

“Azerbaijan Airlines” Closed Joint Stock Company

**Consolidated Financial Statements and
Independent Auditor’s Report
for the Year Ended 31 December 2022**

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

TABLE OF CONTENTS

	Page
STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022	1
INDEPENDENT AUDITOR'S REPORT	2
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022:	
Consolidated statement of profit or loss and other comprehensive income	5
Consolidated statement of financial position	6
Consolidated statement of changes in equity	7
Consolidated statement of cash flows	8-9
Notes to the consolidated financial statements	10-46

**STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION
AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2022**

Management is responsible for the preparation of the consolidated financial statements, which present fairly the consolidated financial position of Closed Joint Stock Company "Azerbaijan Airlines" and its subsidiaries (the "Group") as at 31 December 2022, and the consolidated results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRSs").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRSs;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

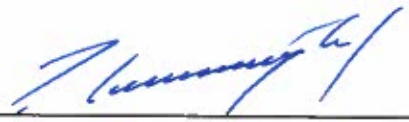
The consolidated financial statements for the year ended 31 December 2022 were approved by the Supervisory Board and management of the Group on 13 October 2023.

On behalf of the Supervisory Board and management:


Samir Rzayev
Acting President

Baku, the Republic of Azerbaijan
13 October 2023




Zaur Dibirov
Head of Finance and Accounting
Department

Baku, the Republic of Azerbaijan
13 October 2023

INDEPENDENT AUDITOR'S REPORT

To the Supervisory Board and the Shareholder of "Azerbaijan Airlines" Closed Joint Stock Company

Opinion

We have audited the consolidated financial statements of "Azerbaijan Airlines" Closed Joint Stock Company and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2022, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2022, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (the "IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. Although the Group has recovered from post-pandemic impacts, the Group still has negative working capital and accumulated deficit brought forward from prior years. These events or conditions, along with other matters as set forth in Note 2, indicate that a material uncertainty related to events or conditions exists that may cast significant doubt on the Group's ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified in respect of this matter.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte & Touche LLC

13 October 2023



“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2022**

(in thousands of Azerbaijani Manat)

	Notes	2022	2021
Continuing operations			
Traffic and other revenue	5	1,149,954	491,750
Subsidies received from government	4	108,809	98,909
Operating costs	6	(1,040,625)	(539,692)
Impairment reversal / (loss) on trade receivables and amounts due from related parties	4	39,815	(36,941)
Operating profit		257,953	14,026
Finance costs	7	(102,210)	(86,824)
Foreign exchange (loss) / gain		(5,815)	4,865
Profit / (loss) before tax		149,928	(67,933)
Income tax (expense) / benefit	8	(39,308)	6,274
Profit / (loss) for the year from continuing operations		110,620	(61,659)
Discontinued operations			
Loss for the year from discontinued operations	16	-	(5,888)
PROFIT / (LOSS) FOR THE YEAR AND TOTAL COMPREHENSIVE INCOME / (LOSS)		110,620	(67,547)

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	Notes	31 December 2022	31 December 2021
ASSETS			
Non-current assets			
Property and equipment	9	1,226,408	1,290,862
Right-of-use assets	10	519,170	345,618
Intangible assets		6,748	4,215
Long-term advances given	11	75,037	50,942
Other non-current assets	12	34,172	27,847
Total non-current assets		1,861,535	1,719,484
Current assets			
Consumable spare parts and inventories	13	33,629	31,280
Trade and other receivables	14	257,315	138,716
Cash and cash equivalents	15	88,289	78,825
Other current assets		463	-
Total current assets		379,696	248,821
Total assets		2,241,231	1,968,305
EQUITY AND LIABILITIES			
Equity			
Share capital	16	823,975	823,975
Additional paid-in capital	16	171,258	168,681
Accumulated deficit		(1,767,498)	(1,882,634)
Total equity		(772,265)	(889,978)
Non-current liabilities			
Long-term loans and borrowings	17	850,342	1,085,079
Lease liabilities, non-current portion	18	330,319	232,853
Deferred revenue related to Frequent Flyer Programme (FFP), non-current portion	19	20,543	25,801
Government grant	20	43,386	44,500
Deferred tax liability	21	75,926	36,618
Total non-current liabilities		1,320,516	1,424,851
Current liabilities			
Trade and other payables	22	79,905	136,542
Short-term borrowings and current portion of long-term loans and borrowings	17	1,473,187	1,200,893
Lease liabilities, current portion	18	66,253	49,949
Unearned revenue	19	60,487	37,101
Deferred revenue related to FFP, current portion	19	5,074	3,268
Other current liabilities		8,074	5,679
Total current liabilities		1,692,980	1,433,432
Total liabilities		3,013,496	2,858,283
Total equity and liabilities		2,241,231	1,968,305

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

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	Notes	Share capital	Additional paid-in capital	Accumulated deficit	Total equity (deficit)
Balance at 1 January 2021		823,975	160,181	(1,763,916)	(779,760)
Loss for the year and total comprehensive loss		-	-	(67,547)	(67,547)
Disposal of subsidiary		-	-	(51,171)	(51,171)
Shareholder's contribution	16	-	8,500	-	8,500
Balance at 31 December 2021		823,975	168,681	(1,882,634)	(889,978)
Profit for the year and total comprehensive income		-	-	110,620	110,620
Asset transferred back to the government		-	(2,907)	-	(2,907)
Derecognition of additional paid in capital		-	(4,516)	4,516	-
Shareholder's contribution	16	-	10,000	-	10,000
Balance at 31 December 2022		823,975	171,258	(1,767,498)	(772,265)

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	Notes	2022	2021
OPERATING ACTIVITIES:			
Profit / (Loss) before tax		149,928	(73,821)
Adjustments for:			
Depreciation and amortization		126,677	127,412
Write-off of property and equipment		-	469
Change in provision for trade and other receivables and advances given		(37,044)	35,091
Gain on disposal of property and equipment		(1,037)	(157)
Change in provision for obsolescence of consumable spare parts and inventories		13,745	6,236
Change in provision for VAT recoverable	6	(1,840)	(3,525)
Impairment of property and equipment and right-of-use assets	6, 9, 10	14,945	4,594
Change in impairment provision of capital projects	6	1,744	(4,392)
Foreign exchange loss / (gain)		5,815	(4,865)
Finance costs	7	102,210	86,824
Amortisation of government grant	20	(1,114)	-
<i>Operating cash flow before movements in working capital</i>		<i>374,029</i>	<i>173,866</i>
Change in trade and other receivables		(84,147)	(107,021)
Change in consumable spare parts and inventories		(20,369)	(12,945)
Change in trade and other payables		(41,382)	56,043
Change in deferred revenue related to FFP	19	(3,452)	382
Change in unearned revenue	19	29,972	11,998
Change in other current liabilities		(11,631)	(23,963)
Cash generated from operations		243,020	98,360
Interest paid		(18,578)	(17,798)
Net cash from operating activities		224,442	80,562
INVESTING ACTIVITIES:			
Purchase of property and equipment		(56,819)	(38,678)
Advances paid for property and equipment and right-of-use assets		(30,592)	(4,984)
Cash paid for additions to right-of-use assets during the period		(37,561)	(1,343)
Purchase of intangible assets		-	(2,954)
Acquisition of subsidiary		-	14
Disposal of subsidiary		-	(1,431)
Net cash used in investing activities		(124,972)	(49,376)
FINANCING ACTIVITIES:			
Shareholder's contribution	16	10,000	8,500
Proceeds from loans and borrowings	17	-	34,574
Principal payments on loans and borrowings	17	(58,608)	(16,724)
Principal payments on lease obligations	17	(36,225)	(22,590)
Net cash (used in) / from financing activities		(84,833)	3,760
NET INCREASE IN CASH AND CASH EQUIVALENTS		14,637	34,946
Effect of exchange rate changes on cash and bank balances held in foreign currencies		(5,173)	(847)
CASH AND CASH EQUIVALENTS, at the beginning of the year		78,825	44,726
CASH AND CASH EQUIVALENTS, at the end of the year		88,289	78,825

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Non-cash transactions excluded from the consolidated statement of cash flows

Amounts presented in the consolidated statement of cash flows for the years ended 31 December 2022 and 31 December 2021 do not include the following non-cash transactions:

- (a) Payment of the government-guaranteed loan and lease liabilities by Ministry of Finance on behalf of the Group of AZN 1,472 and AZN 16,931, respectively, recognised as loan to Ministry of Finance in 2022 (in 2021: AZN 3,308 and AZN 31,465, respectively) (see Note 17);
- (b) Addition of two leased aircraft of AZN 164,730 in 2022 (see Note 17);
- (c) Partial payment of principal amount of a loan from a local bank of AZN 6,311 in 2021, directly by the government on behalf of the Group as a form of subsidy for Baku-Nakhchivan-Baku flights (see Note 17);
- (d) Transfer of control of Fuzuli International Airport to the Group in 2021, recognised as government grant of AZN 44,500 and cash in-flow of AZN 14 as cash and cash equivalents due to non-cash transfer of the subsidiary (see Note 20); and
- (e) Transfer of control of Nakhchivan International Airport to the Cabinet of Ministers of the Autonomous Republic of Nakhchivan in 2021 and disposal of net assets of AZN 51,171. There was a cash out-flow of AZN 1,431 as cash and cash equivalents due to non-cash disposal of the subsidiary (see Note 16).

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

1. NATURE OF ACTIVITIES

“Azerbaijan Airlines” CJSC (the “Company”) was officially established as a state concern on 17 August 1992. In April 2008, under the decree of the President of the Republic of Azerbaijan the Company was reorganised into closed joint stock company, and is wholly owned by the government. The Company is designated as a National air carrier of the Republic of Azerbaijan.

In February 2021, the governance of the Company was transferred from the Ministry of Finance to the Azerbaijan Investment Holding (wholly owned by the government) pursuant to the order signed by the President of the Republic of Azerbaijan.

“Azerbaijan Airlines” CJSC has two subsidiaries – Fuzuli International Airport Limited Liability Company (LLC) and National Aviation Academy (collectively the “Group”) as at 31 December 2022. Cabinet of Ministers of the Republic of Azerbaijan issued a resolution on 23 June 2021 ordering the spin-off of Nakhchivan International Airport as part of structure of the Group and transferring the control to the Cabinet of Ministers of the Autonomous Republic of Nakhchivan, effective from 1 July 2021. The carrying value of total assets of the subsidiary as at the date of the transfer (30 June 2021) was AZN 96,738. The transfer was accounted for at cost as the transaction was between parties under common control.

On 13 December 2021, the Group received Fuzuli Airport LLC as a 100% subsidiary through a transfer of control (see Note 20).

Company name	Registered address	Principal activity	2022	2021
National Aviation Academy	AZ1045, Baku, Khazar, Mardakan, 30, Azerbaijan	Educational Centre	100%	100%
Fuzuli International Airport	AZ1044, Baku, Khazar, Mardakan, 21, Azerbaijan	Airport	100%	100%

The registered office of the Company is 11 Azadlyg Avenue, Baku, AZ1000, Azerbaijan.

The Group’s principal activities comprise:

- Commercial air transportation, which includes passenger and cargo services;
- Air navigation services – provision of air navigation services for overflights and on routes, meteorological services provided in the territory of the Republic of Azerbaijan;
- Aircraft refueling services – refueling services provided to local and foreign passenger and cargo airline companies flying to the Republic of Azerbaijan;
- Ownership and operation of airport terminals and infrastructure, and provisioning of aviation security services in the airports of the Republic of Azerbaijan; and
- Other related activities.

On 28 July 2023, the Group announced that in October 2023, Azerbaijan Airlines and Buta Airways (the low-cost airline carrier and structural division of the Group) would merge under the single brand – AZAL.

The laws of the Republic of Azerbaijan determine the Group to be a natural monopoly and a sole provider for airport operations, runways and structures, as well as passenger aviation. The main objective of the Group is development and improvement of civil aviation in Azerbaijan.

The consolidated financial statements were authorised for issue on 13 October 2023 by the Supervisory Board and management of the Group.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

2. GOING CONCERN

These consolidated financial statements have been prepared on the assumption that the Group will continue as a going concern in the foreseeable future, which implies the realisation of assets and settlement of liabilities in the normal course of business. In making this judgment, management considered the Group’s financial position, current intentions, profitability of operations and access to financial resources.

The Group’s operations were significantly impacted by COVID-19 pandemic which is one of the reasons of the negative equity. The Group finished the year with total comprehensive income of AZN 110,620 in 2022 (total comprehensive loss in 2021: AZN 67,547). In addition, as of 31 December 2022, the Group’s current liabilities exceeded its current assets by AZN 1,313,284 (31 December 2021: AZN 1,184,611) and the Group had negative equity of AZN 772,265 (31 December 2021: AZN 889,978). These results were due to recurring losses from prior years, negative impact of the devaluation of Azerbaijani Manat in 2015 and 2016. The devaluation of Azerbaijani Manat significantly increased the AZN equivalent of the obligations of the Group to financial institutions on lease payables, as well as loans and borrowings denominated in foreign currencies. The vast majority of such loans are state-guaranteed loans from international banks, loans from local banks and the government.

In assessing going concern basis, management have considered the following circumstances:

- During 2022, the Group has further recovered from the negative impact of the pandemic and was also able to generate around 114% of its pre-COVID revenues.
- During 2017, a loan amounting to AZN 273,226 that had been previously transferred to the Ministry of Finance was reinstated as the Group’s liability pursuant to the government decree, resulting in increase in liabilities and decrease in equity. The loan is due in 2026, however, management is in negotiations with the government regarding the terms of settlement of this reinstated liability.
- Major part of current liabilities amounting to AZN 1,408,587 as at 31 December 2022 (31 December 2021: AZN 1,083,609) are due to entities owned by the government, the sole shareholder of the Group. Management believes that in case of immediate cash shortage, the Group has enough leverage (due to fact that the Group is the national carrier and therefore is strategic for the government) to renegotiate terms of its existing liabilities to defer principal and interest payments or obtain additional loans to bridge any liquidity gap as it arises.
- During 2022, the Group received AZN 137,212 of funds as a support from the government to continue its operations, pay salaries and make payments for loan agreements obtained with the government guarantee (recognised as subsidy income of AZN 108,809, loan of AZN 18,403 and additional paid-in capital of AZN 10,000) (2021: AZN 142,110, recognised as subsidy income of AZN 98,909, loan of AZN 34,701 and additional paid-in capital of AZN 8,500).
- The Supervisory Board of the Group approved the budget where the additional support from the government for 2023 is indicated, mainly represented by planned capital costs and other investment projects. Management believes that these funds, together with own cash inflows generated from operations, will cover any liquidity gap that might arise during 2023.
- Management believes that the Group can monetise some of its aircraft and spare engines to close the working capital shortage, if needed.

Management believes that as they have already recovered from the negative impacts of COVID-19 during 2022 as the main CAPEX projects will be funded by government contributions in 2023 and 2024, the Group will be able to cover all its liabilities including those denominated in foreign

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

currencies, as they become due in the foreseeable future. Accordingly, management considers that using the going concern basis of accounting is appropriate.

3. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) and comply with all issued and effective IFRSs for the reporting period.

Basis of preparation

These consolidated financial statements have been prepared on the historical cost basis except for property and equipment, which is stated at deemed cost as of 1 January 2016, the date of transition to the International Financial Reporting Standards (“IFRSs”). The deemed cost as of that date was equal to fair value as determined by an independent appraiser. Historical cost is generally based on the fair value of the consideration given in exchange for assets. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved when the Company:

- Has the power over the investee;
- Is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affects its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of subsidiaries acquired or disposed of during the year are included in profit or loss from the date the Company gains control until the date when the Company ceases to control the subsidiary.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with the Group’s accounting policies.

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between the members of the Group are eliminated on consolidation.

When the Group loses control of a subsidiary, the gain or loss on disposal recognised in profit or loss is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets, less liabilities of the subsidiary and any non-controlling interests, unless the transaction is between the parties under common control in which case the transfer is accounted for at cost.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of sales-related taxes.

Passenger revenue

Ticket sales are reported as traffic revenue when the transportation service has been provided. The value of tickets sold and still valid but not used by the reporting date is reported in the Group’s consolidated statement of financial position in a separate line item (unearned revenue) within current liabilities. This item is reduced either when the Group completes the transportation service or when the passenger requests a refund, or loses the right for refund.

Passenger revenue includes revenue from code-share agreements with certain other airlines as per which the Group and other airlines sell seats for each other’s flights (“code-share agreements”). Revenue from the sale of code-share seats by the Group on flights of other airlines is accounted for in the amount of the commission retained by the Group and is recognised subject to the probability of refund if the ticket sold is not used. Revenue from the sale of code-share seats on Group’s flights by other airlines are recorded at the moment of the transportation service provision and is fully accounted for in the Group’s traffic revenue in the consolidated statement of profit or loss and other comprehensive income.

Ticket reissue revenue – Each fare type that the Group issues will have its own conditions attached, which may include it being refundable or non-refundable. This means that if passengers need to make a change to their booking, cancel flights or buy replacement tickets then a change fee may apply. The change service is not considered distinctly, because the customer cannot benefit from it without taking the flight – because the service for changes in bookings is not distinguishable and is part of the performance obligation to provide a seat for the passenger on the selected flight. Although the change service is provided in advance of the flight, the benefit from it is not provided until the customer takes the flight. As a result, the change fee is recognised as revenue together with the original ticket sale on the date of travel.

Ticket breakage – Certain ticket fare types allow customers to claim a refund of a price paid if the customer hasn’t actually taken a flight. Under IFRS 15, *Revenue from contracts with customers*, the timing of revenue recognition for such amounts depends on whether the entity expects to be entitled to this breakage amount. This amount then should be recognised as revenue in proportion to the pattern of rights exercised by the customer when the entity expects to be entitled to breakage revenue. Otherwise, the entity recognises breakage revenue when the likelihood of the customer exercising its remaining rights becomes remote.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Frequent flyer programme – The Group operates a customer loyalty programme referred to as “AZAL Miles”. Subject to the programme’s terms and conditions, the miles earned entitle members to a number of benefits such as free flights, flight class upgrades and redeem miles for special awards from programme partners. In accordance with IFRS 15, accumulated but as yet unused bonus miles are deferred as a material right. IFRS 15 requires the allocation of transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract in the moment of its signing. The stand-alone selling price of a ticket for a regular flight of the Group is the tariff established by the Group on the specified route at the time of the sale, regardless of whether the customer is a programme participant or not. The stand-alone selling price of one separate bonus mile is an approximation of the fair value of services that will be provided in the future to the programme participant. The portion of revenue associated with miles and accumulated on the Group’s own flights is recognised under current and non-current deferred revenue related to customer loyalty programme within current and non-current liabilities, respectively, in the Group’s consolidated statement of financial position.

Revenue is recognised upon the provision of services to AZAL Miles members or expiry of the rights to receive such services.

Accounting for commission fees payable to agents selling tickets – the Group uses a practical expedient in accordance with IFRS 15 that allows not to capitalise the incremental costs of obtaining a contract with a customer, and recognises commission fees payable to agents on sale of tickets within operating costs in the consolidated statement of profit or loss and other comprehensive income in the period of the sale of the tickets, as according to the current tariffs of the Group the period of performance obligations on transportation of passengers does not exceed one year.

Cargo transportation

Cargo transportation revenue is recognised as revenue when the transportation is provided.

Other services

Revenues from air navigation, refueling, airport and aviation security and other services are recognised net of discounts and VAT taxes when services are provided.

Leases

The Group as lessee

The Group assesses whether a contract is or contains a lease, at inception of the contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (such as tablets and personal computers, small items of office furniture and telephones). For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Group uses its incremental borrowing rate.

The lease liability is presented as a separate line in the consolidated statement of financial position.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

The right-of-use assets are presented as a separate line in the consolidated statement of financial position.

The Group applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the “Property and equipment” policy.

Variable rents that do not depend on an index or rate are not included in the measurement of the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line “Operating costs” in the consolidated statement of profit or loss and other comprehensive income.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The Group has used this practical expedient.

Functional and presentation currency

The national currency of Azerbaijan is the Azerbaijani Manat (“AZN”), which is the functional currency of all entities within the Group, because it reflects the economic substance of the underlying events and circumstances of the Group. Azerbaijani Manat is also the presentation currency for these consolidated financial statements. All values are rounded to the nearest thousand AZN, except when otherwise indicated.

Foreign currencies

In preparing the financial statements of the Group entities, transactions in currencies other than the entity’s functional currency (foreign currencies) are recognised at the rates of exchange prevailing on the dates of the transactions. At each reporting date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Below are exchange rates as at the year-end, which were used by the Group for the purposes of these consolidated financial statements:

	<u>31 December 2022</u>	<u>31 December 2021</u>
AZN / USD	1.7000	1.7000
AZN / EUR	1.8114	1.9265

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Government grants

Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants are recognised in profit or loss on a systematic basis over the periods in which the Group recognises as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that the Group should purchase, construct or otherwise acquire non-current assets (including property and equipment) are recognised as “Government grant” in the consolidated statement of financial position and transferred to profit or loss on a systematic and rational basis over the useful lives of the related assets.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Group with no future related costs are recognised in profit or loss in the period in which they become receivable.

The benefit of a government loan at a below-market rate of interest is treated as a government grant, measured as the difference between proceeds received and the fair value of the loan based on prevailing market interest rates.

Taxation

Income tax expense represents the sum of taxes currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of profit or loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

The Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date at the end of the reporting period.

A provision is recognised for those matters for which the tax determination is uncertain but it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are measured at the best estimate of the amount expected to become payable. The assessment is based on the judgement of tax professionals within the Group supported by previous experience in respect of such activities and in certain cases based on specialist independent tax advice.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current tax and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

Property and equipment is stated at cost (deemed cost) less accumulated depreciation and impairment losses. For assets acquired after 1 January 2016, cost consists of purchase cost, together with any incidental expenses of acquisition. Depreciation is calculated in order to allocate the cost (less estimated residual value where applicable) over the remaining useful lives of the assets.

Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably. Repairs and maintenance are charged to the consolidated statement of profit or loss and other comprehensive income during the period in which they are incurred.

Freehold land is not depreciated.

The useful lives are estimated as follows:

Category	Useful life
Buildings and infrastructure	25-50 years
Aircraft and engines	7-25 years
Machinery and equipment	10-15 years
Other assets	5-10 years

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Aircraft and engines

The purchase price of aircraft and engines is denominated in foreign currencies. They are recognised at the exchange rate prevailing at the date of the transaction. Manufacturer’s discounts, if any, are deducted from the value of the related asset.

Aircraft and engines are depreciated using a straight-line method over their average estimated useful life of 7-25 years, assuming no residual value. During the operating cycle, the Group reviews whether the depreciable base or useful life should be adjusted and, if necessary, determines whether a residual value should be recognised.

Major overhaul expenditures, including replacement spares and labor costs, are capitalised and depreciated over the shorter of the period to the next major overhaul (based on flight hours or flight cycles), the remaining lease term or the useful life of the asset concerned.

Capital projects are stated at cost. When the asset is ready for its intended use it is transferred from capital projects to the appropriate category under property and equipment and depreciated in accordance with the Group’s policies.

Impairment of property and equipment

At each reporting date, the Group reviews the carrying amounts of its property and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

A reversal of an impairment loss is recognised immediately in profit or loss to the extent that it eliminates the impairment loss, which has been recognised for the asset in prior years.

Consumable spare parts and inventories

Consumable spare parts and inventories are stated at the lower of cost and estimated net realisable value. Costs of such inventories are determined on a first-in-first-out basis, except for fuel, which is determined on weighted average cost basis. Fuel is written off upon actual consumption. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Financial instruments

Financial assets and financial liabilities are recognised in the Group’s consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current accounts and cash deposits with banks with original maturities of three months or less.

Financial assets

All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

All recognised financial assets are measured subsequently in their entirety at either amortised cost or fair value, depending on the classification of the financial assets.

Classification of financial assets

Debt instruments that meet the following conditions are measured subsequently at amortised cost:

- The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt instruments that meet the following conditions are measured subsequently at fair value through other comprehensive income (FVTOCI):

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

By default, all other financial assets are measured subsequently at fair value through profit or loss (FVTPL).

Amortised cost and effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period.

For financial assets other than purchased or originated credit-impaired financial assets (i.e. assets that are credit-impaired on initial recognition), the effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) excluding expected credit losses, through the expected life of the debt instrument, or, where appropriate, a shorter period, to the gross carrying amount of the debt instrument on initial recognition.

The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, adjusted for any loss allowance. The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any loss allowance.

Impairment of financial assets

The Group recognises a loss allowance for expected credit losses on investments in debt instruments that are measured at amortised cost. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition of the respective financial instrument.

The expected credit losses on trade receivables are estimated using a provision matrix based on the Group's historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions, credit ratings and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate. The Group always measures the loss allowance for trade receivables at an amount equal to lifetime ECL.

For other financial instruments, the Group recognises lifetime ECL when there has been a significant increase in credit risk since initial recognition. However, if the credit risk on the financial instrument has not increased significantly since initial recognition, the Group measures the loss allowance for that financial instrument at an amount equal to 12-month ECL.

Lifetime ECL represents the expected credit losses that will result from all possible default events over the expected life of a financial instrument. In contrast, 12-month ECL represents the portion of lifetime ECL that is expected to result from default events on a financial instrument that are possible within 12 months after the reporting date.

(i) Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Group compares the risk of a default occurring on the financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

includes the future prospects of the industries in which the Group’s debtors operate, obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organizations, as well as consideration of various external sources of actual and forecast economic information that relate to the Group’s core operations.

Irrespective of the outcome of the above assessment, the Group presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Group has reasonable and supportable information that demonstrates otherwise.

(ii) Definition of default

If historical experience indicates that financial assets, for which information developed internally or obtained from external sources indicates that the debtor is unlikely to pay its creditors, including the Group, in full, the Group considers this as an event of default for internal risk management purposes.

Irrespective of the above analysis, the Group considers that default has occurred when a financial asset is more than 360 days past due unless the Group has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

(iii) Measurement and recognition of expected credit losses

The measurement of expected credit losses is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default.

The Group recognises an impairment gain or loss in profit or loss for all financial instruments with a corresponding adjustment to their carrying amount through a loss allowance account.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

Financial liabilities and equity

Classification as debt or equity

Debt and equity instruments issued by the Group are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Loans and Borrowings

Borrowings are recognised initially at fair value, net of transaction cost incurred. Borrowings are measured at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value recognised in the consolidated statement of profit or loss and other comprehensive income over the period of the borrowings using the effective interest method.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group’s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in the consolidated statement of profit or loss and other comprehensive income.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022 (in thousands of Azerbaijani Manat)

Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy. Income and expense is not offset in the consolidated statement of profit or loss and other comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

New and amended IFRS Standards that are effective for the current year

There were no new and amended standards that are effective which could materially impact the Group's consolidated financial statements.

New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these consolidated financial statements, the Group has not applied the following new and revised IFRS Standards that have been issued but are not yet effective:

Standards and interpretations	Effective for annual periods beginning on or after
IFRS 17 (including the June 2020 Amendments to IFRS 17) <i>Insurance Contracts</i>	1 January 2023
Amendments to IFRS 10 and IAS 28 <i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>	To be determined
Amendments to IAS 1 <i>Classification of Liabilities as Current or Non-current</i>	1 January 2023
Amendments to IAS 1 and IFRS Practice Statement 2 <i>Disclosure of Accounting Policies</i>	1 January 2023
Amendments to IAS 8 <i>Definition of Accounting Estimates</i>	1 January 2023
Amendments to IAS 12 <i>Deferred Tax related to Assets and Liabilities arising from a Single Transaction</i>	1 January 2023

Management does not expect that the adoption of the standards listed above will have a material impact on the consolidated financial statements of the Group in future periods.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In applying the Group’s accounting policies described in Note 3, management is required to make judgments (other than those involving estimations) that have a significant impact on the amounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgments in applying the Group’s accounting policies

The following are the critical judgments that management have made in the process of applying the Group’s accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

Subsidies received from the government

As a continuance of the government financial assistance program to support entities suffering negative impact of COVID-19 pandemic, the Group received AZN 108,809 (2021: AZN 98,909) for the recovery of the operations for the post-pandemic period, AZN 89,500 to AZAL and AZN 19,309 to National Aviation Academy (AZN 86,000 for AZAL and AZN 12,909 for National Aviation Academy).

Management exercised significant judgment in assessing the accounting treatment of the government assistance received in deciding whether the assistance should be treated as a shareholder contribution by government in its capacity as a shareholder, or government grant to be recognised in income. Considering that no equity instruments were issued in return, that the government decree did not specify equity designation of the assistance, and that similar financial support was provided to other companies regardless of whether they were government-owned or not, management concluded that the transaction represented a government grant under IAS 20 rather than a contribution by shareholder. Accordingly, the full amount was recognised as income in the consolidated statement of profit or loss and other comprehensive income, as there were no conditions or future related costs associated with the grant.

Reversal of ECL recognised on amounts due from related party

During 2021, the Cabinet of Ministers of the Republic of Azerbaijan issued a resolution ordering the spin-off of Nakhchivan International Airport (NIA) from the structure of the Group and transferring the control to the Cabinet of Ministers of the Autonomous Republic of Nakhchivan, effective from 1 July 2021. As a result, the Group recognised ECL on receivables from NIA (now a non-group related party), of AZN 35,363 for the year ended 31 December 2021. The Group has been in negotiations with the Nakhchivan Government and NIA management regarding the outstanding balance and its settlement. NIA management has acknowledged the balance as at 31 December 2022 and the Group management expects that settlement mechanism will be agreed with the Nakhchivan Government in the near future.

As at 31 December 2022, management exercised significant judgment in assessing the recoverability of these receivables and deciding whether the previously recognised ECL was still appropriate considering it has become virtually certain that the amounts are expected to be

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

recovered through either inflows of assets or as a result of the transfer of NIA back to the structure of the Group. Accordingly, the remaining amount of previously recognised ECL of AZN 35,299 was recognised as a reversal of ECL in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2022.

Key sources of estimation uncertainty

The below are listed key estimations that management have used in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

Impairment testing

The Group tests whether there is any indication of impairment at the end of each reporting date. If any indications of impairment are identified, the Group performs impairment testing.

The recoverable amount of property and equipment and right-of-use assets is determined based on value in use calculations for Airports, Aeronavigation, AZALOil CGUs and fair value less cost to sell for Airlines CGU. These calculations require the use of the estimates described in more detail in Note 9.

Useful lives of property and equipment

Management assigns useful lives to property and equipment based on the intended use of assets and the economic lives of those assets. The Group's property and equipment are depreciated using the straight-line method over their estimated useful lives or flight cycles / hours, which are based on management's business plans and operational estimates. Subsequent changes in circumstances such as technological advances or prospective utilisation of the assets concerned could result in the actual useful lives or residual values differing from initial estimates. Management periodically reviews the appropriateness of the remaining useful lives of property and equipment. Revisions to estimates of the useful lives of items of property and equipment are recognised prospectively in the period of the revision and where applicable, future periods. Accordingly, this may materially impact the amount of depreciation charge and carrying amount of property and equipment to be recognised in the future.

Recoverability of VAT assets

VAT asset balances that have already become receivable from tax authority (input VAT balances that have been recovered through payment of invoices or provision of services or goods) are equivalent to having a prepayment with tax authority, which can be used to offset the Group's future tax obligations. Management believes that the VAT asset balances due from the government are recoverable and will be used to offset future tax obligations. The Group does not need to get permission from tax authorities to be able to offset tax assets with liabilities and thus it is considered that tax liabilities would offset tax assets as they accrue. This would mean that these tax assets substantially turn over within twelve months and are recoverable. VAT asset balances that not yet become receivables from tax authority ("input VAT recoverable") were analysed by management as at 31 December 2022 and AZN 41,093 of such balances were concluded as being doubtful (31 December 2021: AZN 42,933). Consistent with the prior year, management of the Group believes that these balances will not be recovered in the nearest future due to fact that corresponding payables balances of these VAT balances would not be paid in cash (instead of settling gross balances, management expects settlement on a net basis against receivables with those counter-parties), thus precluding the recoverability of such VAT balances in accordance with the current legislation.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2022**

(in thousands of Azerbaijani Manat)

5. TRAFFIC AND OTHER REVENUE

	<u>2022</u>	<u>2021</u>
Scheduled passenger flights	543,068	194,230
Refueling services	273,298	97,978
Airport and aviation security services	169,124	112,410
Air navigation services	80,076	45,456
Charter passenger flights	37,253	15,991
Cargo transportation	8,261	2,617
Other revenue	38,874	23,068
Total traffic and other revenue	<u>1,149,954</u>	<u>491,750</u>

Due to lifting of COVID-19 pandemic restrictions and recovery of the business operations and flights, the Group was able to recover its revenue and even exceeded pre-pandemic period figures.

6. OPERATING COSTS

	<u>2022</u>	<u>2021</u>
Fuel expenses	392,650	105,161
Staff costs	149,196	99,083
Depreciation and amortisation	126,750	124,235
Ground handling services	69,180	27,920
Aircraft and other maintenance	58,085	29,150
Commercial services and commission fees	38,642	30,933
Air navigation services outside of Azerbaijan	32,650	12,626
Taxes other than income tax	28,237	27,148
Foreign airports passenger fees	26,233	11,436
Food and beverages for catering services	25,609	14,521
Materials expenses	19,418	11,952
Impairment of property and equipment and right-of-use assets	14,945	4,594
Insurance expense	10,014	6,012
Electricity expenses	6,926	5,670
Business trip expenses	4,215	1,731
Passenger services	4,203	2,090
Communication expenses	3,506	3,883
Consulting expenses	2,797	3,862
Change in impairment provision of advances given	2,771	(1,850)
Change in impairment provision of capital projects	1,744	(4,392)
Change in impairment provision of VAT recoverable balance	(1,840)	(3,525)
Other expenses	32,288	29,617
Other income	(7,594)	(2,165)
Total operating costs	<u>1,040,625</u>	<u>539,692</u>

Staff costs include social contribution expense of AZN 29,134 for the year ended 31 December 2022 (31 December 2021: AZN 18,933). Other expenses are mainly made up of short-term and low-value lease expenses and other individually immaterial expenses of the Group. Other income is mainly made up of the income from the payables write-off and amortisation charge of the grant (see Note 20).

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2022
(in thousands of Azerbaijani Manat)**

7. FINANCE COSTS

	<u>2022</u>	<u>2021</u>
Interest expense on loans and borrowings	90,535	75,691
Interest expense on lease liabilities	11,675	11,133
Total finance costs	<u>102,210</u>	<u>86,824</u>

8. INCOME TAX

	<u>2022</u>	<u>2021</u>
Current income tax expense	-	-
Deferred tax expense / (benefit)	39,308	(6,274)
Total income tax expense / (benefit)	<u>39,308</u>	<u>(6,274)</u>

There were no provisions recognised for taxes as at 31 December 2022 and 2021.

The income tax expense for the year calculated at statutory income tax rate of 20% can be reconciled to the accounting profit as follows:

	<u>2022</u>	<u>2021</u>
Income / (loss) before income tax	149,928	(73,821)
Income tax expense / (benefit) at statutory tax rate (20%)	29,986	(14,764)
Effect of non-deductible expenses	6,256	15,077
Effect of utilisation of tax losses not previously recognised and not recognised tax losses	3,066	(6,587)
Total income tax expense / (benefit)	<u>39,308</u>	<u>(6,274)</u>

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2022
(in thousands of Azerbaijani Manat)**

9. PROPERTY AND EQUIPMENT

	Buildings and infrastructure	Aircraft and engines	Machinery and equipment	Other property and equipment	Capital projects	Total
Cost						
At 1 January 2021	879,307	669,617	310,598	65,312	13,927	1,938,761
Additions	691	5,960	21,455	441	24,829	53,376
Acquisition of subsidiary	39,130	-	4,028	1,035	-	44,193
Disposal of subsidiary	(83,241)	-	(23,921)	(12,444)	-	(119,606)
Disposal of assets	(549)	(5,149)	(205)	(803)	-	(6,706)
Transfer of assets	394	89	25,049	101	(25,633)	-
At 31 December 2021	835,732	670,517	337,004	53,642	13,123	1,910,018
Additions	1,153	13,204	1,776	2,083	31,345	49,561
Disposal of assets	(96)	(13,429)	(77)	(38)	-	(13,640)
Transfer of assets	353	1,305	20,399	466	(22,523)	-
At 31 December 2022	837,142	671,597	359,102	56,153	21,945	1,945,939
Accumulated depreciation and impairment						
At 1 January 2021	159,265	222,441	128,043	36,624	9,870	556,243
Charge for the year	28,290	42,121	24,851	5,723	-	100,985
Reversal of impairment	-	-	-	-	(4,392)	(4,392)
Disposal of subsidiary	(13,515)	-	(7,789)	(7,054)	-	(28,358)
Disposal of assets	(348)	(4,781)	(69)	(124)	-	(5,322)
At 31 December 2021	173,692	259,781	145,036	35,169	5,478	619,156
Charge for the year	27,536	43,328	25,891	5,076	-	101,831
Disposal of assets	(68)	(11,419)	(65)	(38)	-	(11,590)
Impairment	670	7,268	70	382	1,744	10,134
At 31 December 2022	201,830	298,958	170,932	40,589	7,222	719,531
Net book value						
At 1 January 2021	662,040	410,736	191,968	18,473	7,645	1,290,862
At 31 December 2022	635,312	372,639	188,170	15,564	14,723	1,226,408

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

The infrastructure is mainly comprised of runways, airport ramps, hangars and terminals.

As of 31 December 2022, the Group had 28 aircraft, including eight leased and 20 owned ones. These include two leased aircraft of Airbus Model A320-271N delivered in December 2022. Subsequently, additional Airbus Model 320-271N was delivered under the same contract in the first quarter of 2023.

In addition to the 28 aircraft mentioned above, the Group had four aircraft with zero carrying value as of 31 December 2021, which were not fit for use and written-off in 2022 after obtaining approval from the State Committee on Property Issues of Azerbaijan Republic.

Both in 2021 and 2022, major vendors engaged in construction work and equipment installation of the Group included Airport and ATC Systems GmbH, and MCG Middle East and Thales Las France S.A.S, which provided navigation equipment for the airport construction works in Zangilan area; and construction of airspace efficiency center, respectively.

No items of property and equipment of the Group were pledged as collateral as at 31 December 2022 and 2021.

Impairment testing

In accordance with IAS 36 *Impairment of Assets*, an entity is required to assess whether there is any indication that assets may be impaired at the end of each reporting period. For Airports, Aeronavigation and AZAL Oil CGUs, the recoverable amounts are determined by reference to the value-in-use by discounting future cash flows to be generated as a result of respective activities, whereas for Airlines CGU the recoverable amount is determined by reference to the fair value less cost to sell (Level 1 as per fair value hierarchy in Note 3). Due to previously recognised impairment on Airlines CGU and possible volatility of aircraft fair values in the market, the Group considers there to be an impairment trigger for Airlines CGU. No internal or external triggers were identified for the other three CGUs as the cash flows used in value-in-use calculations of these CGUs were at or above those previously estimated, and there was no previously recognised impairment to be reversed.

Management has determined that carrying value of property and equipment and right-of-use assets pertaining to the CGU exceeded their fair value less cost to sell determined with reference to market data adjusted to the actual maintenance status of main components, therefore an impairment charge of AZN 8,390 and AZN 6,555 for property and equipment and right-of-use assets, respectively, was recognised as at 31 December 2022 (31 December 2021: nil for property and equipment and AZN 4,594 for right-of-use assets). Management considers the estimate of cost to sell (12.5% of market value of aircraft) as the most sensitive assumption in determining the recoverable amount for the Airlines CGU. For the newly leased aircraft in 2022 (two Airbus aircraft), management considered the estimate of cost to sell of 8% as more appropriate due to newly acquired condition. A change of 1% in the estimate of cost to sell of all aircraft would result in AZN 10,026 of impairment or reversal of impairment to be recognised for the CGU.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022 (in thousands of Azerbaijani Manat)

10. LEASES (GROUP AS A LESSEE)

Right-of-use assets (aircraft and engines)	<u>Total</u>
Cost	
At 1 January 2021	484,222
Additions to right-of-use assets during the period	1,343
Overhaul derecognition	(1,272)
At 31 December 2021	484,293
Additions to right-of-use assets during the period	202,291
Overhaul derecognition	-
At 31 December 2022	686,584
Accumulated depreciation and impairment	
At 1 January 2021	111,754
Charge for the year	23,599
Overhaul derecognition	(1,272)
Impairment loss	4,594
At 31 December 2021	138,675
Charge for the year	22,184
Impairment loss	6,555
At 31 December 2022	167,414
Net book value	
At 1 January 2022	345,618
At 31 December 2022	519,170

The Group leases several assets, which mainly comprise aircraft and engines. The average lease term is 10 years (2021: 10 years). The Group's obligations are secured by the lessors' title to the leased assets for such leases. The maturity analysis of lease liabilities is presented in Note 18. At the maturity of the lease term, and provided that no event of default has occurred, the title to the aircraft and engines will be transferred to the Group.

As mentioned in Note 9 (Property and equipment), there were two leased aircraft for which AZAL signed a new lease agreement in December 2022. The contract covers three Airbus A320-271N aircraft, of which two were delivered on 30 December 2022 and another one was delivered in the first quarter of 2023.

11. LONG-TERM ADVANCES GIVEN

	<u>31 December 2022</u>	<u>31 December 2021</u>
Long-term advances given	88,397	64,178
Less: impairment of long-term advances given	(13,360)	(13,236)
Total long-term advances given	75,037	50,942

Long-term advances given balances mainly comprised advances given to foreign suppliers in regard to aircraft and training equipment. Management estimates unrecoverable portion at the end of every period based on the likelihood of refund or receipt of goods and services in the future.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

As at 31 December 2022, major counterparties that the Group had made advance payments to included Aviation Capital Group, Airbus, Boeing and GE Engine Services LLC for the purchase of aircraft and overhaul of engines.

As at 31 December 2021, major counterparties that the Group had made advance payments to included Boeing and GE Engine Services LLC for the purchase of aircraft and overhaul of engines.

12. OTHER NON-CURRENT ASSETS

Other non-current assets mainly comprised spare part balances of AZN 28,262 and AZN 23,987 as at 31 December 2022 and 2021, respectively. These spare parts were expected to be utilised, were not impaired and were in good condition. Hence, no slow-moving provision was recognised regarding these balances.

13. CONSUMABLE SPARE PARTS AND INVENTORIES

	<u>31 December 2022</u>	<u>31 December 2021</u>
Spare parts	51,989	36,136
Fuel	5,617	5,347
Other inventories	-	29
Less: Allowance	<u>(23,977)</u>	<u>(10,232)</u>
Total consumable spare parts and inventories	<u>33,629</u>	<u>31,280</u>

14. TRADE AND OTHER RECEIVABLES

	<u>31 December 2022</u>	<u>31 December 2021</u>
Trade receivables	77,150	65,963
Amounts due from related parties	<u>58,299</u>	<u>12,923</u>
Financial assets	135,449	78,886
Advances given and prepaid expenses	48,481	26,395
VAT recoverable	6,099	17,489
VAT receivable	<u>67,286</u>	<u>15,946</u>
Non-financial assets	<u>121,866</u>	<u>59,830</u>
Total trade and other receivables	<u>257,315</u>	<u>138,716</u>

Trade receivables mainly include amounts due for overflights and tickets sold by international agents. Advances given and prepaid expenses mainly include prepayments for aircraft spare parts and service fee for air navigation database renewal, which are expected to be delivered and used within twelve-month period.

Both in 2021 and 2022, major customers of the Group included ASG Business Aviation LLC for refueling, air-navigation and airport services, International Air Transport Association ("IATA") members for air-navigation services, Silk Way West Airlines LLC for air-navigation and airport services and Billing and Settlement Plan ("BSP") entities for scheduled passenger flights.

Significant increase in amounts due from related parties is mainly due to the change in the ECL on the related party receivable from the Nakhchivan International Airport (see Note 4).

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Under the local tax legislation, the Group has rights to recover VAT balances only after the associated payables have been settled and contracted work has been delivered, when input VAT recoverable becomes VAT receivable. VAT recoverable balance arises from purchase of equipment, fuel and services that will be set off with tax liabilities as they become eligible for set off. The Group exercised its rights under the local tax legislation to settle tax payable balances with VAT receivable balance of AZN 39,989 for the year ended 31 December 2022 (31 December 2021: AZN 24,596).

Risk profile of trade receivables based on the provision matrix, which is used by the Group for credit risk assessment and risk management is as follows:

31 December 2022	Trade receivables – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	2%	2%	4%	10%	15%	100%	12%
Estimated total gross carrying amount at default	63,851	8,719	2,543	1,711	2,238	8,834	87,896
Lifetime ECL	(1,076)	(213)	(107)	(171)	(345)	(8,834)	(10,746)
Total trade receivables							77,150

31 December 2021	Trade receivables – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	6%	8%	9%	14%	24%	100%	18%
Estimated total gross carrying amount at default	35,031	10,457	11,277	11,299	4,582	8,062	80,708
Lifetime ECL	(2,202)	(799)	(1,009)	(1,584)	(1,089)	(8,062)	(14,745)
Total trade receivables							65,963

	2022	2021
Balance at the beginning of the year	14,745	11,796
Net remeasurement of loss allowance	(3,999)	2,949
Amount recovered	(6,687)	(3,651)
Change in loss allowance due to new trade receivables originated net of those derecognised due to settlement	2,688	6,600
Balance at the end of the year	10,746	14,745

31 December 2022	Amounts due from related parties – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	2%	2%	4%	10%	15%	100%*	5%
Estimated total gross carrying amount at default	7,182	4,301	3,629	5	13	37,784	52,914
Lifetime ECL	(134)	(105)	(103)	(0)	(2)	(2,535)	(2,879)
Total amounts due from related parties							50,035

*Amounts overdue by >360 days are provided 100%, but AZN 35,299 of ECL provision on NIA receivables was reversed in 2022 as disclosed in Note 4.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022 (in thousands of Azerbaijani Manat)

31 December 2021	Amounts due from related parties – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	6%	8%	9%	14%	24%	100%	78%
Estimated total gross carrying amount at default	5,995	2,908	1,136	550	1,269	37,729	49,587
Lifetime ECL	(380)	(222)	(102)	(77)	(302)	(37,729)	(38,812)
Total amounts due from related parties							10,775

The advances given have not been included in the tables above since they are not subject to ECL analysis due to their non-financial nature.

The Group's exposure to credit and currency risks, and impairment losses related to trade and other receivables are disclosed in Note 23.

	31 December 2022	31 December 2021
Short-term advances given	46,072	26,646
Less: impairment of short-term advances given	(975)	(1,136)
Total advances given	45,097	25,510
Prepaid expenses	3,384	885
Total short-term advances given and prepaid expenses	48,481	26,395

15. CASH AND CASH EQUIVALENTS

	31 December 2022	31 December 2021
Cash on bank accounts in AZN	35,198	43,490
Cash on bank accounts in US dollars	36,914	27,395
Cash on bank accounts in Euro	8,794	6,138
Cash on bank accounts in other foreign currencies	6,494	1,300
Other cash and cash equivalents	889	502
Total cash and cash equivalents	88,289	78,825

The Group's exposure to foreign currency, credit risk as well as a sensitivity analysis for financial assets and liabilities are disclosed in Note 23.

16. SHARE CAPITAL

In accordance with the Group's charter, the Group's declared charter capital as at 31 December 2022 and 2021 constituted AZN 823,975 composed of 411,987,235 shares with par value of AZN 0.002 each.

Shareholder's contribution

During 2022, the Group received from the government a total contribution of AZN 10,000, in order to install airnavigation systems in newly liberated territories.

During 2021, the Group received from the government a total contribution of AZN 8,500 for the purchase of flight simulator of Embraer 190-E1 aircraft installed in the National Aviation Academy.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Disposal of subsidiary (Discontinued operations)

In 2021, the Cabinet of Ministers of the Republic of Azerbaijan issued a resolution ordering the spin-off of Nakhchivan International Airport as part of structure of the Group and transferring the control to the Cabinet of Ministers of the Autonomous Republic of Nakhchivan, effective from 1 July 2021. The transfer was accounted for at cost as the transaction was between the parties under common control. As a result, a decrease of AZN 51,171 was recognised in accumulated deficit equivalent to the net assets (including deferred tax liability balance) of the subsidiary at disposal date. Net assets of the subsidiary were mainly represented by property and equipment of AZN 91,248, current assets of AZN 5,490 and liabilities of AZN 45,567 (mainly represented by payables to the Group of AZN 36,387). Loss from discontinued operations of the Group as a result of the disposal of subsidiary during the first six months of 2021 constituted AZN 5,888 (mainly represented by depreciation of property and equipment and staff costs of AZN 5,179).

17. LOANS AND BORROWINGS

	Interest rate	31 December 2022	31 December 2021
<i>AZN – denominated</i>			
Local banks	Fixed	30,872	44,275
Ministry of Finance of the Republic of Azerbaijan	Fixed	624,168	624,168
Total AZN denominated		655,040	668,443
<i>USD – denominated</i>			
Local banks	Fixed	41,199	85,052
Ministry of Finance of the Republic of Azerbaijan	Floating	1,077,899	1,077,899
Ministry of Finance of the Republic of Azerbaijan	Fixed	81,091	64,160
Total USD denominated		1,200,189	1,227,111
<i>EUR – denominated</i>			
Foreign banks	Fixed	25,849	30,338
Ministry of Finance of the Republic of Azerbaijan	Fixed	7,472	6,382
Total EUR denominated		33,321	36,720
Accrued interest		434,979	353,698
Total loans and borrowings		2,323,529	2,285,972
Long-term portion of loans and borrowings		850,342	1,085,079
Short-term portion of loans and borrowings		1,473,187	1,200,893

The effective average interest rate per annum on term loans for AZN, USD and EUR as at 31 December 2022, was 2.6%, 6.3% and 1.2%, respectively (31 December 2021: 5.9%, 3.7% and 1.3%, respectively). Variable rates for 2022 have been calculated on the basis of 3-month USD LIBOR rates plus 2.2% per annum and also fixed annual interest rates ranging from 0.75% to 8% for the period. Loan and borrowing agreements do not contain any financial covenant terms.

The Ministry of Finance of the Republic of Azerbaijan paid AZN 18,403 for loans and leases on behalf of the Group during 2022. Subsequent to year end on 27 February 2023, an agreement with the Ministry of Finance was reached to apply an interest rate of 2% per annum effective from 1 January 2023 with a specified repayment schedule during 2023-2028.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Reconciliation of liabilities arising from financing activities

The table below details changes in the Group’s liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Group’s consolidated statement of cash flows as cash flows from financing activities.

	Cash changes		Non-cash changes			Other changes (iv)	31 December 2022
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Forex	Other non-cash changes (iii)		
1 January 2022							
Bank loans	-	(1,341)	(1,472)	(1,837)	-	127	25,815
Loans from related parties	-	(57,288)	-	(374)	18,403	81,339	2,297,714
Lease liabilities	-	(37,919)	(16,931)	-	-	3,890	396,572
Total liabilities from financing activities	-	(96,548)	(18,403)	(2,211)	18,403	85,356	2,720,101

	Cash changes		Non-cash changes			Other changes (iv)	31 December 2021
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Forex	Other non-cash changes (iii)		
1 January 2021							
Bank loans	-	-	(3,308)	(2,736)	-	400	30,338
Loans from related parties	34,574	(16,724)	(6,311)	(265)	30,623	65,928	2,255,634
Lease liabilities	-	(22,590)	(31,465)	-	-	2,699	282,802
Total liabilities from financing activities	34,574	(39,314)	(41,084)	(3,001)	30,623	69,027	2,568,774

- (i) The cash flows from loans from related parties make up the total amount of proceeds from borrowings in the consolidated statement of cash flows in 2021.
- (ii) Payment on behalf of the Group is disclosed in the consolidated statement of cash flows under heading “Non-cash transactions excluded from the consolidated statement of cash flows”, (d) and (e).
- (iii) Other non-cash changes in 2022 include loan recognised from Ministry of Finance of AZN 18,403 (which was AZN 34,701 in 2021 shown net of AZN 4,078 impact of disposal of subsidiary) for repayments of loans and leases made by the Ministry of Finance on behalf of the Group, which is recognised as loan payable to the Ministry of Finance.
- (iv) Other changes include accruals and payments of interest (net movement) on loans and borrowings and lease liabilities.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022 (in thousands of Azerbaijani Manat)

The maturity profile of loans and borrowings is as follows:

	<u>31 December 2022</u>	<u>31 December 2021</u>
Due in one month	1,260,182	937,283
Due from one month to one year	213,005	263,610
Total current portion of loans and borrowings	1,473,187	1,200,893
Due from one year to five years	837,879	1,068,976
Due over five years	12,463	16,103
Total long-term portion of loans and borrowings	850,342	1,085,079
Total loans and borrowings	2,323,529	2,285,972

18. LEASE LIABILITIES

	<u>31 December 2022</u>	<u>31 December 2021</u>
Non-current portion of lease liabilities	330,319	232,853
Current portion of lease liabilities	66,253	49,949
Total lease liabilities	396,572	282,802

Reconciliation of future lease payments and their present values:

Maturity analysis:	<u>31 December 2022</u>	<u>31 December 2021</u>
Year 1	93,414	60,406
Year 2	91,251	60,807
Year 3	89,001	61,211
Year 4	81,627	61,633
Year 5	35,945	56,921
Onwards	139,342	13,348
Less: unearned interest	(134,008)	(31,524)
Total	396,572	282,802
Analysed as:		
Current	66,253	49,949
Non-current	330,319	232,853
Total	396,572	282,802

All lease arrangements are denominated in US dollar, and the interest rates are linked to market interest rates (normally the LIBOR).

On 1 January 2019, the Group adopted IFRS 16 for the first time and recognised lease liability of AZN 12,648 for contracts previously recognised as operating lease under IAS 17.

In July 2022, the Group signed a new lease agreement to purchase three new Airbus A320 neo aircrafts, as mentioned in Note 9.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2022
(in thousands of Azerbaijani Manat)**

19. UNEARNED REVENUE AND DEFERRED REVENUE RELATED TO FFP

The principal amount of obligations to passenger flight customers relates to the cost of tickets sold but unused at the reporting date, as well as obligations under the Frequent Flyer Program.

Unearned revenue

	<u>2022</u>	<u>2021</u>
Unearned revenue balance brought forward	37,101	25,103
Additions during the year	697,185	301,217
Recognised as revenue during the year	<u>(673,799)</u>	<u>(289,219)</u>
Unearned revenue balance carried forward	<u>60,487</u>	<u>37,101</u>

Deferred revenue related to FFP

Revenue related to FFP is deferred and recognised when the Group fulfils its obligations by supplying free or discounted services on the redemption of the award credits or when such award credits expire.

Deferred revenue is classified within current and non-current liabilities based on expected redemption patterns. The Group accounts for award credits as a separately identifiable component of the sales transaction in which they are granted. The consideration in respect of the initial sale is allocated to award credits based on their stand-alone selling price and is accounted for as a liability (deferred revenue) in the consolidated statement of financial position. The stand-alone selling price of one separate bonus mile is an approximation of the fair value of services that are expected to be provided to the FFP participant in the future.

	<u>2022</u>	<u>2021</u>
Deferred revenue balance brought forward	29,069	28,687
Accrual during the year	4,320	1,881
Redemption during the year	<u>(7,772)</u>	<u>(1,499)</u>
Deferred revenue balance carried forward	<u>25,617</u>	<u>29,069</u>
	<u>31 December 2022</u>	<u>31 December 2021</u>
Deferred revenue, current portion	5,074	3,268
Deferred revenue, non-current portion	<u>20,543</u>	<u>25,801</u>
Total deferred revenue related to FFP	<u>25,617</u>	<u>29,069</u>

The change in obligations under the passenger bonuses program compared to pre-COVID financial years was due to decrease in volume of miles accumulated by program members, and because of the used miles during the COVID-19 pandemic. In 2020, the Group extended expiration period of miles points until 31 December 2021. Subsequently during 2021, expiration period was further extended until 30 June 2022. Non-current portion of deferred revenue recognised as at 31 December 2022 is expected to be released to revenue within next three years (maximum period of expiration) after this date.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

20. GOVERNMENT GRANT

On 13 December 2021, the Group received Fuzuli Airport LLC as a 100% subsidiary through a transfer of control. As a result of this transfer the Group has recognised the assets of AZN 44,500 and corresponding government grant liability in the consolidated statement of financial position. During 2022, the Group recognised amortisation of the grant at the amount of AZN 1,114 which decreased the grant amount to AZN 43,386 as at 31 December 2022.

21. DEFERRED INCOME TAX

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

A deferred tax asset has not been recognised in respect of carried forward tax losses primarily in the subsidiaries of the Company (AZN 12,716 and AZN 28,573 as of 31 December 2022 and 2021, respectively, which expire in five years from origination), as there is no reasonable certainty that the subsidiaries will be able to utilise those carried forward tax losses in the foreseeable future.

Deferred tax assets and (liabilities) presented by types of temporary differences:

	1 January 2022	Recognised in profit or loss	31 December 2022
Property and equipment	(33,889)	(17,928)	(51,817)
Right-of-use assets	(27,595)	(13,711)	(41,306)
Intangible assets	(170)	(66)	(236)
Other non-current assets	1,261	509	1,770
Trade and other receivables	11,683	(8,836)	2,847
Consumable spare parts and inventories	683	2,473	3,156
Cash and cash equivalents	43	-	43
Loans and borrowings	-	(135)	(135)
Lease liabilities	305	137	442
Trade and other payables	4,711	(1,393)	3,318
Unearned revenue	536	62	598
Deferred revenue	5,814	(691)	5,123
Other current liabilities	-	271	271
Total	(36,618)	(39,308)	(75,926)

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	1 January 2021	Disposal of subsidiary	Recognised in profit or loss	31 December 2021
Property and equipment	(33,675)	3,069	(3,283)	(33,889)
Right-of-use assets	(21,959)	-	(5,636)	(27,595)
Intangible assets	(170)	-	-	(170)
Other non-current assets	-	-	1,261	1,261
Trade and other receivables	7,223	-	4,460	11,683
Consumable spare parts and inventories	3,162	-	(2,479)	683
Cash and cash equivalents	43	-	-	43
Loans and borrowings	(348)	-	348	-
Lease liabilities	1,293	-	(988)	305
Trade and other payables	613	-	4,098	4,711
Unearned revenue	(4,624)	-	5,160	536
Deferred revenue	5,738	-	76	5,814
Other current liabilities	(3,493)	236	3,257	-
Total	(46,197)	3,305	6,274	(36,618)

22. TRADE AND OTHER PAYABLES

	31 December 2022	31 December 2021
Trade and other payables	51,353	95,769
Staff related payables	11,465	13,997
Amounts due to related parties	2,564	8,917
Financial liabilities	65,382	118,683
Advances received	11,203	10,734
Other taxes payable	1,913	5,767
Property tax	645	596
Income tax payable	762	762
Non-financial liabilities	14,523	17,859
Total trade and other payables	79,905	136,542

Trade and other payables mainly include payables for repair and maintenance, ground handling, catering and other services provided by suppliers of the Group.

Both in 2021 and 2022, major suppliers of the Group included Azneft PU of SOCAR (fuel), AJ Walter Aviation Ltd. (spare parts), GA Telesis LLC (spare parts), Silk Way Group (aircraft maintenance), ASG Business Aviation Group (ground handling, catering, and maintenance), Silk Row Travel LLC (sales and marketing), Ipek Yolu Sigorta OJSC (insurance), Azerishiq OJSC (electricity) and SITA (communication).

Advances received mainly represents advances paid by foreign airlines for services provided by the Group.

Other taxes payable mainly represents liabilities arising from land, personal income, social and withholding taxes. As at 31 December 2022, it mainly comprised social tax of AZN 329 and output VAT payable of AZN 1,939 after settling tax payables with VAT receivable (Note 14). As at 31 December 2021, it mainly comprised social tax of AZN 2,051 and output VAT payable of AZN 3,599 after settling tax payables with VAT receivable (Note 1).

The Group's exposure to currency risks related to trade and other payables are disclosed in Note 23.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

23. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Exposure to credit, liquidity and market risks arise in the normal course of the Group’s business. The Group does not hedge its exposure to such risks.

Capital management

The Group manages its capital to ensure the Group will be able to continue as a going concern.

The capital structure of the Group consists of net debt and shareholder deficit of the Group (comprising share capital and accumulated deficit).

Under the requirements of the Azerbaijani law, the Group is required to remediate negative equity position in the year subsequent to the year in which such negative equity position arises (see Note 2 for disclosure of management’s going concern considerations). Except for this, the Group is not subject to any other externally imposed capital requirements.

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss from defaults.

Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of trade receivables. A significant portion of the Group’s air tickets are sold by agents participating in the BSP, a clearing system between airlines and sales agents organised by the International Air Transportation Association. The balance (gross of ECL) due from the BSP agents amounted to AZN 9,788 or 11% of trade receivables as at 31 December 2022 (31 December 2021: AZN 5,936 or 7%).

Moreover, some portion of the Group’s air tickets for local flights are generated by Nakhchivan International Airport (related party of the Group) located in Nakhchivan, the capital of the Nakhchivan Autonomous Republic, a landlocked exclave of Azerbaijan. The balance (gross of ECL) due from this counterparty amounted to AZN 37,567 or 43% of trade receivables as at 31 December 2022 (31 December 2021: AZN 38,812).

The sale of passenger and cargo transportation and overflight services arrangements are largely achieved through International Air Transport Association (IATA) approved sales agents and online sales. All IATA agents have to meet minimum financial criteria applicable to their country of operation to remain accredited. Adherence to the financial criteria is monitored on an ongoing basis by IATA through their Agency Programme. The balance (gross of ECL) due from IATA agents amounted to AZN 19,970 or 23% of trade receivables as at 31 December 2022 (31 December 2021: AZN 12,534 or 16%). The credit risk associated with such sales agents is relatively small owing to a broad diversification.

The Group provides air-navigation and airport services to Silk Way West Airlines LLC, which is based at Heydar Aliyev International Airport and operate international cargo flights. The balance (gross of ECL) due from this counterparty amounted to AZN 5,064 or 6% of trade receivables as at 31 December 2022 (31 December 2021: AZN 11,665 or 14%).

The Group also provides air-navigation, refuelling and airport services to ASG Business Aviation LLC, which is based at Heydar Aliyev International Airport and operate international charter flights. The balance (gross of ECL) due from this counterparty amounted to AZN 9,267 or 11% of trade receivables as at 31 December 2022 (31 December 2021: AZN 32,900 or 41%).

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

Starting from 2021, the Group recognises balances with Silk Way Airlines LLC, Silk Way West Airlines LLC, ASG Business Aviation LLC and ASG Helicopter Services LLC on gross basis compared to net basis recognised in previous reporting periods. This decision was made because the Group no longer intends to settle these financial assets and liabilities on the net basis.

The credit risk exposure to BSP, IATA, Silk Way West Airlines and ASG Business Aviation LLC is monitored by the Group on an ongoing basis. In the opinion of management, the Group has no significant credit risk with BSP, IATA and/or Silk Way West Airlines as the Group maintains long-term and stable business relationships with these counterparties with healthy repayment history.

Cash and bank balances are mainly held in two local banks in the amount of AZN 82,576 as at 31 December 2022, and two local banks in the amount of AZN 69,152 as at 31 December 2021.

Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure, except for cash and cash equivalents where exposure is reduced by the amount of petty cash. The maximum exposure to credit risk at the reporting date was:

Carrying amount	31 December 2022	31 December 2021
Amounts due from related parties	52,914	49,587
Trade receivables	87,896	80,708
Cash and cash equivalents	88,289	78,825
Total	229,099	209,120

Market risk

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates (see below).

Interest rate risk

The Group is exposed to the effects of fluctuations at the prevailing levels of market interest rates on its financial results and cash flows. Changes in interest rate impact primarily lease liabilities, loans and borrowings by changing their cash flows. At the time of raising new borrowings including lease liabilities, management uses judgment to decide which (fixed or variable) interest rate would be more favorable to the Group over the expected period until maturity.

Cash flow sensitivity analysis for variable rate instruments

An increase of the variable interest rates, as indicated below, as at 31 December 2022 and 31 December 2021 would have decreased profit or loss and equity, respectively, by the amounts shown below. This analysis is based on variable interest rates variances that the Group considered to be reasonably possible at the end of the reporting.

This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	Profit or (loss) / Equity	
	31 December 2022	31 December 2021
Three-month USD LIBOR 20 basis points increase (2021: 20 basis points increase)	(2,156)	(2,156)
Cash flow sensitivity	(2,156)	(2,156)

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

A decrease of the variable interest rates would have increased equity and profit or loss by the same amounts shown in above table.

Foreign currency risk

The Group is exposed to currency risk in relation to revenue as well as purchases, borrowings and leases that are denominated in a currency other than AZN. The currencies in which these transactions are primarily denominated are Euro and US Dollar. The Groups analyses the exchange rate trends on a regular basis.

Foreign currency sensitivity analysis

The Group is mainly exposed to the risk of change of exchange rates of AZN against USD and EUR.

The book values of the Group’s monetary assets and liabilities in foreign currency as at the reporting date have been provided below. This disclosure excludes assets and liabilities denominated in other currencies, as they do not have significant effect on the consolidated financial statements of the Group. Amounts due to and from related parties figures do not include balances prepaid or advances received from related parties, due to fact that such items are not considered as monetary.

31 December 2022	AZN	USD	EUR	Other	Total
Trade receivables	39,264	32,553	4,552	781	77,150
Amounts due from related parties	58,299	-	-	-	58,299
Cash and cash equivalents	36,087	36,914	8,794	6,494	88,289
Total financial assets	133,650	69,467	13,346	7,275	223,738
Trade and other payables	26,107	16,162	6,354	2,730	51,353
Amounts due to related parties	2,556	8	-	-	2,564
Staff related payables	11,465	-	-	-	11,465
Loans and borrowings	862,197	1,427,830	33,502	-	2,323,529
Lease liabilities	-	396,572	-	-	396,572
Total financial liabilities	902,325	1,840,572	39,856	2,730	2,785,483
Open position		(1,771,105)	(26,510)	4,545	(1,793,070)
31 December 2021	AZN	USD	EUR	Other	Total
Trade receivables	35,736	29,144	593	490	65,963
Amounts due from related parties	12,923	-	-	-	12,923
Cash and cash equivalents	43,992	27,395	6,138	1,300	78,825
Total financial assets	92,651	56,539	6,731	1,790	157,711
Trade and other payables	78,058	4,730	11,731	1,250	95,769
Amounts due to related parties	8,883	14	20	-	8,917
Staff related payables	13,997	-	-	-	13,997
Loans and borrowings	840,756	1,408,424	36,792	-	2,285,972
Lease liabilities	-	282,802	-	-	282,802
Total financial liabilities	941,694	1,695,970	48,543	1,250	2,687,457
Open position		(1,639,431)	(41,812)	540	(1,680,703)

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022 (in thousands of Azerbaijani Manat)

Sensitivity analysis

A weakening of the AZN, as indicated below, against the above-indicated currencies as at 31 December 2022 and 31 December 2021 would have decreased profit or loss and equity, respectively, by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

31 December 2022	USD	EUR	Other	Total
10% weakening of AZN	(177,111)	(2,651)	455	(179,307)
31 December 2021	USD	EUR	Other	Total
10% weakening of AZN	(163,943)	(4,181)	54	(168,070)

A strengthening of the AZN against the above currencies would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they are due and to finance future needs.

The Group's liquidity management process as monitored by senior management, includes the following:

- Day to day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature.
- Maintaining rolling forecasts of the Group's liquidity position on the basis of expected cash flows.
- Maintaining debt financing plans.
- Maintaining diversified credit lines including stand-by credit facility.

Sources of liquidity are regularly reviewed by senior management to maintain a diversification by geography, provider, product and term.

Management of the Group believes, that the strategic importance of the Group to the economy of the Republic of Azerbaijan means that the government of the Republic of Azerbaijan will provide assistance to ensure continuity of local and international flights to, from and within the country. Management believes that the Group will receive necessary financial support from the government of the Republic of Azerbaijan due to the Group's role as the flagship state airline and major provider of air transportation in the country that will allow the Group to continue operations.

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	31 December 2022			
	Within one year	1 to 5 years	Over 5 years	Total
Lease liabilities	93,414	297,824	139,342	530,580
Bank loans	2,976	11,558	12,863	27,397
Loans from related parties	1,514,800	903,635	-	2,418,435
Trade and other payables	51,353	-	-	51,353
Amounts due to related parties	2,564	-	-	2,564
Staff related payables	11,465	-	-	11,465
Total financial liabilities	1,676,572	1,213,017	152,205	3,041,794

	31 December 2021			
	Within one year	1 to 5 years	Over 5 years	Total
Lease liabilities	60,406	240,572	13,348	314,326
Bank loans	3,200	12,439	16,698	32,337
Loans from related parties	1,236,118	1,157,547	-	2,393,665
Trade and other payables	95,769	-	-	95,769
Amounts due to related parties	8,917	-	-	8,917
Staff related payables	13,997	-	-	13,997
Total financial liabilities	1,418,407	1,410,558	30,046	2,859,011

Fair values versus carrying amounts

The Group uses the hierarchy mentioned in Note 3 to determine and disclose fair value of financial instruments.

Management believes that the fair value of the Group’s financial assets and liabilities (such as cash and cash equivalents, trade receivables, trade payables and etc.), which are classified within Level 2 category of the above hierarchy, approximates their carrying amounts due to relatively short maturity and interest rates representative of market rates except for long-term loans and borrowings for which the fair value is less than carrying amount by AZN 11,023 as at 31 December 2022 (31 December 2021: AZN 57,571). The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

24. COMMITMENTS AND CONTINGENCIES

Commitments related to rentals

Rental commitments in respect of short-term and low-value leases mainly comprise of engine, aircraft spare parts and property rental contracts of AZN 1,895 as at 31 December 2022 (31 December 2021: AZN 1,467). All contracts contain market review clauses in the event that the Group exercises its option to renew. The Group does not have an option to purchase the leased asset at the expiry of the lease period.

Rental contracts include fixed and variable lease payments, which vary according to flying hours and cycles.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

	<u>31 December 2022</u>	<u>31 December 2021</u>
Fixed payments	1,739	1,121
Variable payments	<u>156</u>	<u>346</u>
Total payments	<u>1,895</u>	<u>1,467</u>

The fixed and variable rent payments are denominated and settled mainly in US Dollars.

Capital commitments

During 2020, the Group agreed with Boeing to purchase four Boeing 787-8 Dreamliner aircraft. The Group is committed to pre-delivery payments in accordance with the agreed payment schedules. Delivery and expected pre-delivery payments of all aircraft were deferred to 2024 and 2025 in accordance with the latest agreements reached.

The terms of the Group's contracts with suppliers precludes it from disclosing information on the purchase cost of the aircraft.

Other capital commitments include contracts for the purchase and construction of simulator equipment, Air Space Efficiency Center, specialised hardware and software, automated communication and archiving systems with a total committed amount of AZN 11,574 as at 31 December 2022 (31 December 2021: AZN 52,593).

Taxation contingencies

The taxation system in the Republic of Azerbaijan continues to evolve and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Republic of Azerbaijan suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

The Tax Code of the Republic of Azerbaijan establishes general principles of taxation in Azerbaijan, sets the rule for determining, payment and collection of taxes and identifies the rights and responsibilities of taxpayers and tax authorities. The Tax Code does not contain provisions specifically regulating air transportation services. For withholding and value added taxes purposes such services fall under the category of international transportation, whereas for profit tax purposes, they fall under the category of general services provided. All clauses in respect of these service categories are general and subject to interpretations. Therefore, the interpretation for passenger transportation services involves uncertainty and judgement.

These circumstances may create tax risks in Azerbaijan that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijan tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

Operating environment

Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

businesses in Azerbaijan continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future stability of the Azerbaijan economy is heavily influenced by reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Because Azerbaijan produces and exports large volumes of oil and gas, its economy is particularly sensitive to the price of oil and gas on the world market.

On 21 February 2022, the President of Russia signed the executive orders on the recognition of the Donetsk People’s Republic and the Lugansk People’s Republic. On 24 February 2022, Russia initiated invasion of Ukraine. Subsequent to these events, the US, UK, EU and other countries announced an extension of sanctions on certain Russian officials, businessmen and companies and flights were cancelled over airspace of Russia and Ukraine. Because of existing interdependencies between Russian and other CIS economies, these developments may result in reduced access of the regional businesses to international capital and export markets, weakening of the Russian Ruble and other CIS regional currencies, decline in capitals markets and other negative economic consequences.

The flights of the Group to and from Russia and Ukraine were suspended in the beginning of 2022, while the flights to and from Russia were resumed during June of the same year. These events had no material commercial impact on the operations of the Group.

The Group’s management is monitoring developments in the current environment and taking necessary measures to support the sustainability and development of the Group’s business in the foreseeable future. The impact of further economic and political developments on future operations and financial position of the Group might be significant.

25. RELATED PARTY TRANSACTIONS

Transactions with related parties

Parties are generally considered to be related if they are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship attention is directed to the economic substance of the relationship, not merely the legal form.

Related parties comprise the shareholders of the Group and all other companies in which those shareholders, either individually or together, have a controlling interest. The Azerbaijan government directly owns 100% of the Group’s outstanding shares. The Group’s significant transactions with the government of the Republic of Azerbaijan and other entities controlled, jointly controlled or significantly influenced by the government of the Republic of Azerbaijan mainly include loans obtained, customs clearance and fuel expenses.

The remuneration of the key management personnel of the Group constituted AZN 441 for the year ended 31 December 2022 (31 December 2021: AZN 286) in the form of short-term employee benefits.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2022

(in thousands of Azerbaijani Manat)

During the year, the Group entered into the following trading transactions with related parties:

	Notes	Year ended 31 December 2022	
		Related party transactions	Total per category
Traffic and other revenue	5		1,149,954
- Entities under common control		17,717	
Operating costs (fuel expense, insurance expense and including ECL)	6		1,000,810
- Entities under common control		374,394	
Finance cost	7		102,210
- Entities under common control and other related parties		89,897	

	Notes	Year ended 31 December 2021	
		Related party transactions	Total per category
Traffic and other revenue	5		491,750
- Entities under common control		9,633	
Operating costs (fuel expense, insurance expense and including ECL)	6		576,633
- Entities under common control		172,937	
Finance cost	7		86,824
- Entities under common control and other related parties		75,283	

The following balances were outstanding at the end of the reporting period:

	Notes	31 December 2022		31 December 2021	
		Related party balances	Total per category	Related party balances	Total per category
Cash and cash equivalents	16		88,289		78,825
- Entities under common control		83,502		69,168	
Trade and other receivables	15		257,315		138,716
- Entities under common control		58,299		12,923	
Trade and other payables	23		79,905		136,542
- Entities under common control		2,564		8,917	
Loans and borrowings	18		2,323,529		2,285,972
- Shareholder and other related parties		2,297,581		2,255,634	
Other current liabilities	24		8,074		5,679
- Entities under common control and other related parties		3,407		3,302	