

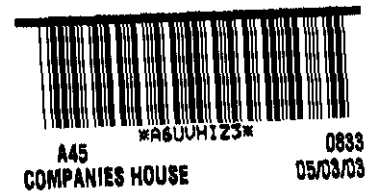
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Financial Statements

Ukraine International Airlines

*Years ended December 31, 2000 and 1999
with Report of Independent Auditors*

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Ukraine International Airlines

Financial Statements

Years ended December 31, 2000 and 1999

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Report of Independent Auditors

The Board of Directors and Shareholders Ukraine International Airlines

1. We have audited the accompanying balance sheets of Ukraine International Airlines (the "Company") as of December 31, 2000 and 1999, and the related statements of operations, shareholders' equity and cash flows for the years 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 audits.
2. We conducted our audits in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those Standards require that we plan and perform the audits 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. As discussed in Note 6 to the accompanying financial statements, the Company has not amortized its route rights intangible asset. International Accounting Standard No. 4, *Depreciation Accounting*, requires that such assets be amortized. Based on straight line amortization, the route rights intangible asset as of December 31, 2000 would be reduced by accumulated amortization of \$11.24 million, and the loss for the year ended December 31, 2000 and accumulated deficit as of December 31, 2000 would be increased by \$2.16 million and \$11.24 million, respectively (\$2.16 million and \$9.08 million for 1999, respectively).
4. As discussed in Note 9 to the accompanying financial statements, the Company has not made a provision for deferred tax liabilities in accordance with International Accounting Standard No. 12 *Income Taxes*. Had a provision for deferred taxes been recorded, deferred tax liabilities and accumulated deficit would both have been increased by \$0.725 million as of December 31, 2000. Additionally, net loss would be increased by \$0.725 million for the year ended December 31, 2000.
5. In our opinion, except for the effect on the financial statements of the matters referred to in paragraphs 3 and 4, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in accordance with International Accounting Standards issued by the International Accounting Standards Committee.



6. We have also audited the financial statements of the Company as of and for the years ended December 31, 2000 and 1999, not presented herewith, prepared in compliance with the regulations for bookkeeping and statutory reporting purposes in Ukraine ("Ukrainian Accounting Standards") and we expect to report separately on those Ukrainian Accounting Standards financial statements. The nature of the significant differences between accounting principles applied in preparing Ukrainian Accounting Standards financial statements and those applied for International Accounting Standards are summarized in Note 2 to the accompanying financial statements.

ERNST + YOUNG UKRAUDIT

Ernst & Young Ukraudit
May 4, 2001
Kyiv, Ukraine



Ukraine International Airlines

Balance Sheets

	December 31,	
	2000	1999
Assets	<i>(In thousands of US Dollars)</i>	
Current assets:		
Cash	\$ 3,624	\$ 660
Restricted cash deposits	-	602
Accounts receivable, net (Note 3)	3,220	2,486
Investment securities (Note 7)	565	-
Prepayments and other current assets	3,183	2,395
	<u>10,592</u>	<u>6,143</u>
Aircraft purchase deposits	867	644
Restricted cash deposits	2,543	2,523
Spare parts and rotables, net (Note 4)	3,597	3,365
Property and equipment, net (Note 5)	535	834
Route rights (Note 6)	32,829	32,829
Other assets, net	940	161
	<u>51,903</u>	<u>46,499</u>
Total assets	\$ 51,903	\$ 46,499
Liabilities and shareholders' equity		
Current liabilities:		
Short-term installments of borrowings (Note 8)	\$ 1,510	\$ 2,603
Accounts payable and accrued expenses	9,258	7,999
Deferred passenger revenue	2,538	2,633
Total current liabilities	<u>13,306</u>	<u>13,235</u>
Long-term installments of borrowings (Note 8)	5,653	5,357
Total liabilities	<u>18,959</u>	<u>18,592</u>
Shareholders' equity:		
Charter capital (Note 10)	54,400	49,000
Accumulated deficit	(21,456)	(21,093)
Total shareholders' equity	<u>32,944</u>	<u>27,907</u>
Total liabilities and shareholders' equity	\$ 51,903	\$ 46,499

The accounting policies and explanatory notes are an integral part of the financial statements.

Ukraine International Airlines

Statements of Operations

	Year ended December 31,	
	2000	1999
	<i>(In thousands of US Dollars)</i>	
Operating revenues:		
Passenger services	\$ 46,514	\$ 41,918
Charter services	3,273	2,756
Cargo and other services	3,230	2,680
Aircraft rentals	4,169	3,974
SITA Foundation depository certificates (Note 7)	565	877
Other	1,969	1,995
	<u>59,720</u>	<u>54,200</u>
Operating expenses:		
Aircraft lease costs	12,246	12,169
Aircraft landing and handling	7,440	7,380
Fuel	8,362	4,953
Maintenance	8,121	7,355
Navigation	4,076	4,383
Salaries	3,715	3,684
Commissions	3,266	3,226
Catering	2,290	2,461
Sales and distribution	1,844	1,817
Block seats	1,101	920
Insurance	722	827
Depreciation	516	537
Administration	2,737	3,199
Representative offices	999	1,272
Provision for bad debts	38	30
	<u>57,473</u>	<u>54,213</u>
Operating gain (loss)	2,247	(13)
Other expenses:		
Interest expense	(1,575)	(1,400)
Other local taxes	(986)	(1,267)
Other, net	(49)	(82)
	<u>(2,610)</u>	<u>(2,749)</u>
Loss before income taxes	(363)	(2,762)
Income taxes (Note 9)	-	-
Net loss	<u>\$ (363)</u>	<u>\$ (2,762)</u>

The accounting policies and explanatory notes are an integral part of the financial statements.

Ukraine International Airlines

Statements of Shareholders' Equity

Years ended December 31, 2000 and 1999

	Charter Capital	Accumulated Deficit	Total
	<i>(In thousands of US Dollars)</i>		
Balances as of December 31, 1998	49,000	(18,331)	30,669
Net loss	-	(2,762)	(2,762)
Balances as of December 31, 1999	\$ 49,000	\$ (21,093)	\$ 27,907
Proceeds from the sale of preference shares to EBRD (Note 10)	5,400	-	5,400
Net loss	-	(363)	(363)
Balances as of December 31, 2000	<u>\$ 54,400</u>	<u>\$ (21,456)</u>	<u>\$ 32,944</u>

The accounting policies and explanatory notes are an integral part of the financial statements

Ukraine International Airlines

Statements of Cash Flows

	Year ended December 31,	
	2000	1999
	<i>(In thousands of US Dollars)</i>	
Operating activities		
Net loss	\$ (363)	\$ (2,762)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	516	612
Loss on disposal of property and equipment	96	-
Unrealized profits from SITA depository certificates	(565)	-
Provision for uncollectible accounts receivable	38	39
Change in operating assets and liabilities:		
Accounts receivable	(680)	342
Prepayments and other assets	(1,659)	(647)
Accounts payable and accrued expenses	1,259	713
Deferred passenger revenue	(95)	124
Cash used in operating activities	<u>(1,453)</u>	<u>(1,579)</u>
Investing activities		
Aircraft purchase deposits returned (paid), net	(223)	2,547
Purchases of spare parts and rotables	(440)	(282)
Purchases of property and equipment	<u>(105)</u>	<u>(250)</u>
Cash provided by (used in) investing activities	<u>(768)</u>	<u>2,015</u>
Financing activities		
Proceeds from the sale of preference shares to EBRD	5,400	-
Net proceeds from (repayments of) borrowings, net	(797)	292
Restricted cash deposits returned (paid), net	<u>582</u>	<u>(876)</u>
Cash provided by (used in) financing activities	<u>5,185</u>	<u>(584)</u>
Net increase (decrease) in cash	2,964	(148)
Cash at beginning of year	<u>660</u>	<u>808</u>
Cash at end of year	<u><u>\$ 3,624</u></u>	<u><u>\$ 660</u></u>
Supplementary cash flow information:		
Interest paid	1,495	1,485
Income taxes paid	-	-

The accounting policies and explanatory notes are an integral part of the financial statements.

Ukraine International Airlines
Notes to Consolidated Financial Statements

December 31, 2000 and 1999

(Amounts in tables in thousands of US Dollars)

1. Description of Business

Ukraine International Airlines (hereinafter referred to as the "Company") was incorporated in Ukraine on October 29, 1992 as a joint venture between the Ukrainian Association of Civil Aviation ("UACA") and Guinness Peat Aviation ("GPA"). In November 1998, GPA changed its name to AerFi Group PLC ("AerFi"). Pursuant to legislation enacted by the Ukrainian Government during 1994, the State Property Fund of Ukraine ("SPF") became the successor as shareholder to the UACA. These changes came into effect in May 1996 upon re-registration of the Company's charter. In November 1996, the Company was again re-registered to reflect an investment made by UIA Beteiligungsgesellschaft GmbH ("UIAB"), a company incorporated in Austria and wholly-owned by Austrian Airlines and Swissair. During December 2000 the Company further increased its shareholders through the sale of preference shares to the European Bank for Reconstruction and Development ("EBRD").

The ownership of the Company as of December 31, 2000 was as follows: SPF: 335,000 ordinary shares, UIAB: 122,500 ordinary shares, AERfi: 32,500 ordinary shares and EBRD: 54,000 preference shares, which represents approximately 61%, 23%, 6% and 10% of the total outstanding share capital, respectively.

The principal activities of the Company consist of the provision of commercial passenger and cargo transportation primarily between selected destinations in western Europe, and Ukraine. The Company's headquarters are located in Kyiv, Ukraine. The Company has approximately 696 employees as at December 31, 2000.

2. Significant Accounting Policies

The following is a summary of significant accounting policies consistently applied during the preparation of the accompanying financial statements:

Basis of Presentation

The accompanying financial statements have been prepared under the historical cost convention and in conformity with International Accounting Standards ("IAS").

The Company maintains its accounting records and prepares its financial statements in Ukrainian Hryvnia ("UAH") in accordance with the requirements of Ukrainian accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in Ukraine in that they reflect certain adjustments, not recorded in the Company's accounting books, which are appropriate to present the financial position, results of operations and cash flows in accordance with IAS. The principal adjustments as of December 31, 2000 are related to the accounting for deferred income taxes, foreign currency translation, investment securities, revenue recognition, inventory valuation, depreciation methods and lives, cost capitalization and the valuation of long term tangible and intangible assets. Adjustments are typically substantial in nature.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Basis of Presentation (continued)

The accompanying financial statements include the operations of a 100% owned subsidiary: Ukraine Aeroservice GmbH, a company incorporated in Germany. The accompanying financial statements also include the proportionate operations of a joint venture: Avicon Boryspil, in which the Company has a 49% interest (1999 – 50%).

Foreign Currencies

The Company's financial statements have been presented in US Dollars because it is the Company's functional currency, i.e. the majority of its revenues, costs, property and equipment purchased, and debt and trade liabilities are either priced, incurred, payable or otherwise measured in US Dollars. Accordingly, transactions and balances not already measured in US Dollars (primarily Ukrainian Hryvnia / "UAH") have been remeasured into US Dollars in accordance with the temporal translation method. Under this remeasurement method, revenues, costs, capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction dates. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Exchange gains and losses arising from remeasurement of monetary assets and liabilities that are not denominated in US Dollars are credited or charged to operations.

During the year December 31, 2000, the International Accounting Standards Committee issued its standing interpretation "SIC 19" which deals with the measurement and presentation of reporting currencies under both International Accounting Standard No. 21 *The Effects of Changes in Foreign Currency Exchange Rates* and International Accounting Standard No. 29 *Financing Reporting in Hyperinflationary Economies*. SIC 19, when adopted in 2001, will require the Company to present its IAS financial statements in an underlying functional ("measurement") currency, as defined by SIC 19. However, the Company believes that this underlying measurement currency will be the US Dollar, and that SIC 19 will have no impact upon adoption.

The UAH is not a convertible currency outside the territory of Ukraine. Within Ukraine, the official exchange rates are determined principally by the National Bank of Ukraine and are generally considered to be a reasonable approximation of market rates. The translation of UAH denominated assets and liabilities into US Dollars for the purpose of these financial statements does not indicate that the Company could realize, settle or distribute in US Dollars the reported values of the assets, liabilities and capital.

The exchange rate used to translate the UAH balances at December 31, 2000 was the official exchange rate of the National Bank of Ukraine of UAH 5.43 for one US Dollar (December 31, 1999: UAH 5.21 for one US Dollar). As of May 4, 2001, the official exchange rate had further fluctuated to UAH 5.42 for one US Dollar. The effect of the change of the UAH since December 31, 2000 on monetary assets and liabilities has not been determined.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in accordance with IAS requires management to make estimates and assumptions that affect the amounts and balances reported in the financial statements and accompanying notes. These estimates are based on information available as of the date of the financial statements. Actual results, therefore, could differ from those estimates.

Cash

The Company considers cash to include all cash on hand and cash held with banks.

Restricted Cash Deposits

The current portion of restricted cash deposits consisted of deposits due within one year which the Company was required to provide for certain trade creditors, aircraft lessors and loan providers. The long-term portion of restricted cash deposits consists of deposits relating to agreements with aircraft lessors which do not expire within one year.

Accounts Receivable

Accounts receivable are stated at their net realizable value. A provision is made for accounts specifically identified as doubtful of collection.

Spare Parts

Spare parts primarily consist of rotatable aircraft spare parts and are stated at the lower of cost and net realizable value. Cost is based on the average unit cost method. Depreciation of rotatable spare parts is computed on a straight-line basis using an estimated useful life of sixteen years. Net realizable value is based on the estimated selling price less any further costs expected to be incurred to disposal.

Property and Equipment

Property and equipment are stated at historical cost and are depreciated on a straight-line basis using an estimated useful life, which is generally five years.

Operating Leases

Leases for aircraft and spare parts are classified and accounted for as operating leases in accordance with International Accounting Standard No. 17, *Accounting for Leases*.

Leased Aircraft Maintenance

Operating lease payments, routine maintenance and airframe and engine overhauls for leased flight equipment are charged to operations when incurred. In addition, accruals for heavy airframe and engine overhaul are made through the payment of supplemental rental reserve charges. To the extent that the actual costs incurred associated with major engine and airframe overhauls exceed the cumulative supplemental rent charges, the Company pays and expenses the excess.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Borrowing Costs

Borrowing and interest costs are expensed as incurred.

Investment Securities

The Company's investment in depository certificates of the SITA Foundation, corresponding to underlying Equant NV common shares, are reflected in the accompanying December 31, 2000 balance sheet at estimated fair value as the Company believes that such securities are current assets. Estimated fair value is based on the underlying public trading price of Equant NV shares. SITA depository certificates were presented in the accompanying December 31, 1999 balance sheet at an underlying cost basis of zero, as they were not considered to be readily liquid at that time. The change in classification was made during the year ended December 31, 2000 based on the facts and circumstances discussed in Note 7.

Income taxes

The Company accounts for income taxes on the tax payable method.

The Company decided not to provide for net deferred tax liabilities in the accompanying December 31, 2000 balance sheet. The Company's decision and resulting accounting policy is contrary to the requirements of International Accounting Standard No. 12 *Income Taxes*. The amount of net deferred tax liability not provided for is disclosed in Note 9. In computing the amounts disclosed in Note 9, deferred income taxes are calculated using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Current tax rates are used.

Revenue Recognition and Revenue-based Taxes

Revenues are recognized net of value-added tax ("VAT") and other taxes charged to customers, in the period in which the transportation or other service is provided. Deferred revenue includes the air traffic liability, which represents the estimated value of sold but unused passenger tickets.

Revenue-based taxes, which were levied at an effective rate of approximately 2% of revenues in both 2000 and 1999, are recorded as other local taxes.

Social Costs

Defined contributions are made by the Company to the Ukrainian state health and retirement benefit and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The cost of these payments is charged to the statement of operations in the same period as the related salary cost. The Company has no further obligations for post retirement benefits.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Non-monetary Transactions

As with many companies operating in Ukraine, a portion of the Company's business is conducted via non-monetary transactions. These transactions are accounted for at selling prices of the items transferred or services provided. However, during the years ended December 31, 2000 and 1999, the total value of these transactions as reported in the accompanying financial statements was not significant.

Fair Value of Financial Instruments

The estimated fair value of financial instruments, consisting of cash, investment securities, deposits, receivables, payables and obligations under debt instruments, are considered to be equal to their carrying values.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of excess cash holdings, deposits and accounts receivable. The Company places its deposits and excess cash with reputable companies and financial institutions and limits the amount of credit exposure to any one institution. Management constantly monitors the status of banks where deposits are maintained. The credit risk associated with trade accounts receivable is limited due to the Company's customer base and ongoing procedures which monitor the credit worthiness of customers.

Impairment of Assets

International Accounting Standard No. 36, *Impairment of Assets* ("IAS 36") requires that the recoverable amount of an asset, including property, plant and equipment, should be estimated whenever there is an indication that the asset may be impaired.

IAS 36 requires that the recoverable amount to be measured as the higher of net selling price and value in use. Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

The Company has no reason to believe that an indication of impairment exists with respect to the carrying value of its long-term assets as of December 31, 2000 and 1999.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

3. Accounts Receivable

Accounts receivable consisted of the following at December 31:

	2000	1999
Travel agents	\$ 2,563	\$ 2,152
Others	934	665
	<u>3,497</u>	<u>2,817</u>
Allowance for uncollectible accounts receivable	(277)	(331)
	<u>\$ 3,220</u>	<u>\$ 2,486</u>

4. Spare Parts and Rotables

Spare parts and rotables consisted of the following at December 31:

	2000	1999
Spare parts and rotables	\$ 4,669	\$ 4,229
Accumulated depreciation	(1,072)	(864)
	<u>\$ 3,597</u>	<u>\$ 3,365</u>

5. Property and Equipment

Property and equipment consisted of the following at December 31:

	2000	1999
Cost:		
Furniture and equipment	\$ 1,402	\$ 1,631
Vehicles	343	372
	<u>1,745</u>	<u>2,003</u>
Accumulated depreciation	(1,210)	(1,169)
	<u>\$ 535</u>	<u>\$ 834</u>

A reconciliation of the carrying amount of property and equipment at December 31 is as follows:

	1999	Additions	Disposals	Depreciation	2000
Furniture and equipment	\$ 742	\$ 105	\$ (94)	\$ (273)	\$ 480
Vehicles	92	-	\$ (2)	\$ (35)	55
	<u>\$ 834</u>	<u>\$ 105</u>	<u>\$ (96)</u>	<u>\$ (308)</u>	<u>\$ 535</u>

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

5. Property and Equipment (continued)

	1998	Additions	Disposals	Depreciation	1999
Furniture and equipment	\$ 743	\$ 239	\$ -	\$ (240)	\$ 742
Vehicles	143	-	-	(51)	92
	<u>\$ 886</u>	<u>\$ 239</u>	<u>\$ -</u>	<u>\$ (291)</u>	<u>\$ 834</u>

6. Route Rights

In April 1996, at a general assembly shareholder meeting, the shareholders agreed to several changes to the Company's authorized share capital. The contribution of the SPF to the authorized share capital was valued at \$33.50 million which consisted of cash contributed of \$671,318 and, as stated in the revised charter documents, "...the complex of measures aimed at increasing the Company's profits and ensuring it achieves its potential without a corresponding increase in active operations, including the predominant position on the air transport market...", which was valued at \$32.83 million. To ensure this value was realized, the SPF, through the State Department of Aviation Transport of Ukraine, provided a guarantee of exclusive rights to the Company to operate twenty air routes until December 31, 2010 ("route rights"). The total value of the SPF share capital contributed is based on the same per share value as that paid in by other shareholders in cash. In addition, the Company may apply for and operate other air routes, but without the guarantee of exclusivity.

Management believes these route rights provide an ongoing benefit after the period of exclusivity and have not suffered economic depreciation in value and, accordingly, no amortization has been reflected in the financial statements. However, International Accounting Standard No. 4, *Depreciation Accounting*, requires that such assets be amortized for financial accounting purposes. Based on straight line amortization over the period of guaranteed exclusivity, the route rights intangible asset would be reduced by accumulated amortization of \$11.24 million as of December 31, 2000, and the loss for the year ended December 31, 2000 and accumulated deficit as of December 31, 2000 would be increased by \$2.16 million and \$11.24 million, respectively (\$2.16 million and \$9.08 million for 1999 respectively).

This intangible asset has also not been amortized for Ukrainian income tax purposes.

7. Investment Securities

As of December 31, 2000 and 1999 the Company owned approximately 18,834 depository certificates in the SITA Foundation ("SITA"), corresponding to underlying shares of Equant NV ("Equant"). Equant is an entity based in The Netherlands which is publicly traded on the New York Stock Exchange in the form of American depository receipts. SITA was established by a consortium of air carriers in an attempt to improve inter-airline communication and distribution. The Company was a founder in SITA, and accordingly, it had no cost basis in the depository certificates that it owns beyond the cost that it paid periodically for the performance of services. Those costs were previously expensed in the Company's financial statements.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

7. Investment Securities (continued)

During 2000, SITA undertook efforts to monetize its holdings in Equant. In December 2000, SITA entered into an agreement with France Telecom whereby it agreed to exchange its Equant shares for shares of France Telecom. The closing of this transaction is subject to certain regulatory and other approvals, but is generally anticipated to occur during the Summer of 2001. At that time, or shortly thereafter, the Company hopes that its holdings will be liquidated in the open market, subject to certain restrictive provisions in the agreement between SITA and France Telecom. To the extent that the securities are not liquidated at that time, the Company would receive freely traded shares of France Telecom within seven months of the closing of the transaction.

Certain restrictions on the Company's ability to dispose of the depositary certificates have historically existed, and accordingly the investment securities were previously considered long-term by nature. However, the Company now believes that it is more likely than not that the France Telecom transaction will close during the Summer of 2001 and that it will liquidate its holdings before December 31, 2001. Accordingly, it has reclassified its SITA depositary certificates from long-term to current, and has recorded unrealized income of approximately \$565,000 in its statement of operations for the year ended December 31, 2000. SITA related income has been recorded as a component of operations as the previous dues paid to SITA were also included in operations.

To the extent that the Company liquidates its SITA holdings during 2001 it is committed to deposit an amount equal to the net proceeds with Boeing in connection with an aircraft purchase agreement which is discussed in Note 12.

8. Borrowings

Borrowings consisted of the following at December 31:

	2000	1999
First Ukrainian International Bank	\$ -	\$ 2,665
Austrian Airlines	3,500	3,000
Swiss Air	2,500	-
Debis AirFinance Ireland plc.	965	1,200
Other	198	1,095
	<u>7,163</u>	<u>7,960</u>
Non-current portion of borrowings	<u>(5,653)</u>	<u>(5,357)</u>
Current portion of borrowings	<u>\$ 1,510</u>	<u>\$ 2,603</u>

In March 1998, the Company entered into a loan agreement for \$3.00 million with Austrian Airlines. Repayment of the loan was to occur over a 24 month period commencing in November 1998, along with interest at a rate of 10% per annum. Between that time and December 31, 2000 the Company made approximately \$2.00 million in principal payments on this obligation. This agreement has been amended two times. The last amendment, dated December 2000, provides for the repayment of remaining borrowings at a rate of \$200,000 per month beginning in February 2001 and ending June 2001.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

8. Borrowings (continued)

In January 2000, the Company entered into an additional loan agreement for \$2.50 million with Austrian Airlines. Underlying borrowings bear interest at a rate of 9% per annum and are repayable \$100,000 on January 15, 2002, and then \$200,000 monthly from February 2002 through January 2003.

In December 31, 1999, the Company entered into a loan agreement for \$2.50 million with Swissair Swiss Air Transport Company Ltd., an affiliate of one of the Company's shareholders. Borrowings were received by the Company in January 2000. The borrowings bear interest at a rate of LIBOR plus 3% per annum, and are repayable on December 31, 2002.

The Company entered into a loan agreement with Debis AirFinance Ireland plc (formerly GPA Group plc) in August 1998 for the amount of \$1.50 million. The borrowing is repayable in equal monthly installments of \$48,400, including interest at a rate of 10% per annum through October 2002.

During the year ended December 31, 2000 the Company repaid in full borrowings from First Ukrainian International Bank ("FUIB"). Those borrowings bore interest at a rate of 18% per annum.

The future maturity of borrowings are as follows as of December 31, 2000:

2001	1,510
2002	5,453
2003	<u>200</u>
Total	<u>\$ 7,163</u>

Subsequent to December 31, 2000 the Company entered into additional loan agreements. The first agreement was entered into with FUIB in the amount of \$0.50 million, bearing interest at a rate of 16% and due in March 2002. The second borrowing was with UkrSotsBank in the amount of \$2.50 million. That borrowing bears interest at a rate of 14%, is secured by spare parts inventory and is also due in March 2002. Both borrowings were made for working capital purposes.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

9. Income Taxes

Ukraine is the only tax jurisdiction in which the Company's income is subject to tax.

The following is a reconciliation of the income tax expense to the amount that would arise by applying 30% to the loss before income taxes reported in the accompanying financial statements for the year ended December 31:

	2000	1999
Expected income tax benefit	\$ (109)	\$ (829)
Permanent differences and other, net	847	1,077
Temporary differences not recognized as measured by the change in the valuation allowance for deferred tax assets and deferred tax liabilities not recorded	(738)	(248)
Income tax expense	\$ --	\$ -

Deferred tax assets and liabilities, calculated by applying the statutory tax rate of 30% in effect at the balance sheet date to the temporary differences between the tax basis of assets and liabilities and the amounts reported in the accompanying financial statements, consisted of the following at December 31:

	2000	1999
Deferred tax assets, arising from:		
Accounts receivable, due to the provision for uncollectible amounts	\$ 174	\$ 91
Accrual of revenue and expenses, net	192	147
Tax loss carry-forwards	446	353
	812	591
Deferred tax liabilities, arising from:		
Long-term assets, differences in depreciation and UAH currency devaluation	(635)	(578)
Deferred passenger revenues	(902)	-
	(1,537)	(578)
Total	(725)	13
Valuation allowance	-	(13)
Net deferred liability not recorded	\$ (725)	\$ -

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

9. Income Taxes (continued)

For Ukrainian income tax purposes the Company has accumulated losses of approximately UAH 8.07 million as of December 31, 2000 which may be carried forward to offset and reduce the Company's future taxable income, if any. The US Dollar value of the tax loss benefit will be eroded by any further devaluation in the UAH and expire in varying increments through 2005. Specific expirations are as follows:

	UAH'000
2003	3,024
2004	3,106
2005	1,944
	<u>8,074</u>

Deferred tax liabilities have arisen in 2000 principally as a result of the differences between the value of assets for IAS financial reporting purposes and the base value for Ukrainian tax purposes. The reason for the liability is as a primarily the result of the devaluation of the UAH with respect to the US Dollar over the past three years. The tax base value is defined in UAH and is therefore significantly reduced in real terms, as a result of the devaluation. This results in reduced depreciation allowances available to the Company for future years and therefore increased tax liabilities in accordance with Ukrainian Corporate Profits Tax law. Deferred tax liabilities have also arisen due to the timing of the recognition of the Company's passenger traffic revenues under IAS as compared to under Ukrainian tax purposes. In accordance with International Accounting Standard No. 12 *Income Taxes*, the increased liability is recognised in the year in which it arises.

The Company has decided not to make provision for deferred tax liabilities. A provision would result in a deferred income tax expense of approximately \$0.725 million during the year ended 31 December 2000. It would result in a deferred tax liability as of December 31, 2000 as set forth above.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

10. Charter Capital

The Company's initial charter capital was consisted of 490,000 shares of common stock with a par value of \$100 per share.

During December 2000, the Company issued preference shares to EBRD in exchange for \$5.4 million. The preference shares also have a par value of \$100 per share, and have preference over common shares with respect to dividends. The Company is to pay dividends on these preference shares annually on December 14, commencing in 2001. Dividends are to be computed based on the US Dollar denominated charter capital contribution. The dividends are computed using a fixed rate comparable to the five year interest rate available to EBRD in the interest swap and option market rate on the day of the dividends disbursement. Dividend payments are not contingent upon the profitability of the Company.

An agreement also exists between EBRD and certain other Company shareholders with respect to EBRD's eventual exit strategy for its investment. The Company, however, is not party to that agreement.

Charter capital of the Company consisted of the following as of December 31:

	2000	1999
State Property Fund of Ukraine	\$ 33,500	\$ 33,500
UIA Beteiligungsgesellschaft GmbH	12,250	12,250
AerFi	3,250	3,250
EBRD	5,400	-
	<u>\$ 54,400</u>	<u>\$ 49,000</u>

In accordance with Ukrainian legislation, the Company can distribute all statutory profits as dividends or transfer them to reserves as specified in the Company's charter. The subsequent use of amounts transferred to reserves may be legally restricted; amounts transferred to reserves typically must be used for the purpose designated when the transfer is made. Dividends are normally only declared from current earnings as shown in the Ukrainian statutory financial statements, not out of amounts previously transferred to reserves. As of December 31, 2000 and 1999, there were no statutory retained earnings available for distribution.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

11. Related Party Transactions

In November 1997, a contract was signed to lease two Boeing 737-300 aircraft from February 1998 and April 1998, respectively. Austrian Airlines Lease and Finance have guaranteed these lease payments up to a maximum of \$1.50 million. The Company pays Austrian Airlines a fee for this facility. A total of \$120,000 was paid during the years ended December 31, 2000 and 1999. These amounts were expensed as incurred. The Company has secured these guarantees with a deposit of \$527,000.

In December 1997 the Company signed lease agreement with Austrian Airlines to lease one Boeing 737-300. The Company has guaranteed the lease payments with a deposit of \$900,000.

The Company has various borrowings and borrowing commitments from shareholders and affiliates. These arrangements are discussed in Notes 8.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies

Lease Commitments

The future minimum lease payments required under non-cancelable operating leases with terms greater than one year beyond the balance sheet date consisted of the following at December 31, 2000:

	Gross Commitment	Sublease	Net Commitment
2001	11,304	(2,820)	8,484
2002	9,034	(705)	8,329
2003	3,611	-	3,611
2004	705	-	705
	<u>\$ 24,654</u>	<u>\$ (3,525)</u>	<u>\$ 21,129</u>

In addition to lease rental payments, the Company pays a per flight hour supplemental rent with respect to the heavy overhaul of the airframe, engines and landing gear to lessors. Rentals under operating leases are charged to operations over the lease term. Total aircraft leasing costs were approximately \$12.25 million and \$12.17 million during the years ended December 31, 2000 and 1999, respectively.

Airplane Purchase Commitment

In 1997 the Company signed an agreement to purchase a Boeing 737-700. Deposits of approximately \$867,000 has been paid to Boeing. The amended agreement dated June 2000 provides for delivery in February 2003, and a payment schedule as presented below - although certain discounts and concessions have been negotiated which will further reduce the total payment:

2001	2,523
2002	2,067
2003	<u>36,921</u>
	<u>\$ 41,511</u>

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

Recoverability of Accounts Receivable

During 1999 the Company entered into daily lease agreements regarding the short term lease of a 737-300 aircraft prior to the negotiation of the long term lease for that aircraft which is currently in place. A dispute arose with the daily lessee with respect to approximately \$77,000 in value added taxes ("VAT"). The Company had previously paid these amounts to tax authorities, though the customer later refused to acknowledge the amounts as being due. The Company arbitrated this matter through the courts and eventually lost its case. Accordingly, in May 2001 the Company amended its April 2001 VAT return so as to obtain an offset (recovery) for the amount previously paid. While the Company believes that it has a position for the recovery based on the arbitration court ruling, it acknowledges of the tax regime in which it operates and accordingly no assurances can be provided with respect to the ultimate recovery of these amounts. No reserves have been established related to these in the accompanying financial statements.

Noise and Emissions Restrictions

The International Civil Aviation Organization recommended that the European Civil Aviation Committee approve special regulations which essentially abolish certain flights into certain European airports due to noise restrictions. These restrictions which come into force in 2002 will result in 737-200 aircraft (for which the Company has two under lease) not being able to fly into many cities in western Europe.

The Company's leases commitments on both 737-200 aircraft expire prior to the start of the regulations. The Company is in the process of negotiating with the owners of the aircrafts that the owners would install (at the cost to the owners) "hush kits" on the aircraft to the extent that the lease agreements are to be extended. Commitment has been received from one owner. The Company believes that this plan of action would result in no impairment with respect to any 737-200 specific spare parts in stock.

In addition to noise restrictions, certain European cities are also currently considering emissions restrictions which could also prohibit 737-200 flights. These restrictions are not currently in place. The Company intends to attempt to negotiate "force majeure" clauses related to emissions standards in any new 737-200 leases that it signs.

General Contingencies

The Ukrainian economy displays emerging market characteristics. These characteristics include high inflation, lack of liquidity in the capital markets, and the existence of currency controls which causes the national currency to be illiquid outside of Ukraine. The success and stability of the Ukrainian economy will be significantly impacted by the government's actions with regard to supervisory, legal, and economic reforms.

Legislation and regulations regarding taxation and foreign currency transactions in Ukraine continue to evolve as the government manages the transformation from a command to a market-oriented economy. The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities, the National Bank of Ukraine and Ministry of Finance. Instances of inconsistent opinions are not unusual.

Ukraine International Airlines

Notes to Consolidated Financial Statements (continued)

12. Commitments and Contingencies (continued)

The current regime of penalties and interest related to reported and discovered violations of Ukraine's laws, decrees and related regulations are severe. Fines are levied when an understatement of tax liability is discovered by the tax administration at a rate of 30% to 100% of the understatement. Interest is assessable at a rate of 120% of the National Bank of Ukraine discount rate. As a result, penalties and interest can result in amounts that are multiples of any unreported taxes.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management's best estimate. The Company's policy is to accrue for contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable. No such accruals have been made as of December 31, 2000.

There is some uncertainty under the current legislation as to the tax consequences related to certain transactions, in particular the recognition of deferred revenue and the application of VAT and withholding tax to offshore aircraft lease and other payments. The Company is reviewing these transactions and has considered the actions that are necessary and possible to mitigate these uncertainties. Due to these uncertainties and because the Company has not yet been questioned by the tax authorities in relation to the particular income and payments, management are currently unable to determine the potential amount of additional taxes, if any. However, there can be no assurances that these issues will not be questioned by the tax authorities and, if the tax authorities apply certain interpretations of the legislation, these issues could result in the assessment of additional taxes and penalties.

Because of the uncertainties associated with the Ukrainian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of December 31, 2000.