



“Avialeasing” Company

Annual Report

of Closed Joint-Stock Company (ZAO)

“Avialeasing” Perm Investment & Finance Company”

for 2005

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Address of the General Director



The main objective of the Company in 2005 was to establish a technical and finance base to develop the leasing market of Tu-154M, new to the Company. Considerable efforts were taken for this purpose during 2005 to study demand and supply of this type of aircrafts in the market, new to us. Concurrently, investment project portfolios, feasibility studies and initial data for project financing were prepared.

The aim set for the reporting period of 2005 was reached. Moreover, in the reporting year two projects for Tu-154M aircrafts were prepared and by the beginning of 2006 the planes were delivered for operation to "UTair" Aviation. Thus, it can be safely forecasted that over 2006 the Company will make considerable progress in implementing new projects and establishing an economic base for the nearest years to change over to operations with foreign-made aircrafts and new generation domestic aircrafts.

In 2006 the Company plans to implement four projects with the Tu-154M aircrafts and work out two leasing projects for Boeing-737 for one of the biggest Russian companies in order to implement them in 2007.

Let me thank all our partners on behalf of all Company workers and voice our confidence in fruitful and mutually beneficial cooperation in the future.

General Director of
ZAO "Avialeasing" Company

signature

O.L. Kislukhin

1. Economic Situation in the Air Traffic Market in 2005

In 2005 the Russian air traffic market moved to a new development stage. Over the last five years, stable growth of demand led to about 10% increase in transportation volume, which, in turn, made it possible for the airlines to define their positions more clearly and improve both production and finance figures. However, in 2005, according to Federal Aviation Transport Agency (FAVT), the number of passengers transported by the Russian civil planes increased, as compared to 2004, only by 3.9% to 35.1 mln people. Particularly, 15.9 millions (+4.8%) accounted for the international air routes and 19.1 millions (+1.9%) accounted for the domestic air routes.

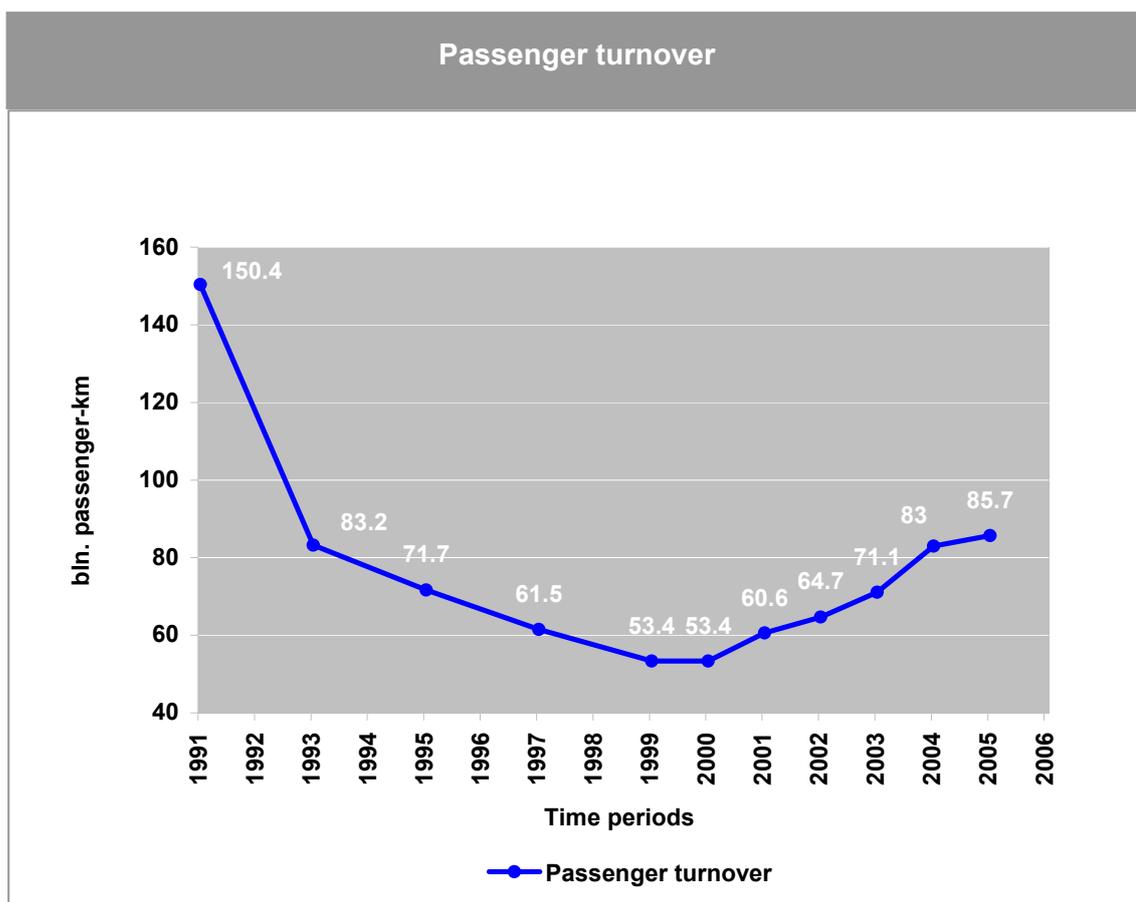
Main Points of Civil Aviation
Service and Finance Activities in 2003-2005

| Items | 2003 | 2004 | 2005 | +/- of 2005 to 2004 in % |
|---------------------------------------|-------|--------|--------|--------------------------------|
| Passenger turnover, bln passenger-km | 71.14 | 82.99 | 85.77 | +3.34 |
| Passengers carried, mln people | 29.45 | 33.79 | 35.10 | +3.87 |
| Cargo turnover, bln ton-km | 2.74 | 3.00 | 2.83 | -5.96 |
| Cargoes carried, thousand tons | 620.9 | 654.87 | 630.67 | -3.69 |
| Income of civil aviation, bln. rubles | 160 | 168 | 180 | +7.14 |

Aggregate passenger turnover of domestic airlines grew by 3.34% and totalled 85.77 bln. passenger-kilometres. Total amount of cargo transported in 2005 was 630.67 thousand tons. Passenger seats occupancy rate in 2005 was 71.90%, the growth in comparison to the last year equalled 1.69%. In particular, for the international air routes the growth in relation to the last year is 2.07% and for the domestic air routes it is 1.16%.

Upon the results of 2005, the airlines achieved an aggregate income growth. Gross income reached 180 bln rubles, that is 7.14% more as compared to the previous year. This is a good economic basis for further development of the airlines.

According to FAVT, in 2005 there were totally 185 air companies in the transportation market (in 2004 there were 199 companies) that operated about 2.5 thousand aircrafts (there are 5.5 thousand aircrafts registered in the Russian Federation). While the year was rather difficult for the industry, the airlines in general managed to preserve positive trends in the passenger traffic volume.



The top ten of the leading airlines in terms of passenger traffic in 2005 somehow changed as compared to 2004:

| Rating of airlines in terms of passenger traffic in 2005 | Passengers transported in 2004, mln. people | Passengers transported in 2005, mln. people |
|--|---|---|
| 1. "Aeroflot-RA" | 6.862 | 6.707 |
| 2. "S7" | 3.748 | 4.204 |
| 3. "Pulkovo" | 2.699 | 2.835 |
| 4. "UTair" | 1.466 | 1.887 |
| 5. "KrasAir" | 1.935 | 1.821 |
| 6. "Vim Airlines" | 0.247 | 1.589 |
| 7. "Transaero" | 1.341 | 1.572 |
| 8. "Ural Airlines" | 0.992 | 0.909 |
| 9. "Aeroflot-Nord" | 0.120 | 0.805 |
| 10. "Domodedovo Airlines" | 0.695 | 0.644 |

“Vim Airlines” and “Aeroflot-Nord” entered the top ten, while FGUP “Dalavia” and GTK “Russia” surrendered their positions. Each of the airlines that hold lower lines among the ten leaders (“Ural Airlines”, “Aeroflot-Nord”, “Domodedovo Airlines”) transported less than 1 mln passengers in 2005.

Passenger turnover rating of the Russian airlines over 2005 looks somewhat differently. See the following table.

| Rating of airlines in terms of passenger turnover in 2005 | Passenger turnover in 2004, mln passenger-km | Passenger turnover in 2005, mln passenger-km |
|---|--|--|
| 1. “Aeroflot-RA” | 20,600.0 | 20,750.0 |
| 2. “S7” | 9,871.0 | 10,949.0 |
| 3. “Pulkovo” | 5,371.1 | 5,736.9 |
| 4. “KrasAir” | 5,846.0 | 5,461.4 |
| 5. “Transaero Airlines” | 4,493.3 | 5,254.0 |
| 6. “Vim Airlines” | 762.5 | 4,578.2 |
| 7. “Domodedovo Airlines” | 3,381.9 | 3,169.3 |
| 8. “UTair Aviation” | 2,468.3 | 2,976.7 |
| 9. “Ural Airlines” | 2,675.9 | 2,348.1 |
| 10. “Dalavia” | 2,194.8 | 1,953.4 |

Over 90% of the total amount of passengers were carried by 35 airlines and 60% of this share was covered by seven biggest companies of the country.

Particularly, the first place in terms of both number of passengers and passenger traffic volume among the mentioned market participants is held by “Aeroflot – Russian Airlines”. In 2005 this air company transported 6.707 mln passengers, that is 2.3% less as compared to the last year (in 2004 there were 6.862 mln passengers; +17% as compared to 2003) and 145.6 thousand tons of mail and cargoes. As compared to 2004, in 2005 “Aeroflot” activities according to almost all criteria decreased 1–2%, except mail traffic that grew by 1.4%. The decrease of the passenger traffic was mainly due to diminishing passenger turnover because of the tariff growth that resulted from steep growth of the aviation fuel cost. The biggest international air carrier of the country also suffered from strengthening positions of the foreign airlines. “Aeroflot” already takes certain actions aimed at passenger turnover increase. For instance, it sales transfers at prices lower than offered by travel agencies.¹

OAD “Aeroflot – RA” increases its traffic volumes within Russia through the subsidiary enterprises. In 2005 there were two subsidiaries: “Aeroflot-Don” and “Aeroflot-Nord”. The network of subsidiaries is favourable for “Aeroflot-RA” both in brand expansion within the country and in giving opportunities of effective fleet employment. The

¹ www.aeroflot.ru

company intends to give to “Aeroflot-Don” and “Aeroflot-Nord” some of low-effective aircrafts and purchase more up-to-date planes for its own needs.

For some of the airlines an important traffic growth factor in 2005 was purchase of used foreign-made aircrafts that are more fuel-effective than the domestic planes. For instance, “S7” (“Siberia”) that expanded its fleet of foreign-made aircrafts to eight Boeing 737-500 and five Airbus A310, achieved 12.3% growth. According to the company’s data, the number of passengers used their service in 2005 totalled 4.204 mln people (there were 3.748 mln passengers in 2004). The carrier that currently undergoes re-branding did not change its position in the total rating of Russian airlines and kept its second place.¹

“S7” (“Siberia”) is followed by FGUAP “Pulkovo”. In 2005, during its “separation” from the same-named airport and merger with GTK “Russia”, the company leased four Boeing 737-500 and increased the number of its passengers by 5%. Having 2.835 mln passengers as a result (in 2004 there were 2.691 mln people) the carrier holds its traditional third position.²

“UTair Aviation” that holds the fourth line of the rating in terms of the number of passengers continues to operate the fleet of domestic aircrafts. However, this did not impede the carrier from demonstrating impressive growth of passenger traffic by 28.7% to 1.887 mln passengers (in 2004 there were 1.466 mln people).³

The fifth position of the rating in terms of the number of passengers belongs to “KrasAir”, Krasnoyarsk city air company that in the previous years was ahead of “UTair Aviation”. 11% decrease of the “KrasAir” passenger traffic in 2005 (down to 1.821 mln passengers), vs. 2004’s 36.7% growth, can be explained by at least three factors. First, there is intense competition both at regular and charter routes. Second, there is a conflict between “KrasAir” and governmental authorities related to the “AiRUnion” alliance that was formally established at the beginning of 2005.⁴ The alliance unifies the air companies of “KrasAir”, “Domodedovo Airlines”, “Samara Airlines”, “Omskavia Airlines” and “Sibaviatrans”. These companies are so far legally independent entities and only the route network is coordinated within the alliance. In future it is planned to establish a unified air company. Equity stakes of the state are 51% for “KrasAir”, 50% for “Domodedovo Airlines”, 46.5% for “Samara Airlines”. The General Director of “KrasAir” B.M. Abramovich and the related entities control about 40% of “KrasAir” equity, 48.6% of “Domodedovo Airlines”, about 40% of “Samara Airlines”, about 70% of “Omskavia Airlines” and 100% of “Sibaviatrans” equity. Upon capitalization appraisal of the carriers unified in the alliance, that was carried out by experts accredited by Russian Property Agency (Rosimushchestvo), it became evident that the state cannot claim for a controlling stockholding of “AiRUnion”. Then Rosimushchestvo made suggested replace several carriers in the alliance in order to preserve a control share of the state in “KrasAir”. “Omskavia Airlines” and “Sibaviatrans” were supposed to be replaced by “Bashkir Airlines” and “Vladivostok Avia”. The suggestion was not supported by “KrasAir”. The conflict was not settled during 2005. Third, decreasing passenger traffic of “KrasAir” is explained by company’s failure in the external market. Hungarian privatization agency did not allow the Russian alliance “Air Bridge” that acted on behalf of the “KrasAir” shareholders to purchase the national aviation enterprise “Malev Hungarian Airlines” having a fleet of 27 aircrafts (2 Boeing 767-200ER, 4 Boeing 737-800NG, 6 Boeing 737-700NG, 6 Boeing 737-600NG, 5 Fokker-70, 4 CRJ-200ER). The leading opposition party of the country – Fidesz (Hungarian Civic Alliance) – considered the offered price to be understated and deemed that the guarantees of stable human

¹ www.s7.ru

² www.pulkovo.ru

³ www.utair.ru

⁴ www.krasair.ru

resources policy of the air company were inadequate. As a result of the refusal, “KrasAir” that is keen to penetrate to the international aviation traffic market and operate a big fleet of Malev planes, suffered both moral and material losses, namely tender bid costs.

Two considerable members of the top ten – “Transaero Airlines” and “Vim Airlines” – reached the end of 2005 with almost equal figures. In terms of number of passengers, “Vim Airlines” held the sixth line of the rating with a small breakaway (1.589 mln people); “Transaero Airlines” transported 1.572 mln passengers. However, in terms of passenger turnover, “Transaero Airlines” was ahead of “Vim Airlines”: 5,253,973 thousand passenger-km vs. 4,578,235 thousand passenger-km. This situation is explained by the fact that “Transaero Airlines” is geared to long-distance routes, while “Vim Airlines” is more active in charter operations to Turkey, Egypt, Spain, Italy and, in the first place, competes with “S7” and “KrasAir”. As for the fleet, in 2005 “Transaero Airlines” became the first Russian operator of passenger Boeings 747-200, having received under a lease contract three of the five declared planes.¹

As it was mentioned above, in 2005 the air traffic industry showed a clearly expanding tendency to operator consolidation. The business entities approached this strategic objective by several ways.

1. “Aeroflot-RA” established a classical vertically integrated holding (“Aeroflot-RA” + “Aeroflot-Don” + “Aeroflot-Nord”). Presently all mentioned operators preserve full self-dependence. After “Aeroflot-RA” gets control over all air traffic market participants that it is presently interested in, it is be natural to expect transition of the entire group to a single stock.

2. Some of the air carriers (“KrasAir”, “Domodedovo Airlines”, “Samara Airlines”, “Omskavia Airlines”, “Sibaviatrans”) chose establishment of the “AiRUnion” alliance that is de-facto led by “KrasAir”. A problem faced by the alliance is that none of the owner groups has a controlling holding in all mentioned operators, and, lacking this, no strict management within the alliance is possible. The very form of unification, an alliance, was chosen because the owners of the alliance leader had no controlling stockholdings. The alliance leader’s attempts to get the control stock of the alliance operators by all means had already resulted in a serious conflict with Rosimushchestvo. Taking into account that the consolidation trend is generally logical and positive, it appears like “AiRUnion” and the participating operators will experience certain difficulties in 2006-2007 in their operations, because the conflict with the state authorities will hold back the development of the alliance itself and the participating operators.

3. GTK “Russia” and “Pulkovo” follow the way of consolidation by acquisition in form of merger. The process is impeded due to separation of the airport facilities from “Pulkovo” air lines and detachment of the transportation facilities from GTK “Russia”, for them to be transferred to SE GTK “Russia”. However, these difficulties are of temporary technical nature since both carriers are owned by the state.

4. “S7” and “UTair Aviation” implemented consolidation procedures by purchasing smaller carriers. Particularly, by 2005 “S7”, having assumed liabilities of the bankrupted “Vnukovo Airlines”, received their aircraft fleet and route network. Moreover “S7” purchased a controlling stock of Chelyabinsk air company and obtained its fleet, route network, and airport facilities of the subsidiary entities. “UTair Aviation” purchased the control stock of “Komiinteravia” and got its route network and fleet. In general, the consolidation of “S7” and “UTair Aviation” shows the tendency to independent development. Consolidation mechanisms of this kind rather demonstrate struggle between the airlines for transportation facilities of the outsiders.

¹ P. Zvereva. Not all to launch. // Aviatransportnoye Obozrenie. – January / February 2006, No. 66, p. 13-14.

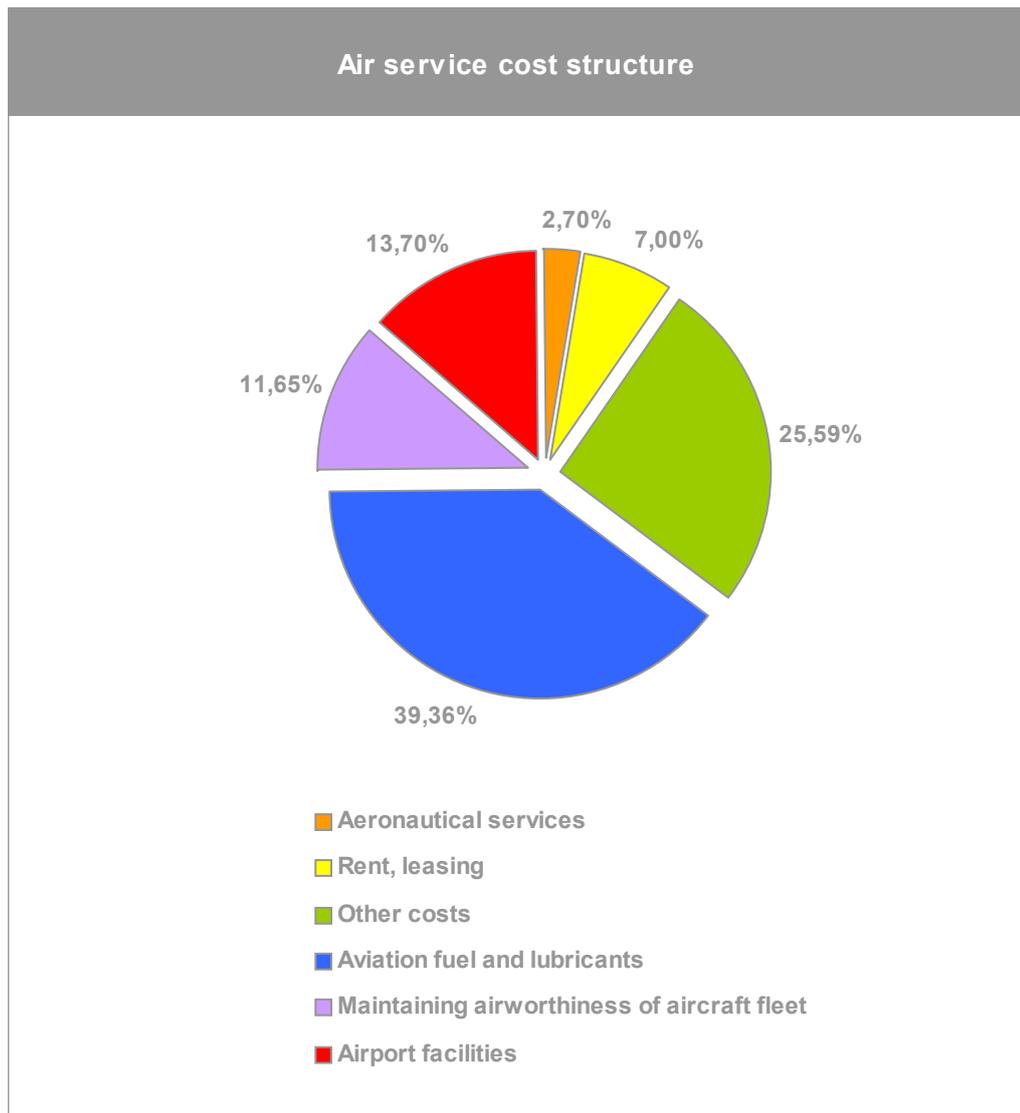
Thus, considering the consolidation trends among the air carriers in 2005 and the previous years, the ratings of the air carrier groups, air carrier holdings and air carrier alliances being established, are as follows:

| Rating of the air carrier groups in terms of passenger traffic in 2005 | Number of passengers carried in 2004, mln people | Number of passengers carried in 2005, mln people |
|--|--|--|
| 1. "Aeroflot" Group | 7.569 | 8.111 |
| "Aeroflot-RA" | 6.862 | 6.707 |
| "Aeroflot-Don" | 0.587 | 0.599 |
| "Aeroflot-Nord" | 0.120 | 0.805 |
| 2. "S7" | 3.748 | 4.204 |
| 3. "Pulkovo" | 3.350 | 3.288 |
| "Pulkovo" | 2.699 | 2.835 |
| GTK "Russia" | 0.651 | 0.453 |
| 4. "AiRUnion" | 3.457 | 3.208 |
| "KrasAir" | 1.935 | 1.821 |
| "Domodedovo Airlines" | 0.695 | 0.644 |
| "Samara Airlines" | 0.473 | 0.441 |
| "Omskavia Airlines" | 0.154 | 0.120 |
| "Sibaviatrans" | 0.200 | 0.182 |
| 5. "UTair Aviation" | 1.466 | 1.887 |
| 6. "Vim Airlines" | 0.247 | 1.589 |
| 7. "Transaero Airlines" | 1.341 | 1.572 |
| 8. "Ural Airlines" | 0.992 | 0.909 |

| Rating of the air carrier groups in terms of passenger turnover in 2005 | Passenger turnover in 2004, mln passenger-km | Passenger turnover in 2005, mln passenger-km |
|---|--|--|
| 1. "Aeroflot" Group | 21,589.4 | 22,569.4 |
| "Aeroflot-RA" | 20,600.0 | 20,750.0 |
| "Aeroflot-Don" | 845.2 | 912.2 |
| "Aeroflot-Nord" | 144.2 | 907.2 |
| 2. "S7" | 9,871.0 | 10,949.0 |
| 3. "AiRUnion" | 10,597.7 | 9,906.7 |
| "KrasAir" | 5,846.0 | 5,461.4 |
| "Domodedovo Airlines" | 3,381.9 | 3,169.3 |
| "Samara Airlines" | 737.3 | 705.4 |
| "Omskavia Airlines" | 408.9 | 338.2 |
| "Sibaviatrans" | 223.6 | 232.4 |
| 4. "Pulkovo" | 6,833.1 | 6,888.7 |
| "Pulkovo" | 5,371.1 | 5,736.9 |
| GTK "Russia" | 1,462.0 | 1,151.8 |
| 5. "Transaero Airlines" | 4,493.3 | 5,254.0 |
| 6. "Vim Airlines" | 762.5 | 4,578.2 |
| 7. "UTair Aviation" | 2,468.3 | 2,976.7 |
| 8. "Uralskye Airlines" | 2,675.9 | 2,348.1 |

The analysis of the above data with the Pareto distribution gives an evident conclusion that the outlined group of leaders in terms of passenger traffic and passenger turnover holds dominating positions in the air service market of the Russian Federation (70.56% of the passenger traffic and 76.33% of the passenger turnover) and in the mid-term prospect will hold these positions. Due to a high penetration barrier of this market, it is only foreign air carriers that can be new in the market and aiming at a seize of a considerable share of this market. This trend is already seen: the foreign airlines that serve international flights to and from the Russian Federation aggregately hold 30-35% of the market. At the same time, no foreign airline is present at domestic Russian air routes.

Airlines expenses in the reporting year grew faster than income. The cost of air transportation in the industry in general increased by 20.2%.



The analysis of the transportation cost change shows that the pace of expense growth is mainly related to the pace of price growth for the aviation fuel. Over the year, the price of aviation kerosene grew by at least 50%. In the reporting year the average price reached 16.3 thousand rubles per ton and its ratio in the cost was about 40%. Considerable growth of fuel prices created an extremely difficult situation for all air traffic market participants. It is difficult for the air carriers to optimize their budget since over a half of the expenses are born in monopolistic markets. Thus, it is a complex issue and joint efforts are required to solve it both at the governmental level and within the industry.

Raising fuel prices could not but influenced the growth of flight tariffs. For the first time over the last several years the annual flight tariff growth (13.7%) outpaced the general inflation factor in the country. The increase happened in the fourth quarter of 2005 when the airlines significantly raised their tariffs.

As follows from the report of the Chief Executive of the Federal Aviation Transport Agency Mr. A.A. Yurchik (hereinafter – the FAVT Report), the advanced cost growth resulted in the decrease of the aggregate profits as compared to 2004. In total, all air

carriers made 2.2 bln rubles of profit, which is almost twice lower comparing to the previous year.¹

Monitoring of finance & economic status of the air carriers, being performed by Rosaviatsiya, demonstrates that almost 50% of them are in a non-satisfactory condition. Only the airlines of large traffic volumes are currently able to maintain profitable or break-even activities. And, taking into account that large airlines increasing their market share force smaller companies out, further growth of the number of unprofitable enterprises is inevitable. A special concern is caused by regional airlines and airlines mainly involved in unprofitable services at local air routes.²

It is impossible to improve competitiveness of the airlines without solving the seemingly most urgent problem of the civil aviation, that is the quickest possible renovation of the aircraft fleet. Currently, the Russian airlines operate 944 passenger planes. 514 of them are long-distance aircrafts (IL-96-300: 14, IL-86: 45, IL-62: 39, Tu-154: 242, Tu-204: 13, Tu-214: 8, Yak-42: 66, A-310: 4, A-319: 8, A-320: 7, A-321: 3, B-737: 29, B-747: 6, B-757: 14, B-767: 19) and 430 are regional ones (Tu-314: 165, IL-114: 2, An-24: 118, An-38: 5, Yak-40: 137, Dash-8-100: 3). Thus, there are only 43 domestic new generation aircrafts operated (such as IL-96-300, Tu-214, Tu-204-100, Tu-204-300, IL-114, An-38), that is 1.7% of the total number (in 2004 there were 38 new-generation aircrafts operated). They are operated by 14 Russian air carriers and yield 7.91% of the passenger turnover.³

The strained situation in the international flight market that relates to the introduction of various limitations on the use of outdated aircrafts, forced to import over 30 foreign planes in 2005, even under high customs duties. The share of foreign aircrafts in the Russian passenger turnover in 2005 was 28.71%. In this situation foreign-made aircrafts have to be imported and operated by Russian airlines to enable them to withstand strict competition with foreign companies both in the international and Russian markets, where they acquire more importance. In 2005 only, the traffic volume of foreign companies in Russia grew by 20% (it is comparable to the annual passenger turnover of Aeroflot). “Lufthansa”, “Air France” and “Austrian Airlines” were followed by “Iberia”, “Turkish Airlines”, “China Pacific”, “China Airlines”, “Qatar Airlines” etc. The share of foreign-made aircrafts grows as well. In 2005 there were 119, including 91 long-distance aircrafts (it is 29 more than in 2004). They account for over one-third of the total traffic. Foreign-made planes are operated by 9 airlines.⁴

Small Russian airlines simply do not have enough working capital to withstand expansion. They have no possibility for target financing of new aircrafts even in case of their purchase under operational lease. These companies cannot ensure a high level of flight safety, regularity of scheduled flights, or meet all kinds of regulations.

The only tool of the Russian airlines to set off the growing foreign presence is rapid consolidation of air carriers, urgent establishment of sound operators among industry leaders, namely the “Aeroflot” Group, the “AiR Union” alliance, “S7”, “Pulkovo”, “UTair Aviation”, “Transaero Airlines”, “Vim Airlines”, “Uralskye Airlines”. Establishment of global aviation alliances remains a global tendency of the last decade development of civil aviation. The main purpose of such alliances is to cut costs, attract more passengers by offering a wide route network, joint competition against other alliances.

¹ Report of the Chief Executive of FAVT A.A. Yurchik – www.mintrans.ru

² Ibid.

³ Ibid.

⁴ Report of the Minister of Transport of the RF I. Levitin to the Collegium of FAVT on results of year 2005 and objectives for year 2006 – www.mintrans.ru

2. Market and Legal Situation in the Aircraft Lease Industry in 2005

The main issue of the aircraft industry development is still discrepancy of the scale and structure of its research and production potential to the effective demand for the industry products.

The industry experiences the decline of design and production technology, aging of capital production facilities, and a flow-out of high-skilled staff. In order to change the situation, the government works out a strategy and programme for aircraft industry development aimed to restore the competitive position of aircraft industry in the domestic market and to expand export of products and services of the aircraft industry. The established objectives were supposed to be achieved also by development of aircraft leasing schemes.

The effective term of the programme of the Russian government No. 910-r dated 10 July 2001 titled "The Programme of Social and Economic Development of the Russian Federation for the Mid-Term Prospect (2002-2004)" adopted by No. 10-FZ Law dated 8 January 1998 of "State Reglamentation of Aviation Development" ended by 2005. In this programme the government declared establishment of a leasing system for the Russian aircrafts as a basis for renovation of the fleet employed by the domestic airlines under the governmental support, that is state guarantees for the raised credits, partial subsidizing of the interests paid upon bank credits, governmental participation in capital of the leasing companies, finance readjustment of the enterprises involved in leasing projects, expansion of finance leasing as a condition of competitive aviation equipment production and Russian planes promotion to the foreign markets. Upon the results of the programme implementation it can be concluded that the government did not establish a leasing system for domestic aircrafts, and financing of the aviation development is viewed solely as state subsidies from the federal budget to cover a part of leasing payments, as well as interests on the credits raised to purchase aircrafts under tenders held by the Ministry of Transport. The mentioned type of financing is mainly applied to the airlines that purchase IL-96, TU-204 and TU-214 aircrafts. The first stage of the target federal program titled "Development of Russian Civil Aircrafts for the Periods from 2002 to 2010 and up to 2015" was completed in 2005. This stage comprised the following: make flight and technical properties of the aircrafts produced in 1992-2001 meet new international requirements (according to noise, emission, and aeronautics) and ensure their competitiveness in comparison to the foreign analogues; to upgrade and certify aircrafts; to create an research basis for a new generation of aircrafts for the first quarter of the 21st century. So far, no official reports on implementation of this stage of the program have been published.

In order to develop aircraft leasing sales schemes, a draft federal law was developed at the end of 2005 on the basic principles of governmental control over aircraft lease. Considering specific features of the aviation equipment (high cost and significant operational risk), it governs particulars of the aircraft lease and establishes measures to ensure state support of commercial activities in this area, as well as to enable aircraft lease participants to protect their lawful interests. Should this draft be adopted, aircraft lease is expected to expand.

The Capetown Convention adopted on November 16, 2001 is a document to promote aircraft lease development at the international level ("The Convention on International Interests on Mobile Equipment" and "Aircraft Equipment Protocol to the Convention on International Interests on Mobile Equipment").

The main objective of this Convention is to considerably lower the risks accompanying aircraft purchase. Certain legal and finance tools under the Convention are aimed to achieve this objective: the seller, the lessor, and the party that invests into aviation

equipment purchase, are provided with different remedies in case the debtor would fail to execute his contract obligations, including an option to de-register and return the aircraft; lessor's authorities are regulated at the international level, the order of provisional legal defence (prior to a judicial decision) is unified, an international title registration system for the aircrafts is introduced (with a possibility to get information from the register round the clock via Internet). Thus, security and, subsequently, attractiveness of investment for the parties that invest in aircraft purchase, is ensured by offering credits under lower interest rates and for longer periods.

Moreover, it should be noted that currently there is a global trend of engine leasing expansion. Engine is a convenient object for pledge. It is high-priced and preserves its value for a long time. The Cape town Convention treats engines as separate objects and it creates favourable conditions to finance their production and purchase.

Currently this Convention is signed by over 20 states, including Great Britain, Germany, Italy, China, the U.S., Turkey, Switzerland, the SAR. So far, the Cape town Convention is not signed by Russia or any of the CIS countries.

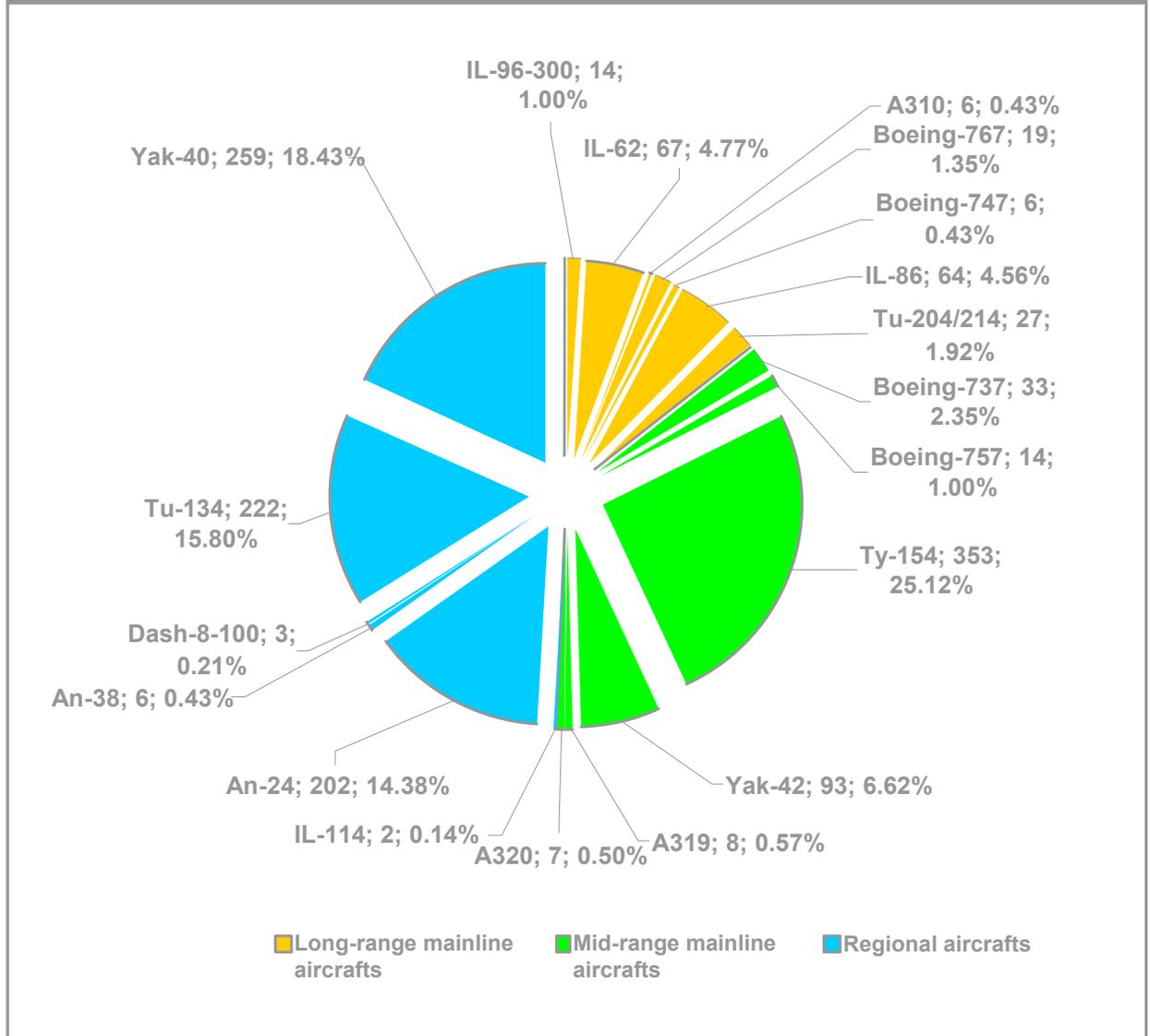
3. Technical Conditions of Air Traffic Market in 2005

In 2005 there were 1,405 passenger aircrafts involved in commercial transportation. 618 of them are long-distance planes (IL-96-300, IL-86, IL-62, Tu-204, Tu-214, Tu-154 and foreign-made aircrafts) and 787 are regional ones (Tu-134, An-24, An-38, Yak-40, Yak-42, IL-114, Dash-8-100). The Tu-154, Tu-134, An-24, and Yak-40 families remain the biggest according to quantity, they account for 75% of the passenger aircrafts. The average age of the long-distance planes is 17 years, the age of the regional fleet approaches 30 years. In the long-distance fleet, the planes of 10 to 20 years of operation life dominate and the average age of the regional fleet is 20 to 30 years.

The graph illustrates structure of passenger aircraft fleet in 2005 (see page 16).

The analysis of the reporting year demonstrated that the situation in new domestic aircraft supplies remained almost unchanged in comparison to the previous years. Aircrafts of new generation are put in operation at an extremely low pace and the fleet receives annually a few new aircrafts. As follows from the report of the Federal Aviation Transport Agency, in 2005 only 17 domestic civil aircrafts were put in operation (5 helicopters and 12 planes). The government helped to put in operation only 6 domestic new generation aircrafts out of those 17. Considering that the existing fleet is mostly outdated, such pace of renovation aggravates the civil aviation crisis even more.

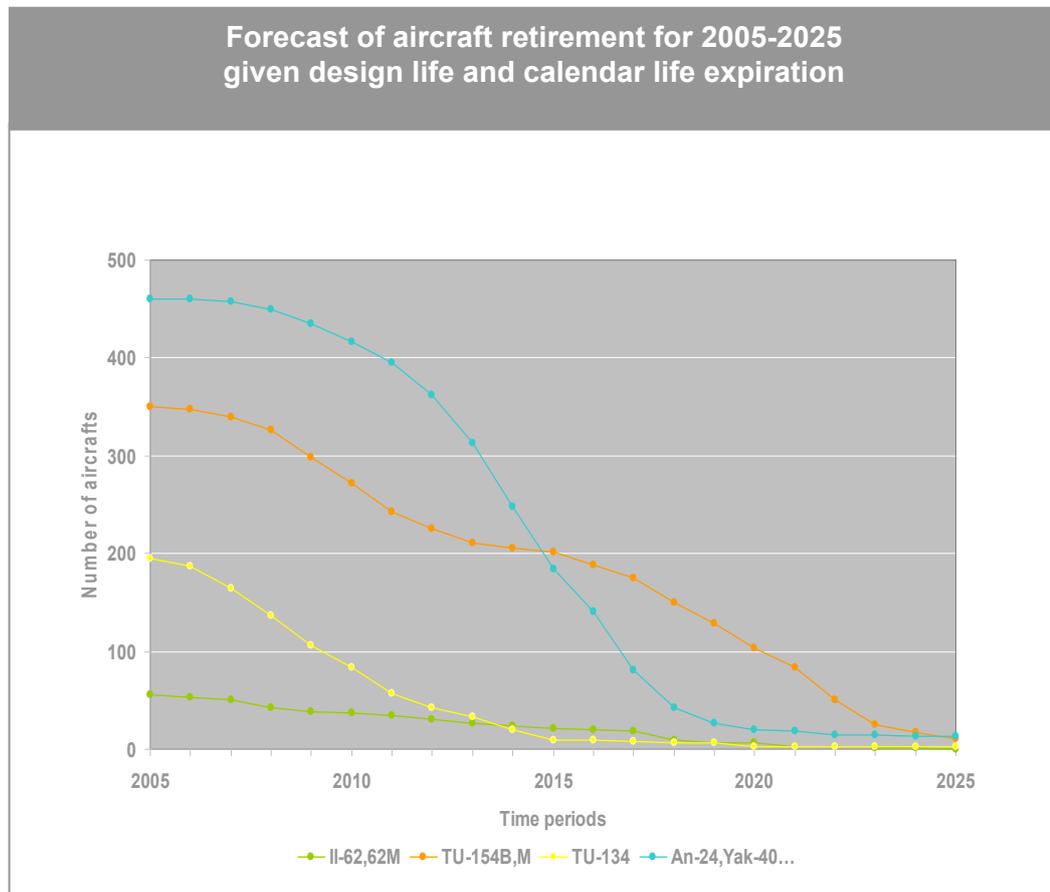
The structure of passenger aircraft fleet in 2005
(number; % of total)



Due to the low renovation pace in 2005, there were only 43 domestic new generation aircrafts in operation (such as IL-96-300, Tu-214, Tu-204-100, Tu-204-300, IL-114, An-38), that is 1.7% of the total number (in 2004 there were 38 new generation aircrafts in operation). These planes are operated by 14 Russian airlines and serve less than 10% of the passenger and cargo traffic volume. There is a growing trend of older-generation aircrafts retirement. Out of 1,350 aircrafts that were put out of operation over the past ten years, only 53% of passenger and 18% of cargo planes were retired due to the end of their operational life. For Tu-154B, IL-18, Tu-134, An-24, Yak-40 the operational life is 70% and more exhausted. For all types of regional aircrafts (Tu-134, Yak-40 and An-24) there shall be a massive retirement since most of this fleet is of critical age. IL-86, Tu-154M, IL-62M, Yak-42 can still remain in operation for a long time considering the individual programmes of life prolongation.

If take into account growing traffic volume and expected retirement of aircrafts due to the end of their design life, there is a problem of efficiency of carrying capacities of the airlines' fleets.

According to the retirement necessity of aircrafts upon their design life expiration and a number of factors of no relation to the design life, there is an obvious tendency that, by 2010, carrying capacities of different sectors of the operating fleet would decrease by 40-70%



The situation is aggravated with the negative practice (that is used since the beginning of economic reforms in the Russian Federation) of nominal aircraft life prolongation instead of scheduled overhaul. This practice has led to poor technical condition of aircrafts and resulted in considerable economic losses for the operators due to the aircraft downtime as units and components of formally proper life break down. Such situation in the Russian transportation market cannot ensure high flight safety. Due to poor economic management, most of the air companies are currently financially drained and have no considerable financial reserve to purchase new aircrafts or even carry out an overhaul of the existing ones. That is why having a certain number of aircrafts does not mean that all of them can currently be operated.

Nowadays the practice of life prolongation is widely spread. Thus, the actual technical condition of the fleet, as well as the trends of aircraft retirement can significantly differ from the forecasts. The equipment is retired at an extremely low pace. Unserviceable aircrafts often stay idle for several years without mandatory maintenance, and assemblies of such aircrafts that still have valid life are used to equip other aircrafts.

We used the data from governmental sources for 2005 to analyze fleet structure of all Tu-154 modifications.

| General figures | 2003 | 2004 | 2005 | +/- 2005/2004 |
|--|-------------|-------------|-------------|--------------------------|
| All Tu-154 modifications | 357 | 327 | 353 | +26 |
| Tu-154A | 2 | 2 | 2 | 0 |
| Tu-154B | 30 | 23 | 24 | +1 |
| Tu-154-B-1 | 8 | 6 | 5 | - 1 |
| Tu-154-B-2 | 129 | 95 | 117 | +22 |
| Tu-154M | 188 | 201 | 205 | +4 |
| Number of operators | 62 | 61 | 55 | -6 |
| Number of owners | 77 | 75 | 83 | +8 |
| Number of lessors | 37 | 40 | 52 | +12 |
| Number of lessees | 28 | 26 | 28 | +2 |
| Number of leased aircrafts | 61 | 56 | 85 | +29 |
| Number of pledged aircrafts | 60 | 76 | 94 | +18 |
| Number of arrested aircrafts | 12 | 4 | 5 | +1 |
| Number of aircrafts, which have a co-operator | 27 | 25 | 42 | +17 |
| Number of aircraft purchase transactions | 41 | 44 | 39 | - 5 |
| Number of new aircrafts | 3 | 7 | 16 | +9 |
| Number of retired aircrafts | 2 | 4 | 20 | +16 |

For the analysis of life cycle status we used the data on validity of aircraft airworthiness certificates, dates of manufacture and dates of re-registration. We also considered the decisions on conditions and procedures of airworthiness continuation (airworthiness period is 30 calendar years) and on life cycle prolongation for the aircrafts over 30 according to their technical condition for 1 year more.

| | 2003 | 2004 | 2005 | +/- 2005/2004 |
|-------------------------------|------|------|------|------------------|
| Suspended | 19 | 18 | 14 | - 4 |
| Not operated during 5-6 years | 31 | 32 | 30 | - 2 |
| Including leased | 9 | 10 | 6 | - 4 |
| Total | 50 | 50 | 44 | - 6 |

It must be noted that the airlines are actively involved in used aircraft purchase when credits on the aircrafts are given. There is a growing practice for the airlines to take possession of the aircrafts they leased before.

4. Forecasted Capacity of the Aircraft Market

Forecasting approach to the transportation market development is based upon the ratio between the pace of GDP and traffic volume growth. Global statistics evidences that 1% growth of the gross domestic product in emerging economies usually leads to 1.6% growth of the passenger traffic volume.

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|--------------------------|-------|------|------|-------|------|
| Growth of GDP, % | 5.00 | 4.30 | 7.30 | 7.10 | 5.90 |
| Growth of air traffic, % | 13.40 | 6.85 | 9.90 | 16.66 | 3.34 |

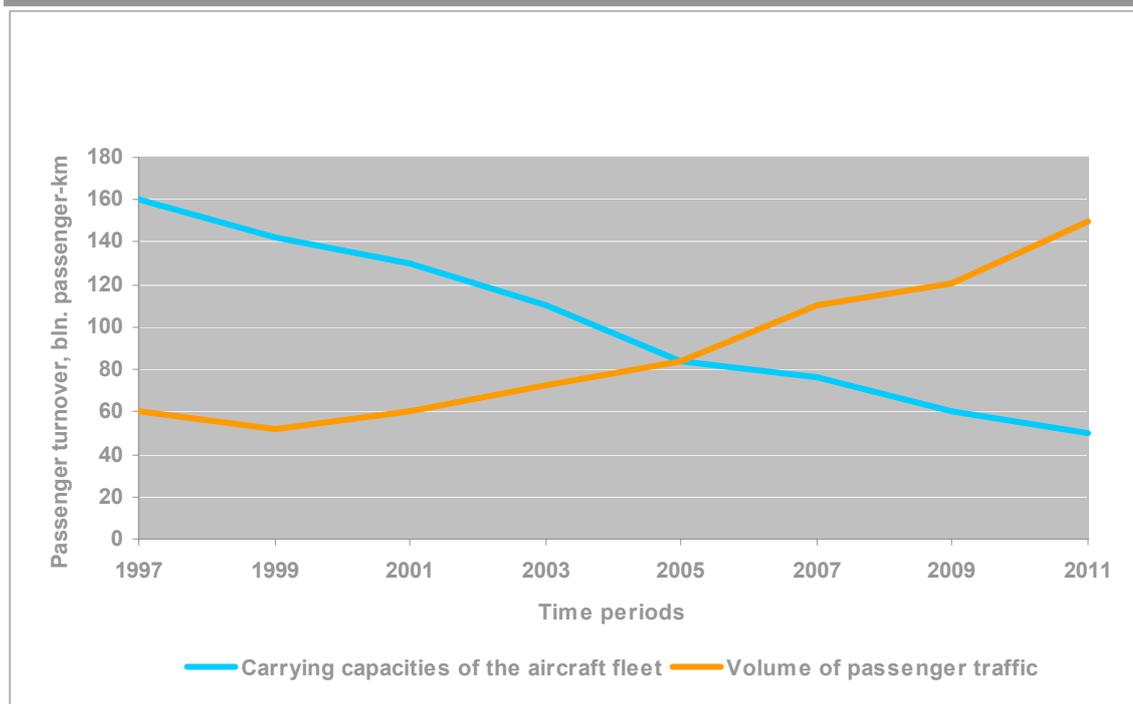
As follows from the table, the year-average GDP growth in the Russian Federation is 5.92%; the transportation volume increases by 10.03%. Thus, in Russia 1% growth of the gross domestic product leads to 1.69% increase of the passenger traffic volume, hence, the annual average pace of passenger traffic growth is higher than it was predicted.

In 2005 the aggregate traffic volume rose by 3.9%. In experts' opinion, if positive trends of the national economy develop actively, the volume of passenger traffic by 2013-2015 will reach the level of the most favorable year (1990) to 150-200 bln passenger-km. According to the forecast of Airports Council International (ACI), the global passenger traffic will increase annually by over 4%, and by 2020 will reach about 7 bln people.¹

The analysis of the air traffic market demonstrates that the demand for the existing aircrafts exceeds the existing carrying capacities (see the graph "Carrying capacities of the existing aircraft fleet and traffic volumes").

¹ www.mintrans.ru

Carrying capacities of the existing aircraft fleet and traffic volumes.



Expected aircraft retirement rate is determined by studying life cycle status of a fleet and possible continuation of aircraft design life, as well as by existing trends in aircraft retirement. It is also taken into consideration that airlines occupying different market positions implement different strategies to manage life cycles of outdated aircrafts. In large companies there is already a prevailing practice to retire planes by reason of economic inefficiency of their further operation. According to the forecasted change of the number of airplanes due to expiration of their design life and calendar life cycle, as well as due to their failure to meet international requirements, it can be expected that by 2010 about 70% of civil aircrafts will be retired.

There is an urgent problem of upgrading of the aircrafts of the Russian airlines, of the use of a new maintenance system during operation, and of flight simulators for the air crews. Unsatisfied demand for air transportation and services shall emerge even in 2006. However, the pace of new domestic aircraft supply is low. The table illustrates governmental programme of new passenger aircraft supplies for 2002-2010.

| Aircraft category in terms of seating capacity | Type of aircraft | 2002-2010 | For years | | | | |
|--|--------------------------|------------|-----------|-----------|-----------|-----------|------------|
| | | | 2002 | 2003 | 2004 | 2005 | 2006-2010 |
| Long-distance: | | | | | | | |
| - large (240–300 seats) | IL-96-300 | 12 | 1 | 1 | 1 | 1 | 8 |
| | IL-96M | 3 | 0 | 1 | 0 | 0 | 2 |
| - mid-size (160–200 seats) | Tu-204(-100) | 16 | 1 | 1 | 2 | 2 | 10 |
| | Tu-214 | 30 | 1 | 2 | 2 | 2 | 23 |
| - moderate (120–160 seats) | Tu-154M | 13 | 1 | 1 | 1 | 1 | 9 |
| | Tu-204-300 | 39 | 0 | 1 | 2 | 2 | 34 |
| - small (80–120 seats) | Yak-42D(-90) | 4 | 1 | 1 | 1 | 1 | 0 |
| | Tu-334-100 | 30 | 0 | 2 | 3 | 5 | 20 |
| | Tu-334-200 | 47 | 0 | 0 | 0 | 0 | 47 |
| Total long-distance: | | 194 | 5 | 10 | 12 | 14 | 153 |
| Regional: | | | | | | | |
| - large (70 seats) with double-flow turbojet and turbofan engines | New regional | 30 | 0 | 0 | 0 | 0 | 30 |
| | IL-114(-100), An-140-230 | 28 | 0 | 0 | 2 | 3 | 23 |
| - mid-size (50 seats) with double-flow turbojet and turbofan engines | Tu-324 | 70 | 0 | 0 | 3 | 7 | 60 |
| | An-140, IL-114, IL-112B | 84 | 0 | 2 | 4 | 9 | 69 |
| - small (30 seats) with double-flow turbojet and turbofan engines | Modification of Tu-324 | 14 | 0 | 0 | 0 | 0 | 14 |
| | An-38-100(-200), C-80 | 80 | 3 | 4 | 6 | 10 | 57 |
| Total regional: | | 306 | 3 | 6 | 15 | 29 | 253 |
| Total passenger aircrafts: | | 500 | 8 | 16 | 27 | 43 | 406 |

The air lines need domestic planes with lifecycle cost lower than that of the existing domestic aircrafts. There is a need for a family of airplanes to meet both Russian and international airworthiness requirements, perspective ICAO requirements, and European Control requirements, and to be equipped with modern high-efficiency long-life engines. It is also required to set up an aircraft line-up the lack of which significantly holds back efficient aircraft operation by the airlines.

The results of a complex aviation market research make it possible to conclude that up to 2015 annual average production of long-distance aircrafts should be over 30 planes. For regional planes, the forecasted annual average demand is about 50-70. An efficient composition of commercial fleet in 2015 will not exceed the current fleet by quantity, while its structure will considerably change due to the varying development pace of different market segments and stricter requirements to air service quality. According to the estimates of State Research Institute of Civil Aviation, by 2015 there will be the demand for 112 new Tu-154M and Tu-234; 149 Tu-334/Yak-42D; 103 Tu-204/214; and 121 Tu-134; that is the aggregate demand for 485 planes. Unfortunately, even the leading air carriers are unable to purchase new aircrafts. There is no economic expediency of such purchases either, at least at present stage of Russian air traffic market development.¹

We used the data from available official sources and calculated the carrying capacities deficit for 2015 and 2025 with consideration of the forecasted retirement of the Russian fleet and supplies of new Russian-made aircrafts. According to the forecasted growth of passenger turnover, by 2015 the expected deficit of carrying capacities can be 59.33% and by 2025, 85.33%. The crisis can be surmounted only provided that Russian airlines operate foreign-made aircrafts though it requires abolition of VAT and import duties charged upon the planes produced out of Russia. The results of the research are given in the table.

| | 2005 | 2015 | 2025 |
|---------------------------------------|-------|--------|--------|
| Passenger turnover, bln. passenger-km | 87.54 | 145.92 | 211.17 |
| Remaining aircrafts upon retirement | 1,271 | 753 | 136 |
| Aircraft renewal program | 34 | 451 | 451 |
| Total number of aircrafts | 1,201 | 814 | 425 |
| Carrying capacities deficit, % | | 59.33 | 85.33 |

¹ www.gosniiga.ru

5. Appraisal of the Domestic Airlines Demands

A forecast of the Russian air service market development is of primary importance to set up technical policy for the civil aviation. Russian air transport is about to overcome a long-lasting crisis. During 2002-2005, the passenger turnover rose by over 30%. In 2005 the aggregate transportation volume increased by 3.9%. According to the estimates of Western experts, the annual demand for air service in Russia will annually grow by 10-15%. Even according to more conservative estimates of Russian experts, the annual increase of passenger traffic in the next 20 years will be about 7%. By 2010 Russian airlines will require new modern and cost-effective aircrafts. During the last year passenger air traffic grew by 1.31 mln people (from 33.79 mln in 2004 to 35.1 mln people). According to the most moderate forecasts, by 2010 it will exceed 50 mln people per year. Deficit of aircrafts will only increase over time. According to the calculations of the General Director of OAO "Aeroflot-RA" Valery Okulov, proceeding from the prospective plan for company development, "Aeroflot" will have to expand its fleet from 90 to 140-150 airplanes. For "S7 Airlines", which holds the second position by the scope of activities, the deficit is a little lower. Operating the fleet of 53 aircrafts, the airlines management forecasts a shortage of 10-15 planes, and in the next year this figure will rise as well.

According to the forecasts of the Russian Ministry of Transport, the aggregate fleet of long-distance aircrafts (MTOW >50 tons) required to cover the current volume of transportation services equals 350-400 aircrafts, and, considering certain replacement of short-distance aircrafts with regional ones, it can be up to 450. The industry will need 700 regional and 80 cargo planes. Annual average flight time of a plane, according to its size and age, is 3,000-4,000 hours. Required annual production of civil aircrafts for the current transportation volume is 40-50 aircrafts, that is 0.9–1.1 bln USD per year. The money flow within the "civil aviation production-to-consumption" system is 2.2–2.5 bln USD per year excluding airworthiness costs, and including the mentioned costs it is 2.9–3.2 bln USD annually.¹

As of now, the most difficult period for the airlines when air traffic volumes were decreasing, which started in 1990s, is over. The traffic flow stabilized even in 2000, over the next years it demonstrated positive trends, and it inevitably influenced business results of the airlines.

Thus, in case of successful development of the passenger air traffic market, by 2013-2015 it can reach the level of 150–200 bln passenger-km. This estimate assumes the period of less speedy development of the domestic transportation market (2002-2005) and a further more intensive growth as compared to the international transportation market. At the same time, if no new aircrafts are supplied after 2006, there shall be a deficit of aggregate carrying capacity of the passenger fleet due to the expected 35-40% growth of traffic volumes.

The leading airlines are interested in purchasing new-generation planes. Renewal is a must, though domestic industry cannot keep pace in filling the gaps. Last year the manufacturers produced only 9 long-distance aircrafts, including one Tu-154M, while the market demands at least 30 planes. Aircrafts are still produced in singular. That is why supplies of used airplanes dominate. There are no prospects of putting in

¹ Report of the Deputy Minister of Transport of the RF A.S. Misharin at the Aero Show MAKS-2005. – www.maks.ru

Activities of the Airlines in 2004-2005

| Items according to types of transportation | 2004 | 2005 | +/- 2005 to 2004, % |
|--|-------|-------|---------------------|
| Passenger turnover, bln passenger-km | 82.99 | 85.78 | +3.34 |
| International, bln passenger-km | 43.72 | 45.79 | +4.73 |
| Domestic, bln passenger-km | 39.27 | 39.99 | +1.83 |
| Passenger traffic, mln people | 33.79 | 35.10 | +3.87 |
| International, mln people | 14.90 | 15.88 | +6.57 |
| Domestic, mln people | 18.89 | 19.22 | +1.74 |
| Passenger seats occupancy rate, % | 70.7 | 71.9 | +1.69 |
| International, % | 72.4 | 73.9 | +2.07 |
| Domestic, % | 68.9 | 69.7 | +1.16 |

operation any considerable number of modern Russian-made aircrafts in the next 3–5 years. The “protectionist” policy of the Russian aircraft industry impedes import of the Western aircrafts which could help Russian air carriers to hold the gained segment of the international market.

Thus, taking into account high prices of the new generation aircrafts, no decrease of import duties charged upon foreign-made aircrafts, and the low rate of aircraft production, it can be concluded that, given the current state of the aviation market, it will be relevant for the airlines to be offered and to operate at perspective domestic routes mid-distance Tu-154M aircrafts. In 2005 there were 205 planes of this type registered in the state register, though such quantity is not enough to serve this passenger air traffic segment. Moreover, in the next years Tu-154M, one of the few domestic long-distance planes suitable for flights to West European countries and the Mediterranean region, will be employed for international passenger flights as well, and regional routes will be primarily served by different modifications of Tu-154 and by Tu-134, despite the fact that their calendar life nearly expired.

Upon the practice of “UTair Aviation”, a regular partner of our Company, one can make sure that dynamically developing airlines are interested in intensive operation of Tu-154 and Tu-134 after overhaul, having components of complete between-shop-visits life cycles; having all maintenance done according to the officially provided service bulletins; and given for lease in complete airworthiness.

Over the 10 years the management of “UTair Aviation” turned a small provincial company, that annually served 400 thousand passengers, into one of the leaders of national civil aviation. There are established routes, special passenger services (catering, ticket sales, maintenance), the fleet is being renewed, corporate shares are freely traded at stock exchanges thus attracting supplementary finance recourses, there is an established public credit history. The company intends to carry 2.5 mln passengers in 2006.

A while ago, the “UTair Aviation” management invested considerable for the company funds into development. This practice has proved to be successful and it has serious prospects for future. The management of “UTair Aviation” intends to become a leading operator on Russian domestic routes and a global helicopter operator. Finance policy of our partner is based upon income diversification and cost control. Simultaneous operation of aircrafts and helicopters makes it possible to diversify the company’s income basis and minimize the losses related to the growth aviation fuel prices.

The General Director of “UTair Aviation” Mr. A.Z. Martirosov believes that active employment of western aircrafts will help the air carriers to overcome the capacity crisis. However, at present “UTair Aviation” should completely use down life limits of domestic aircrafts, particularly of mid-distance Tu-154’s. Even relatively low fuel efficiency of these aircrafts is compensated by their comparably low purchase price, operating costs, safety efforts, staff training, i.e. by low ownership cost of these planes. Technical condition of the “UTair Aviation” fleet meets international standards. The level of comfort is higher in comparison to many used foreign aircrafts. Proper business management and considerable investment in airworthiness maintenance ensures effective employment of domestic aircrafts. According to Mr. Martirosov, the domestic transportation market in Russia is bigger than the international one. This concept of the Russian specificity is considered for the company’s development strategy. Despite temporary non-profitability of domestic transportation, this market offers great opportunities and profits for air liners. The main business strategy of the company according to this is to rely on mid-distance, short-distance and regional transportation services.

Thus, it can be seen even now that the development strategy followed by the company management leads to a considerable increase of performance that could not be reached by any other air carrier of the country. Still operating only domestic aircrafts, “UTair Aviation” demonstrated 28.7% growth of the passenger traffic last year.

The ATR-42 planes purchased to serve regional routes still have not passed the required preflight procedures and are not registered in the Russian state register. The company management plans to put in operation the first of these foreign planes approximately in March 2006. The middle-term plans of “UTair Aviation” include increase of the number of ATR-42 planes in their fleet.

Operating results of “UTair Aviation”:

- Passenger turnover reached 2,976.7 mln passenger-km, 20.6% growth;
- Passenger flow amounted to 1,887,020 people, 28.7% growth;
- Carried mail came up to 917 tons, 20.4% growth;
- Flight time amounted to 94,869 hours, 23.3% growth.

In 2005 OAO (Open Joint-Stock Company) “UTair Aviation” proceeds totalled 11.27 bln rubles, that is 30% more than the proceeds for 2004. As of the end of 2005, the company fleet comprises 114 planes. The company plans to employ 14 Tu-154, 28 Tu-134, 15 An-24, 13 Yak-40 and 43 An-2 planes for passenger flights.¹

“UTair Aviation” and “Avialeasing” have a four-year history of cooperation within the project of upgrading of domestic mid-distance aircrafts. The practice of “UTair Aviation” proves that proper operation of the fleet and business organization in general ensures effective employment of Russian-made aircrafts and positive results of it. In 2005, still operating a fleet of domestic aircrafts, “UTair Aviation” demonstrated an impressive passenger traffic growth of 28.7% and held forth position in the rating of leading Russian airlines in terms of total passenger traffic volume, having moved a line up in the rating of leading domestic airlines.²

6. Mission and Declaration of the Company

The Company’s mission is to meet the growing demand of the domestic airlines by offering safe passenger aircrafts that fully meet airworthiness requirements and ensure:

- for passengers – maximum safety and worthy comfort of the service;
- for airlines – an opportunity to effectively (in view of resource planning) employ owned and leased aircrafts that are completely airworthy, to expand passenger traffic bearing no heavy lump-sum costs, and at the same time to ensure properly flight safety.

We suppose that, as a result of our dedicated activities in 2006 and the following years, the Company will ensure a constant increase of completely airworthy domestic aircrafts promotion to the Russian airlines to meet the air carriers’ demands for safe, comfortable and cost-effective planes. Fruitful cooperation of the Company and its partners in 2005 made it possible to raise profitability and capital yield.

7. Position of ZAO “Avialeasing” Company in the Industry

There are dozens of leasing companies in Russia that deal with aircrafts and aircraft engines. In 2005 the scope of aviation leasing programs in Russia almost doubled. Currently the biggest Russian companies engaged in aircrafts lease, sales, consulting, and maintenance usually rely upon governmental support. For instance, “Ilyshin Finance Co.” (IFC) and “Finance Leasing Company” (FLC) are leasing companies of joint state and private ownership (the governmental shares of the authorized capitals are 38% and 62.7%, respectively). They were chosen by the Ministry of Economic Development and Commerce in 2001 upon the results of a tender.

“Ilyshin Finance Co.” (founded in 1999) specializes in funding for manufacturing and financial/operating lease of new domestic passenger aircrafts. These are IL-96 and An-148 produced by Voronezh city Joint-Stock Aircraft Construction Company and Tu-204 produced by Ulyanovsk city “Aviastar”. Since the onset of the governmental programme of aircraft lease development in Russia (adopted in 2001), IFC has financed the manufacture of nine aircrafts (five Tu-204 and four IL-96). The governmental share of the finance sources was 22%, the rest were private investments and credits. The business partners are OAO “Aeroflot-RA”, “Atlant-Soyuz”, “S7 Airlines”, “KrasAir Airlines”, “Transaero Airlines”, “Kavminvodyavia Airlines” etc. Over the five years, IFC

¹ www.utair.ru

² Rating of 20 leading Russian airlines in terms of passenger traffic volume in 2005. // Aviatransportnoye Obozrenie. – March 2006. No. 67, p. 6.

secured orders for 750 mln dollars: the company entered into agreements for the supply of 12 IL-96 (cargo and passenger), 5 Tu-204, and 15 regional An-148, and is preparing for production of several "Ruslan's". In 2005 "Ilyshin Finance Co." supplied four Tu-204-300 to "Vladivostok Avia" and one IL-96-300VIP to Cubana de Aviacion S.A. In 2005 IFC invested 7.4 bln rubles in aircraft manufacturing, it is 56% more than in the previous year. In 2006 it is planned to raise this figure up to 35 bln. The funds should go for manufacturing of 13 IL-96, 7 Tu-204, and 10 An-148, the work is to be completed in 2006-2009. At Moscow Air Show MAKS-2005, OAO "Ilyshin Finance Co." signed 7 agreements for the supply of 56 aircrafts for over 1.6 bln USD. First, there are 3 agreements to supply 39 An-148. The first agreement dated 16 August 2005 with "Pulkovo" was for the supply 18 An-148-100V aircrafts. (An aircraft of standard specification costs around 20 mln USD). The second agreement dated 17 August 2005 with "Polet" was for the supply of 20 An-148: 15 passenger An-148-100V and 5 cargo An-148T. The third agreement dated 17 August 2005 with "Krasnoyarsk Airlines" was for the supply of An-148-100-VIP. Second, there are 2 agreements for the supply of 10 IL-96 planes. The first agreement dated 18 August 2005 with Cubana de Aviacion S.A. airlines and foreign-trade enterprise AVIAIMPORT S.A. was for the supply of two IL-96-300 planes. Major financing under the contract shall use the export financing mechanism. IFC acts as a final supplier of the aircrafts and arranges funding. The second agreement dated 18 August 2005 as well, was signed with "Volga-Dnepr" air company for the supply of 8 IL-96-400T. Third, there are 3 agreements for the supply of 7 Tu-204. The first agreement dated 16 August 2005 with "Vladivostok Avia" air company was for the supply of 2 Tu-204-300 aircraft. The second agreement dated 17 August 2005 with "Kavminvodyavia Airlines" was for the supply of two Tu-204-100 planes. The third agreement dated 18 August 2005 with Cubana de Aviacion S.A. airlines and foreign-trade enterprise AVIAIMPORT S.A. was for the supply of for two passenger Tu-204-100 or Tu-204-300 aircrafts and one Tu-204S (cargo modification).¹

"Finance Leasing Company" was founded in 1997 by "Tatneft" oil company, "Zenith" bank and "Solid" investment & finance company. The government is among FLC shareholders since 2002, it holds 62.7% of the company equity. The main FLC activity is implementation of the governmental programme of manufacturing and leasing of modern mid-distance Tu-214 aircrafts produced by FSUE "S.P. Gorbunov Kazanskoye Aviation Production Association" ("KAPO"). As a result of the first lease transaction in 2001, "Dalavia" airlines obtained two Tu-214 planes. Since the government joined the company 's capital till the end of 2005, four aircrafts were handed over to the customers for operation. In 2005 FLC supplied two Tu-214 planes: one for "KrasAir" and another one for "Dalavia". In 2005 the main FCL partners were Sberbank and Joint-Stock Commercial Bank (AKB) "Eurofinance Mosnarbank". Besides, in early 2005 KAPO and FLC signed an agreement for production of ten Tu-214 in 2005-2007. Under the agreement, funding is provided by FLC. The aircrafts shall be operated by "Transaero Airlines". FLC and "Transaero Airlines" entered into agreements under which "Finance Leasing Company" shall provide planes to "Transaero Airlines" for financial lease for 15 years. According to Intertat.ru data, the cost of the lease contracts was 600 mln dollars. Several fund sources are being considered for financing of FLC's aircraft purchase from KAPO, these are funds of FLC itself and banks. In 2005 authorized capital of FLC is about 7 bln rubles. The major part of the FLC's authorized capital is comprised of three "budget tranches": 1.3 bln rubles in 2002, 385 mln rubles in 2003 and 3.25 bln rubles in 2005.²

In general, "Ilyshin Finance Co." and "Finance Leasing Company" were not satisfied by their results in 2005. State authorities were not satisfied as well. In June 2005 Russian

¹ www.ifc-leasing.com

² www.newsinfo.ru

Audit Chamber board performed a scheduled audit of targeted and effective use of funds allocated for lease of civil aircrafts. There were two basic objections. First, the auditors pointed out that the former Ministry of Property Management (reorganized to Russian Property Agency (Rosimushchestvo)) purchased shares of IFC for 2.52 bln rubles, while the company received for its authorized capital only 212 thousand rubles. Second, private founders of FLC illegally placed the equity interests, they owned in the company, into the commercial entities that had liabilities to the company the amounts of which were often almost same as the cost of the placed equity stakes. As a result, the amount of budget funds used inefficiently was 749 mln rubles. Moreover, equity holding of the OAO "Ilyshin Finance Co." was arrested under a criminal case initiated against the company management upon the abuse of authorities. About 36% of ordinary shares of the NRC subsidiaries, 15% of the shares of Vnesheconombank and other minority shareholders were arrested. The equities owned by the government were not arrested. At present the criminal case is terminated and the shares are released from arrest.

Both IFC and FLC compete for the budget funds allocated to support leasing projects and implement mutually competitive financing programmes of manufacturing and leasing of new regional aircrafts. By estimates, the volume of the potential market of new regional planes in the next 20 years in Russia only will be around 400 planes; their sale can raise 1.5-2 bln USD of tax income for the national budget.

However, most of the Russian airlines do not have enough working capital to operate modern aircrafts. Targeted financing of new aircraft purchase, even by way of operating lease, is unavailable either. The private leasing companies also do not have enough working capital. That is why currently most of the companies in aircraft lease market deal with used aircrafts.

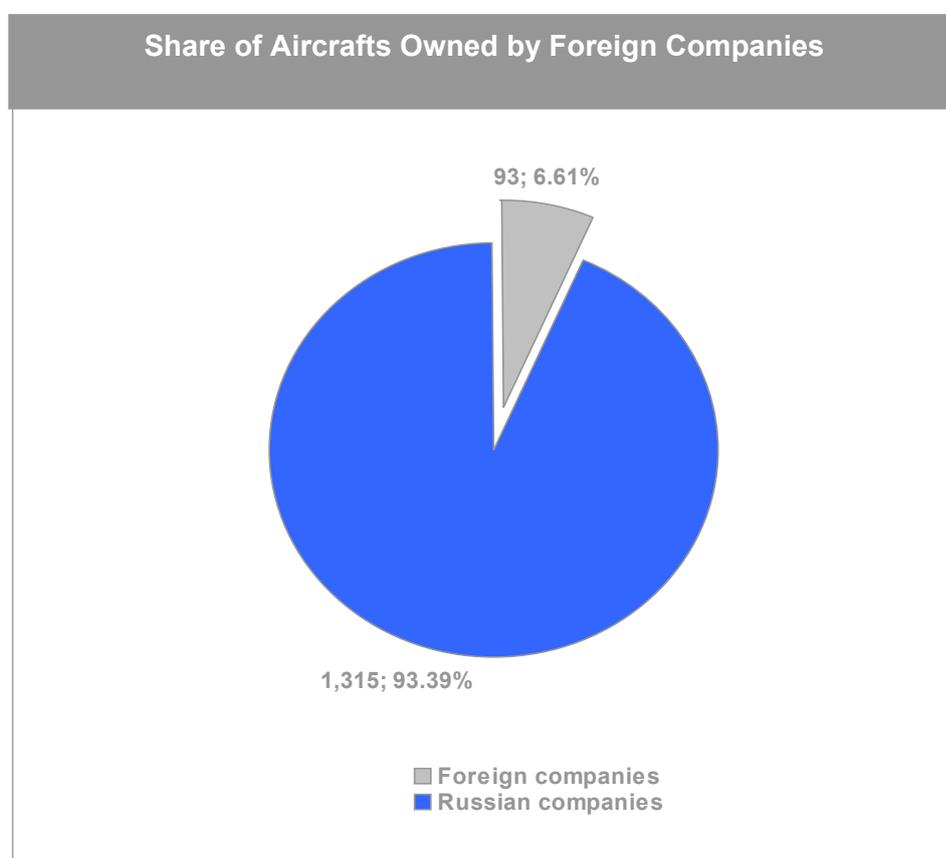
The "Interleasing" group of companies was established on 15 July 1999. State registration certificate No.92574 dated 13 August 1999. Lease license No.1048 dated 04 November 1999. The sole founder of OOO (Limited Liability Company) "Interleasing" is OAO "International Bank of St-Petersburg". The main company activity is offers for lease of the following types of equipment that are of the highest demand in the market: vehicles and trucks, special construction and road machinery, production equipment, aviation equipment, and mining machinery. Supplementary activity is stock trading. As of now, the "Interleasing" group is a dynamic developing company that keeps stable positions in the ratings of leasing companies. The aggregate amount of leasing portfolio in 2005 was over 3.26 bln rubles (in 2004 it equaled 1.5 bln rubles). Leasing transactions are financed with credits received from OAO "International Bank of St-Petersburg", as well as Uralo-Sibirskiy Bank and Gazprombank. Transactions with aviation equipment in the reporting year accounted for 14.05%. According to the governmental sources, in 2005 OOO "Interleasing" owned five aircrafts – one Tu-154B, one Tu-154M, and three Tu-134A given for operation to "Krasnoyarsk Airlines", "Domodedovo Airlines", "Samara Airlines", and "RusAir".¹

OOO "Dalmasheasing" (Khabarovsk city) is a subsidiary of OAO "Machine-Building Leasing Company" (Mashleasing). The idea of the company foundation emerged in 1996 along with the search for new ways to stabilize financial situation needed by the majority of industrial enterprises. OAO "Mashleasing" was founded in 1996 in pursue of the Russian Government Resolution on support and stabilization of machine-building and tool-making enterprises. For several years OAO "Mashleasing" has been successfully operating in the leasing market. The company has subsidiaries in different regions of Russia, Ukraine, and Belarus. The most important activity of OAO "Machine-Building Leasing Company" is participation in the programme of technical renovation of domestic

¹ www.interleasing.ru

machine-building enterprises the scope and significance for the national economy of which makes it possible to minimize financial risks of leasing schemes implementation. The company also offers for lease airplanes, aviation engines, vehicles, and construction and road machinery. According to the official data of 2005, “Dalmashleasing” owns three Tu-154M leased by “Dalavia” airlines.¹

Along with the Russian leasing companies, in 2005 a lot of foreign leasing firms offering foreign-made airplanes emerged into the aviation leasing market. Their emerging resulted from the strained situation in the international transportation market related to various limitations imposed upon employment of outdated aircrafts. In 2005, even considering high import duties, it stimulated bringing of over 30 foreign airplanes to the country. According to the governmental sources of 2005, the share of the passenger airplanes of foreign companies was 6.61%, while the share of the passenger airplanes owned by Russian companies was 93.39%.



In 2005 29 foreign lessors offering for lease passenger aircrafts were registered. Their share in the foreign-made aircraft leasing segment is illustrated by the following graph.

¹ www.mashleasing.ru

The company owns 16 aircrafts – four Airbus-319-111, five Airbus-320-214, one Boeing-737-317, two Boeing-767-300, and four Boeing-767-36N operated by “Aeroflot-RA” (15 aircrafts) and “KD Avia” (one aircraft).¹

Cramington Services (Ireland). Its share among the foreign lessors is 13.27%. According to the available information, this leasing company was established to assist in implementing objectives of “S7” airlines. In 2005, 13 aircrafts were handed over to “S7” for operating lease – ten Boeing-737-500, two Airbus-310-204, and one Airbus-310-304. Due to non-transparency of the pricing factors, we do not consider Cramington Services as a market-oriented company.²

MS2 Denmark Limited APS. Its share is 8.16%. The company owns eight aircrafts – four Airbus-319-111, one Airbus-320-214, and three Airbus-321-211 operated by “Aeroflot-RA” airlines.³

Large leasing companies directly related to the manufacturers, like Airbus Leasing II and Boeing Capital Corporation, have a small share of the total volume. Airbus Leasing II is represented in the leasing market by two Airbus-310-324 planes (manufactured in 1987), were handed over for operation to “S7” airlines. Boeing Capital Corporation owns three aircrafts – two Boeing-737-400 (manufactured in 1989) leased by “Transaero Airlines”, and one Boeing-737-300 operated by “Krasnoyarsk Airlines”. This tendency can be explained by the fact that most large foreign lessors deem the risks of work in the Russian market excessively high. Notably, the age of aircrafts offered for lease comes up to 20 years, and it is the leading (in terms of passenger traffic) airlines that are the lessees.

International Lease Finance Corporation (ILFC), the world second largest leasing company, conducts same policy. ILFC is a part of the U.S largest insurance group, AIG-American International Group. The company cooperates with over 150 airlines, its fleet comprises about 850 jetliners. In the Russian market the company is represented with two aircrafts – Boeing-767-200 (manufactured in 1988; operated by “Transaero Airlines”), and Boeing-737-382 (manufactured in 1989; operated by “KD-Avia”).⁴

The study of the rest mid-sized leasing companies in the aircraft leasing market shows that they offer one or two aircrafts leased by the following airlines: “Aeroflot RA”, “Transaero Airlines”, “Pulkovo”, “Krasnoyarsk Airlines”, “KD Avia”, “Vim Airlines”, and “Volga-Dnepr”. The large number of foreign lessors is explained by the deficit of used airplanes meeting the demands of the airlines in terms of price and condition. That is why the lessees have to work with different leasing companies in order to get the necessary number of aircrafts, thus losing discounts possible in case of cooperation with one leasing company. Particularly, “Transaero Airlines” works with eleven foreign lessors at a time. They are Boeing Capital Corporation, FIN 2 Limited, Megtrade Ltd., Pegasus Aviation, Bravo Aircraft Manag., ILFC, Carotene Limited, Embarcadero AST, Aerco Ltd., Jeritt Ltd, and Virgin Atlantic. “Aeroflot-RA” is a lessee of four leasing companies – GECAS, MS2 Denmark Ltd APS, OH Aircraft, and MSS Bermuda Ltd. “KD Avia” cooperates with four foreign leasing companies – Pegasus Aviation, ILFC, Babcock & Brown, and GECAS. “Krasnoyarsk Airlines” works with three foreign companies – Boeing Capital Corporation, Woodrow Leasing Ltd., and Arbour Finance Ltd.

The analysis of the air service market development allows to assume that the tendency will strengthen. However, one should keep in mind the following. Representatives of

¹ www.ge.com

² www.favt.ru

³ www.favt.ru

⁴ www.aviaport.ru

GECAS and ILFC state that several planes of the same type and same technical condition can hardly be found. 1.5 to 2 years can pass from ordering till receiving an aircraft.¹ Moreover, different models of aircrafts set completely different requirements to personnel, equipment, and general infrastructure of an air carrier. It is true especially for a comparison of foreign and Russian aircrafts. Due to this reason, only complete renewal of the fleet could make sense for most of the Russian airlines, that means a complete conversion to foreign aircrafts of the same type (this way was followed by Kaliningrad airlines of OAO "KD-Avia" that completely converted to Boeing aircrafts and sold out planes of other types). Most of the Russian companies are not ready for a complete conversion to foreign-made aircrafts. It should be noted, that Russian airlines operating foreign aircrafts face another problem. According to the requirements of aircraft designers and lessors, in case a certain aircraft component breaks down, it can be replaced with specially ordered replacement units only. Supply and custom clearance of such replacements takes time, meanwhile the aircrafts stay idle.

In relation to the above said, no rapid and, moreover, simultaneous complete re-equipment of the Russian fleet with foreign-made liners seems possible.

All the above-listed companies are serious and perspective operators in the aviation leasing market. However, according to the available information, none of the mentioned companies specializes in lease of Tu-154 aircrafts.

In the Russian Federation in 2005, according to the verified data, the aircraft leasing market for Tu-154 of different modifications comprised 85 planes totally. It included 52 Tu-154M and 33 Tu-154B (all modifications). The annual leasing payments were about 75,960,000 dollars.

In other words, in 2005 the leasing segment for Tu-154 of all modifications experienced a heavy growth, from 56 aircrafts at the beginning of the year to 85 at the end. The relative growth in the segment as a whole was 51.79%.

In Tu-154B (all modifications) leasing sub-segment the growth had a more moderate pace, 32.00% over the year. In Tu-154M leasing sub-segment the growth reached a record of 67.74%.

The pace of growth shown obviously illustrates several trends:

1. Experiencing a deficit of carrying capacities, the leading airlines implement rapid re-equipment (with foreign liners as well) and get rid of the outdated, in their opinion, aircrafts ("Aeroflot-RA", "S7", "Pulkovo"). The airlines competing with foreign companies at the international air routes ("Aeroflot-RA", "S7", "Pulkovo", "KD-Avia", "KrasAir") have to do this as they bear excessive costs operating at international flights aircrafts that do not meet ICAO requirements.

2. The airlines mainly focused on the domestic flights and the outsiders lease Tu-154 for the domestic routes and, in some cases, for certain international routes (Turkey, UAE, Egypt).

3. According to the industry growth trend, in case no new planes of the said types are manufactured, the companies mobilize all aircrafts that still can be repaired and operated at the domestic routes. However, this opportunity is not inexhaustible.

4. A certain number of aircrafts are mobilized in the outer market and brought to Russia by way of re-export.

Currently the said market is rather heterogeneous. There are quite different operators solving economic, as well as logistics, optimization, and social tasks. Among the operators present in the market, there are commercial repair facilities of civil aviation or

¹ A. Fetisov. To Take All That Is Possible. // Aviatransportnoye Obozrenie. – November 2005, # 64, p. 58-59.

their affiliated entities (OAO "411th Civil Aviation Plant" 1.18%); territories that mostly solve tasks of social service and state property management (Russian Federation 7.06%, Khakassiya and Khanty-Mansi Autonomous Area 2.35% each; Administration of Kogalym town and Tatarstan 1.18% each); operating airlines holding operating certificates, as well as airlines in bankruptcy or those leaving the transportation market served by Tu-154 (Chelyabinsk city Aviation Enterprise 5.88%, "Baikal" and "S7" 2.35% each, "Omskavia Airlines", "KD-Avia", and "BelAvia" 1.18% each, "Aerokuzbass" 4.71%, and "Samara Airlines" 3.53%). Notably, some operators continue leaving this market if aviation leasing is not their main business. In 2004 this segment was left by the divisions of "Gazprom" and "ALROSA" and in 2005 they were followed by Yamal-Nenets Autonomous Area and the Federal State Aviation Enterprise of Tomsk city.

The market share of the aircraft plants decreased (3.03% for Tu-154B, 0.00% for Tu-154M, and 1.18% in aggregate for Tu-154 segment), the share of the airlines also somehow reduced (30.30% for Tu-154B, 26.92% for Tu-154M, and 27.06% in aggregate for Tu-154 segment). There is a considerable decrease of the market share of the territories (12.12% for Tu-154B, 15.38% for Tu-154M and 14.12% in aggregate for the Tu-154 segment).

By our estimates, market-oriented purely leasing companies having market history account for:

- 42.42% in Tu-154B leasing market (actual absolute reduction of the number of aircrafts from 16 to 14 airplanes, i.e. by 12.5%) vs. 64.00% in 2004;
- 40.38% in Tu-154M leasing market (actual growth of the number of aircrafts from 14 to 21 planes, i.e. by 50.00%) vs. 45.16% in 2004;
- 41.18% aggregately in Tu-154 (all modifications) leasing market (actual growth of the number of aircrafts from 30 to 35, i.e. by 16.67%) vs. 53.57% in 2004.

How could it happen that though the growth of the segment was fantastically dynamic, the market-oriented aircraft leasing companies in total showed relatively lower pace of growth? In Tu-154B sub-segment there was 12.50% absolute reduction and the loss of 21.58% of the market; in Tu-154M sub-segment there was 50.00% absolute growth and the loss of 4.78% of the market; in Tu-154 (all modifications) segment there was 6.67% absolute growth and the loss of 12.39% of the market.

From our point of view, there are two main reasons:

1. The market-oriented aircraft leasing companies operating in Tu-154 leasing segment do not have enough capitalization and experience certain difficulties in raising financial resources.
2. 2005 was a year of heavy mobilization of the existing aircrafts of the airlines, and a year of significant penetration of foreign operator into the Russian aircraft leasing market. As the resource base was rather small, the companies were unable to fully realize opportunities for expansion of their leasing segments.

2004 was characterized as a year when the market-oriented aircraft leasing companies crossed the psychologically important 50% threshold of the leasing market of Tu-154B and Tu-154 (all modifications), and as far as Tu-154M leasing sub-segment is concerned, they closely approached this figure. For economic entities it was an obvious and direct sign that this segment was financially attractive. In 2005 new operators began penetration into the segment. The existing growth was achieved through the growth of the share of companies offering for lease one aircraft each. The increase was from 24 aircrafts in 2004 (42.86%) to 34 aircrafts in 2005 (40.00%). The absolute growth of this part of the sub-segment was 41.64% over the year.

The analysis of Tu-154B leasing sub-segment shows that there were no new leasing companies offering two or more aircrafts. Some operators increased or decreased their

shares by one plane. Tu-154B leasing sub-segment grew mainly through the increase of the market share of the companies offering for lease one aircraft each. The growth was from 8 aircrafts in 2004 to 17 in 2005, i.e. 112.5%. The only exception in this sub-segment was OOO “Orel ZAVS” having two Tu-154B airplanes.

Tu-154M leasing sub-segment, on the contrary, grew mainly through the penetration of new operators:

Chelyabinsk Aviation Enterprise – 4 Tu-154M – 11.76%

OOO TK Leasing – 3 Tu-154M – 8.82%

OOO RB Leasing – 3 Tu-154M – 8.82%

Aerokuzbass – 3 Tu-154M – 8.82%

“Samara Airlines” – 3 Tu-154M – 8.82%

OOO “Polistorg” – 2 Tu-154M – 5.88%

ROSSAKHAl leasing – 2 Tu-154M – 5.88% (let us remind that in 2004 the market was left by “ALROSA”).

(Let us also note that we do not consider as market-oriented operators the airlines in bankruptcy or in a poor financial state, and, thus, having to offer their aircrafts for lease).

We suppose that it was all the above mentioned processes that ensured increase of market gross income from 52 to almost 76 mln USD. Along with that the operators consolidate and the competition between the operators (beginning even from selection of an aircraft for an airline) intensifies. The companies compete not only in resource-related factors but primarily in business potentials as aircraft leasing is a very sophisticated and a rather specific area.

In Tu-154 (all modifications) leasing segment in general there is the following situation:

1. The absolute market leader (6 aircrafts; 7.06%) is the Russian Federation; no market motivation.
2. Aerokuzbass (4 aircrafts; 4.71%) and Chelyabinsk Aviation Enterprise (5 aircrafts; 5.88%) in bankruptcy; no market motivation either; 10.59% of the market.
3. A group of strong perspective market-oriented leaders having 3 aircrafts and 3.53% of the market share each: OOO “Dalmashleasing”, OOO “RB Leasing”, OOO “TK Leasing”, “Severleasing”, and ZAO «Avialeasing» Company. (“Avialeasing” is a little behind the competitors in terms of fleet structure, though it has a distinct competitive advantage of business potential); 17.65% of the market.
4. A group of solid “midfielders”, keeping enough development potential, have two aircrafts each (2.35%): OOO “Orel ZAVS”, “Interleasing”, “ROSSAKHAl leasing”, OOO “Polistorg”, “Sibavialeasing” – 11.75% of the market.
5. A group of businesses having no market motivation in sphere of aviation leasing with 2-3 aircrafts: “S7” airlines, “Baikal” airlines, Khanty-Mansi Autonomous Area, Khakassiya, “Samara Airlines” – 12.93% of the market.
6. A group of outsiders having one aircraft each in the considered segment – 40%. The outsiders can survive only provided their fleets are expanded, also they are diversified in other segments. Otherwise these companies will be inevitably withdrawn.

Thus, currently in the leasing segment of all Tu-154 modifications there is the following distinctly established group of leaders (listed in alphabetical order without consideration of legal form):

1. OOO “Dalmashleasing” (3 aircrafts, all of them are Tu-154M)
2. ZAO «Avialeasing» Company (3 aircrafts, all of them are Tu-154B)

3. OOO “RB Leasing” (3 aircrafts, all of them are Tu-154M)
4. OOO “Severleasing” (3 aircrafts, all of them are Tu-154B)
5. OOO “TK Leasing” (3 aircrafts, all of them are Tu-154M)

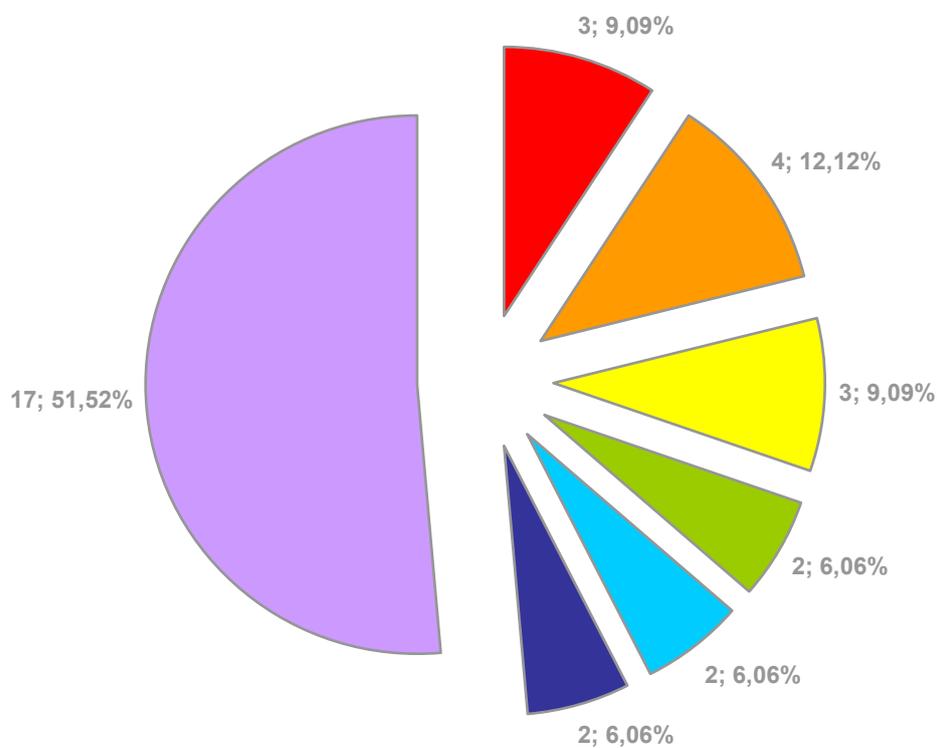
It is not possible to make certain conclusions on competitive positions and competitive advantages of the companies, if there are no finance reports, breakdowns of assets and liabilities, and information on cash flow density.

ZAO “Avialeasing” Perm Investment and Finance Company” was established in September 2001, it is an independent finance entity specializing in aircraft leasing and geared to “Avialeasing” group of companies. The prioritized activity is lease of domestic Tu-154 aircrafts. The Company was established due to the need of “Avialeasing” group of companies (hereinafter “Avialeasing” Group) to further differentiate services offered to the customers, (risks to be concurrently distributed) and to maintain stable functioning of the group companies. The Company has the basic competence meeting demands of the market because it was inherited directly from “Avialeasing” Group. The management of the Company has a long-term experience of work at the enterprises of “Avialeasing” Group. The structure of the Company is optimum for effective functioning. The Company has established systems that ensure effective business activities. The key features of the Company staff are high professionalism, vast experience in aircraft lease and the adjusted areas, sense of purpose, and high diligence. The Company deliberately motivates joint approach to management aimed to generate new business ideas, as well as to ensure creative approach of each employee.

The outlined set of factors allows competition not only in offered services but also in business potentials. In 2005 competitive advantages of the Company allowed to secure 9.09% of Tu-154B market segment (in 2002 there were 5.71%, in 2003 6.06%, and in 2004 12%). As for Tu-154 (all modifications) market segment, the Company secured 3.35% of the market.

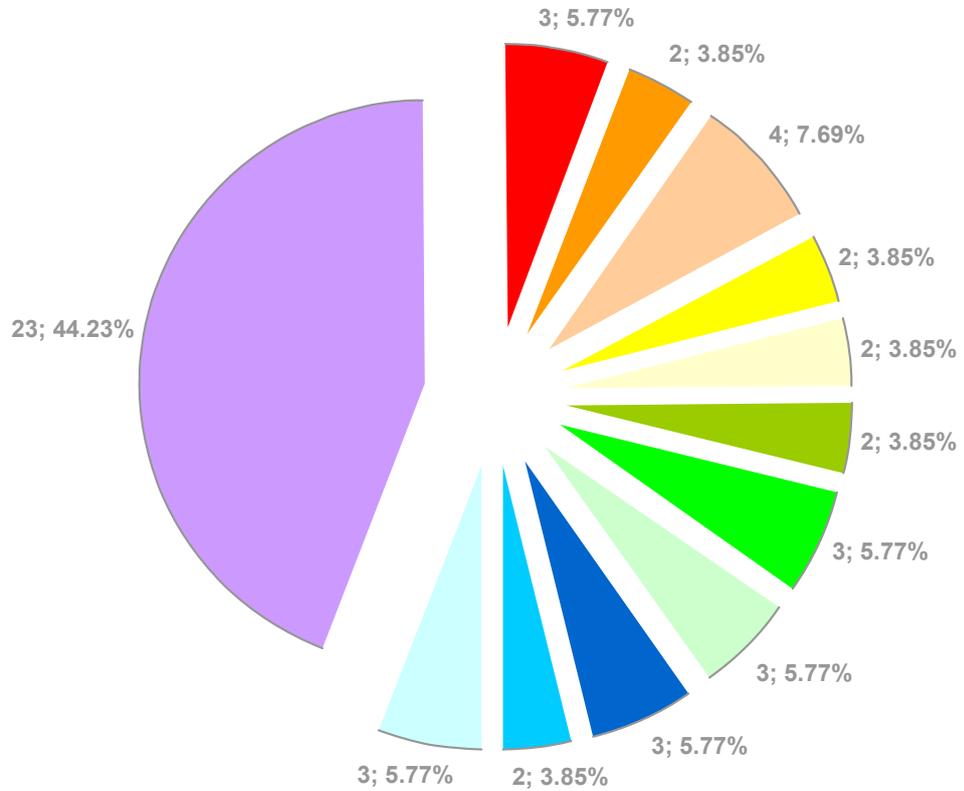
Since its establishment in 2001 the Company successfully employs both leasing and long-term rent schemes for Tu-154 aircrafts. The Company sustains heavy competition in its market segment through its management and financial system of supply of aircrafts that are completely airworthy. The system facilitates the expensive process of obtaining airplanes and allows to meet actual conditions of the operators.

Shares of Tu-154B (Different Modifications)
in the Aircraft Lease Market (pcs, % of the total)



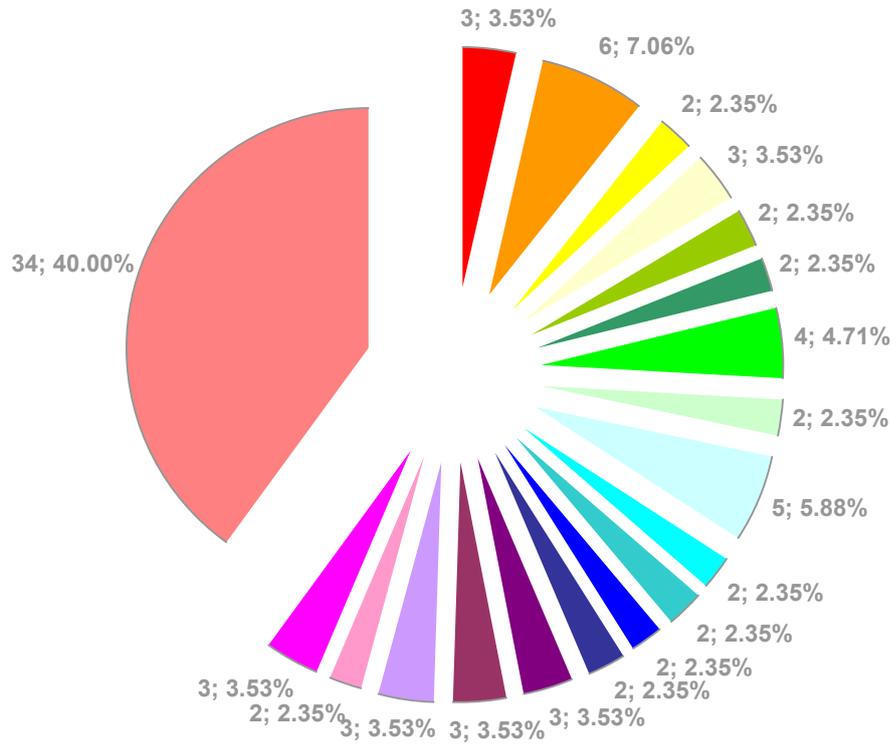
- ZAO "Avialeasing" Company
- The Russian Federation
- Severleasing
- OOO Orel ZAVS
- S7
- Baikal
- 17 companies offering for lease one aircraft each

Shares of Tu-154M (Different Modifications) in the Aircraft Lease Market (pcs, % of the total)



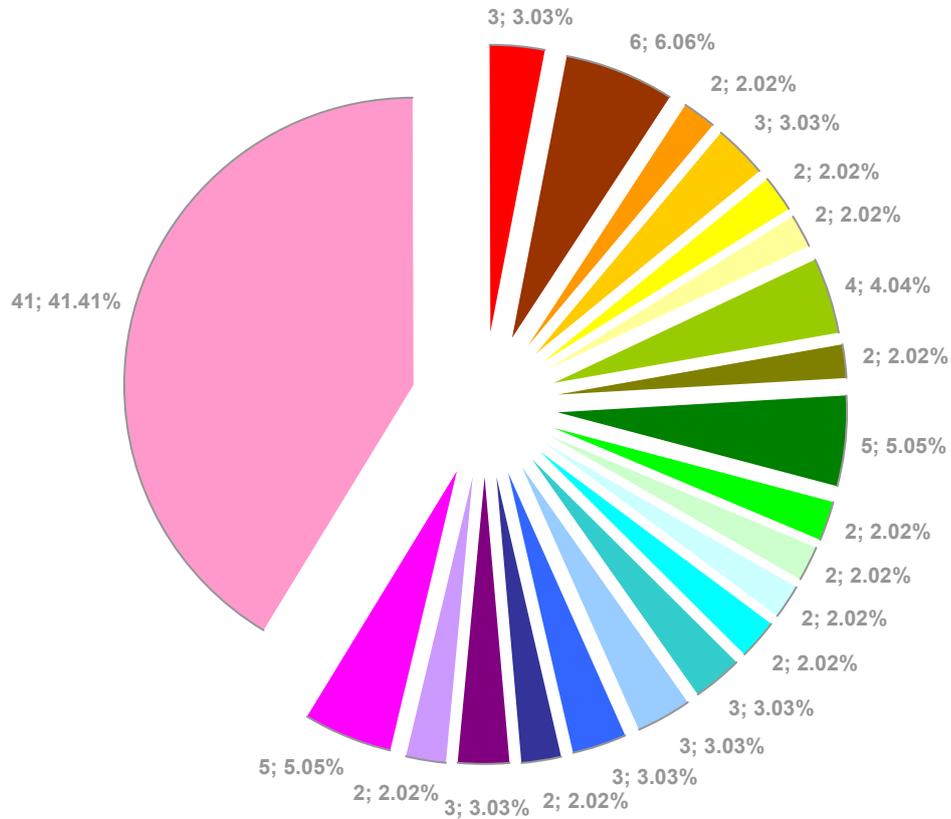
- AEROKUZBASS
- Russian Federation
- Chelyabinsk Aviation Enterprise
- ROSSAKHleasing
- Khanty-Mansi Autonomous Area
- Khakassiya
- OOO TK Leasing
- Samara Airlines
- OOO RB Leasing
- OOO Polistorg
- OOO Dalmashleasing
- 23 companies offering for lease one aircraft each

Shares of Tu-154B (Different Modifications) in the Aircraft Lease Market (pcs, % of the total)



- Avialeasing
- Russian Federation
- SibAviaLeasing
- Severleasing
- OOO Orel ZAVS
- S7
- Aerokuzbass
- Interleasing
- Chelyabinsk Aviation Enterprise
- Baikal
- ROSSAKHLeasing
- Khanty-Mansi Autonomous Area
- Khakassiya
- OOO TK Leasing
- Samara Airlines
- OOO RB Leasing
- OOO Polistorg
- OOO Dalmashleasing
- 34 companies offering for lease one aircraft each

**Shares of Tu-154 (Different Modifications) and Similar Foreign Aircraft
in the Aircraft Lease Market
(pcs, % of the total)**



- Avialeasing
- Russian Federation
- SibAviaLeasing
- Severleasing
- OOO Orel ZAVS
- S7
- Aerocuzbass
- Interleasing
- Chelyabinsk Aviation Enterprise
- Baikal
- ROSSAKHleasing
- Khanty-Mansi Autonomous Area
- Khakassiya
- TK Leasing
- Samara Airlines
- RB Leasing
- OOO Polistorg
- OOO Dalmashleasing
- Boeing Capital Corporation
- GECAS (GE Commercial Aviation Service)
- 41 companies offering for lease one aircraft each

Considering the competition between the domestic aircraft leasing companies and foreign market-motivated lessors, it should be noted that the latter are distinctly present in the Russian market and compete with the domestic leasing companies by importing Boeing 737-400 and Airbus 320 (these aircrafts are close to Tu-154M according to their specifications). The graph above gives the summary data on the leasing market shares of Tu-154 (different modifications) similar foreign-made aircrafts segments.

We assume that the mentioned types of aircrafts (Boeing 737-400 and Airbus 320) are most close to Tu-154 according to the specifications. Thus, the distribution is as follows:

1. A distinct leader of the total segment – GECAS (GE Commercial Aviation Service), five Airbus 320, 5.05% of the market.
2. A group of five Russian operators having three Tu-154 (all modifications) each (3.03% each), 15.15% of the market in total.
3. “Solid midfielders” – five domestic companies having two Tu-154 (all modifications) and one foreign operator, Boeing Capital Corporation: 2 Boeings 737-400 (2.02% each), 12.12% of the market totally.
4. A group of absolute outsiders and companies with no market motivation – 67 aircrafts of all types – 67.68%.

Segmentation of Aircraft Leasing Market operators and Aggregation of Member Clusters (year 2005)

| Company | Number of aircrafts | Share of the company | Total (market share) |
|---|----------------------------------|----------------------|----------------------|
| 1. GECAS | 5 aircrafts (Airbus 320) | 5.05% | 5.05% |
| 2. OOO “Dalmashleasing” | 3 Tu-154 aircrafts | 3.03% | 15.15% |
| ZAO «Avialeasing” Company | 3 Tu-154 aircrafts | 3.03% | |
| OOO “RB Leasing” | 3 Tu-154 aircrafts | 3.03% | |
| OOO “Severleasing” | 3 Tu-154 aircrafts | 3.03% | |
| OOO “TK Leasing” | 3 Tu-154 aircrafts | 3.03% | |
| 3. OOO “Interleasing ” | 2 Tu-154 aircrafts | 2.02% | 12.12% |
| OOO “Orel ZAVS” | 2 Tu-154 aircrafts | 2.02% | |
| OOO “Polistorg” | 2 Tu-154 aircrafts | 2.02% | |
| ROSSAKHAlensing | 2 Tu-154 aircrafts | 2.02% | |
| OOO “Sibavialeasing” | 2 Tu-154 aircrafts | 2.02% | |
| Boeing Capital Corporation | 2 Boeings 737-400 | 2.02% | |
| 4. Outsiders or entities of no market motivation | 67 aircrafts of all types | 67.68% | 67.68% |

Aggregation of member clusters during the analysis of the market operators with the Pareto distribution, showed the following regularities:

- the first two groups of market members account for an aggregate of 20.20% of the market structure. These are the distinct leaders that in the mid-term prospect shall hold their positions;

- the third group accounts for an aggregate 12.12% of the market structure. This is a risk group. Its members shall implement business expansion and diversification strategies in order to keep their market shares but mainly to remain in the market (the exception is Boeing Capital Corporation the capitalization and international market diversification of which raises no doubts);

- the fourth group are absolute outsiders and companies of no market motivation, they account for 67.68% of the market structure.

Pareto distribution and Cluster Aggregation of Market Operators

| Company | Number of aircrafts | Market share of a given cluster | Number of members / controlled market share in 2005 | Share of the members / Pareto |
|-------------------------|---------------------|---------------------------------|---|-------------------------------|
| 1. GECAS (1) | 5 | 5.05% | 1 / 5.05% | 20.20% / ~ 80% |
| 2. Leaders (5) | 15 | 15.15% | 5 / 15.15% | |
| 3. "Midfielders" (6) | 12 | 12.12% | 6 / 12.12% | 79.80% / ~20% |
| 4. Outsiders and others | 67 | 67.68% | 67 / 67.68% | |
| Total | 99 | 100.00% | 99 / 100.00% | 100.00% / 100.00% |

Thus, with a certain assumption, it is obvious that in the future 80% of the aircraft leasing market in the Russian Federation (provided the other conditions are equal) will be controlled by six today's leaders and BCC. The share of the others might total 20%. It is true for market competition in the segment. Should the big operators (like GECAS or Boeing Capital Corporation) follow dump sales policy, the situation could possibly change significantly in favour of foreign operators.

8. Business Activities and Operations of the Company in 2005

The Company operates in the leasing market of Russian-made Tu-154B aircrafts and actively implements projects with Tu-154M planes.

The Company is focused on the consumer segment, namely on the perspective rapidly growing airlines having their own considerable fleet of mid-distance aircrafts, able to effect timely leasing payments. These were the criteria we employed and chose “UTair Aviation” that belongs to the four biggest Russian airlines upon the results of 2005.

In 2005 our partners were:

OAO “UTair Aviation” (Khanty-Mansiysk town). “UTair Aviation” is a long-term partner of the Company. “UTair Aviation” is among the four strongest aviation enterprises in terms of passenger traffic. Since 1991 it is also the biggest helicopter operator in the world market. The Company is accredited by the UN as an official supplier of aviation services.

OAO “Ural Civil Aviation Plant” (Yekaterinburg city) is the supplier of NK-8-2U engines for Tu-154 and the contractor for engine overhaul.

OAO “411th Civil Aviation Plant” (Mineralnyie Vody town) is the supplier of airframes for Tu-154 and the contractor for these airframes overhaul and reworks aimed to bring airplanes to complete airworthiness according to the requirements of the Federal Transport Surveillance Agency (formerly GSGA).

OAO “KD-Avia” (Kaliningrad city) is the supplier of Tu-154M.

These companies managed to preserve their human resources and technologies during the difficult economic situation of the reforms. The Company management’s cooperation experience with the managers of these plants is positive. If to consider the quality of works and products established by the Company, the prices offered by these plants are optimum.

The Company’s experience proves that it is a lessor that has to settle down numerous co-operation matters between designing offices, manufacturers, and suppliers of major assemblies as the system of these relations is rather complicated.

The Company believes that a key for successful development of the chosen business strategy is long-term co-operation with respectable partners.

Technically ZAO «Avialeasing” Company is busy with renovation of Tu-154 aircrafts, including:

- airframe overhaul;
- installation of power jets and auxiliary power units;
- rework of flight director systems;
- rework of aircrafts according to the ICAO requirements to international flights and installation of the required auxiliary equipment and rework of the existing one, it also includes rework of D-30KU-154 engines in terms of noise-absorption according to ICAO (Chapter 3);
- alteration of interior configuration;
- bringing aircrafts to complete airworthiness and complete restoration of between-service life cycles of an aircraft, units, and components;
- handing over of the ready-for-operation aircraft for lease to airlines.

This scheme of activity has proved to be viable.

In 2005 the Company commenced development of another market segment, that is lease of Tu-154M aircrafts. Considerable design improvements shall be implemented under a new modification programme for this type of aircrafts with the help of “Vnukovo Aircraft Repair Plant No. 400”. Through the following upgrades, our aircrafts will obtain a number of operational advantages, namely fuel economy and increased revenue load. The following units will be installed:

1. Winglets of new design. Improved aerodynamics is achieved due to the reduced effect of tip vortices. Tests confirmed the results bleeding and demonstrated economy of 800 kg of fuel at the revenue load of 14 tons and the distance of 5,000 km. Particularly, for “UTair Aviation” the actual economy of aviation fuel per one Tu-154M is 45 kg per 1 flight hour. If annually an aircraft makes 2,000 flight hours, the economy of fuel is 90 tons per year. Assuming average cost of aviation kerosene in 2005 of 16.3 thousand rubles per ton, the economic effect is close to 1,467 thousand rubles per year per each upgraded aircraft.



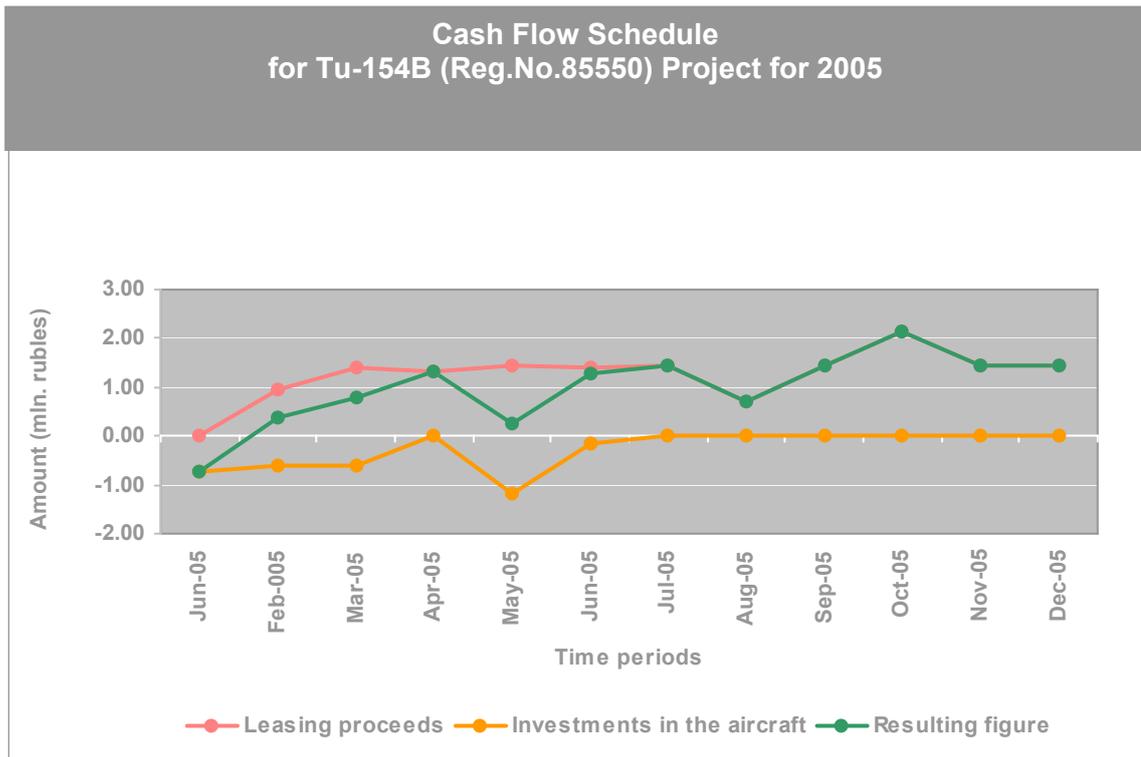
2. “Heksel” lightweight honeycomb floors. This improvement allows to decrease the weight of floors of airplanes, and thus, to increase revenue load of each upgraded aircraft by 670 kg.

The fact that “Aeroflot-RA”, the leading air company, intends to spend over 200 mln rubles in 2006 for a similar modification of domestic aircrafts also confirms that the Company made the right choice as for the new aircraft modification program. Over 60 mln rubles of the said amount shall be invested in installation of winglets of new design on 21 Tu-154M, and about 40 mln rubles shall be spent to decrease the weight of floors of these airplanes.

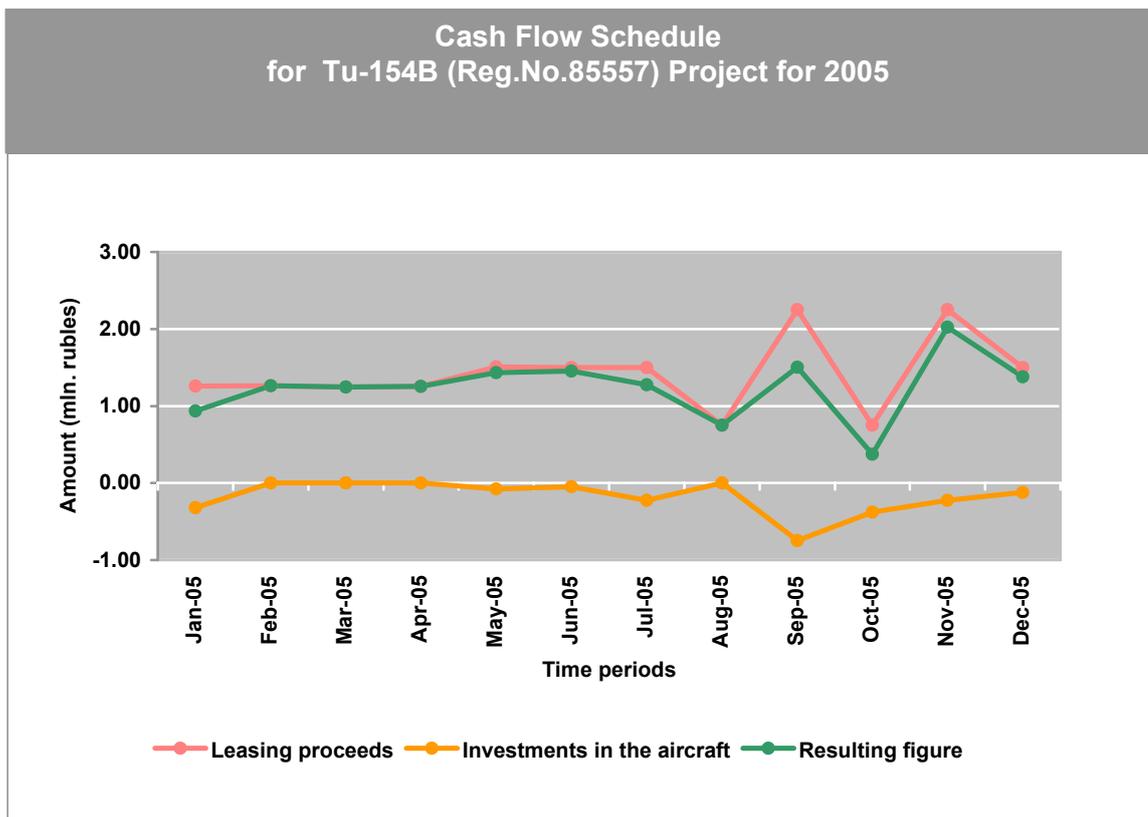
In 2005 the Company was working on the project of purchasing and giving for lease a Tu-154M (Reg.No.RA-85789). On 28 February 2006 the complete airworthy aircraft was handed over for lease to our regular partner “UTair Aviation”.

Implementing this project, the Company employed the system, that was developed even in 2002 and that meets actual economic practice, of monitoring (control over future profits), legal support of the cash flow management process, of aircraft technical condition supervision and prompt scheduled restoration of complete airworthiness of units and components, the system of direct contacts between operating airlines and

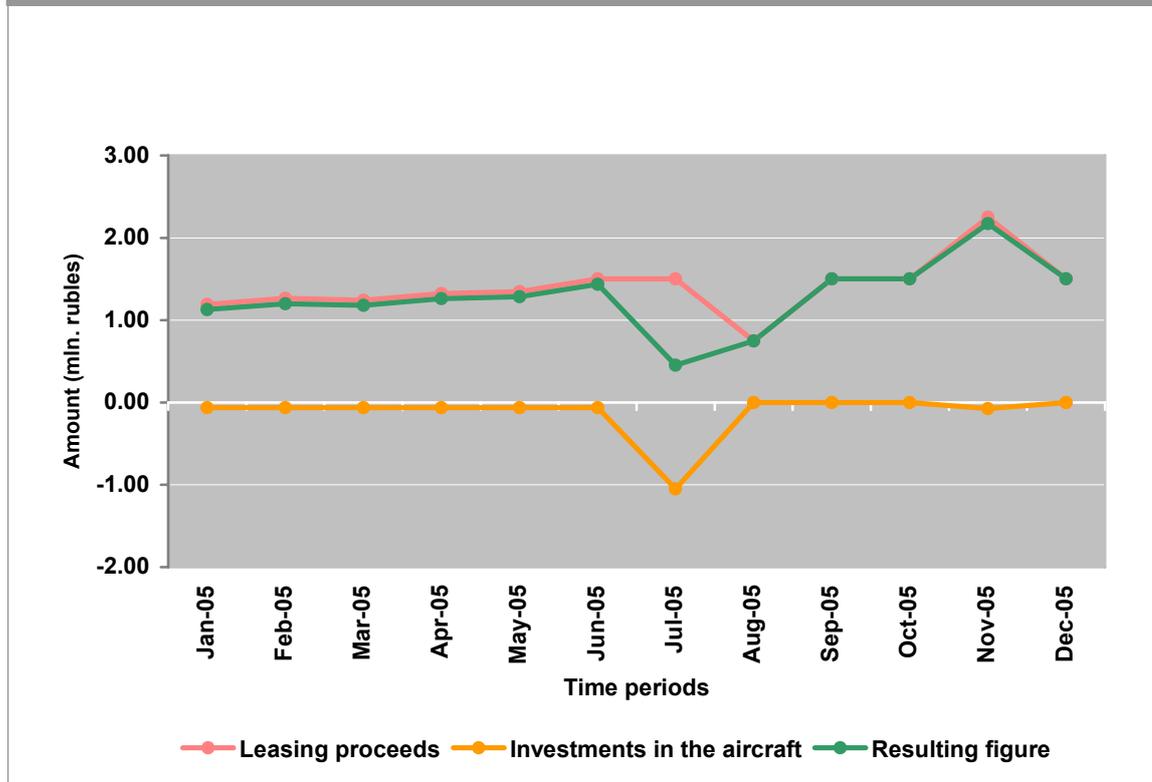
repair plants in removing failures and replacing units and components at their scheduled restoration term, the system of life management for aircrafts, units, and components.



The project of Tu-154B (Reg.No.85550) handing over for lease was implemented in December 2004. In order to implement this project, in 2004 an agreement with OAO “411th Civil Aviation Plant” was signed. The plant performed complete restoration of the aircraft. The payments were effected in the first half of 2005 and it affected the expenditure pattern.



**Cash flow schedule
for Tu-154B (Reg.No.85504) Project for 2005**



In July 2005 investments were made to appraise technical condition of the Tu-154B (Reg.No.85504) to prolong the designed life cycle up to 25 calendar years and 2 months and it influenced the expenditure pattern of this project.

As a result of the operating activities of the Company in 2002-2005 the technology was established. The management acquired considerable experience, and the basic risk factors were identified. In our opinion, airlines should follow the below said main technology stages of a leasing deal:

- To select aircraft type. Choice of a certain aircraft type is the most important decision made by the airlines. In the next years it will determine profitability of the aircraft operation. To choose a plane, several factors should be taken into account, beginning with the most obvious ones, namely a pattern of future traffic, competitiveness of an airline, available working capital, funding sources, effects upon the financial balance of an airline, future technical redundancy. It is also necessary to carry out, step-by-step, an extremely sophisticated economic analysis of operation.
- To search the market. At the very beginning of an aircraft purchasing it is necessary to compose properly the text of an inquiry in reply to lessors' proposals and provide it to airlines' owners. At this stage it is very important to show competence and clear intentions.
- To involve legal advisers. Legal consultation, its correct interpretation, regular contacts with the legal department, and careful attention to their recommendations are mandatory to get maximum profitable conditions of aircraft lease or purchase.
- Technical support. If a company intends to perform in future all kinds of maintenance, except overhaul, on its own, the contract, specifying handing over of appropriate technologies and staff training, becomes crucial as far as operation of a new aircraft is concerned.

- Aircraft registration.
- Commercial matters. It is impossible to cover high expenses of aircraft purchase and get profits if not to operate the aircraft heavily. That is why it is absolutely necessary to re-consider completely the activities of commercial departments of the airline.
- Staff training. Preliminary training of air crews and technical personnel can considerably save money and labour resources.
- Acceptance of the aircraft. The lessor can request, and he is within this right, full and detailed information on ownership status, structure, technical and finance state of the airline taking the aircraft on lease. A considerable number of different documents are required to satisfy all terms of aircraft supply.
- Spare parts. Although supplies of spare parts and consumable materials are specified in a technical agreement, the airline should have some stock of them. Such stock can be purchased or taken on lease. The items for the stock can be recommended by the lessor or there can be a list in an agreement with maintenance, repair and overhaul facility. It is too expensive to keep a large or, vice versa, too small stock of spare parts. An optimum inventory can be created through the most careful analysis of the other operators' experience.
- Insurance. Currently the following items are mandatory according to the Russian law:
 - Insurance of aircraft owner's liability to a third party for damage to a third party's life, health or property caused by operation of the aircraft.
 - Insurance of life and health of aircraft crew members when they execute their official duty.
 - Liability insurance for damage to life and health of aircraft passengers, as well as to baggage and hand luggage of passengers.
 - Liability insurance to cargo owners or consignors for cargo loss, shortage or damage (detriment).
 - Liability insurance to possible damage from aviation activities performed by operator.

According to the terms of the lease agreements concluded by "Avialeasing", aircraft insurance is performed by the Company. This practice is explained by the requirements of the banks crediting aircraft purchase projects.

- Terms of acceptance and further return of the aircraft. This is one of the most important aspects during negotiations on aircraft lease and acceptance. The airline taking the aircraft on lease should check its technical condition, outline technical conditions of supply, requirements to aircraft appearance, conformity to all directives of aviation authorities on maintaining airworthiness of aircrafts of this type, current as of supply, and make sure that terms of aircraft return to the leasing company are equitable and fair.

In our opinion, the main risk factors in business activities of the Company are:

- risk of payment default by airlines having aircrafts on lease;
- aircraft downtime at leasing airlines due to failure of various aircraft components because of expired life time or due to a number of factors of no relation to life cycle and, thus, risk of lease payments decrease;
- flight accidents with Tu-154 aircrafts and, thus, risk of temporary operation suspension for all or a part of aircrafts of the type upon decision of governing authorities. These factors can entail actual damage or loss of profits for the Company.

In order to avoid such risks, the Company established a special system of internal control based on the work performed by two divisions of the Company, legal department, and investment and production department.

The divisions are responsible for functioning of the following systems:

- preliminary analysis and subsequent control of credit solvency and payment capacity of operating airlines;
- effective implementation of contractual conditions ensuring performance of payment obligations by airlines;
- control over life status of aircrafts (as a whole, as well as of their certain components) handed over to airlines;
- claiming process directly connecting plants performing aircraft and engines overhaul and airlines operating them, to minimize duration of removal of defects, faults and failures of units and components revealed during operation;
- continuous economic monitoring.

In general, 2005 was characterized by intense promotion of operational activities of the Company in its market segment. Supervision of projects for aircrafts and engines operation was intensified and it made possible to minimize forced downtime of the aircrafts. Average monthly flight time of the aircrafts was as follows: 137.06 hours for Tu-154B (Reg.No.85557), 138.86 hours for Tu-154B (Reg.No.85504); 129.32 hours for Tu-154B (Reg.No.85550) and it is significantly higher than standard, as well as the industry average flight time.

9. Development Prospects of the Company

Still the most profitable planes in the fleets are Tu-154B and Tu-154M and it proves that the Company made a logical choice to modify Tu-154 aircrafts, and confirms efficiency of the leasing schemes structure that allowed to take leading positions in the relevant aircraft market segment.

The Company's business is secure and stable even under recession. And in case of a favourable economic conjuncture, economic growth in the Russian Federation, and increase in gross domestic product, the Company has vast development prospects.

Focus on Tu-154 segment yielded positive results and it has long-term prospects. These aircrafts will keep their status of optimum domestic airplanes for at least five years for Tu-154B, and fifteen years for Tu-154M.

We have a stable forecast for development of the existing projects for 2006 (Tu-154B Reg.No.85557, 85504, and 85550, and Tu-154M Reg.No.85789).

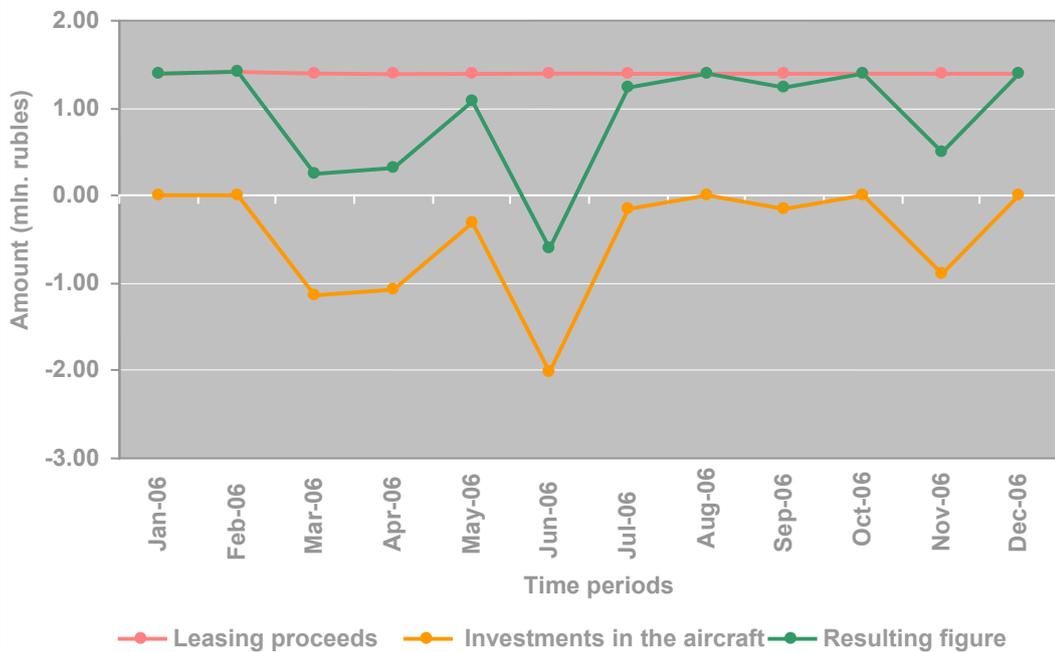
It is planned to purchase in February 2006 engine NK-8-2U, and for October 2006 it is scheduled to invest in prolongation of the designed life up to 25 years, that will effect the structure of this project.

Under Tu-154B (Reg.No.85550) project it is planned to purchase auxiliary power unit in the second quarter of 2006, and invest in prolongation of the designed life up to 25 years in November 2006 and it is shown in the cash flow schedule.

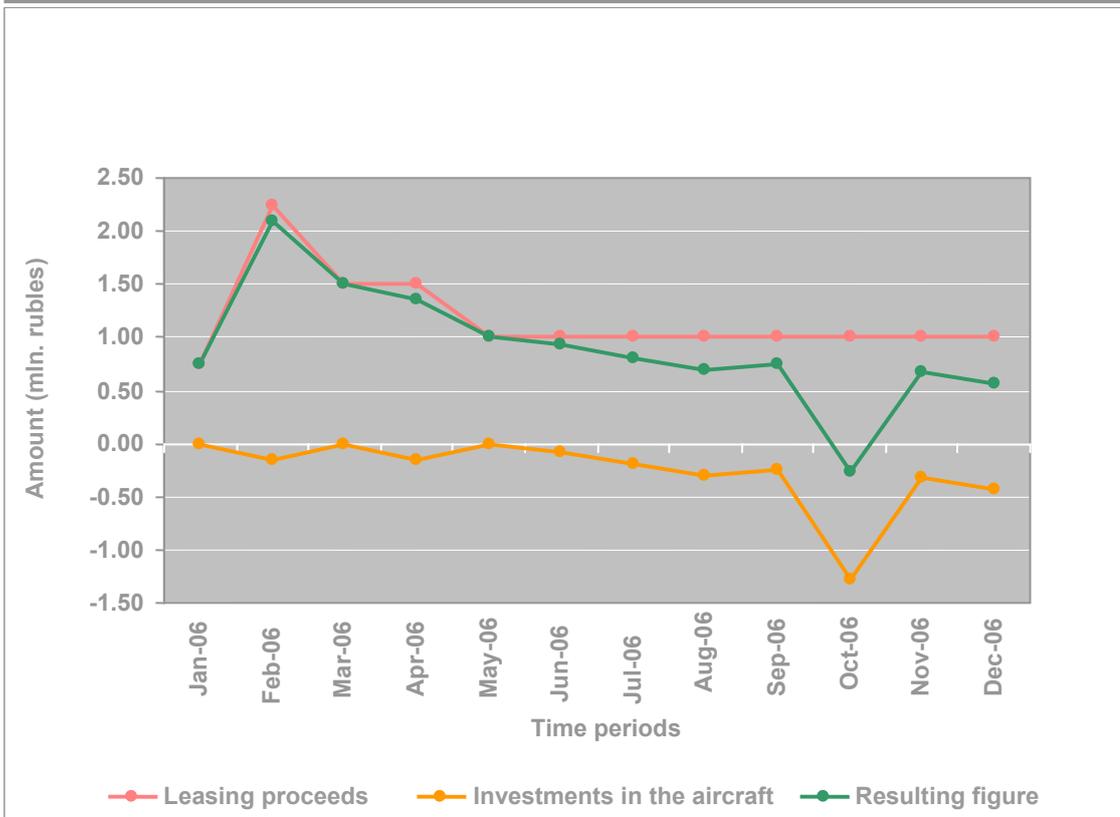
**Cash Flow Forecast
For Tu-154B (Reg.No.85557) Project for 2006**



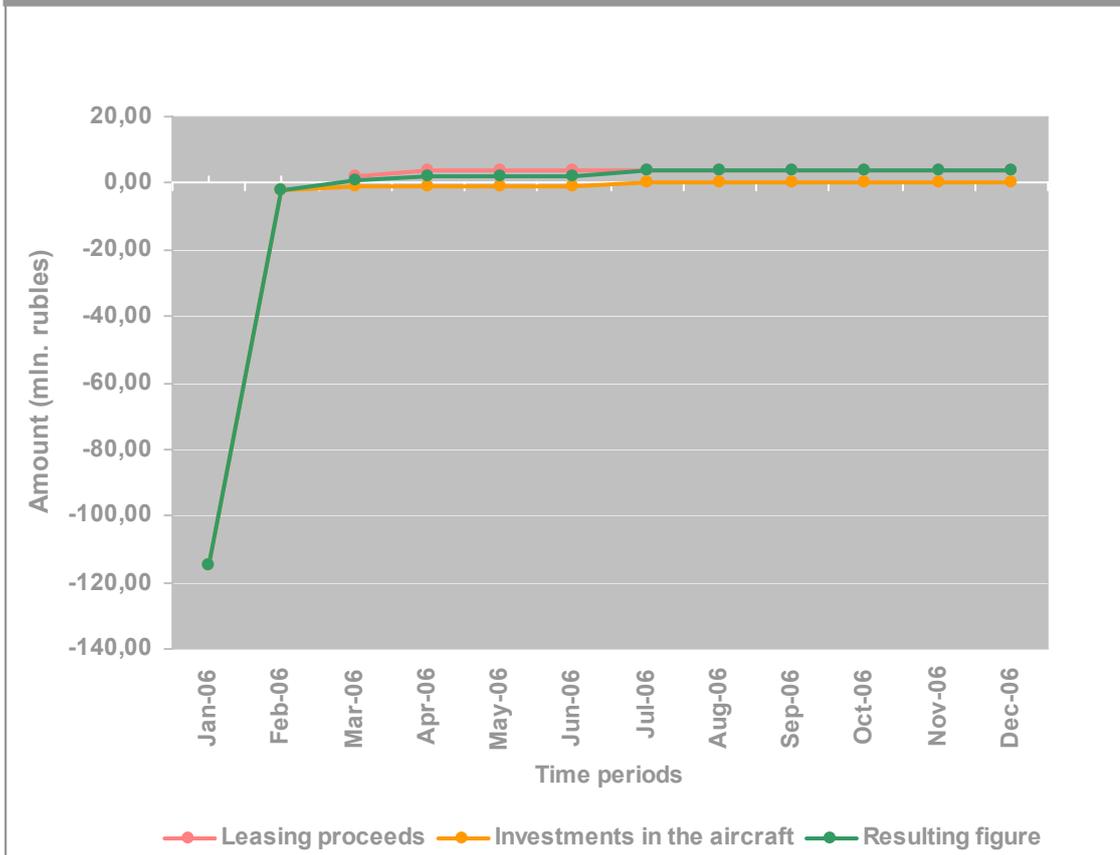
Cash Flow Forecast for Tu-154B (Reg.No.85550) Project for 2006



Cash Flow Forecast for Tu-154M (Reg.No.85504) Project for 2006



Cash Flow Forecast for Tu-154M (Reg.No.85789) Project for 2006



For October 2006 it is scheduled to invest in prolongation of the designed life of Tu-154B (Reg.No.85504) up to 26 years, and it will effect the cost structure.

For 2006 the Company plans to purchase Tu-154M (Reg.No.90A840), bring it to complete airworthiness, and offer for lease.

The Company plans to invest in this aircraft through the cash flows from the currently leased aircrafts (its own funds), as well as by raising loan capital (bank credits).

The Company, together with the biggest Russian airlines, continues to develop leasing projects for the domestic new-generation aircrafts on Tu-204-base, as well as for foreign-made aircrafts.

By our estimates, in the current market segment of the Company there is still a high penetration barrier. For foreign leasing companies this barrier means high import duties upon imported aircrafts. For the Russian leasing companies there is insufficient capitalization and credit capacity, considering that business in this segment is quite capital-intensive. We do take into account that accession of the Russian Federation to the WTO can significantly change the situation in the aircraft leasing market. From our point of view, to respond adequately, we should maximize economic efficiency of the Company's activities.

Thus, we believe that improvement of economic efficiency of the Company and preservation of its leading positions in the current market sector depend upon:

- sustained high pace of growth;
- balanced and optimized borrowing in the stock and credit market;
- improved corporate management systems.

10. Stock Market Tools. Capital Raising Practices

The leasing market in Russia and, particularly, the aviation leasing market show dynamic development. Lessors' own funds are increasingly employed as one of lease funding sources; lessors often invest considerable money in business. In general, over the last years, particularly, from the beginning of 2004, there is a general downward trend in earnings for all money market instruments. This trend is quite ordinary for stock market and national economy development. However, there are more earning instruments.

What does the stock market offer currently, which of its instruments can be used by business entities (including our Company) to raise funds, and by investors to place their free recourses? What is the Company's position in this market? From our point of view, the answers to these questions define long-term prospects of Company's capitalization increase, and tactic decisions related to capital raising practices.

Equity. Investments in fixed capital by way of share issues are still very low because it is quite unreasonable to invest in equity due to high political risk, as well as risks of hostile takeover or violation of minority shareholders' rights. Economic growth and increasing demand for investment resources are not accompanied by a considerable number of new issuers in the stock exchange listings. Primary distribution in the equity market is not employed so far as an investment raising tool. Number of issuers whose equities are traded at stock exchange is decreasing as well. The reasons are:

1. Introduction of new issues to the open stock market is quite expensive and difficult due to unavailability of credit and stock histories.
2. Stock market liquidity goes down due to political risks.

3. As far as general growth in trade volumes is concerned, the fastest pace belongs to the external market turnover. To a considerable extent it is because for large business it is still more profitable to raise investments overseas rather than in the domestic market.

4. For smaller businesses (as we consider our Company) it is quite expensive and economically inefficient to engage in open-market stock trading.

Thus, for such big companies as “Ilyshin Finance Co. ” and “Finance Leasing Company”, unlike our Company, it can be worthwhile to trade their stock. However, because of governmental participation in their authorized capital, these companies also face certain problems when using this investment-raising tool (for example, shares of “Ilyshin Finance Co.” owned by private parties had been arrested for 9 months, from July 2005 till April 2006).

Corporate bonds. The market of corporate bonds is rather young and actively developing. It demonstrates fast growth of volumes, turnover and number of issuers. This is because this type of investment is most attractive for investors. The reasons are:

1. Minimum risk as compared to equities, since bonds are secured by assets of an issuer and have a priority of claims.

2. High financial responsibility of an issuer for timely payment of interests and principal, since in case of a considerable delay these amounts are collected by way of bankruptcy proceedings.

3. Fixed interests paid upon bonds are more stable than average loan interest rates.

Over the last years several leasing companies entered the stock market. It was “RTK-Leasing” that was the first to employ this tool. It has already paid off three loans for 500 mln, 1 bln and 1.5 bln rubles and issued the fourth tranche of bonds in April 2005. In current operation there are the bond issues of “Globus-Leasing” (for 400 mln and 320 mln rubles, from October 2005 for 500 mln rubles), “Inform-Service-Leasing” (15 mln, 150 mln and 20 mln rubles), and “PN-Leasing” (20 mln rubles). All these issuers started from half-year placements, then proceeded to year-long, and then two- and three-year placements. Actually, these bond issues are a component of a leasing assets securitization mechanism (consolidation, in a single specially established company, of leasing portfolio and individual projects that later become a basis for stock emission). That means that raised resources are used to re-finance new projects. It is indirectly evidenced by the fact that during the last years the number of leasing projects sale and purchase transactions increased. We suppose that purchasing specialized leasing portfolios will be the next stage in development of a financial component of the leasing market.

The intention of stock-market issues was declared by several more leasing companies. It means that in 2006-2007 new bond issues shall be expected. However, not all lessors consider this way of funding for their leasing business to be attractive. They believe that issuing is troublesome and not always profitable, for instance in case it is under 200 mln rubles. The matter is that a part of flotation costs is fixed. Thus, the lower borrowing is, the higher issuer’s relative expenses are. Also little loans are deemed to have lower liquidity. In the opinion of our advisers (Vebinvestbank), bond instruments offered for open market are economically efficient and worthwhile (besides other factors) if to start from 300 mln rubles and that was obviously oversized for our Company in 2005. Bond issues in the over-the-counter market involve much lower costs, they are more applicable for local markets, though liquidity is much lower.

Promissory notes. Since promissory notes are not subject to mandatory registration in state authorities, it is impossible to determine exact number of drawers. The segment of promissory notes is the largest. They are mainly used to replenish working capital. Actually contradictory law-enforcement practice turned promissory notes into a high-risk

instrument, which, in turn, made the Company in its business focus on these instruments as subordinated borrowings only. Following conservative policy in respect of promissory notes, the Company does not intend to offer them in open-market trade.

Derivative financial instruments. Currently the derivative instruments are mainly traded at two trading floors. In the Russian Trading System (FORTS) there are transactions with derivative instruments and securities (mostly equities). Contracts for other basic assets, like foreign currency, oil, diesel fuel etc., are concluded at St. Petersburg Exchange Market. The volume of derivative finance instruments trades in Moscow Interbank Currency Exchange (MICEX) is inconsiderable. In general, activities in the term market are growing. Development of the market of derivatives is held back due to the lack of appropriate legislation.

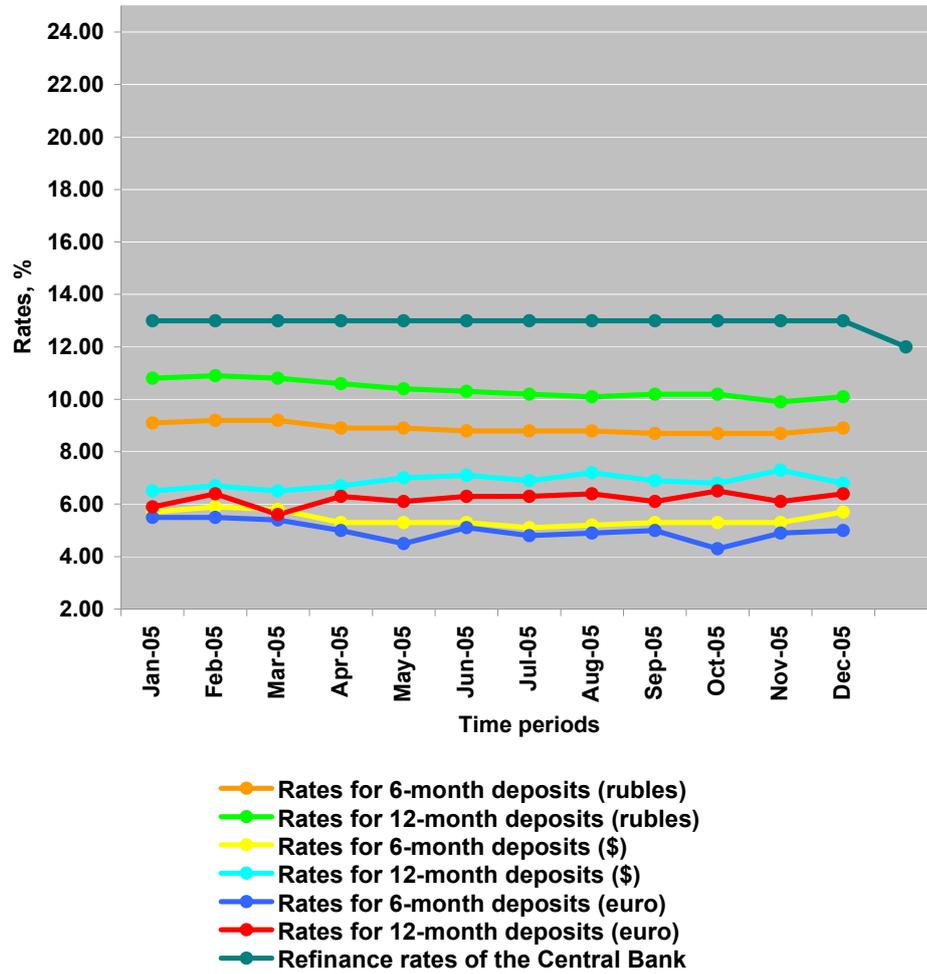
All above-mentioned circumstances prevent the Company from employing derivative finance instruments in its activities.

Mutual funds. In 2005 there was a considerable growth of private investors' activity in purchasing shares of mutual funds. However, currently aggregate investments in mutual funds are quite inconsiderable. Mutual funds are mostly focused on the companies present in the open market (and, particularly, the "blue chips"). Our Company does not belong to the latter, and, thus, this investment source is unavailable.

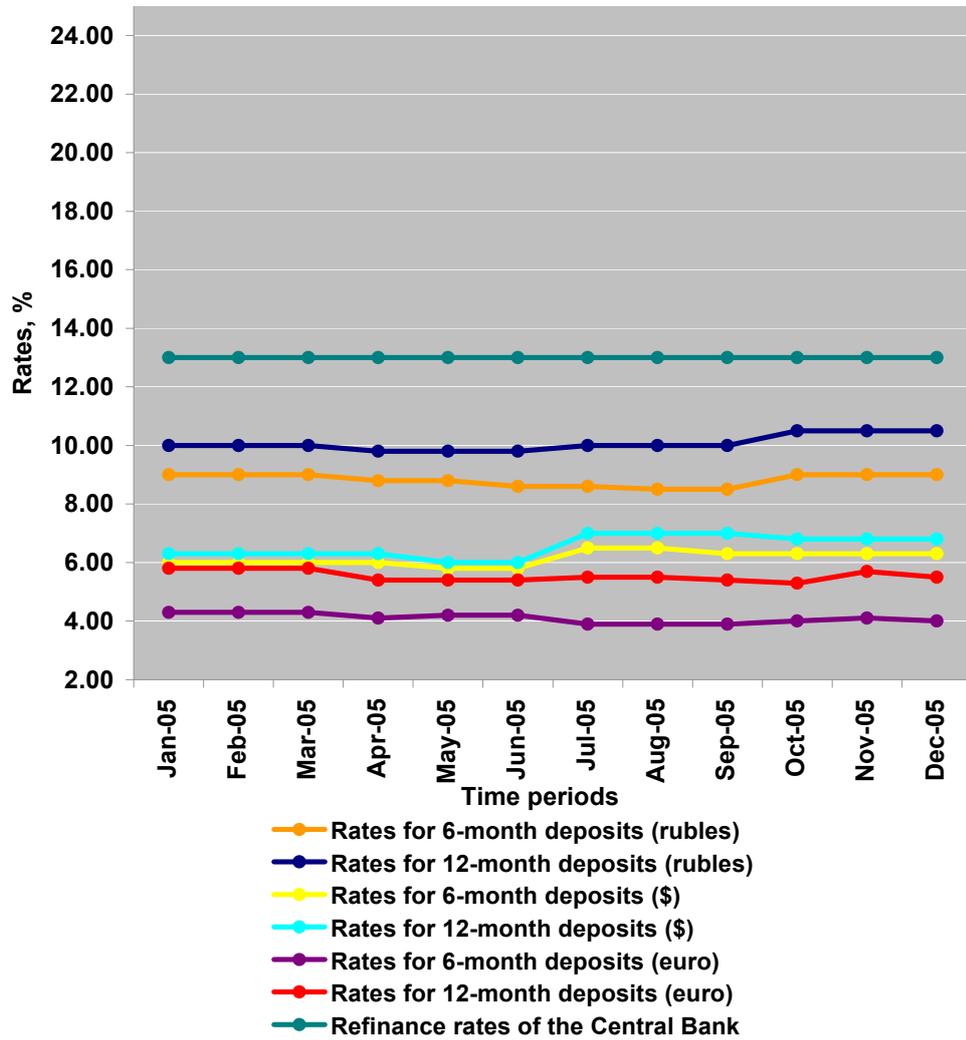
Another question is whether it is possible for the Company to raise funds from, say, individuals and businesses directly rather than from finance institutions. The analysis of possible funds placement of individuals and businesses gives the following results.

Deposits. The average deposit rates for individuals and businesses, effective in 2005 in the Russian Federation and Perm Region, are illustrated in the corresponding graphs.

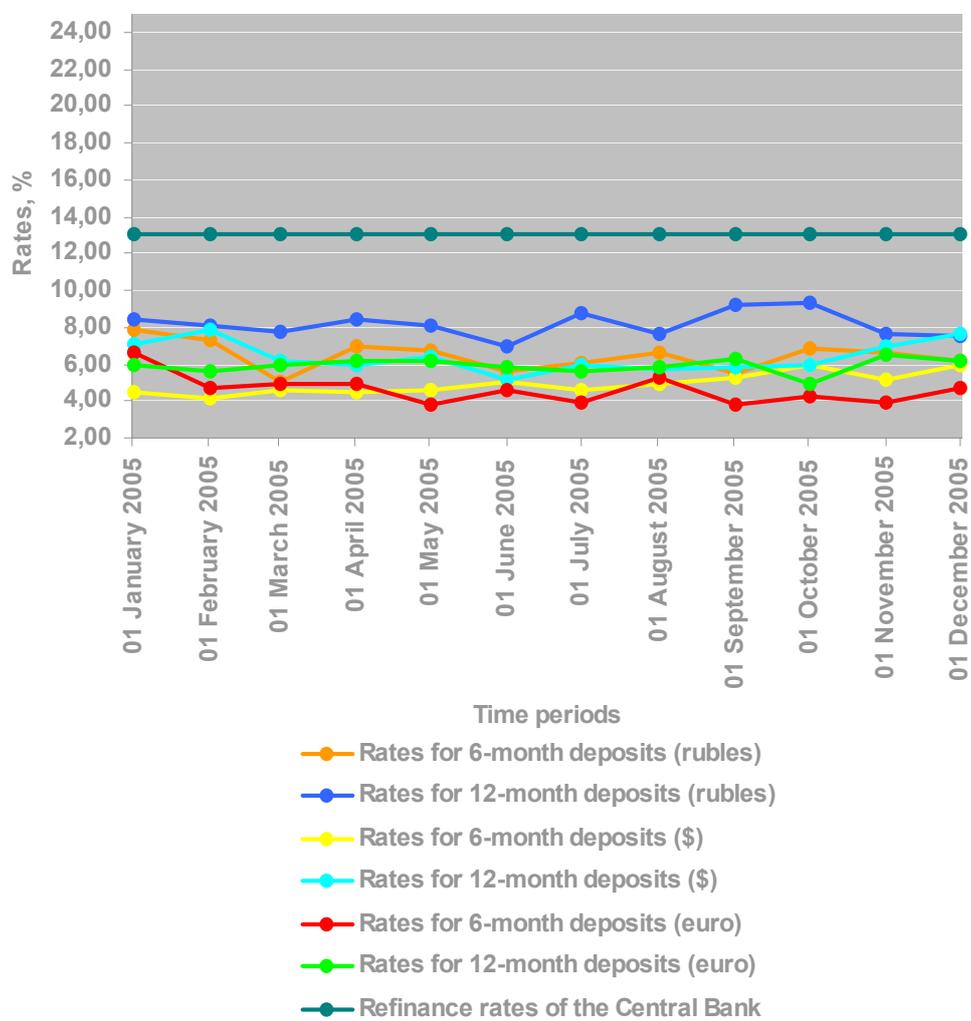
Rates for 6- and 12-month deposits for individuals effective in the Russian Federation



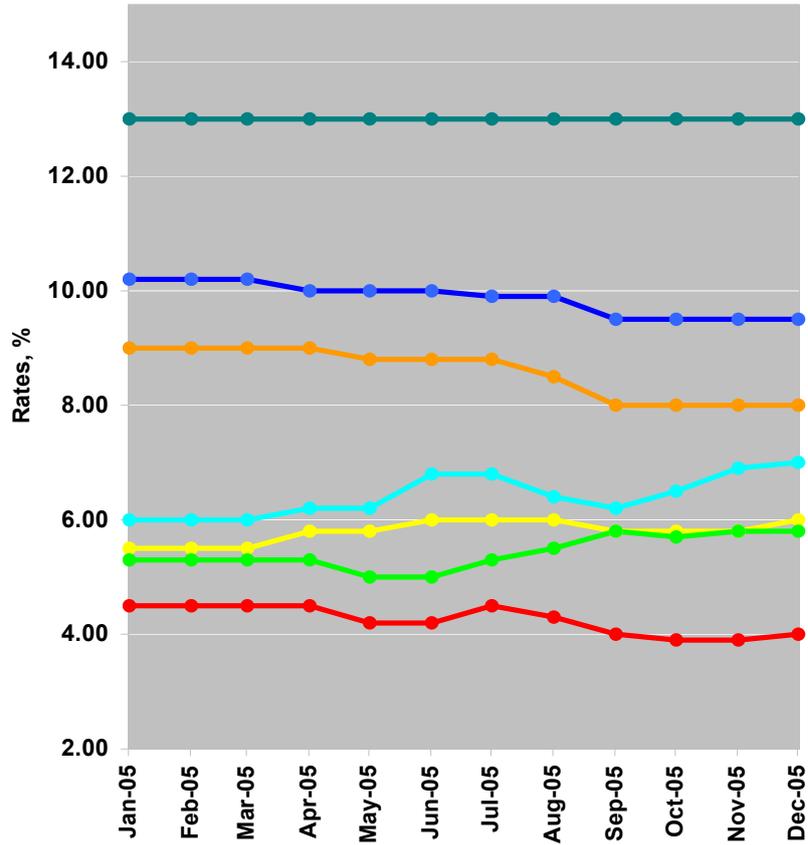
Rates for 6- and 12-month deposits for individuals effective in Perm Region



Rates for 6- and 12-month deposits for legal bodies effective in the Russian Federation



Rates for 6- and 12-month deposits for legal bodies effective in Perm Region

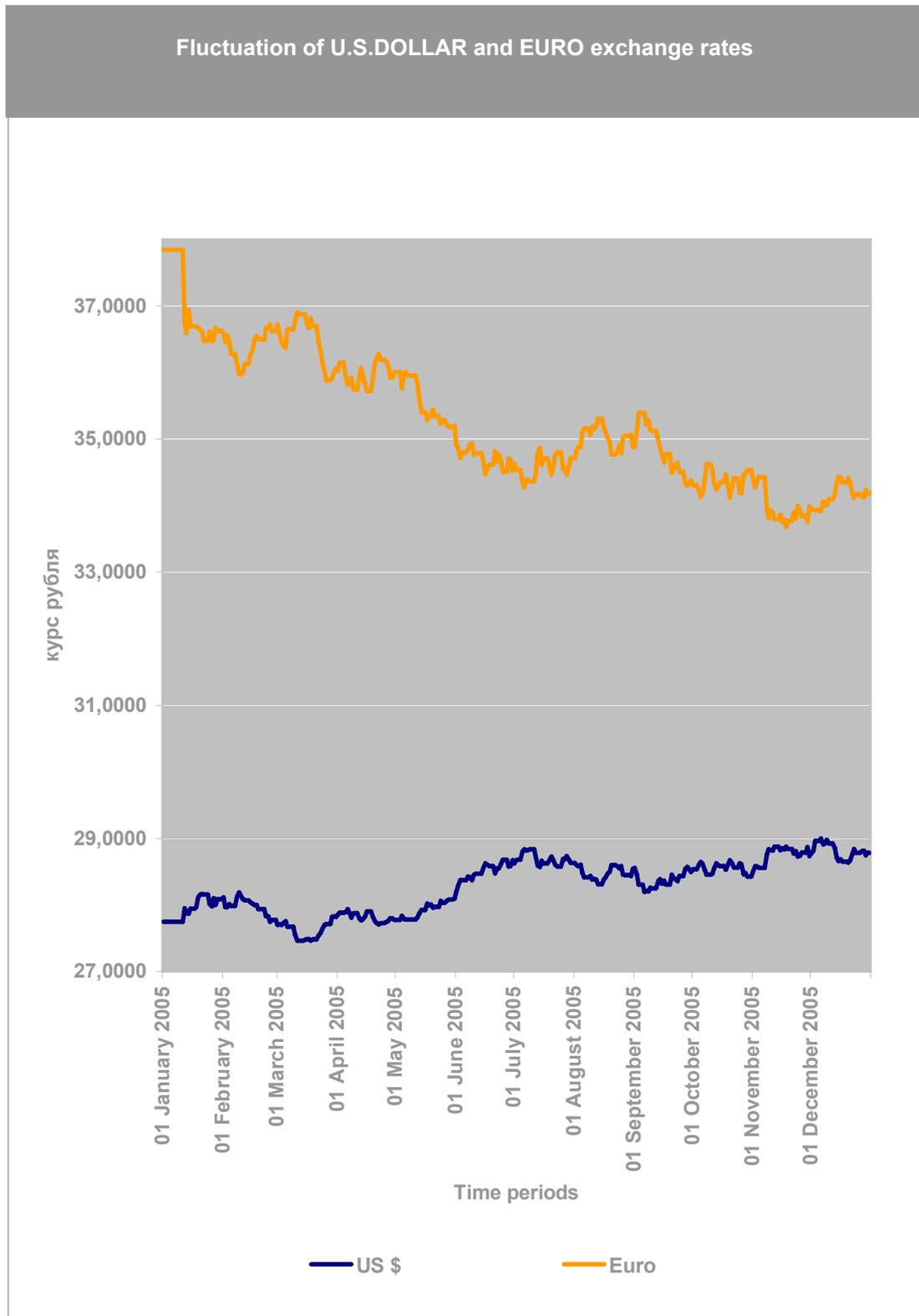


- Rates for 6-month deposits (rubles)
- Rates for 12-month deposits (rubles)
- Rates for 6-month deposits (\$)
- Rates for 12-month deposits (\$)
- Rates for 6-month deposits (euro)
- Rates for 12-month deposits (euro)
- Refinance rates of the Central Bank

Deposit interest rates for individuals tended to decrease over the whole year. The rates depend not only on deposit policy of a particular bank but also on a refinancing rate of the Central Bank, national inflation level, status of the money market. Upon the results of the last year, interest rates in the domestic market lowered by about 1% per annum. Nevertheless, certain commercial banks managed to preserve them at a rather high level, especially for long-term deposits. This is why there was a certain outflow of deposits from Sberbank to other commercial banks. According to RBK, over the last year share of Sberbank dropped for ruble deposits by 7.1%, to 59.7%, and for foreign currency deposits by 3.4% to 42.2%. In December 2005 the Central Bank reduced the refinance rate, which considerably influenced the market, and thereafter ruble deposit rates in many banks somehow lowered. A considerable reason to lower the rates was introduction of deposit insurance system. Participation in this system requires extra expenditure to arrange the process, so the banks obtain free money at the cost of their customers by reducing deposit rates. Besides the deposit insurance system, level of deposit rates is influenced by extremely low (about 1%) rates, that established recently in the interbank credit market. However, according to the experts, deposits are nevertheless profitable for individuals, taking in account that, according to the forecasts of the Ministry of Finance in 2006 inflation will be 8-9%, and ruble deposits starting from six months yield income that exceeds this forecast. Strengthening ruble while prices for oil are lowering helped both individuals and businesses to believe in ruble. Currently it is deemed safer and more convenient to keep savings in ruble deposits, and, thus, increasing share of ruble deposits becomes a general tendency of the deposit market. Over the last two years there has been a four-time growth of their aggregate amount. Ruble deposits for more than one year grow at a fastest pace. Bankers responded to this tendency by a certain drop of ruble deposit rates, especially for long-term deposits; at the same time, rates for middle-term deposits were not cut, and somewhere they even raised. The experts note, that rates for currency deposits (6% per annum on an average) in 2005 remained almost unchanged, and some banks started to raise their yield.

Investments in foreign currency. Active efforts of the Bank of Russia to control ruble-to-U.S. dollar and ruble-to-euro exchange rates lead to a straightforward conclusion on low or negative return on investing in foreign currency as compared to investments in ruble instruments.

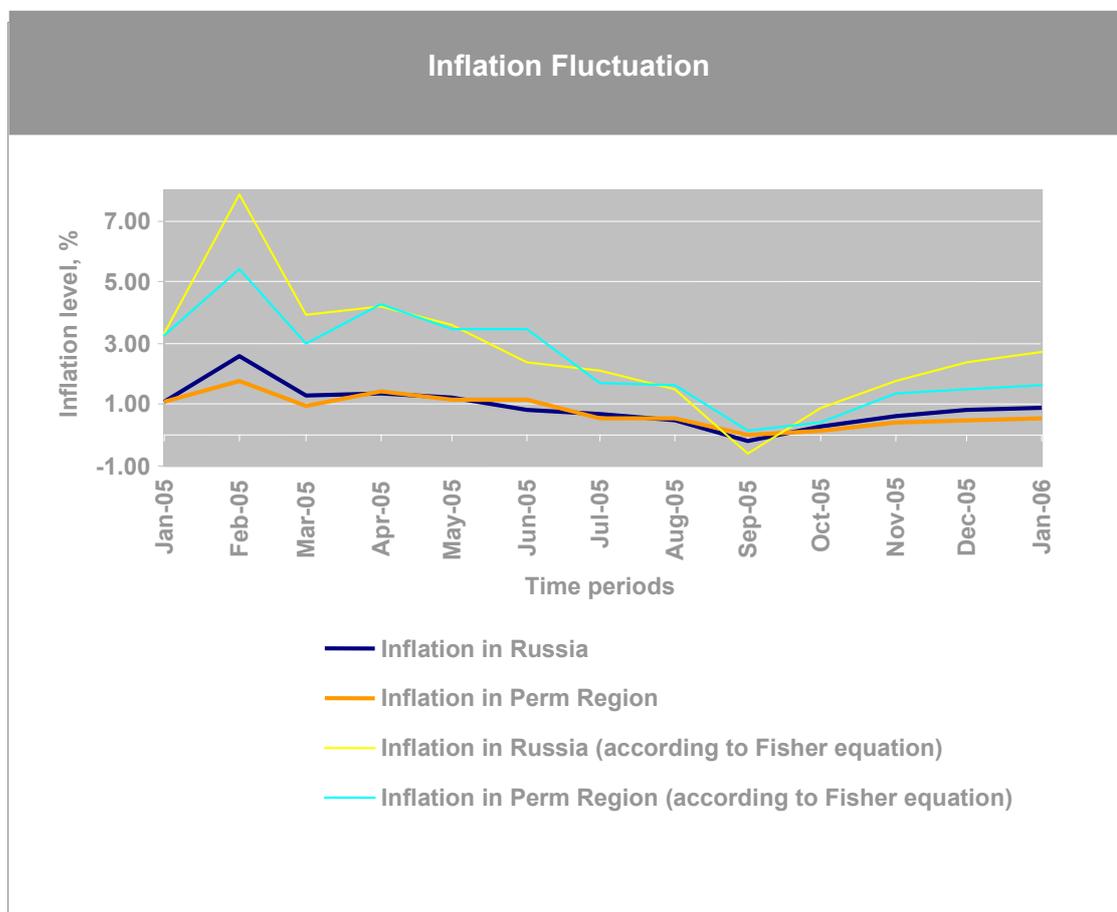
Investments in precious metals. So far, investing in precious metals in Russia is a rather exotic form of wealth accumulation. Liquidity of these instruments is low, while the pricing method and methods to maintain liquidity of this market are non-transparent.



Inflation. Inflation has a considerable effect upon investment decision-making. It is often quite different over different regions from the aggregate figures for Russia. According to the official data, in 2005 inflation (consumer price index) in the Russian Federation was 10.7%. We suppose that inflation should be calculated by the Fisher equation. At that the

calculated inflation significantly differs from that officially published by Federal State Statistics Service (Goskomstat) and the mass media.

The main conclusion to be made upon the above analytical information is that, in order to raise direct investment, the Company must offer in the market a yield at least equal to the refinancing rate (after taxes and with consideration of monthly re-investment of interests).

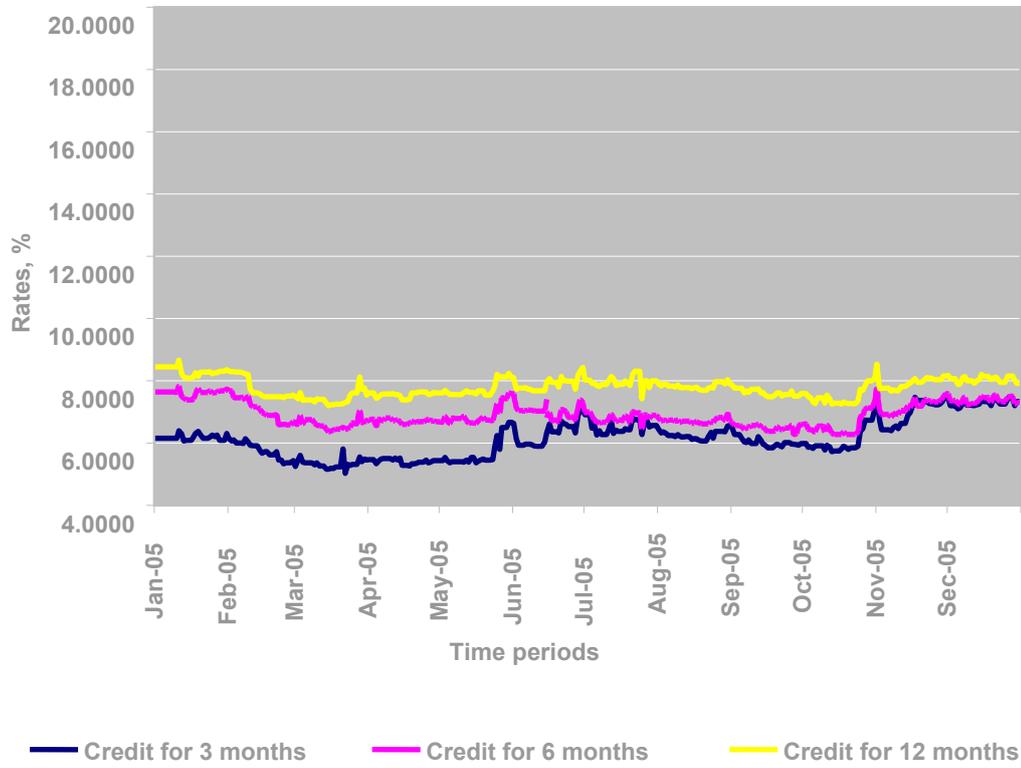


Credits. Fluctuation of interbank offered rates (MIBOR) in 2005 is illustrated in the following graph.

As it is demonstrated by the research performed by the Company experts, it is still bank credits that are the main financial source of leasing transactions in the industry. The Company is not an exception in this aspect. That is why, in 2005, in order to develop current operations the Company implemented active policy of credit borrowings. The weighted average cost of borrowings (as of the date of borrowing) in 2005 was 10.70% per annum. Thus, the available statistics of credit, stock and money markets, as well as the inflation process, allow to forecast the cost limits of fund-raising for current operations of the Company in 2005.

In our opinion the most worthy decisions in terms of “price vs. volume” and “rate of raising vs. volume of raising” ratios, are credits offered at such rates that would ensure in 2006 a weighted average rate not more than the existing weighted average rate of 2005, as well as borrowings in form of bond issues for a pre-defined group of investors, with a yield within 12.00–16.00% per annum and quarterly interest payments.

Credit offered rates (MIBOR)
(per annum, for credits in rubles)



11. Board of Directors' Report

| Members of the Board | Shareholdings in the Company |
|--|------------------------------|
| Sergey Alekseevich Sopov, Chairman of the Board | 0% |
| Vladimir Viktorovich Kinderkneht, First Deputy Chairman of the Board | 0% |
| Viktor Yurievich Novikov, Deputy Chairman of the Board | 0% |
| Oleg Leonidovich Kislukhin | 0% |
| Anatoly Arkadievich Chudinov | 0% |

General Director of ZAO "Avialeasing" Perm Investment and Finance Company" is Mr. Oleg Leonidovich Kislukhin (DOB 1971), higher education (1. Perm State University, Law department; 2. Perm State University, Accounting, Analysis and Audit department). In 1991-1996 he worked as a legal adviser in "Zarya Urala" bank, in 1996-2001 in ZAO "Avialeasing" Corporation". Since 2001 he has been working in ZAO "Avialeasing" Perm Investment and Finance Company".

There is no established joint executive body in the Company.

12. Finance Figures over the Reporting Period

Authorized capital in the Company is 5,000,000.00 rubles.

Proceeds from services rendered in 2005 totalled 44,611,133.38 rubles, including:

- lease of Tu-154B (Reg.No.85504) – 14,462,669.47 rubles,
- lease of Tu-154B (Reg.No.85557) – 14,540,792.33 rubles,
- lease of Tu-154B (Reg.No.85550) – 13,448,806.37 rubles,
- sale of window glass – 101,694.92 rubles,
- technical appraisal of Tu-154B (Reg.No.85557) – 632,033.90 rubles,
- technical appraisal of Tu-154B (Reg.No.85504) – 1,416,661.81 rubles,
- consulting services – 8,474.58 rubles.

Operational income in 2005 totalled 3,108,474.58 rubles, including:

- from sale of securities (bonds) – 3,100,000 rubles,
- from sale of fixed assets – 8,474.58 rubles.

Receivable interests (under agreements with servicing banks for settlement and cash services, interests upon cash balances on the settlement accounts) in 2005 totalled 67,259.15 rubles.

Non-sales proceeds in 2005 totalled 13,572.27 rubles.

Cost of rendered services (fixed assets depreciation) totalled 16,559,771.50 rubles.

Costs of the Company related to the major activity totalled 18,336,118.33 rubles, including:

- wages and salaries – 5,254,446.35 rubles,
- social contributions – 1,223,816.58 rubles,
- materials – 1,628,279.88 rubles.

Operational costs totalled 7,621,620.77 rubles, including:

- historical cost of securities (bonds) – 3,000,000 rubles,
- interests on bonds – 1,354,089.45 rubles,
- interests on bank credits – 2,149,143.99 rubles,
- taxes and duties – 852,064.00 rubles.

Non-sales costs in 2005 totalled 961,493.48 rubles.

Sales proceeds from the major activity in 2005 totalled 9,715,243.55 rubles.

Income before tax – 4,321,435.30 rubles.

Net income of 2005 – 3,400,988.52 rubles.

Net assets as of 31 December 2005 totalled 10,609,575.93 rubles.

According to the charter documents, capital reserve was set up of the amount of 5% of the authorized capital (250.0 thousand rubles).

Borrowings raised in 2005 totalled 10,745,800.00 rubles, including:

- credit from AB “Gazprombank” – 745,800.00 rubles,
- credit from Zapadno-Uralsky Bank of Sberbank of the Russian Federation – 10,000,000.00 rubles.

Borrowings repaid in 2005 totalled 31,864,201.76 rubles, including:

- credit from ZAO “Etalonbank” – 10,000,000.00 rubles,
- credit from AB “Gazprombank” – 745,800.00 rubles.
- credit from Zapadno-Uralsky Bank of Sberbank of the Russian Federation – 5,400,000.00 rubles.
- earlier issued interest-free promissory notes – 3,998,200.00 rubles.
- issued interest-bearing promissory notes – 11,720,201.76 rubles.

Interests paid upon bank credits – 2,094,557.12 rubles, interests paid upon borrowed funds – 156,436.59 rubles.

At the end of the year a credit agreement for 115,000,000.00 rubles was concluded with Zapadno-Uralsky Bank of Sberbank of the Russian Federation.

Book value of the main production assets (fixed assets) as of 31 December 2005 totalled 30,676,304.16 rubles, including:

- Tu-154B (Reg.No.85557) – 8,105,190.87 rubles,
- Tu-154B (Reg.No.85550) – 18,834,299.51 rubles,
- office (two storeys, 633.5 sq.m. totally in a 12-storeyed building in the centre of Perm) – 2,158,626.54 rubles.
- corporate vehicles – 998,629.64 rubles.
- other – 579,557.60 rubles,

Short-term finance investments – 2,799,297.40 rubles,

Accounts receivable as of the end of 2005 totalled 9,284,696.76 rubles, including:

- purchasers and customers – 3,952,415.50 rubles.

There are no overdue accounts receivable.

Accounts payable – 12,229,729.18 rubles, including:

- suppliers and contractors – 1,220,980.22 rubles,
- liabilities on taxes and duties – 1,603,000.87 rubles.

Outstanding credits and borrowings, including interests – 25,953,083.78 rubles.

All accounts payable are current (there are no overdue accounts payable).

13. Supplementary Information for the Shareholders

In the reporting year the Company carried out some transactions aimed to expand activities in Tu-154 leasing segment.

Tu-154M (Reg.No.85789) was the main project of 2005. To implement this project an agreement for purchase of Tu-154M aircraft (Reg.No.85789) from OAO “KD-Avia” was concluded. It was a significant transaction approved by the general meeting of the Company.

The lease agreement was concluded with OAO “UTair Aviation” air company operating Tu-154M (Reg.No.85789). The aircraft was handed over to the operator in February 2006.

In order to finance purchase of the aircraft of Reg.No.85789, the Company concluded an agreement with OAO Joint-Stock Commercial Sberbank of the Russian Federation to open a non-revolving credit line limited to 115,000,000.00 (one hundred fifteen million) rubles under 15% per annum, for 5 years. In order to secure performance under this agreement, pledge agreements were concluded for the TU-154B aircrafts (Reg.No.85504, 85550, and 85557); a pledge agreement was concluded for the premises owned by the company on the 4th ad 5th stories of the building in 47 Kuibysheva St., Perm; a pledge agreement for the rights under Lease Agreement No. 1/85789/05/85/05 for Tu-154M aircraft (Reg.No.85789) dated 15 December 2006; guarantee contracts with Messrs. V.V. Kinderkneht, S.A. Sopov, and V.Yu. Novikov; pledge agreement for the land plot owned by Mr. V.Yu. Novikov at 1a Pyataya Liniya St., Perm. Agreements on the non-revolving credit line, pledge of the aircrafts and premises owned by the company, being

significant transactions, were approved by the general meeting of the Company. The agreement with Mr. V.Yu. Novikov to pledge his property to the bank in order to secure performance of the Company under the credit agreement was approved by the Board of Directors of the Company as a transaction of the Company's interests.

In the reporting year the following projects for Tu-154B (Reg.No.85504, 85557, and 85550) were implemented. Purchase of spare parts, overhaul of auxiliary power unit, and replacement of the low-pressure compressor 1st step wheel for NK-8-2U engine. The cost of these operations totalled about 1,900,000.00 rubles.

Under the projects of Tu-154B (Reg.No.85504, 85550, and 85557), appraisal of technical condition of the aircrafts and prolongation of the designed life were arranged and performed. Technical condition appraisal and designed life prolongation of NK-8-2U engines and TA-6A auxiliary power unit were also performed. The cost of these activities totalled about 3,700,000.00 rubles.

In 2005, aircraft insurance agreements (insurance agreement for aircraft Reg.No.85557, aviation insurance agreements for aircrafts Reg.No.85504 and 85550) were concluded and implemented on a routine basis. The insurers were ZAO "GUTA-Strahovaniye" and, OAO "Voенno-Strahovaya Kompaniya".

These agreements are classified as deals performed by the Company on a routine basis

The Company also concluded a credit agreement with ZAO AB "Gazprombank", a bank of gas industry, to raise a credit of 10,000,000.00 (ten million) rubles under 17% per annum for one year. In order to secure performance under this agreement, a pledge agreement was concluded for the premises owned by the company on the 4th and 5th storeys of the building in 47 Kuibysheva St., Perm; guarantee contracts with Messrs. V.V. Kinderkneht, S.A. Sopov, and V.Yu. Novikov. Upon a partial drawdown of the credit amount and its repayment, the credit agreement was repudiated, and, thus, the pledge agreement and guarantee contracts ceased their effect.

In the reporting year the Company had no other transactions classified as significant transactions or transactions of interests under the Federal Law "Joint-Stock Companies".

Voting Results of the Company's Annual Shareholders Meeting for 2005

At the general shareholders' meeting of the Company for 2005, held on 30 March 2006, the following decisions were made:

1. To approve the annual report, balance sheet, profit and loss statement of the Company for 2005.

To allocate profit for 2005 of 3,400,988.52 rubles for the following:

- dividend payments to the Company shareholders of 1,275,000.00 rubles, that equals to 25.5% of authorized capital of the Company, that is 255.00 rubles per one share of 1,000.00 rubles (25.5% per annum); to pay dividends in the third quarter of 2006;
- to retain the remaining net profit of 2,125,988.52 rubles at Company's disposal.

2. To elect the following Board of Directors of the Company:

Vladimir Viktorovich Kinderkneht

Oleg Leonidovich Kislukhin

Vicktor Yurievich Novikov

Sergey Alekseevich Sopov

Anatoly Arkadievich Chudinov

3. To elect Ms. Yulia Vladimirovna Moskalenko to the position Company's controller.

4. To approve OOO "Invest-Audit", 7-89 Revolutsii St., 614007, Perm, Professional Audit License No. E 004545, registration No. 195 dated 27 June 2003, issued by the Ministry of Finance of the Russian Federation, as the Company's auditor.

14. Information on Securities Issued by the Company

As of 2005, the Company issued the following securities:

1. Type, category of the securities:

Common registered non-documentary shares.

Type of the securities: shares.

Category: common.

2. Form of the securities: registered non-documentary.

3. Face value per one security: 1,000 rubles.

4. Number of securities in the issue: 5,000.

5. Distribution of the securities.

5.1 Method of distribution: distributed among the founders.

5.2 Term and order of distribution of the securities: as of state registration of the Company (25 September 2001), all shares were distributed among the founders.

5.3 Distribution price per issued security: the shares were distributed at face value, 1,000 rubles per share.

5.4 Payment conditions and procedure for the issued securities: money payment for purchase of the issued securities.

5.5 The issue of securities was registered upon No. 275 resolution (dated 26 February 2002) of the Regional Division of the Federal Committee on Security Market in Volga (Privozhsky) Federal District.

5.6 The state registration number of the issue is 1-01-17177-R.

**Authorized Equity Distribution
at the End of the Reporting Period:**

| No. | Shareholder | Voting shares owned by the shareholder, % |
|-----|---|---|
| 1 | OOO "URAL CONSULTING" Consulting Company | 34 |
| 2 | ZAO "Avia Consulting" | 33 |
| 3 | ZAO "Assets" | 33 |

In 2005 the Company issued no securities, including bonds.

Repaid liabilities:

- upon bonds issued prior to 2005 – 15,874,838.35 rubles.

15. Audit Conclusion
on Finance (Accounting) Reports of
ZAO “Avialeasing” Perm Investment & Finance Company”
For the period from 1 January 2005 till 31 December 2005

Addressee:

Executive body of ZAO “Avialeasing” Perm Investment & Finance Company”.
Shareholders of ZAO “Avialeasing” Perm Investment & Finance Company”.

Auditor:

Name: OOO “Invest-Audit”

Address: 50 Lenina St., 614000, Perm, Russia.

State registration: State Registration Certificate No. 2644 issued by Leninsky District Administration of Perm dated 24 November 1994.

Licenses:

- for professional auditing No. E 004545, registration No. 195 dated 27 June 2003, issued by the Ministry of Finance of the Russian Federation for five years;

- for activities related to employment of data classified as state secret No. B 343821, registration No. 586 dated 22 November 2005, issued by Perm Regional Agency of Federal Security Service of the Russian Federation till 07 September 2008.

Membership in the public professional association accredited by the Russian Ministry of Finance:

OOO “Invest-Audit” is a member of the Non-Revenue Partnership “National Federation of Consultants and Auditors” according to the general meeting resolution dated 21 September 2000, certificate No.0097. Accreditation certificate of the professional audit association registered with the Russian Ministry of Finance No.5, issued on 17 July 2002.

Audited entity:

Name: ZAO “Avialeasing” Perm Investment & Finance Company”

Address: 47 Kuibusheva St, 614016, Perm, Russia.

State registration: Registration Certificate of the Legal Entity No.7578 dated 25 September 2001;

Entry Certificate of Unified State Register of Legal Entities (EGRUL): series 59 No. 001616430 dated 11 November 2002, Primary State Registration Number (OGRN) No. 1025900892335.

We had audited the annexed finance (accounting) reports of ZAO “Avialeasing” Perm Investment & Finance Company” for the period from 01 January 2005 till 31 December 2005 inclusively.

Finance (accounting) reports of ZAO “Avialeasing” Perm Investment & Finance Company” comprise:

- balance sheet;
- profit and loss statement;
- statement of changes in stockholders equity;

- cash flow statement;
- annex to the balance sheet;
- explanatory note to the balance sheet.

The executive body of ZAO “Avialeasing” Perm Investment & Finance Company” is responsible for development and submittal of these finance (accounting) reports.

Our responsibility is to conclude authenticity of these reports in all significant aspects and conformity of the maintained accounting records to the law of the Russian Federation, upon the performed audit.

We had carried out the audit in accordance with:

- No. 119-FZ Federal Law dated 07 August 2001 “Professional Audit”;
- the federal regulations (standards) of professional audit approved by Professional Audit Committee of the President of the Russian Federation;
- the internal regulations (standards) of professional audit of Non-Revenue Partnership “The National Federation of Consultants and Auditors”;
- the internal regulations (standards) of professional audit of “Invest-Audit” company.

The audit had been planned and performed to reasonably ensure that the finance (accounting) reports are free from significant discrepancies.

The audit had been carried out on a selective basis and comprised test-based investigation of evidence confirming that information on finance and business activities was significant and properly shown in the finance (accounting) reports; appraisal of accounting principles and methods, documentation rules for finance (accounting) reports; definition of the main appraisal values determined by the management of the audited entity, as well as general opinion on the finance (accounting) reports.

We suppose that the performed audit reasonably allows us to conclude authenticity of the finance (accounting) reports in all significant aspects and conformity of the maintained accounting records to the law of the Russian Federation.

In our opinion, the finance (accounting) reports of ZAO “Avialeasing” Perm Investment & Finance Company”, in all significant aspects, correctly reflect finance status as of 31 December 2005, and results of finance (accounting) reports for the period from 01 January 2005 till 31 December 2005 inclusively.

28 February 2006

General Director

of OOO “Invest-Audit”

signature

E.M. Bogomolova

Seal:

OOO “Invest-Audit”

Perm City

Russian Federation

16. Report on Revision Carried out for 2005 ZAO “Avialeasing” Perm Investment & Finance Company”

Perm city

21-25 February 2006

According to the authorities under the Charter of ZAO “Avialeasing” Perm Investment & Finance Company”, Ms. Yu.V. Moskalenko, the controller, had performed the annual revision of finance and business activities of ZAO “Avialeasing” Perm Investment & Finance Company” for the period from 01 January 2005 till 31 December 2005. The revision inspection had been performed, as planned by the Board of Directors of ZAO “Avialeasing” Perm Investment & Finance Company”, from 21 February 2005 till 25 February 2005.

During the inspected periods the officers of the company were:

- Mr. V.V. Kinderkneht, General Director,
- Mr. O.L. Kislukhin appointed to the position of General Director on 26 October 2005.
- Ms. Ya.S. Gorodko, Chief Accountant.

The inspection had been performed in order to determine credibility and conformity of the finance and business transactions shown in the accounting records to the regulations of the Russian Federation.

The inspection had been performed with the use of the audit documents of OOO “Invest-Audit” company (license No. E 004545 dated 27 June 2003) and data of the submitted primary accounting documents.

The inspection had revealed no substantial discrepancies able to significantly affect credibility of the annual balance sheet and the profit and loss statement of ZAO “Avialeasing” Perm Investment & Finance Company”. Accounting and reporting documents meet the relevant requirements and accounting rules and reflect the essence of finance & business transactions.

Income from the major activities totalled 9,715 thousand rubles.

Operational profit totalled 3,108 thousand rubles, including

- sale of securities (bonds) – 3,100 thousand rubles,
- sale of fixed assets – 8 thousand rubles.

Operational costs totalled 7,622 thousand rubles, including:

- historical cost of securities (bonds) – 3,000 thousand rubles,
- interests on bonds – 1,354 thousand rubles,
- interests on bank credits – 2,149 thousand rubles,
- taxes and duties – 852 thousand rubles.

Receivable interests (under agreements with servicing banks for settlement and cash services, interests upon cash balances on the settlement accounts) totalled 67 thousand rubles.

Non-sales proceeds – 14 thousand rubles.

Non-sales expenses – 961 thousand rubles.

As a result, the pre-tax profit of the reporting year totalled 4,321 thousand rubles.

Net profit of the reporting year totalled 3,401 thousand rubles.

The controller checked conformity of a number of finance and business transactions to the law of the Russian Federation in order to ensure that the finance (accounting) reports are free from significant discrepancies.

Conclusion:

1. The results of the inspection show that accounting and finance reporting was maintained, and finance and business transactions of ZAO “Avialeasing” Perm Investment & Finance Company” were carried out in accordance with the legislation effective in 2005.
2. The results of the inspection allow to conclude that the data comprised in the Annual Report of the Company and the annual accounting reports for 2005 are credible.
3. The shareholders’ meeting is recommended to approve the Annual Report and the annual accounting reports of ZAO “Avialeasing” Perm Investment & Finance Company” for 2005.

Controller:

signature

Yu.V. Moskalenko

Annex to the Annual Report
ZAO “Avialeasing” Perm Investment & Finance Company”

1. Finance Accounts for 2005.
Balance Sheet. Form No. 1
(unit – thousands of rubles)

| Assets | Beginning of the reporting year | End of the reporting year |
|--|---------------------------------|---------------------------|
| I. Non-Working Assets | | |
| Intangible assets | 3 | 3 |
| Fixed assets | 46,567 | 30,676 |
| Construction in progress | 0 | 27 |
| Income-bearing investments in tangible values | 0 | 0 |
| Long-term finance investments | 2,699 | 2,799 |
| Deferred tax assets | 0 | 0 |
| Other non-working assets | 0 | 0 |
| TOTAL for Section I | 49,269 | 33,505 |
| II. Working Assets | | |
| Inventory | 1,855 | 1,233 |
| including: | | |
| raw supplies, materials and similar values | 0 | 0 |
| cost of production in progress | 0 | 0 |
| finished products and goods for resale | 48 | 0 |
| product shipments | 0 | 0 |
| deferred costs | 1,807 | 1,233 |
| other inventories and costs | 0 | 0 |
| Value-added tax | 5,257 | 65 |
| Accounts payable (with expected maturity over 12 months upon reporting date) | 0 | 0 |
| Accounts payable (with expected maturity within 12 months upon reporting date) | 7,592 | 9,285 |
| including: | | |
| purchasers and customers | 5,319 | 3,952 |

| | | |
|--|--------------|--------------|
| other debtors | 2,273 | 5,333 |
| liabilities of members (founders) on contributions to authorized capital | 0 | 0 |
| Short-term finance investments | 0 | 0 |
| Cash | 1,042 | 4,704 |
| Other working assets | 0 | 0 |
| TOTAL for Section II | 15746 | 15287 |
| Summary Total | 65015 | 48792 |

| Liabilities | Reporting year start | Reporting year end |
|---|----------------------|--------------------|
| III. Capital Stock and Allowances | | |
| Authorized capital | 5,000 | 5,000 |
| Own stock redeemed from shareholders | 0 | 0 |
| Extra capital | 0 | 0 |
| Capital reserves | 250 | 250 |
| including: | | |
| reserves established according to the law | 250 | 250 |
| reserves established according to the charter documents | 0 | 0 |
| Target financing and receipts | 0 | 0 |
| Retained earnings (outstanding losses) | 3,209 | 5,360 |
| TOTAL for Section III | 8,459 | 10,610 |
| IV. Long-Term Liabilities | | |
| Loans and credits | 18,355 | 9,669 |
| Deferred tax liabilities | 0 | 0 |
| Other long-term liabilities | 0 | 0 |
| TOTAL for Section IV | 18,355 | 9,669 |
| V. Short-Term Liabilities | | |
| Loans and credits | 27,450 | 16,284 |
| Accounts payable | 10,751 | 12,229 |
| including: | | |
| suppliers and contractors | 5,287 | 1,220 |

| | | |
|--|---------------|---------------|
| liabilities to the staff | 0 | 0 |
| liabilities to the state-run off-budget funds | 0 | 0 |
| liabilities on taxes and duties | 627 | 1603 |
| other creditors | 4,837 | 9,406 |
| Liabilities to the members (founders) on profit payments | 0 | 0 |
| Deferred income | 0 | 0 |
| Allowances for future expenses | 0 | 0 |
| Other short-term liabilities | 0 | 0 |
| TOTAL for Section V | 38,201 | 28,513 |
| Summary total | 65,015 | 48,792 |

Profit and Loss Statement. Form No. 2
(unit – thousands of rubles)

| Item | 2005 | 2004 | 2003 |
|---|--------|--------|--------|
| I. Income and expenses on regular activities | | | |
| (Net) proceeds from sales of goods, products, work, services (less value-added tax, excises and similar mandatory payments) | 44,611 | 28,814 | 26,615 |
| Cost of sold goods, products, work, services | 16,560 | 16,721 | 14,020 |
| Gross profit | 28,051 | 12,093 | 12,595 |
| Marketing costs | 0 | 0 | 0 |
| Managerial costs | 18,336 | 7,981 | 16,566 |
| Sales profit (loss) | 9,715 | 4,113 | -3,971 |
| II. Other income and expenses | | | |
| Interests receivable | 67 | 205 | 32 |
| Interests payable | 3,618 | 1,180 | 2,636 |
| Proceeds from participation in other entities | 0 | 0 | 0 |
| Other operating profits | 3,108 | 5,025 | 30,482 |
| Other operating costs | 4,004 | 5,967 | 17,945 |
| Non-sales proceeds | 14 | 367 | 314 |
| Non-sales costs | 961 | 328 | 136 |
| III. Profit (loss) before taxes | | | |
| | 4,321 | 2,235 | 6,141 |
| Deferred tax assets | 0 | 0 | 0 |
| Deferred tax liabilities | 0 | -317 | 317 |
| Current income tax | 918 | 177 | 1,223 |
| Fines, penalties | 2 | 4 | 37 |
| Adjustment to income tax | 0 | -258 | 0 |

II. Appraisal of Finance & Business Operations

| Item | 2003 | 2004 | 2005 |
|---|--------|--------|--------|
| Depreciable property | | | |
| Historical cost of fixed assets for the beginning of the reporting period (thousands of rubles) | 51,145 | 57,999 | 61,471 |
| Introduced fixed assets (thousands of rubles) | 24,055 | 29,979 | 973 |
| Retired fixed assets (thousands of rubles) | 17,201 | 2,539 | 30 |
| Historical cost of fixed assets for the end of the reporting period (thousands of rubles) | 57,999 | 85,420 | 62,414 |
| Accumulated depreciation (thousands of rubles) | 24,004 | 38,853 | 55,687 |
| Stock | | | |
| Number of ordinary shares (pcs.) | 5,000 | 5,000 | 5,000 |
| Face value of one share (thousands of rubles) | 1 | 1 | 1 |
| Retained earnings of previous years (thousands of rubles) | 0 | 3,209 | 5,360 |
| Dividend per one share (thousands of rubles) | 0 | 0.6418 | 1.072 |
| Credits | | | |
| Accounts payable (thousands of rubles) | 35,487 | 45,805 | 25,953 |
| Income tax rate (%) | 24 | 24 | 24 |
| Bank credit rate (%) | 0 | 17 | 17 |
| Dividend percentage (%) | 0 | 64.18 | 107.2 |
| Percentage amount of the credits charged to the costs (thousands of rubles) | 0 | 1,180 | 3,618 |
| Credit interests not charged to the costs (thousands of rubles) | 0 | 0 | 0 |
| Re-invested profits (thousands of rubles) | 0 | 0 | 0 |
| Volume of credit purchases over the period (thousands of rubles) | 0 | 0 | 0 |
| Non-sales costs | | | |
| Sum differences (thousands of rubles) | 0 | 13 | 5 |
| Other non-sales costs (thousands of rubles) | 135 | 315 | 956 |
| Total non-sales costs (thousands of rubles) | 135 | 328 | 961 |
| Costs per aircraft | | | |
| Yak-40 (Reg.No.87418) (thousands of rubles) | 141 | 0 | 0 |
| Aviation engines 8-NK-2U (thousands of rubles) | 4,259 | 567 | 0 |
| Tu-154B (Reg.No.85450) (thousands of rubles) | 179 | 0 | 0 |

| | | | |
|--|---------------|--------------|--------------|
| Tu-154B (Reg.85557) (thousands of rubles) | 15,836 | 3,641 | 6,236 |
| Tu-154B (Reg.No.85504) (thousands of rubles) | 10,162 | 3,640 | 6,527 |
| Tu-154B (Reg.85550) (thousand rubles) | 0 | 131 | 5,528 |
| Constant cost per property item let on lease (thousands of rubles) | 6,117 | 1,995 | 4,584 |

**Costs adjusted by the cost of borrowed capital
(hereinafter – cbc) per 1 aircraft**

| | | | |
|---|------------------|-----------------|--------------|
| Yak-4, (Reg.No.87418) (thousands of rubles) | 154 | 0 | 0 |
| Aviation engines 8-NK-2U (thousands of rubles) | 4,626 | 651 | 0 |
| Tu-154B (Reg.No.85450) (thousands of rubles) | 195 | 0 | 0 |
| Tu-154B (Reg.No.85557) (thousands of rubles) | 17,201.00 | 4,180.00 | 7,467 |
| Tu-154B (Reg.No.85504) (thousands of rubles) | 11,038 | 4,179 | 7,814 |
| Tu-154B (Reg.No.85550) (thousands of rubles) | 0 | 150 | 6,619 |
| Constant costs adjusted by cbc per 1 aircraft (thousand rubles) | 6,644 | 2,290 | 5,489 |

Proceeds

| | | | |
|---|---------------|---------------|---------------|
| Gross proceeds (thousands of rubles) | 64,468 | 34,000 | 52,641 |
| Net proceeds, including (thousands of rubles) | 26,615 | 28,814 | 44,611 |
| proceeds from Yak-40, hull number 87418 (thousands of rubles) | 123 | 0 | 0 |
| proceeds from aviation engines 8-NK-2U (thousands of rubles) | 3,706 | 2,049 | 0 |
| proceeds from Tu-154B (Reg.No.85450) (thousands of rubles) | 156 | 0 | 0 |
| proceeds from Tu-154B (Reg.No.85557) (thousands of rubles) | 13,780 | 13,148 | 15,173 |
| proceeds from Tu-154B (Reg.No.85504) (thousands of rubles) | 8,843 | 13,145 | 15,789 |
| proceeds from Tu-154B (Reg.No.85550) (thousands of rubles) | 0 | 472 | 13,449 |
| Proceeds “on payment basis” (thousands of rubles) | 64,610 | 33,171 | 52,657 |
| Share of enterprise proceeds received in monetary form | 1.00 | 0.98 | 1 |
| Average monthly proceeds (thousands of rubles) | 5,372.33 | 2,833.33 | 4,386.75 |

Staff

| | | | |
|--|----|----|----|
| Average number of staff per list (persons) | 35 | 31 | 32 |
|--|----|----|----|

**Balance Sheet (Form No. 1) Structure in per cents
to Summary Total (unit – percents)**

| Assets | 2003 | 2004 | 2005 |
|---|--------------|--------------|--------------|
| I. Non-Working Assets | | | |
| Intangible assets | 0.00 | 0.00 | 0.01 |
| Fixed assets | 52.03 | 71.63 | 62.87 |
| Construction in progress | 0.00 | 0.00 | 0.06 |
| Income-bearing investments in tangible values | 21.47 | 0.00 | 0.00 |
| Long-term finance investments | 0.00 | 0.00 | 5.74 |
| Deferred tax assets | 0.00 | 0.00 | 0.00 |
| Other non-working assets | 0.00 | 0.00 | 0 |
| TOTAL for Section I | 73.51 | 71.63 | 68.67 |
| II. Working Assets | | | |
| Inventory | 0.45 | 2.85 | 2.53 |
| including: | | | |
| raw supplies, materials and similar values | 0.00 | 0.00 | 0.00 |
| cost of production in progress | 0 | 0 | 0 |
| finished products and goods for resale | 0.00 | 0.07 | 0.00 |
| product shipments | 0 | 0 | 0 |
| deferred costs | 0.45 | 2.78 | 2.53 |
| other inventories and costs | 0 | 0 | 0 |
| Value-added tax | 0.06 | 8.09 | 0.13 |
| Accounts receivable (with expected maturity over 12 months upon reporting date) | 0 | 0 | 0 |
| Accounts payable (with expected maturity within 12 months upon reporting date) | 4.15 | 11.68 | 19.03 |
| including: | | | |
| purchasers and customers | 3.85 | 8.18 | 8.10 |
| other debtors | 0.31 | 3.5 | 0 |
| Short-term finance investments | 8.27 | 4.15 | 0.00 |
| Cash | 13.56 | 1.6 | 9.64 |

| | | | |
|-----------------------------|---------------|---------------|---------------|
| Other working assets | 0.00 | 0.00 | 0.00 |
| TOTAL for Section II | 26.49 | 28.37 | 31.33 |
| Summary total | 100.00 | 100.00 | 100.00 |

| Liabilities | 2003 | 2004 | 2005 |
|--------------------|-------------|-------------|-------------|
|--------------------|-------------|-------------|-------------|

III. Capital Stock and Allowances

| | | | |
|---|-------------|--------------|--------------|
| Authorized capital | 10.81 | 7.69 | 10.25 |
| Own stock redeemed from shareholders | 0.00 | 0.00 | 0.00 |
| Extra capital | 0 | 0 | 0 |
| Capital reserves | 0.38 | 0.38 | 0.51 |
| including: | | | |
| reserves established according to the law | 0.49 | 0.38 | 0.51 |
| reserves established according to the charter documents | 0 | 0 | 0 |
| Retained earnings (outstanding losses) | 1.30 | 4.94 | 10.99 |
| TOTAL for Section III | 12.6 | 13.01 | 21.75 |

IV. Long-Term Liabilities

| | | | |
|-----------------------------|--------------|--------------|--------------|
| Loans and credits | 54.57 | 28.23 | 19.82 |
| Deferred tax liabilities | 0.69 | 0.00 | 0.00 |
| Other long-term liabilities | 0 | 0 | 0 |
| TOTAL for Section IV | 55.25 | 28.23 | 19.82 |

V. Short-Term Liabilities

| | | | |
|--|-------|-------|-------|
| Loans and credits | 22.16 | 42.22 | 33.37 |
| Accounts payable | 9.99 | 16.54 | 25.06 |
| including: | | | |
| suppliers and contractors | 1.29 | 8.13 | 2.5 |
| liabilities to the staff | 0.00 | 0.00 | 0.00 |
| liabilities to the state-run off-budget funds | 0 | 0 | 0 |
| liabilities on taxes and duties | 2.00 | 0.96 | 3.29 |
| other creditors | 6.70 | 7.44 | 19.28 |
| Liabilities to the members (founders) on profit payments | 0 | 0 | 0 |

| | | | |
|--------------------------------|--------------|--------------|--------------|
| Deferred income | 0.00 | 0.00 | 0.00 |
| Allowances for future expenses | 0 | 0 | 0 |
| Other short-term liabilities | 0.00 | 0.00 | 0.00 |
| TOTAL for Section V | 32.14 | 58.76 | 58.44 |
| Summary total | 100.00 | 100.00 | 100.00 |

Calculation of Business Ratios Finance Stability Appraisal upon Relative Indices

| Name of finance | 2003 | 2004 | 2005 | Recommended values |
|--|-------|-------|-------|--------------------|
| Autonomy ratio | 0.13 | 0.13 | 0.22 | >0.5 |
| Debt capital ratio (finance leverage) | 0.87 | 0.87 | 0.78 | <0.5 |
| Own capital multiplier | 7.93 | 12.38 | 9.29 | - |
| Finance dependency ratio (debt to own funds) | 6.93 | 6.69 | 3.6 | <1 |
| Long-term finance independence ratio | 0.68 | 0.41 | 0.42 | growth |
| Long-term investment structure ratio | 0.74 | 0.39 | 0.29 | - |
| Long-term debt ratio | 0.81 | 0.68 | 0.48 | - |
| Long-term investments coverage ratio (index of permanent assets) | 5.83 | 5.51 | 3.16 | - |
| Interest coverage ratio | -1.51 | 3.49 | 2.69 | >1 |
| Own working assets provision ratio | -2.3 | -2.07 | -1.5 | >0.1 |
| Own capital mobility ratio | -0.5 | -2.34 | -1.25 | 0.2-0.5 |
| Actual property cost ratio | 0.52 | 0.72 | 0.63 | 0.5 |

Balance-Sheet Liquidity Appraisal upon Relative indices

| Item | 2003 | 2004 | 2005 | Recommended values |
|--|------|------|------|--------------------|
| Liquidity and solvency ratios | | | | |
| Coverage ratios (current solvency) | 0.81 | 0.44 | 0.49 | 2 |
| Interim solvency ratio (quick liquidity) | 0.81 | 0.43 | 0.49 | 0.8 and > |
| Absolute liquidity ratio | 0.68 | 0.1 | 0.16 | >=0.2–0.5 |

Finance Stability Appraisal upon Absolute Indices

| Item | 2003 | 2004 | 2005 |
|---|--------------------|---------------------------|---------------------------|
| Sources of own funds (thousands of rubles) | 5,829 | 8,459 | 10,610 |
| Non-working assets (thousands of rubles) | 33,998 | 46,570 | 33,505 |
| Sources of own working assets in form of inventories and expenses (thousands of rubles) | - 28,169 | - 38,111 | - 22,895 |
| Long-term credit and loan funds (thousands of rubles) | 25,556 | 18,355 | 9,669 |
| Sources of own assets, adjusted by amount of long-term loan funds (thousands of rubles) | - 2,613 | - 19,756 | - 13,226 |
| Short-term credit and loan funds (thousands of rubles) | 10,248 | 27,450 | 16,284 |
| Total amount of asset sources with consideration of long-term and short-term loan funds (thousands of rubles) | 7,635 | 7,694 | 3,058 |
| Amount of inventory and stock accounted in assets (thousands of rubles) | 208 | 1,855 | 1,233 |
| Surplus (+)/deficit (-) of the sources of own working assets (thousands of rubles) | - 28,377 | - 39,966 | - 24,128 |
| Surplus (+)/deficit (-) of the sources of own assets and long-term loan sources (thousands of rubles) | - 2,821 | - 21,611 | - 14,459 |
| Surplus (+)/deficit (-) of total value of all sources in form of inventory and stocks (thousands of rubles) | 7,427 | 5,839 | 1,825 |
| Finance stability of the enterprise | relative stability | unstable finance standing | unstable finance standing |

Business Activity Figures

| Item | 2003 | 2004 | 2005 |
|--|------|------|------|
| Assets turnover (times) | 0.58 | 0.44 | 0.91 |
| Inventory turnover (times) | 0 | 9 | 13 |
| Accounts receivable turnover (times) | 14 | 4 | 5 |
| Total debts turnover (times) | 0.66 | 0.51 | 1.17 |
| Accounts receivable turnover length (days) | 26 | 96 | 76 |
| Average inventory age (days) | no | no | no |
| Operating cycle length (days) | 26 | 96 | 76 |
| Own capital turnover (times) | 5 | 3 | 4 |
| Working capital turnover (times) | 2 | 2 | 3 |

Profitability Indices

| Item | 2003 | 2004 | 2005 |
|---|-------|-------|------|
| Profitability of assets (economic profitability ratio) (EP) | 0.10 | 0.04 | 0.07 |
| Profitability of own capital | 0.78 | 0.31 | 0.32 |
| Profitability of sales (commercial profitability ratio) | -0.15 | 0.14 | 0.22 |
| Profitability of current expenses | -0.13 | 0.17 | 0.28 |
| Profitability of invested (employed) capital | -0.24 | -0.27 | 3.61 |

Market Activity Figures

| Item | 2003 | 2004 | 2005 |
|---|------|-------|--------------------------|
| Profit (loss) per one share (thousands of rubles/piece) | 0.91 | 0.53 | 0.68 |
| Watered profit (loss) per one share (thousands of rubles/piece) | 0.91 | 0.53 | 0.68 |
| Book value of one share (thousands of rubles) | 1 | 1 | 1 |
| Share price-to-profit ratio | 1.1 | 1.9 | 1.47 |
| Share price-to-book value ratio (quotation ratio) | 1 | 1 | 1 |
| Dividend rate (%) | no | 25.00 | 25.50 |
| Amount of paid dividends in relation to profits (in %) | no | 47.52 | planned to be paid 37.50 |

Break-Even Point

| Item | 2003 | 2004 | 2005 |
|--|-----------------|------------------|------------------|
| Added value (thousands of rubles) | 33,882 | 9,299 | 17,745 |
| Net added value (thousands of rubles) | 27,106 | 7,439 | 14,551 |
| GROSS investment payback (thousands of rubles) | 21,995 | 2,679 | 7,140 |
| NET investment payback (thousands of rubles) | 6,142 | 2,235 | 4,321 |
| Threshold value of NET investment payback | 41.10 | 21.95 | 25.49 |
| Transformation ratio (net asset turnover) | 1.24 | 0.53 | 0.98 |
| Trade margin (net turnover profitability) | 0.11 | 0.06 | 0.09 |
| Gross margin (thousands of rubles) | 26,615 | 12,093 | 28,051 |
| Gross margin adjusted by cost of borrowed capital (thousands of rubles) | 23,979 | 10,913 | 24,433 |
| Average calculated interest rate (%) | 7.23 | 1.78 | 5.22 |
| Differential (%) | 2.64 | 2.26 | 1.75 |
| Differential adjusted by tax rate (%) | 2.01 | 1.72 | 1.33 |
| Finance leverage level of effect | 13.94 | 11.49 | 4.80 |
| Finance leverage influence force | 0.02 | 0.02 | 0.04 |
| Operational leverage influence force (operational leverage effect) | -6.70 | 2.94 | 2.89 |
| Profitability threshold (break-even point) (thousands of rubles) | 30,586 | 19,014 | 29,161 |
| Profitability threshold (break-even point) (thousands of rubles) | 33,948 | 21,070 | 33,479 |
| Finance safety factor | -0.15 | 0.34 | 0.35 |
| Level of combined operational and finance leverage effect | -0.11 | 0.06 | 0.12 |
| Break-even point (times) | 5.75 | 1.11 | 1.23 |
| Break-even point (times) | 6.24 | 1.27 | 1.48 |
| Break-even point per 1 aircraft (thousands of rubles) | 5,323 | 17,163.78 | 23,649.08 |
| Break-even point per 1 aircraft (thousands of rubles) | 5,908.15 | 19,019.67 | 27,151.00 |

Fixed Assets Turnover and Status Indices

| Item | 2003 | 2004 | 2005 |
|---|--------|-------|--------|
| Growth ratio, % | 113 | 147 | 102 |
| Introduction ratio, % | 47 | 52 | 2 |
| Renewal ratio, % | 41 | 35 | 2 |
| Retirement ratio, % | 33.63 | 4.38 | 0.05 |
| Wear ratio, % | 41.39 | 45.48 | 89.22 |
| Worthiness ratio, % | 58.61 | 54.52 | 10.78 |
| Yield of basic production assets, % | 110.59 | 61.88 | 145.43 |
| Profitability of basic production assets, % | 16.3 | 20.53 | 37.08 |

Accounts Receivable

| Item | 2003 | 2004 | 2005 |
|---|-------|-------|-------|
| Amount of accounts receivable (thousands of rubles) | 1,921 | 7,592 | 9,285 |
| Volume of post-due debts (thousands of rubles) | 0 | 0 | 0 |
| Share of post-due debts | 0 | 0 | 0 |
| Turnover ratio of accounts receivable (days) | 26 | 96 | 76 |
| Share of accounts receivable in aggregate volume of current assets | 0.04 | 0.12 | 0.19 |
| Accounts payable-to-gross proceeds ratio | 0.03 | 0.22 | 0.18 |
| Share of uncertain accounts receivable in aggregate amount of receivables | no | no | no |
| Actual cost of accounts receivable (thousands of rubles) | 1,921 | 7,592 | 9,285 |

Accounts Payable

| Item | 2003 | 2004 | 2005 |
|---|-------|--------|--------|
| Amount of accounts payable (thousands of rubles) | 4,619 | 10,751 | 12,229 |
| Volume of post-due accounts payable (thousands of rubles) | 0 | 0 | 0 |
| Volume of non-post-due accounts payable (thousands of rubles) | 4,619 | 10,751 | 12,229 |
| Share of post-due accounts payable | 0 | 0 | 0 |
| Turnover ratio of accounts payable (days) | 63 | 136 | 100 |

III. Net Assets

Net Assets Cost Calculation (unit – thousands of rubles)

| Assets | As of 01 Jan 04 | As of 01 Jan 05 | As of 01 Jan 06 |
|--|--------------------|--------------------|--------------------|
| 1. Intangible assets | 3 | 3 | 3 |
| 2. Fixed assets | 24,066 | 46,567 | 30,676 |
| 3. Construction in progress | 0 | 0 | 27 |
| 4. Income-bearing investments in tangible values | 9,929 | 0 | 0 |
| 5. Long-term and short-term finance investments | 3,824 | 2,699 | 2,799 |
| 6. Other non-working assets | 0 | 0 | 0 |
| 7. Inventory | 208 | 1,855 | 1,233 |
| 8. Value-added tax | 30 | 5,257 | 65 |
| 9. Accounts receivable | 1,921 | 7,592 | 9,285 |
| 10. Cash | 6,271 | 1,042 | 4,704 |
| 11. Other working assets | 0 | 0 | 0 |
| 12. Total assets considered for calculation | 46,252 | 65,015 | 48,792 |

| Liabilities | As of 01 Jan 04 | As of 01 Jan 05 | As of 01 Jan 06 |
|--|--------------------|--------------------|--------------------|
| 13. Long-term liabilities on loans and credits | 25,239 | 18,355 | 9669 |
| 14. Other long-term liabilities | 317 | 0 | 0 |
| 15. Short-term liabilities on loans and credits | 10,248 | 27,450 | 16,284 |
| 16. Accounts payable | 4,620 | 10,751 | 12,229 |
| 17. Liabilities to the members (founders) on profit payments | 0 | 0 | 0 |
| 18. Allowances for future expenses | 0 | 0 | 0 |
| 19. Other short-term liabilities | 0 | 0 | 0 |
| 20. Total liabilities considered for calculation | 40,424 | 56,556 | 38,182 |
| 21. Net assets value (item 12 – item 20) | 5,828 | 8,459 | 10,610 |

Management Structure of ZAO “Avialeasing” Perm Investment & Finance Company”

