175)	(39,112)
Income Taxes Paid	(52,028)	(37,569)
Net Cash Provided by Operating Activities	301,927	422,370
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Change in Financial Assets Held for Trading	-	2,355
Cash Inflow From Sale of Financial Assets	-	3,853
Cash Outflow From Purchase of Financial Assets	(5)	-
Dividend Received From Investment Accounted Per Equity Method	2,888	-
Cash Proceeds From Sale of Fixed Assets	5,922	11,371
Interest Received	28,207	26,346
Acquisition of Fixed Assets	(78,771)	(41,849)
Advances Given for Aircraft	(289,956)	7,877
Net Cash Provided by / (Used in) Investing Activities	(331,715)	9,953
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal Payment of Finance Leases	(170,685)	(176,360)
Principal Payment of Bank Borrowings	210	(455)
Net Cash used in Financing Activities	(170,475)	(176,815)
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	(200,263)	255,508
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	472,700	217,192
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	272,437	472,700

# 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, 2004, the shareholders and their respective shareholdings in the Company were as follows:

Turkish Republic Prime Ministry	
Privatization Administration	75.17 %
Others	24.83 %
Total	<u>100.00%</u>

The total number of employees working for the Company as of December 31, 2004 is 10,956 (December 31, 2003: 10,239). The average number of employees working for the Company in 2004 and 2003 is 10,341 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. 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 69.7 % for the three years ended December 31, 2004 based on the wholesale price index announced by the Turkish State Institute of Statistics.

Although the three year cumulative inflation rate was below the rate indicated in the preceding paragraph, since majority of the people keep their savings in foreign currencies, the prices of services and goods are set in terms of foreign currencies, interest rates and wages are expressed in terms of the inflation indexes, and the market prices are determined taking into account the losses due to the credit sales including the short term transactions, the economy shows the characteristics of a hyperinflationary environment and therefore SFAS 52 was applied to the accompanying financial statements.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

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

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”.

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

<u>Years</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Currency devaluation US \$	(3.8)%	(14.6)%	13.5%	114.3%	24.4%
WPI inflation	13.8%	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 December 31, 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.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 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.

The Company develops estimations using historical statistics and data for unredeemed tickets. Total estimated unredeemed tickets were recognized as operating revenue as of December 31, 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 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 is 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.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

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

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

- 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.

- 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 Generally Accepted Accounting Principles in the United States of America 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 December 31, 2004 and 2003 and the basic earnings per share calculation is as follows:

	<b>2004</b>	<b>2003</b> <b>(As Restated)</b>
Number of shares outstanding at January 1, (in full)	175,000,000,000	175,000,000,000
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 for the year (US \$ 000)	175,056	212,450
Basic earnings per share (US \$ Full)	<b>0.0010</b>	<b>0.0012</b>

# 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, 2004 US \$ 000	December 31, 2003 US \$ 000
Cash	121	125
Cheques Received	87	39
Banks	271,096	467,135
Other Liquid Assets	1,133	5,401
	<u>272,437</u>	<u>472,700</u>

Foreign currency bank balances are US\$ 184,453,682 at December 31, 2004. (2003: US \$ 464,872,331).

#### Time Deposits:

<u>Amount</u>	<u>Currency</u>	<u>Opening Date</u>	<u>Interest Rate %</u>	<u>Maturity</u>	December 31, 2004 US \$ 000
115,431,254	YTL	25.10.2004- 31.12.2004	%15.79-19.43	03.01.2005- 24.01.2005	86,008
22,500,000	US \$	31.12.2004	%1.67	03.01.2005	22,500
89,790,000	EURO	31.12.2004	%1.14-%1.52	03.01.2005	122,218
					<u>230,726</u>

  

<u>Amount</u>	<u>Currency</u>	<u>Opening Date</u>	<u>Interest Rate %</u>	<u>Maturity</u>	December 31, 2003 US \$ 000
2,400,000	YTL	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:

	December 31, 2004 US \$ 000	December 31, 2003 US \$ 000
Trade Receivables	130,834	98,683
Discount on Receivables	(254)	(241)
Provision for Doubtful Receivables	(12,418)	(13,804)
	<u>118,162</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:

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Güneş Ekpress Havacılık A.Ş. (Sun Express)	606	75
Uçak Servisi A.Ş. (USAŞ)	-	10
Due from Related Parties - Short Term	<u>606</u>	<u>85</u>

Long term due from related parties consists of the following:

	December 31, 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% was 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 letter sent by the Turkish Republic Privatization Administration to THY on February 17, 2003. Interest rate had been changed to 23.35% after December 2003 based on the letter sent on May 31, 2004. The receivables from Turkish Republic Privatization Administration and Turban together with accrued interest has been paid to THY on July 16 and 27, 2004, respectively.

### 8. INVENTORIES

Inventories consist of the following:

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Spare Parts, Flight Equipment	35,241	24,045
Other Inventories	7,477	6,484
	<u>42,718</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:

	December 31, 2004	December 31, 2003
	US \$ 000	US \$ 000
VAT Deductible	114	79
Tax to be Refunded	1,999	1,968
Third Party Maintenance Service Income Accrual	4,599	8,881
Prepaid Operating Lease Expenses	2,967	2,194
Prepaid Sales Commissions	6,946	5,779
Deposits Given Related to the Outstanding Litigations	-	1,363
Prepaid Rent Expenses	328	282
Other Prepaid Expenses	6,542	2,710
Receivables from Personnel	428	386
Business Advances Given	258	96
Restriction on Transfer of Funds from Banks (*)	630	11,944
Receivable from SITA Deposit Certificates	112	109
Interline Passenger Income Accrual	136	197
Other Receivables	1,296	1,181
	<u>26,355</u>	<u>37,169</u>

(\*) As of December 31, 2004, the balance of this account is related to bank balance in Egypt. The restriction on transfer of funds from banks as of December 31, 2003 was related to funds held at banks in Iran, Libya, Egypt, Algeria and India and as of December 31, 2004 they are classified as cash and cash equivalents as they can be transferred to Turkey or used for payment of expenses in related sales bureaus within a period of less than 3 months.

### 10. FINANCIAL ASSETS

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

	December 31, 2004	December 31, 2003
	US \$ 000	US \$ 000
Güneş Ekspres Havacılık A.Ş. (Sun Express)	<u>12,448</u>	<u>5,092</u>

Financial assets available for sale are as follows:

	December 31, 2004	December 31, 2003
	US \$ 000	US \$ 000
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 Share	(2,001)	(2,982)
Uçak Servisi A.Ş. (USAŞ)	5,053	4,082
Increase in Value of USAŞ Shares	6,194	-
	<u>18,766</u>	<u>10,615</u>

## TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

### NOTES TO THE FINANCIAL STATEMENTS

#### 10. FINANCIAL ASSETS (cont'd)

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 \$ 7,680,921. "Deferred income" amount is amortized to income during 5 years catering service agreement on a straight-line basis. The Company has sold 342 million USAŞ shares in İstanbul Stock Exchange Market in 2003.

USAŞ distributed 1,852,500,000 of free shares to the Company based on the decision of General Assembly held on December 8, 2004 about the share capital increase from the inflation adjustment difference arising from capital restatement.

Details of the Company's long-term financial assets at December 31, 2004 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%	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

### 11. FIXED ASSETS (NET)

	Land, Land Improvements & Building	Technical Equipments, Simulators and Vehicles	Other Equipments, Fixtures and Softwares	Aircraft and Spare Engines	Rotables and Repairable Spare Parts	Construction In Progress	Total Owned Assets	Leased Aircraft	Other Leased Fixed Assets & Simulators	Total Leased Assets	Total
<b>Cost</b>											
Opening Balance 1 January 2004	66,859	109,190	129,580	214,783	123,351	30	643,793	1,781,661	26,551	1,808,212	2,452,005
Transfers from leased assets*	-	21,002	3,281	290,869	-	-	315,152	(296,189)	(18,963)	(315,152)	-
Additions	106	3,708	5,665	7,367	61,700	26,221	104,767	-	-	-	104,767
Disposals	(131)	(6,735)	(2,454)	(697)	(30,207)	(25,996)	(66,220)	-	-	-	(66,220)
Closing Balance December 31, 2004	66,834	127,165	136,072	512,322	154,844	255	997,492	1,485,472	7,588	1,493,060	2,490,552
<b>Accumulated Depreciation</b>											
Opening Balance 1 January 2004	17,545	87,042	113,465	130,633	58,643	-	407,328	507,269	19,756	527,025	934,353
Transfers from leased assets *	-	15,987	3,281	162,232	-	-	181,500	(163,329)	(18,171)	(181,500)	-
Depreciation for the year	1,100	6,464	5,496	12,911	42,033	-	68,004	69,318	577	69,895	137,899
Disposal	(47)	(1,711)	(2,325)	(618)	(30,207)	-	(34,908)	-	-	-	(34,908)
Closing Balance December 31, 2004	18,598	107,782	119,917	305,158	70,469	-	621,924	413,258	2,162	415,420	1,037,344
Accumulated impairment	-	-	-	56,228	-	-	56,228	115,850	-	115,850	172,078
<b>December 31, 2004 net book value</b>	<b>48,236</b>	<b>19,383</b>	<b>16,155</b>	<b>150,936</b>	<b>84,375</b>	<b>255</b>	<b>319,340</b>	<b>956,364</b>	<b>5,426</b>	<b>961,790</b>	<b>1,281,130</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>

(\*) Finance leased assets which their legal title has passed to the Company due to their repayment of finance lease liabilities were completed, were classified to owned assets from leased assets.

### 12. LONG TERM ADVANCES GIVEN

Long term advances given consist of the following:

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Prepayments for Aircraft Purchases	294,814	4,753
Deposits Given for Operational Leases	925	1,030
	<u>295,739</u>	<u>5,783</u>

### 13. OTHER LONG TERM RECEIVABLES AND ASSETS

Other long term receivables and assets consist of the following:

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Prepaid Aircraft Financing Expense	2,003	2,276
Prepaid Eximbank USA Guarantee and Exposure Fee	5,217	5,801
Due From Personnel	840	932
Receivables From SITA Deposit Certificate	524	463
Deposits Given	1,291	1,536
Other Receivables	70	64
	<u>9,945</u>	<u>11,072</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 14. BANK BORROWINGS

Bank borrowings of US \$ 210 thousand (December 31, 2003: - US \$) consists of overnight interest free borrowings for the purposes of settlement of tax and social security premium payments.

### 15. FINANCE LEASE OBLIGATIONS

The future lease rental payments under finance leases are:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Not later than one year	183,048	204,351
Between 1 – 2 years	171,240	171,024
Between 2 – 5 years	408,826	307,614
Over 5 years	209,318	457,173
	<u>972,432</u>	<u>1,140,162</u>
Less: Future interest expense	(107,786)	(104,831)
Present value of future rentals shown in the balance sheets	<u>864,646</u>	<u>1,035,331</u>
Represented by :		
Current Liabilities	151,041	174,602
Long Term Liabilities	713,605	860,729
	<u>864,646</u>	<u>1,035,331</u>
Interest Range :		
Floating rate obligations	650,417	767,597
Fixed rate obligations	214,229	267,734
	<u>864,646</u>	<u>1,035,331</u>

As of December 31, 2004, the US \$ denominated lease obligations' interest rates are between 5.96% and 7.68%, for the fixed rate obligations; and a margin ranging between LIBOR and LIBOR plus 3.00% for the floating rate obligations.

### 16. DUE TO RELATED PARTIES

Due to related parties consist of the following:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Sun Express	157	173
Uçak Servisi A.Ş (USAŞ)	4,692	3,674
	<u>4,849</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:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Taxes and Funds Payable	14,411	12,940
Social Security Premiums Payable	9,082	7,471
Payable to Personnel	189	1,438
State Airport Administration ("DHMI") Protocol Payable	1,358	11,448
Discount on DHMI Protocol Payable	(27)	(930)
Deferred Income from USAŞ Share Transfer (Note 10)	1,866	1,366
Deferred Income	24	141
Other Liabilities	589	1,228
	<u>27,492</u>	<u>35,102</u>

Other Long term payables consist of the following:

Deferred Income from USAŞ Share Transfer (Note 10)	1,866	2,732
	<u>1,866</u>	<u>2,732</u>

### 18. DEPOSITS AND ADVANCES RECEIVED

Advances received consists of the following:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Deposits and Guarantees Received	8,727	11,258
Advances Received for Mileage Credit Sales	17,213	18,245
Deposit Received from Turkish Republic Religious Affairs	1,751	9,056
Order Advances Received	1,272	1,448
	<u>28,963</u>	<u>40,007</u>

### 19. PASSENGER FLIGHT LIABILITIES

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Flight Liability - Advanced Ticket Sales	93,796	57,762
Flight Liability Resulting from Sales of Mileage	28,946	13,693
	<u>122,742</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:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Sales Incentive Premium Accrual	5,763	3,062
Fuel Oil Privilege Expense Accrual	544	6,876
Rejected Passengers Expense Accrual	-	520
DHMİ Expense Accrual	1,199	26
Accrued Salaries	11,638	15,121
Accrued Maintenance Costs	11,880	8,307
Accrued Frequent Flyer Liability	5,211	8,200
Provision for Legal Claims	6,889	3,657
Rent Accrual for RJ Aircraft That Will Be Returned	-	718
Other Liabilities	468	862
	<u>43,592</u>	<u>47,349</u>

### 21. TAXATION

Corporate Tax Payable is as follows:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Corporate Tax Payable	-	56,590
Prepaid Taxes and Funds	(38,228)	(42,790)
	<u>(38,228)</u>	<u>13,800</u>

Major components of tax charge consist of the following:

	2004	2003
	<u>US \$ 000</u>	(As Restated) <u>US \$ 000</u>
Current Tax Charge	-	56,590
Deferred Tax Charge	7,193	27,780
Tax Charge	<u>7,193</u>	<u>84,370</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (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 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.

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 2005: 30%

In Turkey, prepaid taxes are calculated and accrued on a quarterly basis. The prepaid corporate income tax rate was increased from 25% to 30%, effective from April 24, 2003. In 2004, the prepaid corporate income tax rate was applied 33%. Starting from 2005, prepaid corporate income tax rate will be 30%.

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 who are resident companies in Turkey and Turkish branches of foreign companies. The rate of income withholding tax is 10% starting from April 24, 2003. Undistributed dividends incorporated in share capital are not subject to income withholding taxes.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (cont'd)

#### *Income withholding tax (Cont'd)*

Income withholding tax which was calculated in 2002 and prior years on various types of income and gains exempt from corporation tax, whether distributed or not, 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 24, 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. Carried forward investment incentives to be deducted from corporate tax liability in the following periods are revalued with the applicable WPI.

#### *Inflation adjusted legal tax calculation:*

For December 31, 2003 and the periods before, fixed assets and accumulated depreciations were revalued and revaluation differences were booked as revaluation fund under shareholders' equity. With the Law no.5024, published in Official Gazette no.25332 dated December 30, 2003, tax bases were started to be determined on the basis of inflation accounting. According to that Law, the adjusted balance sheet for December 31, 2003 will be the opening balance sheet, and therefore, December 31, 2003 balance sheet must be restated in accordance with inflation accounting. The restatement differences booked as accumulated gains (losses) in the opening balance sheet are not subject to any tax charge. For the following years, if the yearly inflation rate exceeds 10% and 3-year cumulative inflation rate exceeds 100%, the financial statements will be restated and tax base will be adjusted accordingly. According to the Law, if the above conditions are met in any of interim tax periods in a year, inflation accounting will be applied for the whole year. As of June 30, 2004, the above two conditions were met and therefore, the tax amount in the year 2004 has been computed in accordance with inflation accounting, effective from June 30, 2004.

#### *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.

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (cont'd)

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

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 (As Restated) <u>US \$ 000</u>
Allowance for Unrecoverable Bank Accounts	-	870
Prepaid Expenses	216	-
Provision for Doubtful Receivables	310	268
Changes in Other Short Term Assets	45	-
Short Term Finance Lease Obligation	35,666	39,194
Provision for Advance Ticket Sales	(13,630)	(12,818)
Accrued Liabilities	9,780	7,322
Discount on Receivables	76	72
Discount on Payables	(15)	(279)
(Appreciation) / Diminution in Value of Financial Assets	(1,106)	798
Interest Accrual on Bank Accounts	-	(673)
Unused Investment Incentives	2,760	-
Unused Tax Losses	3,643	-
Short Term Deferred Tax Asset	<u>37,745</u>	<u>34,754</u>
Useful Life of Fixed Assets and Finance Lease Adjustment	(313,977)	(340,971)
Long Term Finance Lease Obligation	214,081	258,219
Adjustments to Long Term Assets	(462)	(1,426)
Retirement Pay Liability	22,303	16,902
Manufacturers' Credit	536	914
Deferred Income	1,120	1,358
Long Term Deferred Tax Liability	<u>(76,399)</u>	<u>(65,004)</u>
Total Deferred Tax Liability	<u>(38,654)</u>	<u>(30,250)</u>

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

	2004 <u>US \$ 000</u>	2003 (As Restated) <u>US \$ 000</u>
Deferred Tax Charge Related to the Origination and Reversal of Temporary Differences	7,193	28,004
Deferred Tax Charge Resulting from Change in Effective Tax Rate	-	(224)
Net Deferred Tax Charge	<u>7,193</u>	<u>27,780</u>
Translation Loss on Deferred Tax Liabilities	1,211	361
Change in Net Deferred Tax	<u>8,404</u>	<u>28,141</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 21. TAXATION (cont'd)

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

	2004	2003
	US \$ 000	(As Restated) US \$ 000
Profit before taxation	182,249	296,820
Expected tax (at 2004: 33% and 2003: 30%)	60,142	89,046
Reconciling Items:		
Non taxable Income	(22,114)	(671)
Effect of Investment Incentives	(2,760)	(747)
Non Deductible Expenses	516	3,740
Translation Gains Not Taxable	(21,083)	(6,774)
Unused Tax Losses	(3,643)	-
Tax Benefit Due to Using Tax Rate of 30% for Calculation of Deferred Tax	(3,865)	-
Deferred Tax Benefit Resulting From Change in Effective Tax Rate	-	(224)
Actual Tax Expense	<u>7,193</u>	<u>84,370</u>

### 22. MANUFACTURERS' CREDIT (Net)

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

	December 31, 2004	December 31, 2003
	US \$ 000	US \$ 000
Gross Manufacturer's Credit	12,634	12,634
Accumulated Amortization (-)	(10,849)	(9,589)
	<u>1,785</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 YTL 1,574.7 (US \$ 1,173) as at December 31, 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:

	December 31, 2004 <u>US \$ 000</u>	December 31, 2003 <u>US \$ 000</u>
Current Service Cost	19,085	18,919
Interest Cost	3,639	2,782
	<u>22,724</u>	<u>21,701</u>

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

	2004 <u>US \$ 000</u>	2003 <u>US \$ 000</u>
Provision at January 1	56,342	46,939
Charge for the Year	22,724	21,701
Payments During the Year	<u>(4,722)</u>	<u>(12,298)</u>
Provision at December 31	<u>74,344</u>	<u>56,342</u>

The estimated value of the vested benefit obligation is discounted with an approximate rate of 5.45 % 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:

			December 31, 2004		December 31, 2003
	<u>Class</u>	<u>%</u>	<u>US \$ 000</u>	<u>%</u>	<u>US \$ 000</u>
Turkish Republic Prime Ministry Privatization Administration	A,C	75,17	582,854	98,17	761,192
Others	A	24,83	192,527	1,83	14,189
			<u>775,381</u>		<u>775,381</u>
Nominal Share Capital (YTL)			<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.

23% of the Company's shares which were owned by Turkish Republic Prime Ministry Privatization Administration were offered to the public during December 2004. As a result of this secondary public offering ownership rate of Turkish Republic Prime Ministry Privatization Administration has decreased to 75.17% from 98.17%.

As at December 31, 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 YKr 0.1 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 YKr 0.1 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'

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

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

e) 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%)

f) To make decisions about to merging with another companies and liquidation.

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 Prime Ministry 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:

	December 31, 2004	December 31, 2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Guarantee Letters Given	25,367	24,371

#### b) Purchase Commitments:

The Company has signed agreements to purchase 51 aircraft which will be obtained between years 2005-2008. Total value of these aircraft is approximately US \$ 4.1 Billion according to the list prices before any discounts to be applied by aircraft producer firms. THY paid a deposit of US \$ 280 million as of December 31, 2004 related to these new purchases.

Furthermore, the Company paid a deposit of US \$ 15 million related to the purchase of one VIP aircraft that will be delivered in 2005.

#### c) Letter of Comfort:

	<u>December 31, 2004</u>	<u>December 31, 2003</u>
Letters of Comfort	US \$ 2,900,000	US \$ 2,900,000
Given to Sun Express	EURO 2,556,459	EURO 2,556,459

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 25. CONTINGENT LIABILITIES (con'td)

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 \$ 72,948 thousand as of December 31, 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

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.

The conflict between DHMI and THY about the rent demand of DHMI for the buildings and facilities of THY on lands leased from DHMI came to a conclusion in October 2004. In accordance with the agreement between THY and DHMI, THY paid the invoice amount of YTL 515,272 for the “indoor area rent” of 2000, 2001, 2002 and 2003 and THY agreed to pay 50% rent for the currently leased land which have a clause of “indoor rent will paid” in their assignment and for the buildings that will be constructed on land that will be leased from DHMI in future.

e) The Company discounted its retirement pay provision to US \$ 74,344,220 (see note 23). The Company’s total undiscounted liability for retirement pay would be US \$ 117,948,839 as of December 31, 2004, if all employees had been dismissed as at that date.

### 26. OPERATING LEASE COMMITMENTS

Commitments for future operating leases are as follows:

	December 31, 2004	December 31, 2003
	US \$ 000	US \$ 000
Not later than one year	55,752	30,179
Between 1 and 2 years	49,109	18,553
Between 2 and 5 years	39,716	1,062
	<u>144,577</u>	<u>49,794</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 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 December 31, 2004, has decreased from Euro 24.36 at December 31, 2004 to Euro 22.87 at 30 March 2005. Hence, the total market value of these securities decreased by US \$ 411,170 compared to balance sheet date.
- Market price of 2,223 Millions USAŞ securities, which is traded in İstanbul Stock Exchange Market, and included in the financial investments as available for sale as of December 31, 2004, has decreased from YTL 6,79 at December 31, 2004 to YTL 5.20 on 30 March 2005. Hence, the total market value of these securities decreased by US \$ 2,633,611 compared to balance sheet date
- Retirement pay ceiling has been increased to US \$ 1,228.6 as of 1 January 2005

### 28. OPERATING REVENUES

Operating Revenues are as follows:

	2004 <u>US \$ 000</u>	2003 <u>US \$ 000</u>
Scheduled Services		
- Passenger	1,468,730	1,295,460
- Cargo and Mail	170,931	150,045
	<u>1,639,661</u>	<u>1,445,505</u>
Non-Scheduled Services	30,433	29,459
Other Revenue	202,571	180,242
Total Revenue	<u>1,872,665</u>	<u>1,655,206</u>

Geographical analysis of scheduled services traffic revenue is as follows:

	2004 <u>US \$ 000</u>	2003 <u>US \$ 000</u>
International		
- Europe	688,094	623,649
- Middle East	160,457	132,512
- South Africa	-	3,766
- North Africa	43,855	35,081
- North America	94,992	90,523
- Far East	279,755	220,524
	<u>1,267,153</u>	<u>1,106,055</u>
Domestic	<u>372,508</u>	<u>339,450</u>
Total Scheduled Services Traffic Revenue	<u>1,639,661</u>	<u>1,445,505</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 29. OPERATING EXPENSE

Operating expenses consist of the following:

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Fuel Oil Expenses	343,945	226,346
Maintenance Expenses	96,549	55,641
Passenger Service and Catering Expenses	108,293	93,296
Landing and Navigation Expenses	160,680	138,004
Handling and Station Expenses	120,901	101,342
Staff Expenses	400,993	326,661
Marketing and Selling Expenses	212,008	184,830
General Operations	31,180	25,842
General Administrative Expenses	21,640	20,965
Insurance Expenses	20,930	17,506
Depreciation Expenses	137,899	137,975
Operating Lease Expenses	39,747	44,252
Impairment Loss	12,241	5,789
Aircraft and Seat Rent Expense	18,547	6,077
	<u>1,725,553</u>	<u>1,384,526</u>

### 30. FINANCIAL EXPENSE (NET)

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Interest Income	28,207	26,346
Income From Investment Accounted		
From Equity Method	10,244	2,744
Increase in Value of Available for Sale Financial		
Assets	7,176	5,188
Foreign Exchange Gains	169,119	332,797
Discount Income	432	2,108
Financial Income	<u>215,178</u>	<u>369,183</u>
Foreign Exchange Losses	(152,516)	(146,709)
Interest Expenses-Third Parties	(2,622)	(3,223)
Finance Lease Interest Expense	(31,553)	(35,889)
Retirement Pay Interest Cost	(3,639)	(2,782)
Discount Expense	(1,016)	(1,243)
Financial Expense	<u>(191,346)</u>	<u>(189,846)</u>
Translation Loss	(4,238)	(170,091)
Financial Income (Net)	<u>19,594</u>	<u>9,246</u>

### 31. INCOME FROM OTHER OPERATIONS

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

Income from other operations consists of the following:

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Commission Income	214	609
Dividend Income	194	2,045
Insurance Claims Received	3,073	2,873
Gain from Sale of Fixed Assets	606	568
Discounts Received From Spare Parts Suppliers	5,727	5,002
Manufacturer's Credit Income	1,263	1,179
Free of Cost Materials Income	1,038	994
Reversal of Unnecassary Provision	10,244	3,721
Compensations Received	920	-
Other	3,205	7,251
	<u>26,484</u>	<u>24,242</u>

### 32. LOSS FROM OTHER OPERATIONS

Losses from other operations consist of the following:

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Provision Expenses	5,940	5,257
Rent Expense of RJ Aircraft to be Returned	3,118	-
Other Expenses	1,883	2,091
	<u>10,941</u>	<u>7,348</u>

### 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:

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Services given to Sun Express	1,269	920
Services given to USAŞ	173	132
	<u>1,442</u>	<u>1,052</u>

# TÜRK HAVA YOLLARI ANONİM ORTAKLIĞI

## NOTES TO THE FINANCIAL STATEMENTS

### 33. TRANSACTIONS WITH RELATED PARTIES (con'td)

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Services taken from Sun Express	1,699	228
Services taken from USAŞ	44,781	39,670
	<u>46,480</u>	<u>39,898</u>

Dividend income from equity investments are as follows:

	2004	2003
	<u>US \$ 000</u>	<u>US \$ 000</u>
Sun Express	2,888	-
Uçak Servisi A.Ş.	125	1,111
Emek İnşaat ve İşletim A.Ş.	5	1
	<u>3,018</u>	<u>1,112</u>