

CAYMAN AIRWAYS LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

30 JUNE 2004

Independent auditor's report

To the Shareholder and Board of Directors of Cayman Airways Limited

We have audited the accompanying consolidated financial statements of Cayman Airways Limited and its subsidiary (together the "Group") which comprise the consolidated balance sheet as of 30 June 2004 and the consolidated statement of loss, consolidated statement of changes in shareholder's equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 30 June 2004, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to the fact that as discussed in Note 2, the Company is dependent upon the financial support of the government of the Cayman Islands to enable it to continue as a going concern and to meet its obligation as they fall due.

[Date]

CAYMAN AIRWAYS LIMITED
CONSOLIDATED BALANCE SHEET

(Expressed in United States dollars)

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
ASSETS		
Current assets		
Cash and cash equivalents	3,225,840	1,649,351
Accounts receivable (Note 4)	3,674,073	2,996,997
Prepaid expenses	1,287,957	882,894
Flight equipment held for sale (Note 6)	<u>44,920</u>	<u>45,000</u>
Total current assets	8,232,790	5,574,242
Property, plant and equipment, net (Note 7)	<u>10,192,816</u>	<u>10,427,407</u>
Total assets	<u>\$18,425,606</u>	<u>\$16,001,649</u>
LIABILITIES AND SHAREHOLDER'S DEFICIT		
Current liabilities		
Bank overdraft	1,759,146	1,934,022
Accounts payable and accrued expenses (Notes 5 and 20)	12,919,396	18,603,943
Unearned transportation liability	6,122,008	4,395,465
Current portion of long-term liabilities (Note 8)	<u>3,493,526</u>	<u>3,000,000</u>
Total current liabilities	24,294,076	27,933,430
Long-term liabilities (Note 8)	<u>23,817,454</u>	<u>20,334,333</u>
Total liabilities	<u>48,111,530</u>	<u>48,267,763</u>
Shareholder's deficit (Note 2)		
Share capital (Note 9)	38,376,215	38,376,215
Share subscriptions (Note 9)	19,357,635	8,507,249
Accumulated deficit	<u>(87,419,774)</u>	<u>(79,149,578)</u>
Total shareholder's deficit	<u>(29,685,924)</u>	<u>(32,266,114)</u>
Total liabilities and shareholder's deficit	<u>\$18,425,606</u>	<u>\$16,001,649</u>

Approved for issuance on behalf of Cayman Airways Limited's Board of Directors by:

Director

Date

Director

Date

The accompanying notes are an integral part of these financial statements

CAYMAN AIRWAYS LIMITED**CONSOLIDATED STATEMENT OF LOSS**

(Expressed in United States dollars)

	30 June <u>2004</u>	18 month period ended 30 June <u>2003</u>
Operating revenues		
Passenger	31,903,212	36,270,162
Cargo	2,775,143	3,479,198
Handling	2,392,871	3,901,895
Other	<u>264,819</u>	<u>356,215</u>
Total operating revenues	<u>37,336,045</u>	<u>44,007,470</u>
Operating expenses		
Salaries and wages	12,705,605	17,458,159
Other staff costs	3,968,473	4,521,831
Aircraft fuel	7,572,073	7,288,600
Aircraft rentals	1,970,312	207,713
Commissions and related sales costs	2,527,955	3,044,875
Maintenance, materials and repairs	3,174,952	3,801,383
Landing and parking fees	1,588,403	1,802,225
Aircraft and passenger service	6,291,820	7,225,169
Advertising and promotion	536,310	611,567
Communications	1,243,215	1,366,893
General and administrative (Note 14)	1,851,170	2,608,498
Depreciation (Note 7)	2,255,049	3,267,023
Other operating expenses	<u>4,044,342</u>	<u>5,188,995</u>
Total operating expenses	<u>49,729,679</u>	<u>58,392,931</u>
Operating loss before non-operating items and Government subsidy	(12,393,634)	(14,385,461)
Non operating items		
Interest expense	(630,232)	(1,084,764)
Other (Note 10)	(8,230)	(10,655)
Impairment loss (Note 7)	<u>-</u>	<u>(1,808,775)</u>
Loss before Government subsidy	(13,032,096)	(17,289,655)
Government subsidy (Note 2)	<u>4,761,900</u>	<u>7,142,850</u>
Net loss for the year/period	<u>\$ (8,270,196)</u>	<u>\$ (10,146,805)</u>

The accompanying notes are an integral part of these financial statements

CAYMAN AIRWAYS LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY

(Expressed in United States dollars)

	<u>Share capital</u>	<u>Share subscriptions</u>	<u>Accumulated deficit</u>	<u>Total</u>
Balance at 31 December 2001	38,376,215	8,507,249	(69,002,773)	(22,119,309)
Net loss for the period	<u>-</u>	<u>-</u>	(10,146,805)	(10,146,805)
Balance at 30 June 2003	38,376,215	8,507,249	(79,149,578)	(32,266,114)
Share subscriptions for the year	-	10,850,386	-	10,850,386
Net loss for the year	<u>-</u>	<u>-</u>	(8,270,196)	(8,270,196)
Balance at 30 June 2004	<u>\$38,376,215</u>	<u>\$19,357,635</u>	<u>\$(87,419,774)</u>	<u>\$(29,685,924)</u>

The accompanying notes are an integral part of these financial statements

CAYMAN AIRWAYS LIMITED
CONSOLIDATED CASH FLOW STATEMENT

(Expressed in United States dollars)

	30 June <u>2004</u>	18 month period ended 30 June <u>2003</u>
Cash flows from operating activities		
Net loss for the year/period	(8,270,196)	(10,146,805)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,255,049	3,267,023
Interest expense	630,232	1,084,764
Gain on sale of investment	-	(7,549)
Loss on disposal of property, plant and equipment, net	8,230	18,204
Provision for impairment in value of aircraft	<u>-</u>	<u>1,808,775</u>
Operating expense before working capital changes	(5,376,685)	(3,975,588)
Changes in current assets and liabilities:		
Increase in accounts receivable	(677,076)	(92,653)
(Increase)/decrease in prepaid expenses	(405,063)	12,237
Decrease in flight equipment held for resale	80	91,767
* Increase in accounts payable and accrued expenses	5,165,839	5,607,698
Increase in unearned transportation liability	<u>1,726,543</u>	<u>868,440</u>
Cash generated from operations	433,638	2,511,901
Interest paid	<u>(630,232)</u>	<u>(1,084,764)</u>
Net cash (used in)/ provided by operating activities	<u>(196,594)</u>	<u>1,427,137</u>
Cash flows from investing activities		
Purchase of property, plant and equipment	(2,028,686)	(2,168,846)
Proceeds on disposal of property, plant and equipment	-	140,000
Proceeds on sale of investment	<u>-</u>	<u>7,549</u>
Net cash used in investing activities	<u>(2,028,686)</u>	<u>(2,021,297)</u>
Cash flows from financing activities		
Repayment of long term borrowings	(2,990,922)	(4,539,735)
Proceeds from long term borrowings	<u>6,967,567</u>	<u>5,337,756</u>
Net cash provided by financing activities	<u>3,976,645</u>	<u>798,021</u>
Net increase in cash and cash equivalents	1,751,365	203,861
Net cash, cash equivalents and bank overdraft at beginning of year/period	<u>(284,671)</u>	<u>(488,532)</u>
Net cash, cash equivalents and bank overdraft at end of year/period (Note 12)	<u>\$ 1,466,694</u>	<u>\$ (284,671)</u>

* Note: see Note 9 for details of non-cash transactions regarding government debt forgiveness during the year.

The accompanying notes are an integral part of these financial statements

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

30 JUNE 2004

1. Incorporation and activity

Cayman Airways Limited (the "Company") is incorporated in the Cayman Islands and is wholly-owned by the Government of the Cayman Islands ("Government"). The Company's main activity is the provision of scheduled passenger and cargo air transportation to, from and within the Cayman Islands. The Company's registered office is 233 Owen Robert's Drive, George Town, Grand Cayman, B.W.I.

At 30 June 2004 the Company had 322 employees (2003: 283).

During the period ended June 30, 2003, the Company changed its fiscal year end from 31 December to 30 June such that the Company's fiscal year end will be the same as the Government's fiscal year end. As a result, the comparative amounts for the statements of loss, changes in shareholder's equity and cash flows and related notes are not for comparable periods.

2. Going concern

Historically, the Company has been dependent upon the financial support of Government to allow it to continue as a going concern. At 30 June 2004 the Company's total liabilities exceeded total assets by US\$29,685,924 (30 June 2003: US\$32,266,114) and current liabilities exceeded its current assets by US\$16,061,286 (30 June 2003: US\$22,359,188), and the Company remains dependent on an annual subsidy and other financial support from Government to allow it to continue as a going concern. Government has indicated that its current policy is to continue to support the Company in the foreseeable future by the provision of an annual subsidy of approximately US\$4.7 million. For the 18 month period ended 30 June 2003, Government provided a general subsidy of US\$7.1 million to Cayman Airways Limited and no additional subsidy for advertising and marketing. Government has also issued guarantees to the Company's principal bankers to secure borrowings aggregating up to US\$46.9 million (2003: \$32.8 million), which at 30 June 2004 comprised one term loan (2003: one) repayable over a period of five years (see Note 8), an overdraft facility of up to US\$2.2 million (2003: US\$2.2 million), and a letter of credit facility of US\$0.62 million (2003: US\$0.4 million). The Government has also issued a guarantee of US\$1.3 million with respect to Cayman Airways lease of an aircraft from International Lease Finance Corporation.

These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to amounts and classification of liabilities that may be necessary should the Company be unable to continue as a going concern.

3. Accounting policies

The Company's financial statements have been prepared under the historical cost convention and in accordance with International Financial Reporting Standards ("IFRS"). The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant accounting policies are:

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Cayman Airways Express, a company incorporated in the Cayman Islands. All significant intercompany accounts and transactions have been elimination on consolidation.

Passenger revenue: Passenger ticket sales are initially recorded as a current liability in an unearned transportation liability account until transportation is provided. This current liability is released as revenue is earned, sales are refunded, or billings from other airlines are received.

Government subsidy: The Government subsidy is a non-refundable operating subsidy and is recognised in the statement of loss during the year/period to which it relates.

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

30 JUNE 2004

3. Accounting policies (continued)

Aircraft maintenance:

(a) Routine maintenance and annual periodic maintenance

All routine aircraft maintenance is provided on a continuous basis and the related costs are expensed as incurred.

(b) Periodic major maintenance and overhauls

Liability for overhauls and periodic major maintenance is recognised at the time the Company becomes obligated for such costs. The actual cost of periodic major maintenance and overhauls is capitalized and depreciated over the estimated useful life (which will normally be the expected interval to the next scheduled major maintenance or overhaul).

Property, plant and equipment: Property, plant and equipment is initially recorded at cost. Cost includes all direct attributable costs of bringing the asset to working condition for its intended use. The Company capitalises borrowing costs which are directly attributable to the acquisition of an asset and which are incurred in respect of the period of time before an asset is introduced in to use or service.

Property, plant and equipment and other long lived, non-current assets, are reviewed annually at each balance sheet date for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets whose carrying values exceed their recoverable amount are written down to the recoverable amount, being the higher of market value or value in use (on a discounted cash flow basis), and the resulting impairment loss recorded in the statement of operations. To the extent that a previously recognised impairment loss no longer exists or decreases, the carrying amount of the asset will be increased to the lower of recoverable amount or depreciated cost and the resulting reversal of impairment loss will be recorded in the statement of operations.

Depreciation: Property, plant and equipment are depreciated to estimated residual value using the straight-line method over their estimated useful lives as follows:

<u>Type of Property, plant and equipment</u>	<u>Estimated useful life</u>
Aircraft airframe and related overhauls	
Airframe and related components	113 - 162 months
D checks and landing gear	21,000 flight hours or 105 months
Aircraft engines and related overhauls	
Engine shop visit 1	9,000 flight hours
Engine shop visit 2	4,500 flight hours
Limited life parts	20,000 cycles
Other property, plant and equipment:	
Buildings	20 - 50 years
Flight equipment	10 years
Other property, plant and equipment	3 - 5 years

The estimated residual value for the airframes is US\$250,000 per aircraft. The residual value for the aircraft engines is US\$50,000 (2003: US\$50,000) per engine. The residual value for flight equipment is 5%. All other property, plant and equipment have no salvage value.

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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3. Accounting policies (continued)

Where impairment losses have been recorded against property, plant and equipment, the recoverable amount is depreciated to estimated residual value using the straight-line method over the remaining estimated useful life.

Flight equipment held for sale: Flight equipment held for sale is carried at the lower of cost and management's estimate of net realisable value. No depreciation is taken on the flight equipment held for sale (Note 6).

Cash and cash equivalents: For the purpose of the statement of cash flows, cash and cash equivalents includes balances with bankers, all of which are on demand or at short notice, net of short-term overdrafts.

Foreign currency translation: The accounting records of the Company are maintained in United States dollars. Monetary assets and liabilities in a foreign currency are translated into United States dollars at the prevailing rates of exchange at year end. Revenue receipts and expense payments are translated into United States dollars at the prevailing exchange rate on the respective dates of transactions. The rate of exchange between United States dollars and Cayman Islands Dollars is fixed at US\$1.00: CI\$0.84.

Employee benefits: In accordance with the Cayman Islands National Pensions Law, 1996 (the "Law") those of Company's employees that are located in the Cayman Islands participate in a defined contribution pension plan. Employees are required to contribute an amount up to 5% of their annual salaries to the plan during the year and the Company matches such contributions up to 5%. The Company's US based employees are eligible to participate in a 401K defined contribution pension plan. Contributions are matched by the Company, to a maximum of 3% of the employee's basic salary. Independent trustees administer both of these plans. The pension contributions paid by the Company under these plans are expensed in the statement of loss.

In addition, the Company's employees participate in a private health insurance plan. The Company contributes part of the cost and such contributions paid by the Company are expensed in the statement of loss.

4. Accounts receivable

Accounts receivable comprise:

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Trade receivables	2,837,876	2,190,666
Other - interline clearing accounts	<u>836,197</u>	<u>806,331</u>
	US\$ <u>3,674,073</u>	US\$ <u>2,996,997</u>

5. Accounts payable and accrued expenses

Accounts payable comprise:

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Trade payables	11,698,801	17,081,746
Accrued expenses	<u>1,220,595</u>	<u>1,522,197</u>
	US\$ <u>12,919,396</u>	US\$ <u>18,603,943</u>

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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6. Flight equipment held for sale

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Flight equipment held for sale	US\$ <u>44,920</u>	US\$ <u>45,000</u>

Flight equipment held for sale includes aircraft parts that are not intended for use on the current fleet, all of which are held for sale by consignees.

Management believes that the carrying value of the flight equipment held for sale at 30 June 2004 and 30 June 2003 is a reasonable estimate of net realisable value. After a comprehensive physical inventory count and valuation, management determined that no valuation adjustment was required for flight equipment held for resale at 30 June 2004 and 30 June 2003.

7. Property, plant and equipment

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Aircraft airframe, D Checks and related overhauls		
Cost		
Opening balance	\$11,106,352	\$11,952,026
Additions during the year/period	-	616,993
Provision for impairment during the year/period	<u>-</u>	<u>(1,462,667)</u>
Closing balance	11,106,352	11,106,352
Accumulated depreciation		
Opening balance	7,213,993	6,027,984
Depreciation expense for the year/period	<u>572,506</u>	<u>1,186,009</u>
Closing balance	7,786,499	7,213,993
Aircraft airframe, D Checks and related overhauls - net book value	\$ <u>3,319,853</u>	\$ <u>3,892,359</u>
Aircraft engines and related overhauls		
Cost		
Opening balance	\$ 5,857,671	\$ 5,075,696
Additions during the year/period	1,473,120	1,128,083
* Dispositions during the year/period	(1,296,886)	-
Provision for impairment during the year/period	<u>-</u>	<u>(346,108)</u>
Closing balance	6,033,905	5,857,671
Accumulated depreciation		
Opening balance	3,084,207	2,309,738
Depreciation expense for the year/period	793,257	774,469
* Dispositions during the year/period	<u>(1,296,886)</u>	<u>-</u>
Closing balance	2,580,578	3,084,207
Aircraft engines and related overhauls - net book value	\$ <u>3,453,327</u>	\$ <u>2,773,464</u>

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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7. Property, plant and equipment (continued)

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Other property, plant and equipment		
Cost		
Opening balance	\$10,202,669	\$10,282,989
Additions during the year/period	555,566	423,770
* Dispositions during the year/period	(164,590)	(504,090)
Closing balance	10,593,645	10,202,669
Accumulated depreciation		
Opening balance	6,441,085	5,480,426
Depreciation expense for the year/period	889,284	1,306,545
* Dispositions during the year/period	(156,360)	(345,886)
Closing balance	7,174,009	6,441,085
Other property, plant and equipment - net book value	\$ <u>3,419,636</u>	\$ <u>3,761,584</u>
Total property, plant and equipment - net	US\$ <u>10,192,816</u>	US\$ <u>10,427,407</u>

* In the foregoing table, dispositions includes the gross cost and accumulated depreciation/amortization of periodic major maintenance and overhauls which reach the end of their useful lives (as defined in Note 3) in the reporting period.

In accordance with its accounting policy, the Company annually reviews its property, plant and equipment, as well as any other non-current assets, for impairment losses. Over the past few years many airlines have expanded their fleet by acquiring new generation aircraft and, as the aviation industry began to slow in 2000, many of these airlines began to offer their older aircraft, such as the Boeing 737-200, for sale. The excess supply of older aircraft was increased significantly as a result of the decrease in air travel immediately following September 11, 2001. As a result of the dramatic increase in supply of Boeing 737-200's for sale combined with limited demand, the estimate fair market value of the aircraft (as well as for other similar aircraft) has decreased significantly since 2001.

The results of the 2003 annual impairment review indicated that there had been a further decline in the market for the aircraft owned by the Company during the period ended 30 June 2003. Using the criteria established by IAS 36 ("Impairment of Assets"), effective for periods beginning on or after July 1, 1999, the Company determined that the carrying value of its aircraft was higher than the recoverable amount (being the higher of market value or value in use on a discounted cash flow basis). Accordingly, the Company has recorded an impairment loss of \$1,808,775 as at 30 June 2003. No further impairment was recorded for the year ended 30 June 2004.

Management have estimated no impairment is necessary in 2004 based on quotes obtained from third parties who indicated an interest in purchasing the Company's aircraft. However, given the current market for these types of aircraft, there remains significant uncertainty over the value attributed to the aircraft and ultimately any selling price obtained could be lower than the current carrying value.

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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8. Long-term liabilities

Future principle repayments of long-term liabilities for years ending 30 June are as follows:

	<u>2004</u>	<u>2003</u>
No later than 1 year	3,493,526	3,000,000
Later than 1 year and no later than 5 years	7,263,955	20,334,333
Later than 5 years	<u>16,553,499</u>	<u>-</u>
	US\$ <u>27,310,980</u>	US\$ <u>23,334,333</u>

All long-term liabilities relate to term loans held with the Royal Bank of Canada and a loan agreement with GE Celma.

In February 2004, the Royal Bank of Canada agreed to refinance the then existing debts and made additional funding available to the Company. The total credit facility is US\$47,502,333 and is comprised of three facilities. Facility one is an overdraft of US\$2,220,000 with interest payable at a floating rate equal to Royal Bank Prime per annum. This facility is repayable on demand. Facility two is available for letters of credit of US\$625,000 with interest payable at 1% per annum. Facility three comprises two Libor loans of (a) US\$23,602,333 and (b) US\$21,055,000 which have a five year term and an amortization period of fifteen years. A local bank is to participate for 50% (US\$10,527,500) for part (b) of the third facility. The interest rate on the term loans is floating at Libor + 1.25% per annum. In addition there is a standby fee of 1/8% on any drawdown portion of the second portion of facility three. The balance of the term loan will be drawn as required.

Undrawn funding from lines of credit and committed loans amounted to approximately US\$18.09 million at 30 June 2004 (2003: US\$7.1 million).

The Royal Bank of Canada has issued letters of credit on behalf of the Company totaling US\$374,000 (2003: US\$374,000). These are used by an overseas bank as collateral for letters of credit issued by that bank on behalf of the Company in the same amount.

Government has issued guarantees to the Royal Bank of Canada to secure the Company's borrowings under the above facilities.

9. Share capital

	<u>30 June 2004</u>	<u>30 June 2003</u>
Authorised:		
50,000,000 ordinary shares of CI\$1 each	US\$ <u>60,000,000</u>	US\$ <u>60,000,000</u>
Issued and fully paid:		
31,980,179 ordinary shares of CI\$1 each	US\$ <u>38,376,215</u>	US\$ <u>38,376,215</u>

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

30 JUNE 2004

9. Share capital (continued)

Share subscriptions represent amounts received from the Company's shareholder in respect of the future issue of shares. Share subscriptions are comprised of:

	<u>30 June 2004</u>	<u>30 June 2003</u>
451,000 (2003: Nil) ordinary shares of CI\$1 each to be issued in exchange for assumption of Company's obligation to the Legal Department of the Cayman Islands Government	536,905	-
1,000,000 (2003: 1,000,000) ordinary shares of CI\$1 each to be issued in exchange for cash	1,190,476	1,190,476
12,884,803 (2003: 5,411,472) ordinary shares of CI\$1 each to be issued in exchange for assumption of Company's obligation to Civil Aviation Authority of the Cayman Islands.	15,339,052	6,442,228
1,844,525 (2003: 734,618) ordinary shares of CI\$1 each to be issued in exchange for assumption of Company's obligations to Customs Department of Cayman Islands Government.	2,195,863	874,545
80,085 (2003: Nil) ordinary shares of CI\$1 each to be issued in exchange for assumption of Company's obligation to the Mosquito Research Control Unit.	<u>95,339</u>	<u>-</u>
Total	US\$ <u>19,357,635</u>	US\$ <u>8,507,249</u>

10. Other non-operating items

Other non-operating items comprise:

	<u>30 June 2004</u>	<u>30 June 2003</u>
Profit on sale of France Telecom securities	-	7,549
Loss on disposal of property, plant and equipment	<u>(8,230)</u>	<u>(18,204)</u>
	\$(<u>8,230</u>)	\$(<u>10,655</u>)

11. Lease commitments

(a) Premises

At 30 June 2004, future minimum lease payments under operating leases of office space were payable as follows:

	<u>Offices</u>
2005	71,402
	<u>US\$ 71,402</u>

CAYMAN AIRWAYS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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11. Lease commitments (continued)

(b) Aircraft

In October 2003, the Company entered into an aircraft lease agreement for a Boeing B737-300 aircraft and accepted delivery in November 2003. The term of the lease is for 36 months and the Company will pay \$105,000 per month and supplemental rent based on the Company's use of the aircraft during the lease term. The lease is supported by a guarantee of the Government of the Cayman Islands equal to the amount due and payable under the lease up to a maximum of \$1,260,000.

In November 2003, the Company signed a month-to-month lease in November 2003 that included two twin Otter aircraft, crew, maintenance and insurance to facilitate its service between Grand Cayman, Cayman Brac and Little Cayman. During March 2004, the Company signed a replacement lease agreement for two Twin Otter aircraft at a rate of \$19,500 per month for each aircraft for a period of 24 months. The leases may be canceled upon 90 days written notice by either party.

In June 2004, the Company entered into an aircraft lease agreement for a further Boeing B737-300 aircraft and accepted delivery in November 2004. The term of the lease is for 38 months and the Company will pay \$110,000 per month and supplemental rent based on the Company's use of the aircraft during the lease term. The lease is supported by a guarantee of the Government of the Cayman Islands equal to the amount due and payable under the lease up to a maximum of \$1,320,000.

At 30 June 2004, future minimum lease payments under operating leases of aircraft were payable as follows:

	<u>Aircraft</u>
2005	3,048,000
2006	2,892,000
2007	1,635,000
2008	<u>220,000</u>
	US\$ <u>7,795,000</u>

12. Cash and cash equivalents

Cash and cash equivalents included in the statement of cash flows comprise the following balance sheet amounts:

	<u>30 June</u> <u>2004</u>	<u>30 June</u> <u>2003</u>
Cash on hand and balances with banks	3,225,840	1,649,351
Short-term overdrafts	(<u>1,759,146</u>)	(<u>1,934,022</u>)
Cash and cash equivalents	US\$ <u>1,466,694</u>	US\$ (<u>284,671</u>)

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13. Financial instruments

Credit risk

Financial assets which potentially subject the Company to concentrations of credit risk consist principally of cash and trade receivables. The Company's cash is placed with high credit quality financial institutions. Trade receivables are presented net of the allowance for doubtful receivables. Credit risk with respect to trade receivables is limited due to the large number of customers comprising the Company's credit base and the fact that almost half of all receivables are credit card or interline clearing house receivables, collection of which is virtually certain.

Interest rate risk

The floating interest rate on the Company's debt is presented in Note 8.

Fair Values

At 30 June 2004 and 30 June 2003 the carrying amounts of cash, accounts receivables, accounts payables and accrued expenses approximated their fair values due to the short-term maturities of these assets and liabilities. The fair value of the borrowings approximates their carrying value because of the terms attaching to such borrowings (see Note 8).

14. Related party transactions

The Company uses the legal services of the Legal Department of Government. No formal agreement between the Company and the Legal Department exists and prior to 1993, no charge for legal services had been levied and no expense had been accrued at 30 June 2004. The Company had an obligation to the Legal Department of the Cayman Islands Government for legal services in the amount of US\$56,940 (18 month period ended 30 June 2003: US\$545,845) which has been included in accounts payable and accrued expenses. The amount expensed in 30 June 2004 and included in general and administrative expenses was US\$48,000 (18 month period ended 30 June 2003: US\$105,845).

15. Contingent liabilities

Miami Dade County has threatened all past and present tenants of the Miami International Airport with a lawsuit regarding environmental remediation costs. The outcome and potential liability to the Company, if any, cannot presently be determined. The defendants of this lawsuit are numerous and it is unknown how the potential liability would be divided amongst them. The lawsuit is in its infancy and management cannot at present determine the likely outcome, however, if the lawsuit is successful the potential liability could be material to the financial statements.

The Company is routinely involved in a number of claims or potential claims arising from daily operations.

Management is actively contesting all such claims of which they are aware. At 30 June 2004, accounts payable and accrued expenses included US\$130,656 (30 June 2003: US\$130,656) for these claims. The outcome and potential liability to the Company, if any, in excess of the accrued amount cannot presently be determined. In the opinion of management, except as noted in the paragraph above, it is unlikely that any such liability would be material to the Company's financial position.

16. Taxation

Under the current laws of the Cayman Islands, there are no income, sales or other Cayman Islands taxes payable by the Company. Management believes that the Company currently conducts its affairs so as not to be liable for income taxation in any other jurisdiction.

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17. Employee benefit costs

The pension plan expense for the period was \$686,849 (2003: \$987,019)

The health insurance expense for the period was US\$861,383 (2003: US\$1,600,829). The health insurance expense and pension plan expense are included in other staff costs in the statement of loss.

18. Certain significant estimates

The Company is subject to a number of specific and industry-wide factors which impact management's estimates of the useful life and residual value of the Company's aircraft, and may also impact any management decisions taken with respect to the timing of overhauls and the amortization of the related costs. Such factors include, amongst others:

- regulatory requirements which vary depending upon the country in which the aircraft are operated;
- volatility in demand for aircraft and, therefore, prevailing values;
- uncertainty over the cost of overhauls and upgrades to airframes, engines and aircraft components.

Because of the age of the Company's aircraft, the effect of these factors on the estimates made by management and the potential impact on the operations of the Company as a whole may be more significant than with newer aircraft.

19. Subsequent events

In September 2004, Hurricane Ivan passed within 30 miles of Grand Cayman. Although all the Company's aircraft were evacuated prior to the storm, high winds, rain, and sea surge caused extensive damage to the Company's property in Grand Cayman. Under the direction of the National Hurricane Committee the airline operated emergency flights to evacuate people and carry relief supplies after the storm without receiving income from the passengers for these services.

In March 2005 the Government of the Cayman Islands approved an additional funding injection to the Company of \$4,097,619 (CIS 3,442,000). \$2,380,952 (CIS\$2,000,000) is intended to fund additional operating expenses incurred in the aftermath of Hurricane Ivan and through June 2005. The balance, \$1,716,667, is to be applied against amounts owing to the Civil Aviation Authority of the Cayman Islands in relation to the period up to 1 July 2004.

In May 2006 Cayman Airways Express, a wholly-owned subsidiary of Cayman Airways, purchased two twin otter aircraft to replace aircraft that had previously been leased. The cost to bring the aircraft into service, including purchase price is approximately \$4.5 million.

In July 2006 the airline purchased a building located near the airport for a total purchase price of \$2.9 million. The building will be renovated to support office staff and will house all local staff with the exception of maintenance and airport operations.

In July 2006 the airline signed an amendment to the lease for the 737-300 (VP CKY). The original lease, scheduled to mature in November 2006, was extended to September 2007 and the monthly lease rate was increased from \$105,000 per month to \$113,000 per month.

In July 2006 the airline signed a credit agreement with a local financial institution. The new agreement provides for a term loan of \$4.2 million to fund the purchase of the two Twin Otter aircraft. The loan will be amortized over 15 years and the interest rate will be LIBOR plus 85 basis points. The loan is supported by an unconditional guarantee of the Cayman Islands Government.

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20. Maintenance checks

During the year under review, the Company, to comply with the provisions of IAS 37 changed their accounting policy and will discontinue providing in advance for the cost of periodic maintenance ("C" checks). The effect of this change in accounting policy in 2004 resulted in a reduction in maintenance expenses of approximately US\$600,000. Management are unable to determine what years the C Check provision balance as of June 30, 2003 relates to and thus retrospective application of the policy is impracticable.