OAO Scientific Production Corporation “IRKUT”

Consolidated Financial Statements

December 31, 2002 and 2001

(with Independent Auditors’ Report thereon)

KPMG Limited

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Independent Auditors' Report

To the Board of Directors of OAO Scientific Production Corporation "IRKUT"

We have audited the accompanying consolidated balance sheet of OAO Scientific Production Corporation "IRKUT" and its subsidiaries ("the Group") as of 31 December 2002 and the related consolidated statements of operations, stockholders equity and cash flows for the year then ended. The consolidated financial statements, as set out on pages 3 to 24, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit. The examination of certain underlying documentation on sales, cost of sales, inventories and fixed assets were performed by another auditor due to the circumstances described in Note 1 (d) to the consolidated financial statements. Our audit opinion, insofar as it relates to the examination of such documentation, is based on the work of this auditor. The consolidated financial statements of the Group as of and for the year ended 31 December 2001 were audited by another auditor whose report dated 26 February 2002 and 3 November 2003 expressed a qualified opinion on those financial statements because this auditor was unable to satisfy themselves regarding inventory quantities as of 31 December 2001 and their related effect on the net income for the year then ended.

Except as described in the following paragraph, 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.

Because we were not appointed auditors of the Group until after 31 December 2001, we were not able to observe the counting of the physical inventories at that date or satisfy ourselves concerning those inventory quantities by alternative means. The amount of inventories at 1 January 2002 enters into determination of the consolidated financial position, results of operations and cash flows.

In our opinion, based on our audit as described in the first paragraph, and except for the effects on the consolidated financial statements, if any, of the matter referred to in the preceding paragraph, the consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of OAO Scientific Production Corporation "IRKUT" and its subsidiaries as of 31 December 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG Limited
November 3, 2003
Moscow, Russian Federation

OAO Scientific Production Corporation "IRKUT"
Consolidated Balance Sheets as of December 31, 2002 and 2001
(Thousands of US dollars)

	Note	December 31, 2002	December 31, 2001
ASSETS			
Current assets			
Cash and cash equivalents	4	22,217	122,413
Short-term investments	5	71,438	58,566
Accounts receivable, net of allowance for doubtful accounts of US$ 925 (December 31, 2001: US$ 1,053)	6	39,806	10,221
Taxes and other receivables	7	95,878	42,883
Inventories	8	206,875	104,294
Prepaid expenses and other current assets		2,188	3,443
Deferred income taxes, short-term	15	2,074	17,959
Total current assets		**440,476**	**359,779**
Property, plant and equipment	9	152,653	132,830
Intangible assets		2,983	543
Long-term investments	10	31,133	28,972
Deferred income taxes, long-term	15	6,873	6,692
Total assets		**634,118**	**528,816**
LIABILITIES, STOCKHOLDERS' EQUITY AND MINORITY INTEREST			
Current liabilities			
Short-term borrowings	12	460,330	246,167
Accounts payable, trade		18,312	80,207
Advances received		851	2,124
Accrued liabilities		8,186	14,754
Income and other taxes payable		8,533	10,678
Other current liabilities, third parties		4,430	4,482
Other current liabilities, related parties		272	1,570
Total current liabilities		**500,914**	**359,982**
Long-term borrowings	12	104,393	136,045
Total liabilities		**605,307**	**496,027**
Minority interest		**890**	**3,826**
Commitments and contingencies	19		
Stockholders' equity	11		
Common stock		84,183	29,004
Treasury stock, at cost		-	(7,015)
(Accumulated losses)/Retained earnings		(56,262)	6,974
Total stockholders' equity		**27,921**	**28,963**
Total liabilities, stockholders' equity and minority interest		**634,118**	**528,816**

The consolidated financial statements as set out on pages 3 to 24, were approved by the Group's management on November 3, 2003.

Senior Vice-President
Tsivilev S.V.

The accompanying notes are an integral part of these consolidated financial statements.

OAO Scientific Production Corporation "IRKUT"
Consolidated Statements of Operations for the years ended December 31, 2002 and 2001
(Thousands of US dollars)

	Note	2002	2001
Sales and other operating revenues	13	528,481	308,146
Cost of products and services	14	(343,903)	(229,872)
Gross profit		**184,578**	**78,274**
Research and development costs		(29,802)	(11,986)
Taxes other than on income		(7,712)	(7,668)
Selling, general and administrative expenses		(46,896)	(14,348)
Social expenditure		(5,755)	(6,927)
Repairs and maintenance		(4,828)	(4,697)
Other operating income and expenses, net		(1,228)	(1,318)
Operating income		**88,357**	**31,330**
Interest expenses, net		(72,588)	(38,375)
Loss from investments		(1,471)	(1,888)
Share in losses of associates		(1,483)	(316)
Foreign exchange loss		(3,539)	(1,577)
Income (loss) before taxes and minority interest		**9,276**	**(10,826)**
Income taxes			
Current tax expense	15	(1,728)	(4,577)
Deferred tax (expense)/credit	15	(15,704)	10,767
Total tax expense/(credit)		**(17,432)**	**6,190**
Loss before minority interest		**(8,156)**	**(4,636)**
Minority interest		348	2,068
Net loss		**(7,808)**	**(2,568)**

The accompanying notes are an integral part of these consolidated financial statements.

OAO Scientific Production Corporation "IRKUT"
Consolidated Statements of Cash Flows for the years ended December 31, 2002 and 2001
(Thousands of US dollars)

	Note	2002	2001
Net cash used for operating activities	16	**(235,717)**	**(14,580)**
Investing activities			
Capital expenditure		(34,771)	(15,431)
Loans repaid by/(advanced to) third parties		10,297	(982)
Net cash received from disposal/(used for acquisition) of trading equity securities		1,031	(13,859)
Cash used for acquisition of subsidiary and associate		(8,473)	(3,672)
Net cash used for investing activities		**(31,916)**	**(33,944)**
Financing activities			
Loans received, third parties		355,496	399,442
Repayment of loans, third parties		(186,398)	(228,720)
Loans received, related parties		-	2,294
Repayment of loans, related parties		-	(3,295)
Dividends paid		(171)	-
Net cash received from financing activities		**168,927**	**169,721**
Effect of exchange rate changes on cash and cash equivalents		(1,490)	(1,247)
Net change in cash and cash equivalents		**(100,196)**	**119,950**
Cash and cash equivalents at the beginning of the year		**122,413**	**2,463**
Cash and cash equivalents at the end of the year		**22,217**	**122,413**
Supplemental cash flow information			
Interest paid		(75,187)	(36,354)
Income taxes paid		(3,332)	(10,149)

The following non-cash transactions were excluded from investing and financing activities:

	2002	2001
Non-cash investing activities		
Acquisition of securities	(37,172)	(91,673)
Total non-cash investing activities	**(37,172)**	**(91,673)**
Non-cash financing activities		
Issue of promissory notes	37,172	91,673
Total non-cash financing activities	**37,172**	**91,673**

The accompanying notes are an integral part of these consolidated financial statements.

OAO Scientific Production Corporation "IRKUT"
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2002 and 2001
(Thousands of US dollars)

	Capital stock	Treasury stock	Retained earnings/ (accumulated losses)	Total
Balance at January 1, 2001	**29,004**	**(7,015)**	**9,542**	**31,531**
Net loss	-	-	(2,568)	(2,568)
Balance at December 31, 2001	**29,004**	**(7,015)**	**6,974**	**28,963**
Dividends	-	-	(249)	(249)
Increase of par value of shares	55,179	-	(55,179)	-
Disposal of subsidiary (Note 3)	-	7,015	-	7,015
Net loss	-	-	(7,808)	(7,808)
Balance at December 31, 2002	**84,183**	**-**	**(56,262)**	**27,921**

The accompanying notes are an integral part of these consolidated financial statements.

(Thousands of US dollars, except as indicated)

Note 1. BACKGROUND

(a) Organization and operations

OAO Scientific Production Corporation "IRKUT" ("the Company") was formed as an open joint stock company following the President Decree and State Privatization Programme of 1992. The principal activity of the Company is the construction of military aircraft under contracts with Russian and foreign governments. In accordance with Russian legislation the supply of military equipment to foreign government is the competence of the Russian government and, therefore, all contracts with foreign governments are concluded through the Russian state organization FGUP "Rosoboronexport". The Company's operations are subject to licenses for production and repair of aviation equipment awarded by FGUP "Rosaviacosmos". The current license is valid until April 2007.

The Company and its subsidiaries ("the Group") are also engaged in research and development works for military and civil aircraft. This research and development is carried out for the Group's own purposes. In addition, starting from 1991 the Group commenced development of the Be-200 amphibian aircraft for fire fighting and certification for such use was received in August 2001. Currently the Company is in the process of obtaining full certification for other uses, which is a requirement for serial production. In 2000 the Company concluded a contract for the supply of seven civil aircraft with the Russian Ministry for Emergencies.

In 2000 FGUP "Rosoboronexport", acting as the Company's agent, concluded a general license agreement with a foreign government for the production of military aircraft. This agreement involves the supply of technical documentation and equipment and provision of relevant services to launch the production of military aircraft. With the framework of this agreement, the Company has signed a contract for the supply of technical documentation. Other contracts are under negotiation.

(b) Ownership, subsidiaries and associates

The main stockholders of the Company are state owned enterprise OAO OKB Sukhogo, DCL-KF Corporation, Fenway Services Corporation, StradeBroke Trading Limited, ZAO Company FTK, ZAO Aerocom, ZAO Ornatus and ZAO FTK-Invest.

The entities of the Group, included in these consolidated financial statements are as follows:

Name	Principal activities	Ownership interest	
		31 December 2002	31 December 2001
Subsidiaries			
ZAO Beta-Air	Development of Be-200	66%	71%
ZAO Russian Avionics (in 2002 only)	Research and Development	51%	27%
ZAO Company FTK (in 2001 only)	Finance and Investment	9%	56%
ZAO FTK-Invest (in 2001 only)	Finance and Investment	-	-
Associates			
OAO TANTK Imeni Berieva	Research and development	43%	20%

ZAO FTK-Invest was effectively controlled by the Company through control of ZAO Company FTK and management arrangements, and was therefore consolidated in the financial statements in 2001.

(c) Russian business environment

The Russian Federation has been experiencing political and economic change, which has affected and may continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

The accompanying financial statements reflect management's assessment of the impact of the business environment in the countries in which the Group operates on the financial position of the Group. The impact on the Group of the current and future business environments may differ from management's assessment and such differences may be significant.

(d) State Secrets

The operations of the Group related to the construction and sale of military aircraft are subject to the Law of the Russian Federation on State Secrets signed by the President of the Russian Federation on July 21, 1993. This Law provides that the information on the foreign economic activities of the Russian Federation, disclosure of which can cause damage to the security of the country, is considered a state secret. Access to information classified as a state secret can be granted by the appropriate authorities only to organizations and individuals holding security licenses with the appropriate form of clearance. In addition, part of the property, plant and equipment of the Company makes up the mobilization capacity of the state and is also subject to the Law on State Secrets. The law also limits the authority of the Company to dispose of those assets.

(e) Basis of preparation

The Group maintains its accounting records in accordance with the legislative requirements of the Russian Federation. The consolidated financial statements have been prepared from those accounting records and adjusted as necessary to comply, in all material respects, with the requirements of accounting principles generally accepted in the United States of America ("US GAAP").

(f) Going concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment. The accompanying consolidated financial statements do not include any adjustments should the Group be unable to continue as a going concern.

The Group's current liabilities exceeded current assets by US$ 60,438 at December 31, 2002. The Group had a net loss of US$ 7,808 in 2002. The ultimate realization of the Group's assets and its long-term liquidity will be impacted by its operating success. To the extent cash flow from operations is insufficient to fund future capital expenditures, additional sources of equity or debt financing may be necessary or the Group may need to curtail its operations. Subsequent to December 31, 2002 the Company received a loan from Sberbank for US$ 193,000 maturing in 2005, as described in Note 20, which, with its other capital resources, was sufficient to meet the current portion of its December 31, 2002 obligations as they became due in 2003.

(g) Risks and Concentrations

Certain aircraft components and development services necessary for the Group's operations are available from a limited number of suppliers. The Group's activity is dependant upon the ability of such suppliers to continue as a going concern. At December 31, 2002 management does not foresee any counterparts failing to meet their obligations to supply goods and services to the Group.

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions which affect reported amounts of assets, liabilities, revenues and expenses. Eventual actual amounts could differ from such estimates.

Principles of consolidation

Subsidiary undertakings, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over the operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All significant intercompany transactions have been eliminated in consolidation.

Minority interest at the balance sheet date represents the minority stockholders' portion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in equity since the date of the consolidation. Minority interest is presented separately from liabilities and stockholders' equity.

Investments in associated undertakings are accounted for by the equity method of accounting. These are undertakings over which the Group generally has between 20% and 50% of the voting rights, or otherwise the Group has significant influence, but which it does not control. Unrealized gains on transactions between the Group and its associated undertakings are eliminated to the extent of the Group's interest in the associated undertakings; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Foreign currency and translation methodology

Because the economy of the Russian Federation is considered to be hyperinflationary, the US dollar is the functional currency of the Group in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "*Foreign Currency Translation*". For the purposes of presenting financial statements prepared in conformity with US GAAP, the US dollar is also the reporting currency of the Group.

Monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates, which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in the consolidated statements of operations.

Foreign currency transaction gains and losses are included in the consolidated statement of operations.

As of December 31, 2002 and 2001, exchange rates of 31.78 and 30.14 Russian rubles, respectively to the US dollar have been used for translation purposes.

The Russian ruble is not freely convertible outside of the Russian Federation. Accordingly, the translation of amounts recorded in rubles into US dollars should not be construed as a representation that such currency amounts have been, could be or will in the future be converted into US dollars at the exchange rate shown or at any other exchange rate.

Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary in accordance with the provisions of SFAS No. 52. As a result, the Group has assessed its functional currency for its operations in the Russian Federation and determined that the US dollar should continue to be considered the functional currency for financial reporting beginning January 1, 2003. This is primarily due to the market in which the Group operates, the significance of operations and transactions conducted in US dollars, and the fact that management's measurement and decision making of the Group are based on US dollars. The US dollar will continue to be the reporting currency for the Group under US GAAP.

Classification of assets and liabilities

The operating cycle for aircraft construction contracts exceeds one year. Assets, which are reasonably expected to realize in cash or sold or consumed during the operating cycle of the business are shown under current assets. Liabilities whose liquidation is reasonably expected within the operating cycle of the business are also shown under current liabilities.

Revenue recognition and costs

The operations of the Group principally consist of building aircraft under fixed-price contracts. Revenues under such contracts are recognized on a percentage of completion basis, measured by the ratio of total direct materials and design and development costs incurred to date relative to the total estimated respective costs on the contract. This method is used because management considers this to be the best available measure of progress on the contracts.

Costs incurred in relation to the general license agreement concluded with foreign government are treated as work in process and are taken to cost of sales when the relevant milestones are achieved, at which time the related revenue is also recognized.

Contract costs are charged to cost of sales as incurred and include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, tools, repairs, and depreciation of property, plant and equipment. Selling, general, administrative costs are charged to expense as incurred. Marketing costs that are incurred for a specific contract may be included in contract costs, but only if the costs can be directly associated with a specific contract and if their recoverability from that contract is probable.

Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, contract conditions, and estimated profitability, including those arising from contract penalty provisions, if any, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Warranties

An accrual for warranty costs is recognized based on the Group's historical experience on previous deliveries of aircrafts. The accrual is recognized when the underlying products or services are sold. Estimates are adjusted as necessary based on subsequent experience.

Accounts receivable

Accounts receivable are stated at cost less allowance for doubtful accounts.

Cash and cash equivalents

The Group considers only those short-term, highly liquid investments with original maturity of 90 days or less to be cash equivalents, net of any restricted cash amounts.

Inventories

Inventories are carried at the lower of cost or market value. Inventories include amounts relating to programs and contracts with long production cycles, a portion of which is not expected to be realized within one year. The cost of aircraft components and general inventory materials are stated at average cost.

Construction work in progress is stated at cost plus earnings recognized to date, less an allowance for foreseeable losses and progress billings. Other work in progress comprises costs incurred on the license agreement (see Note 1 (a)) and work on sundry orders for aircraft components and spare parts.

Inventories are presented in the balance sheet net of advance payments received.

Property, plant and equipment

Property, plant and equipment are recorded at cost. Depreciation is recorded principally on the straight-line method at rates based on the estimated useful lives of the assets, which are as follows:

Buildings	40 – 50 years
Machinery and equipment	5 – 20 years

Profits or losses from the sale of assets are included in operating income.

Research and development costs

Research and development costs include design, construction and materials used in testing of pre-production prototypes and models. Such costs are expensed as incurred. Test planes, which have an alternative use are capitalized as fixed assets and depreciated over ten years, which is management's estimate of their useful life.

Long-lived assets

In accordance with SFAS No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets",* long-lived assets are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows.

Financial instruments

The fair value of financial instruments (cash and cash equivalents, short-term and long-term investments, accounts receivable, accounts payable and loans) is determined with reference to various market information and other valuation methods as considered appropriate. At December 31, 2002 and December 31, 2001 the fair values of financial instruments held by the Group did not materially differ from their recorded book values.

Investments

Investments include investments in debt and equity securities and investments in associated companies accounted for under the equity method. Investments in securities are classified into the three categories: held to maturity, available-for-sale and trading.

Trading securities are bought and held principally for the purpose of selling in the near term. Held-to-maturity securities are those securities in which a Group company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in the consolidated statement of operations. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividends and interest income are recognized in the consolidated statement of operations when earned.

A permanent decline in the market value of any available-for-sale or held-to-maturity security below cost is accounted for as a reduction in the carrying amount to fair value. The impairment is charged to the consolidated statement of operations and a new cost base for the security is established. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method and such amortization and accretion is recorded in the consolidated statement of operations.

Employee benefits

The Group, in the normal course of business, makes payments to the pension fund, medical insurance, employment fund and social insurance fund of the Russian Federation. These payments are expensed when incurred and included within personnel costs.

Income Taxes

Deferred income tax assets and liabilities are recognized in respect of future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income 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 reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of operations in the reporting period which includes the enactment date.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

Presentation of comparative information

Prior year amounts have been reclassified, where applicable, to conform with presentation for the current year.

Recently issued accounting standards

In July 2002, the FASB issued SFAS No. 146, *"Accounting for Costs Associated with Exit or Disposal Activities"*. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this statement are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Group does not expect any material impact of adopting SFAS No. 146.

In December 2002, the FASB issued SFAS No. 148, *"Accounting for Stock-Based Compensations – Transition and Disclosure"*. which amends SFAS No. 123, *"Accounting for Stock-Based Compensation"*. The standard permits two additional transition methods for entities that adopt the fair-value-based method of accounting for stock-based employee compensation and amends the disclosure requirements in both annual and interim financial statements. The Group is required to adopt SFAS No. 148 effective January 1, 2003. The Group does not expect any material impact of adopting SFAS No. 148.

In November 2002, the FASB issued Interpretation No. 45, *"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others"* ("Interpretation No. 45"), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. Interpretation No. 45 also requires recognition of a liability by a guarantor at the inception of certain guarantees.

Interpretation No. 45 requires the guarantor to recognize a liability for the non-contingent component of the guarantee, this is the obligation to stand ready to perform in the event that specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at inception. The recognition of the liability is required even if it is not probable that payments will be required under the guarantee or if the guarantee was issued with a premium payment or as a part of a transaction with multiple elements.

The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002 and are not expected to have a material effect on the Group's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, *"Consolidation of Variable Interest Entities"* ("Interpretation No. 46"), which addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The Group does not expect any significant impact on the Group's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, *"Amendment of Statement 133 on Derivative Instruments and Hedging Activities"*. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133 "*Accounting for Derivative Instruments and Hedging Activities"*. The Statement is effective for contracts entered into or modified after June 30, 2003, except for the provisions that relate to previously effective SFAS No. 133 Implementation issues, and for hedging relationships designated after June 30, 2003. The Group does not expect any material impact of adopting SFAS No. 149.

In May 2003, the FASB issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"*. SFAS No. 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Group does not expect any material impact of adopting SFAS No. 150.

Note 3. BUSINESS COMBINATIONS

In December 2001, ZAO Russian Avionics, the company which performs development of electronic navigation equipment for military aircraft, issued 15 ordinary shares all of which were purchased by the Company. As a result, the effective shareholding of the Group in ZAO Russian Avionics increased from 27% to 51%. The acquisition has been accounted for using the purchase method. The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair market values. The fair values did not materially differ from book values.

In January 2002, ZAO Company FTK, a former subsidiary of the Group, issued 155,532,143 ordinary shares all of which were purchased by third parties. As a result, the effective shareholding of the Group in ZAO Company FTK decreased from 56% to 9%. The Company's investment in ZAO Company FTK is recorded at cost and is included in "Long-term investments".

(Thousands of US dollars, except as indicated)

Note 4. CASH AND CASH EQUIVALENTS

	December 31, 2002	December 31, 2001
Cash at bank, US$ accounts	14,986	5,078
Cash at bank, Russian ruble accounts	7,231	117,335
Total cash and cash equivalents	**22,217**	**122,413**

As of December 31, 2002 the Group had cash and cash equivalents of US$ 5,042 on deposit with related party bank.

Note 5. SHORT-TERM INVESTMENTS

	December 31, 2002	December 31, 2001
Debt securities, available-for-sale	64,193	45,887
Loans to related parties	4,563	3,822
Loans to third companies	1,817	6,961
Trading equity securities	865	1,896
Total short-term investments	**71,438**	**58,566**

As of December 31, 2002 promissory notes with a carrying value of US$ 42,796, included under debt securities, available-for-sale above, were pledged as collateral for the Group's liabilities.

In addition, the Group pledged promissory notes with a carrying value of US$ 8,358, included under debt securities, available-for-sale above, as collateral for the debt of OAO Ramenskoe Priborostroitelnoe KB, a third party.

Note 6. ACCOUNTS RECEIVABLE, NET

	December 31, 2002	December 31, 2001
Contracts in progress	33,953	-
Completed contracts	401	826
Other trade accounts receivable, third parties	6,377	9,434
Other trade accounts receivable, related parties	-	1,014
	40,731	11,274
Less: allowance for doubtful accounts	(925)	(1,053)
Total accounts receivable, net	**39,806**	**10,221**

(Thousands of US dollars, except as indicated)

Note 7. TAXES AND OTHER RECEIVABLES

	December 31, 2002	December 31, 2001
VAT recoverable	93,675	32,242
Prepaid taxes	37	5,827
Other receivables	2,166	4,814
Total taxes and other receivables	**95,878**	**42,883**

Note 8. INVENTORIES

	December 31, 2002	December 31, 2001
Advances to third parties	69,461	103,644
Advances to related parties	64,032	65,149
Aircraft components	39,268	37,461
Work in progress	10,351	11,416
General stock materials and other	31,201	26,883
Costs and earnings recognized on contracts in excess of billings	198,940	209,930
	413,253	454,483
Advance payments received	(206,378)	(350,189)
Total inventories	**206,875**	**104,294**

Inventories with a carrying value of US$ 90,155 are pledged as collateral for loans at December 31, 2002 (at December 31, 2001: US$ 38,454).

Note 9. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2002	December 31, 2001
Buildings, cost	142,650	145,798
Machinery and equipment, cost	206,514	204,924
Accumulated depreciation	(238,260)	(234,909)
	110,904	115,813
Construction in progress	23,652	10,089
Advances given for capital investments	18,097	6,928
Total property, plant and equipment	**152,653**	**132,830**

Depreciation expense related to property, plant and equipment in amount of US$ 14,399 for the year ended December 31, 2002 (2001: US$ 14,290) was included in "Cost of products and services" (refer Note 14).

(Thousands of US dollars, except as indicated)

The net book value of property, plant and equipment restricted for sale by the Russian government in accordance with the state military programme amounted to US$ 41,178 at December 31, 2002 (at December 31,2001: US$ 44,450).

Property, plant and equipment with a carrying amount of US$ 12,466 are pledged as collateral for secured loans at December 31, 2002 (at December 31,2001: US$ 7,545).

Note 10. LONG-TERM INVESTMENTS

	December 31, 2002	December 31, 2001
Investments in "equity method" affiliate	8,840	4,610
Loans to related parties	1,169	1,182
Loans to third parties	371	6,252
Equity securities, available-for-sale	20,753	16,928
Total long-term investments	**31,133**	**28,972**

Note 11. STOCKHOLDERS' EQUITY

Common stock

At the Company's annual stockholders meeting on June 19, 2002, stockholders approved a measure to increase the par value of authorized ordinary shares in aggregate from Russian rubles 0.8 to 3. At December 31, 2002 authorized, issued and fully paid capital stock consisted of 791,051,875 ordinary shares with a nominal value of Russian rubles 3 each.

Dividends and dividend limitations

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. At December 31, 2002 amounts available for distribution amounted to US$ 12,387 (December 31, 2001: US$ 2,122).

At the annual stockholders' meeting on May 30, 2003, dividends were declared for 2002 in the amount of Russian rubles 0.09 per common share, which at the date of the decision was equivalent to US$ 0.003.

(Thousands of US dollars, except as indicated)

Note 12. BORROWINGS

		December 31, 2002	December 31, 2001
Short-term borrowings			
Secured bank loans:	– US$, fixed at 8-13%	20,105	109,294
	– US$, variable at 8%	15,261	-
	– Russian rubles, fixed at 17%	4,090	67,420
Unsecured bank loans:	– US$, fixed at 10-14%	66,274	6,826
	– US$, variable at 14-15%	-	35,539
	– Russian rubles, fixed at 24-25%	-	3,196
Current portion of long-term secured bank loans:			
	– Russian rubles, fixed at 10-26%	222,876	-
	– US$, fixed at 12-13%	35,104	-
Current portion of long-term unsecured bank loans:			
	– US$, fixed at 19%	1,406	-
Unsecured bond issues:	– Russian rubles, fixed at 19%	68,168	-
Promissory notes:	– Russian rubles, fixed at 20%-25%	26,383	18,131
Other loans from third parties		663	5,761
Total short-term borrowings		**460,330**	**246,167**
Long-term borrowings			
Secured bank loans:	– US$, fixed at 10%	60,141	15,327
	– Russian rubles, fixed at 19%	44,252	116,725
Unsecured bank loans:	– Russian rubles, fixed at 19%	-	2,213
	– US$, fixed at 11%	-	1,780
Total long-term borrowings		**104,393**	**136,045**
Total borrowings		**564,723**	**382,212**

Details of significant loan balances are summarized below:

(a) Sberbank credit lines and other loans

The Group has non-revolving ruble denominated credit line agreements and other loan agreements with Sberbank. At December 31, 2002 the amount outstanding under these agreements was US$ 251,418, inclusive of interest. Borrowings under these agreements bear interest at fixed rates from 16% to 20%. Property, plant and equipment, aircraft components and accessories and other materials have been pledged as collateral against these credit lines and loans. The Group is obliged to insure all property, plant and equipment pledged under these agreements.

(Thousands of US dollars, except as indicated)

(b) Vneshtorgbank

The Group has a US$ denominated loan agreement with Vneshtorgbank for the amount of US$ 60,000. Borrowings under this loan bear fixed interest of 10%. At December 31, 2002 the amount outstanding under the loan agreement was US$ 60,141, inclusive of interest. The Group pledged the right to receive future revenues under the general license agreement with a foreign government.

(c) Rosbank

The Group has a US$ denominated loan agreement with Rosbank for the amount of US$ 56,000, which is unsecured and bears fixed interest of 10%. At December 31, 2002 the amount outstanding under the loan agreement was US$ 56,253, inclusive of interest.

(d) Alfa-Bank

The Group has three US$ denominated loan agreements with Alfa-Bank. At December 31, 2002 the amount outstanding under these agreements was US$ 40,092, inclusive of interest. Borrowings under these loans bear fixed interest of 13%. Inventory of non-ferrous metals and work in progress with a carrying value of US$ 28,962 has been pledged as collateral against these loans.

(e) Russian ruble bonds

During 2002, the Group issued 2,100,000 Russian ruble bonds with a face value of 1,000 Russian rubles each, maturing in 2005. The Group makes semi-annual interest coupon payments. Annual interest rate for the first coupon was 20.4%, for the second – 18.5%. Every time the Group changes the coupon interest, the offer is made to redeem outstanding bonds from the market. At December 31, 2002 the amount of outstanding bonds was US$ 68,168.

(f) Promissory notes

Starting in 2001, from time to time the Company issues promissory notes, which are traded in the local securities market, as means of financing its business.

Maturities of long-term debt

Annual maturities of total long-term debt, including the portion classified as current, are US$ 259,386 in 2003, US$ 21,014 in 2004, US$ 23,238 in 2005 and US$ 60,141 in 2006.

Note 13. SALES AND OTHER OPERATING REVENUES

	2002	**2001**
Revenue earned on military aircraft construction contracts	444,327	285,663
Revenue earned on civil aircraft construction contracts	8,790	7,189
Revenue on sales of aircraft components and related products	48,991	4,871
Other operating revenues	26,373	10,423
Total sales and other revenues	**528,481**	**308,146**

(Thousands of US dollars, except as indicated)

Note 14. COST OF PRODUCTS AND SERVICES

	2002	2001
Cost of aircraft components and other materials	238,052	152,497
Personnel costs	26,240	27,854
Depreciation	14,399	14,290
Design and development, third party	4,238	9,757
Design and development, related party	36,573	5,145
Energy and utilities	7,202	4,359
Insurance	3,325	1,681
Warranty repairs	631	4,436
Cost of other goods and services	13,243	9,853
Total cost of products and services	**343,903**	**229,872**

In 1997 the Group contracted OAO OKB Sukhogo, a principle stockholder of the Company, to develop the design of the SU-30 MKI aircraft for supply under the contract with a foreign government. Expenses incurred by the Group on this contract in 2002 and 2001 are disclosed in the line "Design and development, related party". The balances of prepayments made by the Group to OAO OKB Sukhogo for work to be performed in future periods were US$ 46,849 as of December 31, 2002 and US$ 62,611 as of December 31, 2001.

Note 15. INCOME TAXES

The Group calculated deferred income taxes in accordance with SFAS No. 109, *"Accounting for Income Taxes"*, applying the specific provisions for foreign companies using the US$ as the reporting currency. In accordance with SFAS No. 52 and SFAS No. 109 deferred tax assets and liabilities are not recognized for exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with SFAS No. 109, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

(Thousands of US dollars, except as indicated)

The following table sets out the tax effects of major types of temporary differences which give rise to deferred income tax assets and liabilities:

	December 31, 2002	December 31, 2001
Inventory and cost of sales	10,297	25,965
Unrealized foreign exchange losses	31,068	32,272
Prepaid expenses	16,179	25,741
Other differences	1,774	1,180
Deferred income tax assets	**59,318**	**85,158**
Contract revenue recognized in excess of billings	(47,746)	(50,383)
Accruals	(77)	(8,604)
Allowance for doubtful collections	(1,499)	-
Other differences	(1,049)	(1,520)
Deferred income tax liabilities	**(50,371)**	**(60,507)**
Net deferred income tax assets	**8,947**	**24,651**

The reconciliation between the income tax expense and taxes determined by applying the statutory tax rate to income before income taxes and minority interest is presented below:

	2002	2001
Income/(loss) before income taxes, and minority interest	9,276	(10,826)
Statutory income tax rate	24%	35%
Theoretical income tax (expense)/credit at statutory rate	(2,226)	3,789
Decrease/(increase) due to:		
Non-taxable income /Non-deductible expenses, net	(15,206)	(9,640)
Change in treatment of unrealized foreign exchange losses for tax purposes (refer below)	-	20,256
Capital allowance	-	2,898
Effect of change in the tax rate	-	(11,113)
Income tax expense	**(17,432)**	**6,190**

In 2001 the Company revised its treatment, for tax purposes, of ruble unrealized foreign exchange losses on US$ advances received from customers from 1998 to 2001. As a result of this, a deferred tax asset in relation to unrealized losses available for offset against future taxable profits was recognized at December 31, 2001 of US$ 32,272. Prior to this, only exchange losses, which accrued in the period between August 1, 1998 and December 31, 1998 could be carried forward for tax purposes.

(Thousands of US dollars, except as indicated)

Note 16. CASH USED FOR OPERATING ACTIVITIES

Reconciliation of net loss to cash used for operating activities:

	2002	2001
Net loss	(7,808)	(2,568)
Adjustments to reconcile net loss to cash used for operating activities:		
Depreciation	14,399	14,290
Change in deferred income taxes	15,704	(10,928)
Change in provision for warranty repairs	(6,568)	2,432
Change in provision for taxes	(2,145)	(8,945)
Minority interest	(348)	(2,068)
Loss from investments	1,471	1,888
Share in losses of associates	1,483	316
Foreign exchange differences	(3,403)	(2,967)
Changes in operating working capital:		
(Increase)/decrease in receivables	(82,580)	15,398
Increase in inventories	(102,581)	(13,797)
Decrease/(increase) in prepaid expenses and other current assets	1,255	(10,429)
Decrease in accounts payable, trade	(61,895)	(5,983)
(Decrease)/increase in advances received	(1,273)	1,129
(Decrease)/increase in other current liabilities	(1,428)	7,652
Cash used for operating activities	**(235,717)**	**(14,580)**

Note 17. BACKLOG ON CONSTRUCTION CONTRACTS

	December 31, 2002	December 31, 2001
Balance at the beginning of the year	1,067,873	1,360,725
Foreign currency adjustment	(6,702)	-
Contract revenue recognized	(453,117)	(292,852)
Balance at the end of the year	**608,054**	**1,067,873**

Note 18. RELATED PARTY TRANSACTIONS

Related party transactions are disclosed on the face of each primary consolidated financial statement and in the corresponding notes to the financial statements.

In addition, the Group contracted OAO TANTK Imeni Berieva to perform research and development works related to Be-200 amphibian aircraft. In the year ended December 31, 2002 the expenses incurred in relation to this project, included in the line "Research and development costs" of the Consolidated Statement of Operations, were US$ 5,708 (US$ 1,496 in the year ended December 31, 2001). As at December 31, 2002 the Group held 43% of the shares of OAO TANTK Imeni Berieva (as at December 31, 2001: 20%).

Note 19. COMMITMENTS AND CONTINGENCIES

Capital commitments

As of December 31, 2002 the Group is committed to capital expenditure of approximately US$ 3,052 (as of December 31, 2001: US$ 15,395).

Purchase commitments

Commitments with third parties for the supply of aircraft components and services in 2003 under long-term supply agreements are estimated at US$ 180,529 at current market prices (as of December 31, 2001: US$ 195,273).

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes, occurring frequently. Furthermore, the interpretation of such legislation by the authorities as applied to the transactions and activity of the Group may not coincide with that of management. As a result, such authorities may challenge certain transactions.

The Group is involved in a number of disputes with tax authorities. Based on results of the recent tax audits tax authorities claim US$ 23,750 of additional tax payments. Management believes that these disputes will be resolved without significant loss to the Group and, accordingly, no provision has been made for these liabilities.

Environmental contingencies

Governmental authorities are continually considering environmental regulations and their enforcement and the Group periodically evaluates its obligations related thereto. As obligations are determined, they are recognized immediately. The outcome of environmental liabilities under proposed or any future legislation, or as a result of stricter enforcement of existing legislation, cannot reasonably be estimated. Under current levels of enforcement of existing legislation, management believes there are no liabilities, which will have a materially adverse effect on the financial position or the operating results of the Group.

Note 20. SUBSEQUENT EVENTS

On June 6, 2003 the Group signed a US$ 193,000 non-revolving credit line agreement with Sberbank maturing in 2005. Borrowings under this agreement are made in Russian rubles and bear a fixed interest rate of 10%. The loan was used by the Group to refinance its current obligations.

On August 5, 2003 an agreement was signed to sell Su-30MKM aircrafts to the Malaysian air force. The contract provides that aircrafts are to be constructed by the Group. The contract also contains conditions to provide after-sale service, aircraft modernization and pilot training.

On August 20, 2003 the Group announced the plan to create a joint venture with EADS. The main purpose of the joint venture will be market research and promotion of Be-200 amphibian aircraft on the European market.

On August 20, 2003 the Group and OAO OKB Imeni Yakovleva announced a merger. The merged company will promote the Yak-130, an aircraft which won the tender to be the combat-training aircraft for the Russian air force.