

KLM ROYAL DUTCH AIRLINES

Form 20-F/A

January 12, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 20-F/A

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 1-4059

Koninklijke Luchtvaart Maatschappij N.V.

(Exact name of Registrant as specified in its charter)

KLM Royal Dutch Airlines

(Translation of Registrant's name into English)

The Netherlands

(Jurisdiction of incorporation or organization)

55 Amsterdamseweg, Amstelveen, The Netherlands

(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|------------------------------------|--|
| Common shares, par value 2 euro | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

| | |
|------------|--------------------------------|
| 46,809,699 | Common shares |
| 8,812,500 | Cumulative preference shares A |
| 7,050,000 | Cumulative preference shares C |
| 1,275 | Priority shares* |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17

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* Priority shares: 1,312 shares issued of which 37 shares and 2 scripts are held by KLM.

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EXPLANATORY NOTE

This Form 20-F/A amends Items 3, 4, 5 and 18 of KLM's Annual Report on Form 20-F for the fiscal year ended March 31, 2003, which was filed with the U.S. Securities and Exchange Commission (the SEC) on June 12, 2003. In connection with our proposed combination with Air France, our Annual Report on Form 20-F will be incorporated by reference by Air France into a registration statement under the U.S. Securities Act of 1933 on Form F-4. In that connection, and to increase the comparability of information in the Form F-4 to that contained in our Annual Report on Form 20-F we have retroactively:

Restated the selected financial data and note 28 to our consolidated financial statements to reflect the reclassification of KLM's low-cost buzz business as a discontinued operation in light of its disposal to Ryanair in April 2003.

Reclassified our operating income under Netherlands GAAP to reflect changed accounting rules with respect to the presentation of extraordinary items that became effective as of April 1, 2003.

We have also:

Restated our earnings per share figures under Netherlands GAAP and U.S. GAAP for each of the fiscal years ended in the period from April 1, 1998 through March 31, 2002 to reflect the exclusion from the calculation of earnings per share of shares held by KLM.

Removed certain non-GAAP information relating to operating costs per available ton-kilometer (unit costs) and break even load factors.

In the selected financial data:

Reclassified our operating income (loss) under U.S. GAAP to reflect the inclusion in operating income (loss) of results on sale of holdings and results on sale of assets, which had been recognized in separate line items called results on sale of holdings and results on sale of assets.

Recaptioned net assets as assets less current liabilities to conform to the presentation in our balance sheets and included stockholder's equity as a new line item.

Revised assets less current liabilities and total assets as of March 31, 2002 under U.S. GAAP to exclude net non-current deferred tax liabilities, which were previously included in assets less current liabilities and total assets.

Added new footnote 29 to our consolidated financial statements to describe the above changes to the extent they affect the consolidated financial statements.

This Form 20-F/A does not reflect events occurring after the filing of the original Form 20-F and does not modify or update the disclosure therein in any other way than as required to reflect the amendments discussed above.

The complete text of Items 3, 4, 5 and 18, as amended, have been set forth in their entirety, in accordance with Rule 12b-15 under the U.S. Securities Exchange Act of 1934. These items should be read together with the other items included in the original Form 20-F. Unless otherwise indicated, the exhibits previously filed with the original Form 20-F are not re-filed herewith.

The filing of this Form 20-F/A shall not be deemed an admission that the original Form 20-F, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

WARNING ABOUT FORWARD-LOOKING STATEMENTS

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This Form 20-F/A contains, and the Company and its representatives may make, forward-looking statements within the meaning of the U.S. Private Securities Litigation Act of 1995, either orally or in writing, about KLM and its business. Forward-looking statements generally can be identified by the use of terms such as ambition, may, will, expect, intend, estimate, anticipate, believe, plan, seek, continue. These forward-looking statements are based on current expectations, estimates, forecasts, projections about the industries in which we operate, management's beliefs, and assumptions made by management about future events. Any such statement is qualified by reference to the following cautionary statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors, many of which are outside of our control and are difficult to predict, that may cause actual results to differ materially from any future results expressed or implied from the forward-looking statements. These statements are not guarantees of future performance and involve risks and uncertainties including:

the proposed combination with Air France, including such factors as the risk that Air France and KLM will not be integrated successfully, the ability of Air France to develop an integrated strategy for the combined group and changing relationships with customers, suppliers and strategic partners;

the airline pricing environment;

competitive actions taken by other airlines;

general economic conditions;

changes in foreign exchange and jet fuel prices;

governmental and regulatory actions and political conditions;

developments affecting labor relations or our airline partners;

the outcome of any material litigation;

the future level of air travel demand;

our future load factors and yields;

industrial actions or strikes by our employees, employees of the combined group following the proposed combination of Air France and KLM or employees of our suppliers or airports; and

the many effects on KLM and the airline industry from terrorist attacks, the possibility or fear of such attacks and the threat or outbreak of epidemics, hostilities or war, including the adverse impact on general economic conditions, demand for travel, the cost of security, the cost and availability of aviation insurance coverage and war risk coverage and the price and availability of jet fuel.

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Developments in any of these areas, as well as other risks and uncertainties detailed from time to time in the documents we file with or furnish to the SEC, could cause actual outcomes and results to differ materially from those that have been or may be projected by or on behalf of us. We caution that the foregoing list of important factors is not exhaustive. Additional information regarding the factors and events that could cause differences between forward-looking statements and actual results in the future is contained in our SEC filings, including our Annual Report on Form 20-F. We undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

PRESENTATION OF INFORMATION AND EXCHANGE RATES

Unless otherwise specified or the context requires otherwise, us, we, our, KLM and the Company refer to KLM Royal Dutch Airlines and its group companies.

References to dollars, U.S. dollars and \$ are to United States dollars, references to euro and EUR are to the currency introduced at the second stage of the Economic and Monetary Union (EMU) pursuant to the Treaty establishing the European Economic Community as amended by the treaty on the European Union. The conversion rates between the euro and the participating member states' national currencies were irrevocably fixed on December 30, 1998. Our consolidated financial statements are reported in euro. Previously presented statements denominated in Dutch guilders (NLG) have been translated for all periods presented into euro using the irrevocably fixed conversion rate applicable since January 1, 1999 (EUR 1 = NLG 2.20371).

U.S. dollar amounts presented are unaudited and have been translated solely for your convenience at and for the year ended March 31, 2003, from euro into U.S. dollars at an exchange rate of \$1.09 per EUR 1.00, the noon buying rate published by Bloomberg for that date. For information regarding the rate of exchange between euro and U.S. dollars, see Item 3-Key Information-Exchange Rates. We do not represent that the U.S. dollar amounts presented in the U.S. dollar convenience translations or any amounts translated from euro into other currencies could have been converted from euro at the rates indicated.

ITEM 3. KEY INFORMATION

A. Selected financial data

The selected consolidated financial data presented below for each of the years ended March 31, 2003, March 31, 2002, and March 31, 2001 has been derived from information included in our audited consolidated financial statements and the related notes appearing elsewhere in this annual report. The selected consolidated financial data for each of the years ended March 31, 2000, and March 31, 1999 has been derived from information included in our audited consolidated financial statements which are not included in this annual report.

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in The Netherlands (Netherlands GAAP), which differ in certain respects from accounting principles generally accepted in the United States (U.S. GAAP). Note 28 to our consolidated Financial Statements provides a description of the applicable principal differences between Netherlands GAAP and U.S. GAAP and a reconciliation of net income and shareholders' equity to US GAAP.

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Unless otherwise indicated, all amounts in this report are expressed in millions of euro.

Selected financial data presented in accordance with Netherlands GAAP

| | Fiscal year ended March 31, | | | | |
|---|-----------------------------|----------------------|--------|--------|--------|
| | 2003 | 2002 | 2001 | 2000 | 1999 |
| Total assets | 8,165 | 8,943 ⁽¹⁾ | 8,590 | 8,647 | 8,299 |
| Assets less current liabilities ⁽²⁾ | 5,975 | 6,851 ⁽¹⁾ | 6,533 | 6,404 | 6,300 |
| Long-term debt | 3,971 | 4,417 | 3,686 | 3,712 | 3,503 |
| Stockholders' equity | 1,476 | 1,992 | 2,061 | 2,019 | 2,157 |
| Capital stock | 125 | 125 | 125 | 125 | 187 |
| Operating revenues | 6,485 | 6,532 | 6,960 | 6,296 | 6,047 |
| Operating income (loss) ⁽³⁾ | (484) | (94) | 277 | (18) | 193 |
| Net income (loss) | (416) | (156) | 77 | 337 | 207 |
| Net income (loss) per common share ^{(4)/(5)} : | | | | | |
| Basic | (9.26) | (3.46) | 1.63 | 7.21 | 4.01 |
| Diluted | (9.26) | (3.46) | 1.63 | 7.21 | 4.01 |
| Dividend declared per common share | 0.10 | 0.20 | 0.60 | | 0.68 |
| Dividend declared per common share (in U.S. dollars) | 0.11 | 0.22 | 0.66 | | 0.74 |
| Average number of common shares outstanding (in thousands): | | | | | |
| Basic | 45,071 | 45,682 | 46,133 | 46,569 | 50,965 |
| Diluted | 45,071 | 45,682 | 46,133 | 46,569 | 50,965 |

- (1) The March 31, 2002 balance sheet included a EUR 100 million deferred tax liability presented under provisions. Consistent with Netherlands GAAP, we have reclassified this liability as a negative deferred tax asset under financial fixed assets for comparative purposes, since KLM's overall tax position turned into a deferred tax asset during the fiscal year ended March 31, 2003.
- (2) Net assets has been recaptioned as assets less current liabilities to conform to the presentation in our balance sheets.
- (3) Operating income under Netherlands GAAP has been adjusted retroactively to reflect the changed accounting rules effective for KLM as of April 1, 2003 with respect to the presentation of extraordinary items.
- (4) After taking into account the rights of holders of priority shares, cumulative preference shares A and cumulative preference shares C and based on the weighted average outstanding shares during the year.
- (5) The figures for each of the fiscal years ended during the period from April 1, 1998 through March 31, 2002 have been restated to exclude shares held by KLM.

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Selected financial data presented in accordance with U.S. GAAP

| | Fiscal year ended March 31, | | | | |
|--|-----------------------------|-----------------------|--------------------|--------------------|--------------------|
| | 2003 | 2002 | 2001 | 2000 | 1999 |
| Total assets | 10,331 | 11,306 ⁽¹⁾ | 10,934 | 10,641 | 10,087 |
| Assets less current liabilities ⁽²⁾ | 8,148 | 9,214 ⁽¹⁾ | 8,304 | 7,840 | 7,679 |
| Long-term debt | 4,288 | 4,799 | 4,314 | 4,199 | 3,998 |
| Stockholders' equity | 2,827 | 3,220 | 3,229 | 3,081 | 3,088 |
| Capital stock | 125 | 125 | 125 | 125 | 187 |
| Operating revenues | 6,367 | 6,412 | 6,869 | 6,286 | 6,047 |
| Operating income (loss) ⁽³⁾ | (244) | 86 | 458 | 731 | 572 |
| Net income (loss) | (267) | (2) ⁽⁴⁾ | 154 ⁽⁴⁾ | 510 ⁽⁴⁾ | 354 ⁽⁴⁾ |
| Income (loss) from continuing operations ⁽⁵⁾ | (234) | 28 | 209 | 530 | 354 |
| Income (loss) from discontinued operations ⁽⁵⁾ | (33) | (30) | (55) | (20) | |
| Net income (loss) per common share ^{(6)/(7)} : | | | | | |
| Basic | (5.97) | (0.08) | 3.30 | 10.91 | 6.90 |
| Diluted | (5.97) | (0.08) | 3.30 | 10.91 | 6.90 |
| Income (loss) from continuing operations per common share ^{(5)/(6)/(7)} : | | | | | |
| Basic | (5.23) | 0.57 | 4.49 | 11.34 | 6.90 |
| Diluted | (5.23) | 0.57 | 4.49 | 11.34 | 6.90 |
| Income (loss) from discontinued operations per common share ^{(5)/(7)} : | | | | | |
| Basic | (0.74) | (0.65) | (1.19) | (0.43) | |
| Diluted | (0.74) | (0.65) | (1.19) | (0.43) | |
| Dividend declared per common share | 0.10 | 0.20 | 0.60 | | 0.68 |
| Dividend declared per common share (in U.S. dollars) | 0.11 ⁽⁶⁾ | 0.22 | 0.66 | | 0.74 |
| Average number of common shares outstanding (in thousands): | | | | | |
| Basic | 45,071 | 45,682 | 46,133 | 46,569 | 50,965 |
| Diluted | 45,071 | 45,682 | 46,133 | 46,569 | 50,965 |

- (1) Total assets and assets less current liabilities as of March 31, 2003 were reduced by 853 to mainly exclude net non-current deferred tax liabilities.
- (2) Net assets has be recaptioned as assets less current liabilities to conform to the presentation in our balance sheets.
- (3) Operating income under US GAAP has been reclassified to reflect the inclusion of results on sale of holdings and results on sale of assets, which had been previously recognized in separate line items called results on sale of holdings and results on sale of assets. The reclassification resulted in a decrease in operating income for the year ended March 31, 2003 of EUR 36 million, an increase of EUR 19 million for the year ended March 31, 2002, an increase of EUR 31 million for the year ended March 31, 2001, an increase of EUR 456 million for the year ended March 31, 2000 and an increase of EUR 150 million for the year ended March 31, 1999.
- (4) As explained in note 28 to KLM's annual consolidated financial statements, KLM adopted SFAS 142 on April 1, 2002. Under SFAS 142 goodwill and intangible assets with indefinite lives are no longer amortized, but instead tested for impairment at least annually. If this amortization had been excluded from KLM's results for prior periods, net income (loss) and net income (loss) per share would have been increased by EUR 7 million (EUR 0.15 per share) for the year ended March 31, 2002, EUR 11 million (EUR 0.24 per share) for the year ended March 31, 2001, EUR 13 million (EUR 0.28 per share) for the year ended March 31, 2000 and EUR 18 million (EUR 0.35 per share) for the year ended March 31, 1999.
- (5) For comparative purposes, restated to reflect buzz as a discontinued operation effective April 1, 1998. On April 11, 2003, KLM sold KLM's low fare business, buzz, to Ryanair. Under U.S. GAAP, buzz is considered a discontinued operation as from April 11, 2003.
- (6) After taking into account the rights of holders of priority shares, cumulative preference shares A and cumulative preference shares C and based on the weighted average outstanding shares during the year.
- (7) Exclusive of any shares held by KLM; the figures for each of the fiscal years ended during the period from April 1, 1998 through March 31, 2002 have been restated.

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For the 1998/99 fiscal year, a dividend of EUR 0.68 per common share was paid on each common share, either wholly in cash or in wholly in common shares. The value of the dividends paid in shares was 2.7% lower than the cash dividend. For the 1999/00 fiscal year, no dividend was paid. For the 2000/01 fiscal year a dividend of EUR 0.60 per common share was paid in cash. For the 2001/02 fiscal year a dividend of EUR 0.20 per common share was paid in cash.

For the 2002/03 fiscal year, a dividend of EUR 0.10 was charged out of our reserves and distributed in respect of each common share fully in cash.

Exchange rates

The following tables set forth the noon buying rates published by Bloomberg for the Dutch guilder, restated in euro for all periods prior to January 1, 1999, and, for all subsequent periods, the noon buying rates for the euro. For the calculation of the euro amounts for all periods prior to December 31, 1998, we have restated the applicable noon buying rate for the Dutch guilder into euro at the official fixed conversion rate of NLG 2.20371 per EUR 1.00. This restatement matches the restatement into euro of our consolidated financial statements, which for all periods prior to January 1, 1999, were prepared in Dutch guilders and the Dutch guilder amounts were restated into euro amounts.

| Fiscal year ended March 31, | High | Low | Period end | Average rate ⁽¹⁾ |
|-----------------------------|-------------------------|--------|------------|-----------------------------|
| | (U.S. dollars per euro) | | | |
| 1999 | 1.2147 | 1.0549 | 1.0808 | 1.1226 |
| 2000 | 1.0887 | 0.9524 | 0.9574 | 1.0238 |
| 2001 | 0.9650 | 0.8271 | 0.8773 | 0.9079 |
| 2002 | 0.9277 | 0.8364 | 0.8717 | 0.8847 |
| 2003 | 1.1054 | 0.875 | 1.0915 | 0.9939 |

Source: Bloomberg

(1) Average of the noon buying rates on the last day of each month during the year

| Month | Highest rate | Lowest rate |
|---------------|-------------------------|-------------|
| | (U.S. dollars per euro) | |
| December 2002 | 1.0492 | 0.9968 |
| January 2003 | 1.0853 | 1.0362 |
| February 2003 | 1.0884 | 1.0688 |
| March 2003 | 1.1054 | 1.0524 |
| April 2003 | 1.1184 | 1.0695 |
| May 2003 | 1.1909 | 1.1233 |

Source: Bloomberg

On June 12, 2003, the noon buying rate was \$1.00 = EUR 1.1745.

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

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D. Risk factors

Key risks to our company and the airline industry as a whole are outlined below. The risks we face are not limited to the risks listed here. Some risks are not yet known to us and some of the risks that we currently do not believe to be material to our operations could prove to be material at a later date. All of these risks can materially affect our business, revenues, operating income, net income, net assets, liquidity, and capital resources.

Risk factors relating to the airline industry

The effects of September 11, 2001 terrorist attacks and the threat of future terrorist attacks may increase the cost of our operations and reduce demand for our services, thereby harming the results of our operations.

The terrorist attacks of September 11, 2001 adversely affected the airline industry generally as well as our financial condition, the results of our operations and our future financial prospects specifically by increasing operational costs and reducing demand. These effects continue to persist to a degree and were further intensified by the period of military build-up and the conduct of war in Iraq. Moreover, additional terrorist attacks, even if not made directly on the airline industry, or the fear of such attacks, could further negatively impact the airline industry by escalating costs and depressing demand. After the September 11, 2001 terrorist attacks, we immediately experienced the following adverse effects: the necessary cost of significantly increased security measures, increased insurance and other costs, decreased load factors and reduced yields. Additionally, war-risk coverage or other insurance coverages responsive to the terrorist threat might cease to be made available to us on favorable terms, if at all. In the uncertain future, these coverages might be available only at significantly increased premiums or only for significantly reduced amounts. This would further inflate costs that cannot effectively be passed on to our customers during sustained periods of reduced demand and adversely impact our operations.

Deteriorating economic conditions and changes in consumer behavior may reduce demand for our services and decrease our earnings.

The demand for the leisure and business air transportation services we provide may decline in response to worsening regional, national or international economic conditions. Economic downturns, or changes in consumer preferences, perceptions or spending patterns, could negatively affect our ability to sustain our traffic volumes and yields.

Intense competition in the airline industry and future competitive price discounting may reduce our revenues.

The airline industry in which we compete is highly competitive and susceptible to price discounting, which may depress our future income. Competing carriers use discount fares to stimulate their traffic during periods of slack demand to generate cash flow and to increase their market share. Some of our competitors have substantially lower cost structures than we have. Furthermore, some of our competitors receive direct or indirect government subsidies, which we do not receive.

Changes in foreign exchange rates, interest rates, and fuel prices may increase our operational costs and reduce our revenues.

We are susceptible to market risks beyond our control, e.g. movements in interest rates, fuel prices and foreign exchange rates, which could materially affect our operating results. Fuel costs rose to historically high levels during the 2002/03 financial year and threaten to continue climbing higher. The ongoing conflicts in the Middle East, political turmoil in Venezuela and other major uncertainties concerning the availability and price of oil amplify this risk. We also have operating revenues, operating expenses and assets and liabilities denominated in various foreign currencies. Fluctuations in those currencies can materially affect our operating revenues, the values of our assets and our costs.

Legislative or regulatory changes may impose greater costs on us and reduce our operating efficiency.

Our operations are subject to the risk of changes in legislation, taxation, charges and regulation and environmental regulation which could negatively affect our result of operations by imposing additional compliance costs. Additional laws, regulations, taxes on airport rates and charges have been proposed from time to time that could significantly increase the cost of airline operations. We are subject to a number of different environmental laws and regulations. We incur costs with each measure we take to comply with regulations regarding the prevention, control, abatement or elimination of regulated releases into the environment, as well as for our efforts toward the disposal and handling of regulated wastes at our operating facilities.

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Fluctuations in seasonal demand may reduce our revenue.

Our operations are affected by seasonal changes in demand. Due to greater demand for air travel during the summer months, our revenue in the second and third quarters of the year is generally stronger than our revenue in the first and fourth quarters due to increased leisure travel during the spring and summer months.

Consolidation or new alliances in the airline industry may reduce our relative competitiveness and degrade our strategic position.

The airline industry has undergone substantial consolidation over the last decade. This global trend may continue in the future. Continued consolidation may increase the competitive pressures on us, reduce revenues and threaten our strategic position. The impact of any future consolidation within the U.S. or European sectors of the airline industry cannot be predicted at this time, but could adversely affect our financial results and condition.

Changes in the political landscape may result in KLM being subject to air transportation treaties with less favorable terms.

The European Court of Justice's ruling of November 5, 2002 seems to have changed the Member States' position on negotiating aviation treaties with non-Member States. As of June 5, 2003 the European Transport Council decided to authorize the European Commission to open negotiations with the United States in the field of air transport. Furthermore, it was decided to authorize the European Commission to open negotiations with non-Member States on the replacement of certain provisions in existing bilateral agreements with a Community agreement. Future aviation treaties might be less favorable to us and thus weaken our competitiveness.

The outbreak of medical epidemics may reduce passenger traffic.

The outbreak of the SARS virus in 2003 had an adverse impact on our Asian operations. While it is not clear what the long-term effects of this new disease will be on passenger traffic, the recent developments, including international travel warnings and restrictions, clearly show the vulnerability of the airline industry to the outbreak of medical epidemics.

Risk factors relating to KLM

High labor costs may place us at a competitive disadvantage to other airlines.

Labor costs comprised 29% of our total operating expenses in the 2002/03 financial year. Wage rates have a significant impact on our operating results. Our profitability could suffer if we are not able to conclude future collective labor agreements on satisfactory terms with our employees. Most of our major competitors are seeking to reduce their labor costs by renegotiating their labor agreements in their favor.

Labor disruptions could result in reduced revenues and increased costs.

Strikes, work stoppages and slowdowns could negatively affect our results and disrupt our operations. Actions by large unions or even relatively small, but influential, groups of our employees could seriously disrupt our operations. Additionally, actions leading to labor disruptions of our operations may occur for reasons unrelated to our collective labor agreements with any particular union or group of employees. If we are not able to renew our collective labor agreement, or any other key agreements, with our employees in a satisfactory way, or if a strike, work stoppage or work slowdown occurs for whatever reason, our revenues and operating results could be adversely affected.

Our realization of benefits from our alliances with other airlines is uncertain and the actual results of these alliances may be lower than our expectations.

Our ability to successfully achieve the anticipated benefits of our alliances with other airlines is subject to many risks, including those risks associated with any disapproval or delay of our allied plans by regulatory authorities or any adverse regulatory developments, competitive pressures, customer reactions or modifications to any contracts relevant to our alliances (either on our part or on the part of our allied partners). We are currently a party to several important alliances with other airlines, including our joint venture with Northwest Airlines. We are also considering entering into additional alliances. Our ability to grow our route network by entering into alliances also depends upon the availability of suitable alliance partner candidates and our abilities as well as those of our alliance partners to meet business objectives and to perform each obligation under the alliance agreements.

Unfavorable outcomes of lawsuits may weaken our liquidity position.

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We and our consolidated holdings are involved in various legal actions. Unfavorable outcomes of these actions could further weaken our results and liquidity position.

See Item 8-Litigation .

Our highly leveraged status may affect our ability to satisfy financing needs or meet our obligations.

We carry a high proportion of debt compared to equity, as well as significant operating leases and facility rental costs. Though we have sufficient cash resources, this may not be the case in the future.

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ITEM 4. INFORMATION ON THE COMPANY

A. History and development of the company

Koninklijke Luchtvaart Maatschappij N.V., commonly known by its trade name, KLM, is a public limited liability stock corporation organized in 1919 under the laws of The Netherlands. Our registered office is at Amsterdamseweg 55, 1182 GP Amstelveen, The Netherlands. We may be contacted via telephone at +31 20 649 9123. We have operated continuously as a corporate entity longer than any other scheduled airline. Since 1929 the State of The Netherlands (the State) has owned a substantial interest in our issued share capital (as of March 31, 2003 approximately 14%). However, we have been managed and operated as a private business enterprise at all times since our organization.

We are an international airline operating worldwide. Our home base is Amsterdam Airport Schiphol, one of the most modern major airports in the world. KLM forms the core of the KLM Group, other members being KLM cityhopper, and Transavia. Through its strong alliance with Northwest Airlines and close cooperation with European and intercontinental network and route partners, the KLM Group offers passengers and airfreight shippers more than 125,000 city-pair connections throughout the world via one or more air transport hubs.

B. Business overview

We have four core activities: passenger transport, cargo transport, engineering and maintenance and the operation of charters and low-cost/low-fare scheduled flights. These activities are performed by our Passenger, Cargo, Engineering & Maintenance businesses and Transavia respectively. We and our partners serve more than 350 cities, in 73 countries on six continents.

In fiscal year 2002/03, we carried more than 23.4 million passengers and 489,000 tons of cargo and provided engineering and maintenance services to more than 20 airlines. Measured by international revenue ton-kilometers, KLM ranks fifth among the 270-plus members of the International Air Transport Association (IATA). We operate a modern fleet of 219 aircraft, many configured for combined passenger/cargo flights. The number of our employees as of March 31, 2003 was 37,487, of whom 31,638 were employed in The Netherlands and 5,849 abroad.

We are a key player in a global alliance that commands an important position in the world's three major trading areas: America, Europe and Asia. Our goal is to be the first choice passenger and cargo airline and provider of maintenance services, while consistently enhancing our shareholder value, providing a stimulating and dynamic working environment for our staff, and participating in mutually beneficial relationships with our partners.

We are aware of our influence on the people, society and the environment and seek to balance our interests with those of the broader society. The high profile of the aviation industry, the involvement of a large number of stakeholders and the political implications of local and global issues make it essential to strike the right balance. To KLM, sustainability is a pre-condition for it to realize our business objectives. The controlled expansion of the Amsterdam Airport Schiphol is part of this objective.

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| | Fiscal year ended March 31, | | |
|--|-----------------------------|---------------------|--------|
| | 2003 | 2002 ⁽¹⁾ | 2001 |
| Capacity | | | |
| * Available ton-kilometers (ATK) | 12,952 | 12,859 | 12,978 |
| * Available seat-kilometers (ASK) | 74,825 | 74,051 | 75,222 |
| * Available freight ton-kilometers (AFTK) | 5,852 | 5,817 | 5,783 |
| * Kilometers flown | 349 | 370 | 370 |
| Hours flown (in thousands) | 454 | 455 | 471 |
| Traffic | | | |
| * Revenue passengers and baggage (ton-kilometers) | 5,935 | 5,840 | 6,037 |
| * Revenue cargo (ton-kilometers) | 4,197 | 4,050 | 4,146 |
| | <hr/> | <hr/> | <hr/> |
| * Total revenue ton-kilometers (RTK) | 10,132 | 9,890 | 10,183 |
| | <hr/> | <hr/> | <hr/> |
| Load factor (%) | 78.2 | 76.9 | 78.5 |
| * Passenger kilometers | 59,417 | 58,447 | 60,047 |
| Passenger load factor (%) ⁽²⁾ | 79.4 | 78.9 | 79.8 |
| Cargo load factor (%) | 71.7 | 69.6 | 71.7 |
| * Weight of cargo carried (in kilograms) | 489 | 490 | 502 |
| Average distance flown per passenger (in kilometers) | 3,057 | 3,567 | 3,728 |
| Yield per revenue passenger kilometer ⁽³⁾ | 7.1 | 7.3 | 7.1 |
| Yield per revenue cargo ton kilometer ⁽⁴⁾ | 24.2 | 25.0 | 26.0 |
| Yield per RTK ⁽⁵⁾ | 51.5 | 53.4 | 52.2 |

* in millions

- (1) As of April 1, 2002, traffic and capacity figures comprise KLM, KLM cityhopper bv and KLM cityhopper uk Ltd. Prior-year figures have been restated for comparative purposes. In the prior years the figures of KLM cityhopper uk (former KLM uk feeder operation) were not included in the statistics. As of April 1, 2002, KLM cityhopper uk solely acts as a capacity provider for the KLM operation
- (2) Passenger load factor: Revenue passenger-kilometers expressed as a percentage of available seat-kilometers
- (3) Yield per revenue passenger-kilometer: Total passenger traffic revenue divided by total passenger-kilometers
- (4) Yield per revenue cargo ton kilometers: Total cargo traffic revenues divided by total cargo ton-kilometers
- (5) Yield per RTK: Total passenger and cargo traffic revenues divided by total revenue ton kilometers

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| | Fiscal year ended March 31, | | |
|--------------------------------------|-----------------------------|-------|-------|
| | 2003 | 2002 | 2001 |
| | (in millions of euro) | | |
| Traffic revenue | | | |
| Passengers | 4,210 | 4,267 | 4,527 |
| Cargo | 1,017 | 1,016 | 1,109 |
| Charter / Low-cost | 553 | 543 | 490 |
| Total traffic revenue | 5,780 | 5,826 | 6,126 |
| Other revenue: | | | |
| Maintenance and other technical work | 280 | 273 | 273 |
| Cargo and mail handling | 40 | 39 | 131 |
| Tax-free sales | 115 | 107 | 104 |
| Aircraft handling | 105 | 92 | 93 |
| Miscellaneous | 165 | 195 | 233 |
| Total other revenue | 705 | 706 | 834 |
| Total operating revenues | 6,485 | 6,532 | 6,960 |

Other revenue represents revenue from our ancillary activities (see Information on the Company – Ancillary Activities). These activities generally employ many of the same facilities employed by us in our airline operations and, accordingly, any allocation of expenses between airline and ancillary activities is arbitrary. However, our ancillary activities contribute positively to our overall results.

Geographical data

We conduct worldwide operations. We break down our traffic statistics and yield by geographic market in the following tables:

| | Fiscal year ended March 31, | | |
|----------------------------|---------------------------------|-------|--------|
| | 2003 | 2002 | 2001 |
| | (in millions of ton-kilometers) | | |
| Traffic ⁽¹⁾ | | | |
| Europe | 1,034 | 939 | 821 |
| North Atlantic | 2,582 | 2,649 | 2,997 |
| Asia Pacific | 3,366 | 3,240 | 3,505 |
| Central and South Atlantic | 1,271 | 1,301 | 1,163 |
| Middle East / South Asia | 760 | 799 | 800 |
| Africa | 1,119 | 962 | 897 |
| Total | 10,132 | 9,890 | 10,183 |

(1) As of April 1, 2002, traffic and capacity figures comprise KLM, KLM cityhopper bv and KLM cityhopper uk Ltd. Prior-year figures have been restated for comparative purposes. In the prior years the figures of KLM cityhopper uk (former KLM uk feeder operation) were not included in the statistics. As of April 1, 2002, KLM cityhopper uk solely acts as a capacity provider for the KLM operation

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| | Fiscal year ended March 31, | | |
|-----------------------------------|-----------------------------|-------|-------|
| | 2003 | 2002 | 2001 |
| | (in millions of euro) | | |
| Traffic revenue | | | |
| Europe (including domestic lines) | 1,505 | 1,176 | 1,260 |
| North Atlantic | 1,032 | 1,118 | 1,338 |
| Asia Pacific | 1,200 | 1,317 | 1,350 |
| Central and South Atlantic | 535 | 572 | 508 |
| Middle East / South Asia | 413 | 335 | 448 |
| Africa | 542 | 494 | 442 |
| | <hr/> | <hr/> | <hr/> |
| Total scheduled services | 5,227 | 5,012 | 5,346 |
| Subsidiaries revenue | 553 | 814 | 780 |
| | <hr/> | <hr/> | <hr/> |
| Total | 5,780 | 5,826 | 6,126 |
| | <hr/> | <hr/> | <hr/> |
| | (in euro cents) | | |
| Yield per RTK | | | |
| Europe (including domestic lines) | 146 | 125 | 153 |
| North Atlantic | 40 | 42 | 45 |
| Asia Pacific | 36 | 41 | 39 |
| Central and South Atlantic | 42 | 44 | 44 |
| Middle East/South Asia | 54 | 43 | 56 |
| Africa | 48 | 51 | 49 |
| | <hr/> | <hr/> | <hr/> |
| Total | 52 | 51 | 52 |
| | <hr/> | <hr/> | <hr/> |

Seasonality

Our operations are affected by the seasonality associated with the airline industry. Due to a greater demand for air travel during the summer months, revenue in the first and second quarters of our fiscal year is generally greater than the revenue in the third and fourth quarters of the fiscal year. The results of our operations generally reflect this seasonality, but these results are also affected by numerous other factors that are not necessarily seasonal, such as fare levels, fuel prices, weather, air traffic control delays, foreign currency exchange rates and general economic conditions.

Marketing and sales

On March 31, 2003 KLM maintained over 134 passenger sale offices worldwide staffed by KLM personnel. In the USA, Canada and Mexico, we are represented by our partner Northwest Airlines. In addition, we have appointed 123 general sales agents, mainly in countries where we do not offer air transport services. Through its participation in the International Air Transport Association, an association which includes most other major international air carriers, our tickets are sold by approximately 46,000 sales agents. Travel agent commissions vary depending on the country and/or market segment and range from 0% to 9% or are set by the IATA Traffic Conferences based on the type of transportation sold by the sale agents and the countries of sale destination. Certain agents have contracts with us, which provide for incentive commission. During the 2002/03 fiscal year, sales agents accounted for approximately 93% of our total gross air transportation sales.

Franchises and landing rights

Our authorization to operate our routes and to serve destinations inside and outside The Netherlands is subject, among other things, to obtaining and retaining the requisite permits and authorizations from the appropriate Dutch and foreign governmental authorities as well as to the possession of required local operating concessions, franchises and permits relating, to operating rights, the use of airports and facilities and the utilization of radio and meteorological services.

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The various necessary concessions, franchises and permits that we hold differ widely as to the rights granted, the obligations or restrictions imposed, their terms and conditions, the duration of their effect and other miscellaneous details. In the majority of cases, our rights stem from bilateral air services agreements entered into between the State of The Netherlands and another country, in which the Dutch government has designated KLM as the air carrier officially authorized to operate the routes and enjoy the rights accorded to the State of The Netherlands under these bilateral agreements. The Dutch government has traditionally followed a civil aviation policy favorable to competition. In conformity with international practice, the great majority of the bilateral air services agreements concluded by The Netherlands can be terminated after one year's notice given by either contracting governments. Some rights are of a unilateral nature, terminable at will by the government that granted them. In practice, termination is normally preceded by consultations.

On some of our routes or route segments, governmental limitations are imposed on the number of services, the number of passengers, the amount of cargo and other matters relating to traffic. Our activities and the possibilities for our growth are limited by these restrictions. We continually strive to maintain and improve our traffic and operating rights.

Cooperation with Northwest Airlines

We operate our transatlantic routes between The Netherlands and the United States under a far-reaching alliance with Northwest Airlines (Northwest), which offers our customers seamless travel options between North America and Europe, Africa, The Middle East and India. The KLM-Northwest alliance was originally established in 1989 when we made a major equity investment in NWA Corp., the parent company of Northwest. In September 1992, the United States and The Netherlands agreed to expand their bilateral Air Transport Agreement to create an open skies environment. This agreement authorizes the carriers of both countries to provide air transportation between any U.S.-Netherlands city pair and to operate connecting services to any third country that has granted the reciprocal right to do so. We no longer possess an equity investment in NWA Corp.

Based primarily on the open-entry market created by this expansion, KLM and Northwest petitioned the U.S. Department of Transportation (DOT) for immunity from the United States antitrust laws for the KLM-Northwest Commercial Co-operation and Integration Agreement and were granted that immunity by the DOT in January 1993. The antitrust immunity allows KLM and Northwest to act jointly in most commercial operations, including cost and revenue sharing, pricing, yield management, scheduling, product integration, marketing, market allocation, advertising, purchasing and cost reduction activities.

KLM and Northwest expanded their alliance in September 1997 by entering into an Enhanced Alliance Implementation Agreement providing for a minimum term of 13 years. Under this enhanced alliance agreement, the two airlines expanded their areas of cooperation to include services between the United States, Canada and Mexico, on the one hand, and Europe, Africa, the Middle East and India, on the other hand. In addition, the two companies increased the level of co-operation between their respective cargo divisions. KLM and Northwest continue to explore the potential for extending their alliance to include additional partners and to further develop strategies for joint marketing and product development.

Code sharing arrangements, through which airlines sell under their own code or prefix seats on another carrier's services, have been introduced on all routes between Amsterdam and Northwest's hubs as well as to destinations in the United States, Europe, Africa and Asia served by the alliance.

In 2002, KLM and Northwest synchronized their respective frequent flyer programs to create increased opportunities to earn frequent flyer miles and to offer additional worldwide destinations as travel awards.

Through the co-ordination of route schedules and aircraft deployment, KLM and Northwest have the ability to improve their utilization of assets such as aircraft and gates. KLM and Northwest have also combined certain sales and distribution channels to improve the products offered at reduced costs to their corporate customers and travel agents and to market a common World Business Class product.

The alliance between KLM and Northwest Airlines is described in more detail in Item 5 Operating and Financial Review and Prospects.

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Cooperation with Continental Airlines

In October 2001, KLM and Continental Airlines announced a limited and, for the time being, temporary commercial co-operation. In the first instance, code sharing was introduced on connecting flights between Newark International Airport in the United States and other domestic destinations in the United States and on connecting flights between Amsterdam Airport Schiphol and other European destinations. KLM and Continental also concluded a fully reciprocal Frequent Flyer Agreement. The agreement was reached in close consultation with Northwest Airlines. Subsequently, as of May 2002, a code share agreement between KLM and Continental was renewed for a further period of one year covering selected connecting flights between Newark and Houston and other domestic destinations in the United States and on selected connecting flights between Amsterdam Airport Schiphol and other destinations in Europe, Africa, and the Middle East. As of June 10, 2003, this contract was further expanded in scope and extended so as to make it co-terminous with the KL/NWA Enhanced Alliance Implementation Agreement as referenced to above.

Cooperation with other airlines

Interline Agreements enable passengers and shippers to arrange with us to pay for transportation to any point in the world in one transaction under a single contract. More intensive cooperation exists between KLM and a select number of carriers in either the commercial field (such as code sharing arrangements and the carriage of feeder traffic for each other's services) or the operational field (such as pooling of spare parts or equipment, joint handling of passengers or cargo, etc.).

These agreements, which are intended to reduce the participating airlines' cost of operation and to offer better service to the public, are of course subject to applicable rules and regulations including the competition and anti-trust rules of the United States, the EU and other countries as the case may be.

The alliances between KLM and other airlines are described in more detail in Item 5 Operating and Financial Review and prospects.

Fuel supplies

We purchase most of our fuel pursuant to local fuel supply contracts, which generally have terms varying from one to two years. The prices of fuel set forth in these contracts fluctuate with market indicators and are subject to periodic adjustment. We cannot predict the extent to which fuel prices may fluctuate or fuel shortages may occur in the future. See Item 11 Quantitative and Qualitative Disclosures about Market Risk Fuel Prices.

Insurance

We procure insurance to cover our operational risks. Following the events of September 11, 2001, European governments temporarily assumed responsibility for underwriting risks that could no longer be properly insured in the market. As of November 1, 2002, we replaced all of our insurance in the market at competitive rates.

Competition and traffic restrictions

In most areas we service, we are subject to intense direct and indirect competition by other air carriers operating scheduled or chartered services. Our future operations may be affected by expanded services offered by competing air carriers, some of which receive direct or indirect government subsidies, by the entry of new air carriers into the market, by restricted low fares offered by carriers that are protected by their governments' policies, by the imposition of traffic restrictions, by the limitation of our operating rights in foreign countries, by other applicable governmental or regulatory action or by changes in the international political or economic situation.

We are currently the major scheduled airline providing service between the United States and The Netherlands. Under the bilateral Air Transport Agreement between The Netherlands and the United States, American and Dutch scheduled and charter carriers may operate services between the United States and The Netherlands without restrictions as to frequency and capacity. The North Atlantic route sector, comprising routes between The Netherlands and each of Canada, the United States and Mexico, accounted for approximately 25% of our total traffic ton-kilometers in fiscal year 2002/03.

The Dutch Government, with our support, is pursuing an air transport policy that is favorable to competition in the EU, of which The Netherlands is a member.

The EU has liberalized its internal air transport market gradually. Under the articles establishing a common transport policy and the competition rules of the Rome Treaty of 1957, the Council of Transport Ministers of the EU adopted legislation regarding intra-EU air transport, which came

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into force on January 1, 1988. On January 1, 1993, the third and last phase of the rules developed pursuant to this pro-competitive policy came into force. As of April 1, 1997, the free intra-EU air transport market came into effect. This market includes three non-EU countries as well: Norway, Iceland and Liechtenstein. In the past year, the European Commission finalized negotiations, pursuant to a specific mandate by the EU member states, which granted to a number of Central European countries (the three Baltic states, Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria and Slovenia) as well as Cyprus and Malta accession to the intra-EU market. All of these countries with the exception of Romania and Bulgaria will become part of the EU Aviation Area as per their date of accession to the European Union (May 1, 2004). The accession of Bulgaria and Romania is expected to occur on different, later dates. The last country to achieve full accession is expected to do so by 2008.

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In general, however, air transportation rights between EU countries and other countries are presently governed by bilateral treaties. This situation will change in view of the decision by the European Court of Justice of November 5, 2002 in which the European Commission brought claims against certain EU member states (The Netherlands not being among these). In these proceedings the European Commission specifically challenged the right of individual EU member states to enter into so-called open skies agreements with the United States. The decision holds that while EU member states retain exclusive competence to negotiate traffic rights with third countries, the European Commission is competent in areas where the Commission's exclusive authority had already been established (these areas include computer reservation systems, slots and intra-EU fares). The court also held that nationality clauses as they appear in present day bilateral air services agreements violate the right of free establishment for EU member states anywhere within the EU. This finding has created the obligation for the member states to replace the typical nationality clause with a new clause that is compatible with EU law. Negotiations between EU member states and the European Commission are being held to establish a procedure that will facilitate this replacement in a total of over 1000 bilateral agreements between member states and third party countries. The consequences of the court's decision will change forever the political landscape for airlines operating from Europe.

Governmental regulations

In The Netherlands the two main legislative acts applicable to aviation are called Wet Luchtvaart and the Luchtvaartwet. These are administered by the Ministry of Transport, Public Works and Water Management, and they define the nature and extent of the regulation of airports and of civil aircraft operating within and/or registered in The Netherlands. These acts provide the framework for safety regulation, air traffic control rules, aircraft airworthiness, pilot competency certificates, airport and air navigation standards and environmental protection measures.

In addition to the bilateral air services agreements mentioned above, our operations are also subject to treaties and international agreements, including the International Civil Aviation Convention of December 7, 1944, as amended, to which The Netherlands is a party, and to economic, safety, environmental and other regulations by the governmental authorities of many countries and organizations, including of course The Netherlands itself and the EU. The legislatures and other governmental bodies of many foreign jurisdictions have adopted or are considering various noise-reducing measures, including limitations on hours of operation applicable to jet aircraft generally or to specific types of aircraft. The extent to which these regulations will affect us is unclear, but compliance with these regulations could have an effect upon the cost of our future operations.

Rates and tariffs

Passenger tariffs on our international routes are generally established in consultation with members of the IATA Passenger Tariff Coordinating Conferences, which includes most international airlines. Where applicable, these tariffs need the expressed or implied approval of the governments concerned. Additionally, The Netherlands is a party to bilateral agreements with a number of foreign countries, most of which provide for foreign government approval of our fares, rates and charges for routes covered by those agreements. Within the EU and within the area covered by the European Civil Aviation Conference, approval by the governments concerned is automatic if fares fall within certain agreed-upon ranges.

The laws of some of the countries that we service, such as Canada and the United States of America, require us to publish and file with those countries' aeronautical authorities our general pricing policies, tariffs showing passenger fares, freight rates and other charges.

We endeavor to base our pricing policy on market requirements as much as possible. In addition to devoting considerable attention to the demands of our most important sub-market, the business travel market, we make use of promotional fares, which substantially increase total revenues. In the freight sector, we also aim to achieve a rate structure suited to the needs of the freight industry.

We also charter aircraft to third parties for their individual use, or for purposes of group travel, at prices that we determine in accordance with government regulations.

We determine our compensation for the delivery of both Dutch and foreign mail, including United States mail, transported by our international services on the basis of rates officially established by the Universal Postal Union, a body composed of representatives of the postal systems of the various countries of the world.

Ancillary activities

We also engage in other business activities, which are ancillary to our air transport operations. We service, maintain and modify airframes, engines and spare parts operated by third parties, including other air carriers, and we manufacture a limited number of aircraft accessories. We also operate tax-free shops at Schiphol Airport and engage in on-board sales of a variety of products. We provide technical, operational and commercial handling, management, advisory, training and catering services, as well as computerized hotel and flight reservation systems, to

third parties. Gross revenues from ancillary activities during the 2002/03 fiscal year were EUR 705 million, or 11% of KLM's operating revenues.

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As of the date of this annual report, the KLM group consisted of KLM and the significant subsidiaries detailed below as consolidated holdings.

| Holding | Country of Incorporation | Proportion of KLM Ownership Interest and Voting Power |
|---|---------------------------------|--|
| KLM Cityhopper bv | The Netherlands | 100 |
| KLM UK Holdings Ltd | United Kingdom | 100 |
| KLM Catering Services Schiphol bv | The Netherlands | 100 |
| KLM Luchtvaartschool bv | The Netherlands | 100 |
| KLM Arbo Services bv | The Netherlands | 100 |
| KLM Equipment Services bv | The Netherlands | 100 |
| KLM Financial Services bv | The Netherlands | 100 |
| Cygnific bv | The Netherlands | 100 |
| KLM Ground Services Ltd | United Kingdom | 100 |
| Transavia Airlines bv | The Netherlands | 80 ⁽¹⁾ |
| Martinair Holland nv | The Netherlands | 50 |
| Polygon Insurance Company Ltd | Guernsey | 31 |
| Kenya Airways Ltd | Kenya | 26 |
| H.S.A. Beheer nv | The Netherlands | 10 |
| Opodo Ltd | United Kingdom | 9 |
| Travel Unie International Nederland nv | The Netherlands | 9 |

(1) Economic ownership is 100%.

D. Property, plants and equipment

On March 31, 2003, we owned or financially leased the following aircraft:

Aircraft

| Number of aircraft | Type | Term of depreciation | Average age |
|-------------------------------|--------------------------|---------------------------------|--------------------|
| | | in years | in years |
| 5 | Boeing 747-400 | 18 | 12.3 |
| 17 | Boeing 747-400 Combi | 18 | 9.1 |
| 2 | Boeing 747-300 | 25 | 22.8 |
| 5 | Boeing 747-300 Combi | 25 | 22.6 |
| 2 | Boeing 747-300 Freighter | 25 | 27.3 |
| 8 | Boeing MD-11 | 18 | 8.1 |
| 1 | Boeing 737-900 | 18 | 1.5 |
| 25 | Boeing 737-800 | 18 | 3.2 |
| 2 | Boeing 737-700 | 18 | 0.1 |
| 7 | Boeing 737-400 | 18 | 11.3 |
| 7 | Boeing 737-300 | 18 | 10.5 |
| 3 | Boeing 757-200 | 15 | 9.7 |
| 15 | Fokker 100 | 12 | 13.9 |
| 17 | Fokker 70 | 15 | 7.0 |
| 10 | Fokker 50 | 15 | 12.2 |
| 2 | BAe 146-300 | 15 | 13.3 |

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| | | | |
|----|-------------------|----|-----|
| 3 | ATR 72 | 15 | 4.9 |
| 23 | Training aircraft | | |

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During the 2002/03 fiscal year we took delivery of a 747-400ERF aircraft, a 747-400 Combi aircraft, two Boeing 737-700, four Boeing 737-800 and six Boeing 737-300.

Two MD-11 aircraft, one Boeing 737-300 Combi aircraft, three Boeing 737-900 aircraft and seven Boeing 737-300 aircraft were sold and leased back from the owner for our operational use. Three Boeing 737-300 aircraft were retired from our operational fleet and one Boeing 757-200 was sold to the lessor.

At March 31, 2003, we had the following aircraft on order for utilization in our future passenger transport, cargo transport, charters, and scheduled flight operations:

Ten Boeing 777-200ER aircraft

Six Airbus 330-200 aircraft

Two Boeing 747-400ERF aircraft

Two Boeing 737-700 aircraft, scheduled for delivery in the period May 2003 through June 2003

Two Boeing 737-800 aircraft, scheduled for delivery in the period April 2004 through May 2004
The expenditures already paid on these assets amounted to EUR 604 million.

Encumbrances

The book value of tangible fixed assets for which, as of March 31, 2003, encumbrances were in effect, amounted to EUR 2,722 million (55% of the book value as per March 31, 2003). Of this amount EUR 2,538 million relates to encumbrances on fleet resulting from concluded financial lease agreements. The remaining part (EUR 184 million) relates to other tangible fixed assets whose availability is based on limited right of use, such as buildings on land held under long-term rental agreements.

Ground facilities

The Company owns its head office buildings in Amstelveen in which its corporate management and various staff bureaus and divisions are located. The Company maintains and operates complete and modern facilities at Amsterdam Airport Schiphol for the servicing, overhauling and repair of aircraft and engines and of a wide range of aircraft parts and accessories. These facilities include hangars, engine, communications and other workshops, engine test cells and warehousing facilities. In addition, we house our operations, engineering and purchasing personnel at Schiphol Airport. All such facilities are either leased or constructed on leased land. The land leases typically have a term varying from 75 to 99 years. The airport is operated by a corporation owned jointly by the State of The Netherlands, the City of Amsterdam and the City of Rotterdam.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating results

You should read the following discussion in conjunction with the consolidated financial statements included in this document. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles in The Netherlands, which differ in certain significant respects from U.S. GAAP. A discussion of the principal differences between Dutch accounting policies and U.S. GAAP and a reconciliation from Dutch accounting policies to U.S. GAAP of net income and shareholders' equity as of March 31, 2002 and 2003 and in respect of the three years ended March 31, 2003, is described in note 28 to our consolidated financial statements.

Earnings per share calculations for the year ended March 31, 2003 are exclusive of any shares held by KLM. Outstanding shares used for the earnings per share calculations are based on the weighted average outstanding shares during the year. As described in the explanatory note to this Form 20-F/A, the earnings per share figures under Netherlands GAAP and US GAAP for each of the years ended March 31, 2002 through March 31, 1999 have been restated due to the erroneous inclusion in the past of treasury stock in the average number of common shares outstanding.

Where reference is made to extra-ordinary items in the Form 20F filed on June 12, 2003, we have accordingly adjusted the wording of our comments below. We note that extraordinary items relate to reorganization costs and the settlement of the Alitalia arbitration award. As described in the explanatory note to this Form 20-F/A, these items have been reclassified to operating income under Netherlands GAAP. All other comments have remained unchanged in comparison with those included in the Form 20F filed on June 12, 2003.

Strategic perspective

Momentous changes in the aviation market, worldwide economic weakness, geo-political instability, the emergence of the SARS virus and an unforeseen financial setback were the overriding elements in what was a turbulent year for KLM. The year was again closed with a net loss. Following the recovery that commenced at the beginning of the fiscal year, this was a disappointing result, one that was not alleviated by the fact that KLM still ranks among the strongest players in its industry.

Conditions in most of our markets changed rapidly in 2002/03. Many businesses economized on their travel policies, while demand for leisure flights fell. Necessary price reductions exerted even more pressure on our tight margins.

By controlling both capacity and costs, KLM initially mitigated the negative consequences. But the decline in demand for transport, compounded by the new capacity of the low-cost carriers in Europe, again led to overcapacity in the industry. Far-reaching measures were announced at the end of the fiscal year designed to effect an improvement in results in both the short- and the long-term.

Our short-term efforts will concentrate on restoring the company's earning capacity by increasing productivity and further reducing the cost base. Although the current downturn has cyclical elements, many of the changes occurring in our business environment are structural. The aviation industry will not find a fitting response to these changes unless it thoroughly reviews the concepts underlying the airlines themselves. KLM's strength is that it remains an intercontinental network carrier with a sophisticated hub-and-spoke system that allows fast and comfortable connections between many, even relatively small, airports. As a network carrier, KLM must introduce new service concepts and cost structures that satisfy the differing priorities of business and leisure passengers. What is certain, however, is that airlines as we know them today are about to undergo fundamental change.

Focused margin management

One of the structural causes of the current situation is the cost structure of our network organization. Given the drop in yields, our cost base is too high despite the rationalizations of recent years. With limited influence on short-term labor costs and virtually no influence on the cost of fuel, airports, air traffic control, flyover rights, booking systems and security and insurance, the pressure on results is intense. Further cost control is possible and necessary, but there is a point at which the network structure is in danger of being compromised and further economizing is counterproductive. Cooperation between airlines in the form of alliances or other partnerships is designed primarily to enlarge markets and not to address this problem.

There will have to be a fundamental redesign of our network organization's cost structure. Within the Association of European Airlines (AEA), European carriers recently commissioned a study of the future and preferred structure of the European aviation industry. Its clear conclusions form a platform for improvement and perhaps the first step towards necessary new business concepts. In broad lines, KLM is continuing its strategy to strengthen its position in the near term. The driving forces behind the strategy are the four businesses: Passenger (KLM, KLM

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cityhopper/KLM cityhopper uk), Cargo, Engineering & Maintenance (E&M) and Charter/Low-Cost (Transavia/BASIQ AIR). Each business will concentrate on one or more specific markets in which it can achieve a sustainable profit. Their success will be determined by the development of distinctive price and cost structures, the prevention of non-profitable growth, the outsourcing of non-core activities, and we will seek participation in alliances to achieve economies of scale or enhance market profile and so gain a better position in the value chain. The central organization will need to create the right conditions for success. Key building blocks in this respect are human resources, information technology, activities relating to the infrastructure in the air and on the ground, and developments in the air political environment. The extensive fleet replacement program being implemented is also essential.

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Low-cost is here to stay

Although they initially tapped new markets, low-cost carriers have turned their attention to the established carriers' connections over the years. In reply, KLM set up buzz in 1999, which grew into the third largest low-cost airline in Europe with ambitious plans for expansion. But the prospect of an independent, profitable operation faded rapidly during the 2002/03 fiscal year as a large number of new carriers entered the market and the regular airlines presented their response to them. A decision taken in the middle of the 2002/03 fiscal year not to continue the development of buzz without a strong partner ultimately resulted in its sale of its activities to the Irish carrier Ryanair. KLM is now represented in the low-cost market through Transavia's BASIQ AIR label.

The arrival of low-cost carriers has clearly demonstrated the difference between the network carrier and the low-cost point-to-point airline. When both are measured by the same standards, the network carrier's higher costs cannot be denied, but they are a direct consequence of the higher service level, the hub-and-spoke model to carry passengers on complicated itineraries as comfortably and as quickly as possible and the assurance of transportation within an agreed time frame. A matter of some concern is that the general public is led to believe that a network carrier can offer extremely low prices while retaining a full service package and that a low-cost airline can maintain low prices in the longer term without making concessions on its flight operations. The high cost of fleet maintenance, insurance and security and the forthcoming compulsory minimum service guarantee must raise doubts about the latter. Low-cost companies, however, have established their own, permanent position in the aviation landscape.

Cooperation

The future of aviation is unthinkable without close cooperation between airlines. Our long-standing alliance with Northwest Airlines has shown that the benefits can be high, even in a difficult year and in the face of strong competition. There are currently three major alliances in the airline industry, and we expect that KLM will eventually become a member of one of them: OneWorld in Europe, built around British Airways; SkyTeam, with Air France and others; and Star Alliance, with Lufthansa. We are in talks with OneWorld and SkyTeam. What form the cooperation will take has not yet been decided. Moreover, KLM believes the decision is too important to all concerned for it to be taken hastily. Furthermore, the situation in the U.S. aviation industry is still uncertain. The U.S. Department of Transportation's initial objections to an alliance between KLM's partners Northwest Airlines and Continental Airlines, on the one hand, and Delta Airlines, on the other, have been settled, but some of the other U.S. airlines are in great financial difficulties. A reordering on the American continent will inevitably have consequences for European carriers.

In making its choice, KLM will focus on strengthening its market position, the continuity of the company and of the Schiphol hub and, last but not least, the development of KLM's value to its customers, shareholders and employees.

Schiphol and the operation

The opening of the new Polder Runway at Schiphol on February 20, 2003 was a significant milestone for KLM, the airport and not least the region itself. New legislation will enable further long-term growth within the limits of a new system of safety and environmental standards. We expect that KLM will reap the benefits not only now but also in the future when it ties up with partners. The new runway at Schiphol has not yet resulted in a direct increase in capacity but it has enhanced the ability to use the airport in a variety of weather conditions. Punctuality should benefit.

KLM's hub operation, which has been thoroughly redesigned in the past six years, has proven its worth in numerous areas. In particular, closer cooperation between platform and gate and local management of the turnaround teams have considerably accelerated the process and increased punctuality. Peaks due to the coincidence of critical connections at specific times of the day still form a problem. Additional manpower has to be deployed for a brief period of time, after which it is effectively no longer needed. Methods are being devised to reduce the peaks by changing flight schedules with minimal loss of quality in the connections. A frustration during the year was the continued poor performance of the Schiphol baggage system. It is a source not only of high additional costs but also of substantial damage to KLM's image.

A long-term solution has not been found to the congestion in European airspace but the decline in flight numbers during the year did make the problem less acute. In anticipation of renewed growth, however, the debate on the integration of European air traffic control must be forcefully continued.

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Safe and secure flights

We made substantial investments in aircraft and airports during the year designed to prevent terrorist or other incidents compromising passenger and building security. In accordance with new regulations, many of our aircraft were equipped with additional security features. On the whole, the operation has been extremely expensive and we have had to bear the costs. In some countries, such as the U.S., however, the government pays these costs. Together with the soaring cost of insurance, these commitments exerted further pressure on our profitability. It is therefore difficult to accept the complete lack of uniformity and standardization in airport security. Each country and each national authority has its own approach and standards. Not all of them are effective; some are even counterproductive.

KLM and the environment

KLM has made sustainable business an integral part of its operations, and not without good cause. However important flying is for people to explore new countries, strengthen family ties or do business, it also has negative effects. Just like road, rail or water transport, aircraft pollute the environment. And for local residents, the aviation industry is a particular source of nuisance. In brief, it has a large and very visible ecological footprint. It is in KLM's interest to make the footprint as small as possible and thus earn the license to grow that is vital for the continuity of the company.

For KLM, sustainable business means striking the right balance between people, planet and profit. In many instances, commercial and social interests run parallel to environmental interests. Engineering & Maintenance, for example, started construction of a new center to overhaul aircraft engines at Schiphol during the year. From the very first design, account was taken of environmental factors, which are extremely critical at such a location. On completion, the center will have many modern environmental requirements. It will also boast the latest facilities for optimal working conditions and provide high-quality and knowledge-intensive employment for the region.

Fleet replacement also marries the interests of the economy with those of the environment. Phasing in a large number of new aircraft to replace older ones is one of the most visible environmental improvements. Their engines are without exception quieter, cleaner and more economical than those of their predecessors. The lower energy consumption and maintenance requirements represent an important part of the savings KLM is seeking to achieve in the years ahead.

All of KLM's activities, apart from ground operations at outstations, have operated ISO 14001 certified environmental management systems since 1999. Such certification is not obtained easily, and we believe that KLM is one of the very few airlines to have integrated environmental management so deeply into its operations. The re-certification process was successfully completed during the past year thanks to the hard work of management and staff.

To provide a clear view of the scope and implementation of its sustainability policy, KLM issues an annual Sustainability Report, explaining the balance between people, planet and profit. The report is also available on the Internet.

Inflation

Approximately 75% of our cost basis is affected by inflation. The remaining part (25% of our cost basis) relates to fuel expenses (principally affected by changes in market prices) and depreciation charges. The effects of general inflation on our cost basis is only to a limited extent compensated at the revenue side, since fierce competition in the airline industry puts continuous pressure on our yields. The airline industry in general and KLM in particular is therefore adversely impacted by inflation. Nevertheless, in recent years inflation has been at historically low levels and inflation has not materially affected our results.

Impact of foreign currency fluctuations

Our results were to a limited extent affected by foreign currency movements, since our exposures in major currencies (U.S. dollar, British pound, and Japanese yen) are hedged. Operational cash flow exposures are hedged within a range of 40-80% on a 12 month-rolling basis. Long-term exposures in foreign currencies (especially U.S. dollar purchase options of aircraft) are hedged through U.S. dollar-denominated deposits. Net investments in subsidiaries are not hedged. The differences arising from the translation of assets and liabilities into euro, however, do not affect our results since these differences are accounted for through equity. See also note 28 to our consolidated financial statements and Item 11.

Other factors

Governmental, economic, fiscal, monetary or political policies or factors did not materially affect our operations in the financial year 2002/03.

2002/03 compared with 2001/02

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We realized an operating loss for this financial year of EUR 484 million (2001/02: EUR 94 million operating loss). The net loss before tax amounted to EUR 622 million (2001/02: EUR 224 million loss). After tax, the net loss for the year amounted to EUR 416 million (2001/02: EUR 156 million loss).

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Operating income was negatively affected by higher depreciation and phasing-out charges of EUR 87 million for the Boeing 747-300 fleet. The operating result in the previous year had included a EUR 27 million contribution from the State of the Netherlands following the closure of U.S. airspace for three days in the wake of the September 11, 2001 attacks.

Operating revenues decreased by 1% to EUR 6,485 million. Total traffic, in ton-kilometers, was 2% higher than in the previous year. Since capacity was 2% higher, the load factor increased by 1.3 percentage points to 78.2%. Due to the changing market conditions, yield per revenue ton-kilometer decreased by 4%. Operating expenses decreased by EUR 8 million to EUR 6,618 million. Salary costs were 9% higher, principally due to general salary increases (in part from new contractual pay agreements) and due to additional costs for pre pension and retirement plans.

The EUR 42 million loss on the sale of assets (2001/02: EUR 10 million income) was caused by the sale of KLM uk's low-cost buzz activities (EUR 9 million) and the sale of assets from our fleet (EUR 33 million). The result on the sale of KLM uk's low-cost activities is the net effect of sales proceeds received from Ryanair on the transfer of assets (EUR 20 million, received at April 11, 2003), costs arising from arrangements under the sales agreement (EUR 20 million) and staff redundancies costs (EUR 9 million) which will be borne by KLM uk. The result on the sale of fleet assets arose principally from sale and leaseback transactions entered into to limit future residual value risks on these aircraft.

Financial income and expense improved by EUR 36 million (27% compared to the previous year) principally due to lower interest expense in connection with investments in the fleet.

Results on holdings were EUR 11 million better at EUR 4 million negative. The increase was attributable in part to an improvement in Martinair's earnings.

Operating expenses included exceptional costs to an amount of EUR 351 million. Of these exceptional costs EUR 276 million related to the arbitration tribunal's decision on the dispute between KLM and Alitalia regarding the termination of their alliance as of April 28, 2000. The tribunal ruled that our termination of the agreement was void and allowed Alitalia's claim for EUR 250 million plus interest. The claim brought by us against Alitalia to recover EUR 100 million plus interest paid for the development of Malpensa Airport was also awarded. The remaining exceptional loss (EUR 75 million) related to a provision for restructuring and relates to redundancy costs for approximately 1,000 full-time equivalents. In the fiscal year 2001/02 there were no exceptional items.

The results of the joint venture between KLM and Northwest Airlines improved significantly in comparison with the previous year, which had been negatively influenced by the September 11, 2001 attacks. On balance, the joint venture's capacity was gradually reduced over the fiscal year. The number of seat-kilometers was 3% lower than in the previous year. Revenue rose by 6%, chiefly because of the improved yield per revenue ton-kilometer. The settlement of the joint venture contribution is recognized as revenue or expense under the heading Commercial cooperation (included in operating expenses).

Passenger load factor for the financial year as a whole was 79.4% (2001/02: 78.7%). Measured in passenger kilometers, traffic increased by 2% from 58,447 million in 2001/02 to 59.417 million. The passenger business realized an operating loss of EUR 25 million.

Over the year as a whole, freight capacity increased by 1%. In freight ton-kilometers, traffic increased by 4% to 4,197 million (2001/02: 4,050 million). The load factor rose from 69.6% to 71.7%.

The decline in traffic had an indirect effect on engineering and maintenance activities. Thanks to an active sales policy, the engineering and maintenance division maintained its volumes. Third party revenue amounted to EUR 329 million. The engineering and maintenance business operating income came to EUR 41 million.

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Operating results by business segment in 2002/03

Passenger business

At the beginning of the fiscal year, demand for flights continued the recovery that had begun relatively soon after the fall in the market following the attacks of September 11, 2001. Beginning in the third quarter, however, the number of passengers started to decline, mainly because of the disappointing economy and the unrest in the Middle East, followed by the war in Iraq. The number of business class passengers in particular was lower. Since nearly all network carriers were affected by this downturn, the response was a general reduction in prices. We also used this means to keep our load factor high, but the yield was inevitably significantly lower. The decline was most marked on North Atlantic routes and connections with South Asia. African destinations remained remarkably firm. The increase in fuel prices in the course of the year forced us to introduce a fuel surcharge on March 1, 2003. Immediately after the outbreak of war in Iraq, we revised the schedule for a number of destinations in the Middle East. Toward the end of the fiscal year, concern about the SARS virus triggered a sharp fall in passenger traffic from and to the Far East.

Cargo business

Due to the weak economy, Cargo generally reported only a slight rise in volumes, mainly in the United States. Furthermore, competition on the North Atlantic route was fierce. Connections with Asia, especially Southeast Asia and China picked up though. Exports from Europe also remained at a reasonable level. The economic slowdown exacerbated the overcapacity and exerted pressure on prices. On balance, revenue rose by approximately 3% over the previous fiscal year. Higher fuel prices were again a factor on the cost side and forced Cargo to introduce a fuel surcharge and then increase it twice in accordance with the applicable rules during the year.

Engineering & Maintenance

The decline in traffic had an indirect effect on the maintenance activities. Thanks to an active sales policy, E&M maintained its volumes. Third-party revenue amounted to EUR 329 million. The Engineering & Maintenance business's operating income came to EUR 41 million. One of the largest maintenance contracts ever, for the maintenance of 12 Virgin Atlantic Boeing 747-400s, took full effect in the course of the fiscal year. Although demand for maintenance services was slightly lower, maintenance capacity in the market remained unchanged; the outcome was overcapacity. The resultant fierce competition, in combination with a weaker dollar against the euro, placed prices under pressure. Further growth is essential if E&M is to meet the needs of its clients, who are also growing through alliances. The alliances with General Electric, Hamilton Sundstrand and others illustrate how broadening the basis can facilitate growth. In addition, E&M is seeking to expand by winning more military contracts, performing maintenance services for regional airlines and by further increasing its presence outside The Netherlands in order to work closer to its customers.

Charter/low-cost business

The Charter/low-cost business had an operating loss of EUR 2 million, which was the balance of a positive result at Transavia and a negative result at Buzz. Despite lower economic growth, volumes on the charter market were slightly firmer and Transavia grew its market share. The scheduled services some operated as traditional scheduled flights and some in accordance with the Basiq Air concept reported good load factors. Passenger numbers on the three new destinations served by Basiq Air, Bordeaux, Marseille and Madrid, were mainly good. In response to the concept's success, all scheduled services were reorganized as Basiq Air flights at the beginning of 2003. Buzz's results for 2002/03 came under pressure from fierce competition.

2001/02 compared with 2000/01

Operating income fell so substantially that the year closed with an operating loss of EUR 94 million (2000/01: EUR 277 million operating income). The net loss amounted to EUR 156 million (2000/01: EUR 77 million net income). Net loss per common share came to EUR 3.46 (2000/01: EUR 1.63 net income).

The fall in operating income was due principally to a drop in passenger revenues, which fell by 4% to EUR 4,810 million owing to the 5% decline in passenger traffic. Yield per passenger kilometer was the same as in the previous year. Cargo revenue was 8% lower, due in almost equal measure to the decline in traffic and the decline in yield per cargo ton-kilometer. Total traffic, in ton-kilometer, was 4% lower than in the previous year. Since capacity was 2% lower, the load factor declined by 1.6 percentage points.

Due to a number of targeted actions to improve cost control, operating expenses excluding fuel costs were unchanged from the previous year. The actions were designed chiefly to reduce capacity and to control personnel expenses. This latter measure was realized through the postponement of a general salary increase and a reduction in staff numbers by about 1,200 full time employees, which was achieved without

forced redundancies. The effects of these measures were seen mainly in the third and fourth quarters of the 2001/02 financial year.

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For the first time in two years, fuel costs declined and were EUR 55 million lower than in the previous year. This decline was the outcome of both lower fuel prices and less consumption due to the reduction in capacity.

Results on holdings were EUR 6 million higher than in the previous year, partly because of an increase in Martinair's results. Results on the sale of holdings benefited from the sale of the remaining interest in Equant (EUR 22 million), but were also depressed by the sale of Braathens (EUR 14 million).

In fiscal year 2001/02 we set aside EUR 100 million (2000/01: EUR 96 million) for the settlement with Northwest Airlines. This amount has been recognized as an operating expense under the heading Commercial Cooperation. Joint venture revenue fell by more than 14% during the year to US\$2,076 million. Joint venture expenses fell by about 7%, chiefly because of the lower capacity contribution. The number of our available seat-kilometers was 14% lower than in the previous year. The fall in Northwest Airlines' available seat-kilometers in this route area was 6%. The number of passengers was 11% lower at approximately 5.1 million.

The passenger load factor for the year was lower than in the record year 2000/01 but due to the capacity reduction and the careful balancing of capacity and demand, the decline was limited: 78.7% versus 79.8% in 2000/01. Measured in passenger kilometers, traffic fell by 5%, from 60,047 million in 2000/01 to 56,891 million in the 2001/02 financial year.

The cargo division saw a decline in demand as early as the first quarter of the fiscal year, particularly on flights to Asia. In Europe, too, growth in traffic fell sharply. The organization accordingly took measures to bring costs into line with the projected lower level of activity. Fewer changes were therefore required following the events of September 11, 2001. Freight capacity remained virtually unchanged. An increase in traffic with a narrower margin, however, led to a modest decline in traffic revenue. In cargo ton-kilometers, traffic declined by 3% from 4,146 million in 2000/01 to 4,042 in 2001/02. The load factor weakened from 71.7% to 69.4%.

A significant part of engineering and maintenance's work consists of periodic, planned maintenance carried out in accordance with strict schedules based on the number of flying hours. Fluctuations in fleet utilization owing to changing traffic patterns therefore have an immediate impact on the workplaces. The decline in traffic from virtually the beginning of the fiscal year and the sharp drop in demand for maintenance following the September attacks curbed the service package's growth considerably. We took immediate measures to bring costs into line with the drop in volume. Additional services and several new customers subsequently brought some stability to revenue and income. Although under utilization at competitor maintenance companies exerted some pressure on margins, the engineering and maintenance division responded to the developments with such innovations as e-trading, supply chain initiatives and organizational flexibility. High priority was given to reducing working capital.

Critical accounting policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Netherlands GAAP. The preparation of these financial statements requires us to make estimates and judgements that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially result in materially different results under different assumptions. We believe that our critical accounting policies are limited to those described below. See the accounting policies section beginning on page F-3 of our consolidated financial statements for additional discussion of our accounting policies.

Frequent flyer accounting

We utilize a number of estimates in accounting for our frequent flyer program, which we believe are consistent with industry practices.

We record a liability for the estimated incremental costs of providing travel awards, which include costs for catering, fuel and taxes payable by us. Costs of non-travel awards are based on contracts, which have been concluded with partners. Costs for travel and non-travel awards are calculated per frequent flyer point, based on our members' behavior, and are evaluated annually. Costs of usage of points through airline partners are based on the same incremental cost basis.

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Outstanding frequent flyer points may not always be redeemed for travel. A member may not reach the threshold necessary for a free ticket or may not take any initiative to redeem his or her awarded points. Therefore, based on prior years experience, we estimate how many miles will never be used and do not record a liability for those points. Furthermore, members may use their points for upgrades, which do not lead to incremental costs for us. Points that are used for upgrades are therefore not recorded as a liability.

Passenger revenue

Passenger revenue is initially recorded as a liability for sales in advance of carriage. Revenue from ticket sales is recognized at the time when we provide the transportation. We make estimates based on historical trends regarding liability for tickets sold but not yet reported, the timing and amount of tickets used for travel on other airlines and the amount of tickets sold that will not be used. Changes to these estimation methods could have a material effect on the presentation of our financial results. Moreover, in light of the uncertainties surrounding the effects of the events of September 11, 2001, these historical trends may not be representative of future results.

Impairment

We evaluate impairment of long-lived assets in compliance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. We record impairment losses on long-lived assets used in operations when events and circumstances indicate the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. The impairment loss is measured by comparing the fair value of the asset to its carrying amount.

In the 2002/03 financial year an impairment loss of EUR 78 million was recognized for the Boeing 747-300 fleet due to an accelerated phasing out process.

New U.S. accounting standards

In June 2001, FASB Statement 143, *Accounting for Asset Retirement Obligations*, was issued. The statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of the fair value can be made. The associated asset retirement costs are capitalized as part of the carrying value of the relevant long-lived asset. This statement is effective for us on April 1, 2003. We are currently evaluating the impact of adopting Statement 143 on our financial statements.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. This statement requires that only certain debt extinguishment transactions be classified as an extraordinary item. Additionally, under this statement, capital leases that are modified so that the resulting agreement is an operating lease, shall be accounted for under the sale-leaseback provisions of SFAS No. 98. SFAS No. 145 also includes minor modifications to existing U.S. Generally Accepted Accounting Principles literature. SFAS No. 145 is effective for us on April 1, 2003. The adoption of this statement is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. The statement is effective for exit or disposal activities initiated after December 31, 2002 and is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In November 2002, the FASB issued Interpretation No. 45, *Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. Interpretation No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees. Disclosures under Interpretation No. 45 are effective for us in the 2002/03 financial statements. Additionally, Interpretation No. 45 clarifies the requirements for recognizing a liability at the inception of the guarantee equal to the fair value of the obligation undertaken in issuing the guarantee and incorporates the guidance in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*. KLM is currently assessing the impact of the adoption of this interpretation on its financial position, results of operations and cash flows. The recognition provisions of FIN 45 are required for certain guarantees issued or modified after December 31, 2002.

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In December 2002, the FASB issued SFAS No. 148 *Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123*. This Statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, it requires more prominent disclosures in both annual and interim financial statements. KLM does not intend to adopt either of the transition provisions allowed within SFAS 148.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, which requires the consolidation of variable interest entities, as defined. Interpretation No. 46 is effective for us on April 1, 2003. KLM is currently assessing the impact of this Interpretation.

In April 2003, the FASB issued FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, which amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to address (1) decisions reached by the Derivatives Implementation Group, (2) developments in other Board projects that address financial instruments, and (3) implementation issues related to the definition of a derivative. Statement 149 has multiple effective date provisions depending on the nature of the amendment to Statement 133. The Company is currently evaluating the impact of adopting Statement 149 on its financial statements.

In May 2003, the FASB issued FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classifies a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. We are currently evaluating the impact on our financial statements of adopting Statement 150.

B. Liquidity and capital resources

Internal and external sources of liquidity

Currently our liquidity position exceeds the minimum required levels of liquidity to sustain our business adequately. Currently there are no unusual provisions in any of our financial guarantees, debt or lease agreements or other arrangements that could trigger a requirement for an early payment, additional collateral support, changes in terms, acceleration of maturity, or the creation of additional financial obligations to any material extent. If required, we believe that our liquidity position could be extended further by the use of internal and external resources.

Our internal source of liquidity consists of operating cash flows. The availability of these funds could be reduced by risk relating to the airline industry such as the threat or effects of terrorists attacks, deteriorating economic conditions, intense competition in the airline industry and seasonal changes in demand.

Our external sources of liquidity consist of our EUR 500 million commercial paper program, mortgages secured by aircraft and non-fleet assets, sale-and-lease back transactions of aircraft and non-fleet assets. As of March 31, 2003, no amounts were outstanding under our commercial paper program. The program is scheduled to be automatically renewed in September 2003. The book value of our unencumbered fleet and non-fleet assets (as of March 31, 2003, EUR 1,615 million) offers a possible source of liquidity through the financing and the sale (and lease back) of assets. Despite the current situation in the airline industry, we have demonstrated ourselves to be a strong and attractive party in fleet financing programs and sale/lease back transactions.

Our overall liquidity position is expected to decrease temporarily as a result of our planned fleet renewal program. Furthermore, this program will decrease our borrowing capacity. We expect, however, that our overall liquidity position will be in excess of minimum required levels to sustain our business. Furthermore we expect that our working capital is sufficient to meet our present requirements.

Evaluation of the sources and amounts of our cash flows

We invest our liquid reserves in short-term instruments at current interest rates. Nonetheless in some of our foreign establishments exchange controls, transfer formalities and currency shortages restrict a portion of our funds. The part of our liquid reserves subject to these restriction amounts to EUR 15 million generally does not earn interest and is subject to the risk of currency devaluation. These restrictions however do not affect our ability to meet any cash obligations. We have covered our Japanese yen and parts of our U.S. dollar long-term commitments with forward exchange contracts. The euro portion of our long-term debt, excluding perpetual loans, as of March 31, 2003 of this annual report amounted to 71% of those commitments. A 25% portion of the commitments is in U.S. dollars and 4% is in British sterling.

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KLM's cash flow from operating activities amounted to EUR 297 million. Included in this amount is a payment of EUR 172 million for the settlement of the Alitalia arbitration award. KLM's liquidity position was reduced, however, by substantial investment expenditure, principally on fleet replacements, and loan repayments. Cash flow used by investing activities amounted to EUR 346 million, of which EUR 637 million related to the purchase of and advance payments for aircraft. Cash outflow from financing activities amounted to EUR 280 million. Financing was arranged for two aircraft and existing debt relating to aircraft financing was repaid during the financial year. In addition, we repurchased our own shares to an amount of EUR 6 million. We constantly seek opportunities to optimize our current debt position in order to further reduce our weighted average cost of capital.

Cash and marketable securities as of March 31, 2003 were EUR 608 million. Furthermore the Company holds triple A bonds and long-term deposits to an amount of EUR 311 million, which are included in financial fixed assets. Triple A bonds and long-term deposits are available on call to the Company.

Group equity fell from EUR 1,992 million as of March 31, 2002 to EUR 1,477 million as of March 31, 2003. Our net-debt-to equity ratio deteriorated from 1.31 as of March 31, 2002 to 1.95 as of March 31, 2003.

Information on borrowings

Borrowings principally consist of deposits. We have placed deposits in legal structures that accomplish either legal defeasance or defeasance in-substance. Defeasance is accomplished by linking deposits placed with investment grade financial institutions to lease commitments, in some cases through pledge and escrow agreements. Deposits amounting to EUR 248 million, EUR 382 million and EUR 658 million as of March 31, 2003, March 31, 2002, and March 31, 2001, respectively, were pledged, held in escrow or on deposit to satisfy all scheduled payments on the related lease commitments. In order to hedge interest rate and currency risk, the deposits are in the same currencies as the related lease commitments and have the same scheduled dates and amounts for payments. We believe that the possibility that we will be required to make future payments with respect to these obligations is relatively remote.

Information on debt

For information on the types of our financial instruments, the maturity profile of our debt, the currency and interest rate structure of our debt please see notes 8 and 14 to our consolidated financial statements.

Capital Expenditures

Capital Expenditures 2002/03

Capital expenditures made during the 2002/03 financial year amounted to EUR 715 million and included the purchase of one Boeing 747-400 aircraft (valued at EUR 169 million), two Boeing 737-700 aircraft (valued at EUR 80 million) and one Fokker 70 aircraft (valued at EUR 20 million). Capital expenditures on other material tangible fixed assets totaled EUR 50 million, mainly invested in equipment and buildings. Capital expenditures on intangible fixed assets totaled 28 million. On March 31, 2003, our total commitments, net of amounts prepaid, with respect to current orders for aircraft amounted to EUR 1,042 million and for other assets to EUR 45 million. Approximately EUR 150 million (21%) of the capital expenditures were funded externally.

Prepayments were made on three Boeing 747-400 aircraft (EUR 219 million), four Boeing 777-200 aircraft (EUR 203 million), six Airbus 330-200 aircraft (EUR 18 million) and two Boeing 737-700 aircraft (EUR 15 million).

Capital Expenditures 2001/02

Capital expenditures made during the 2001/02 financial amounted to EUR 430 million and included the purchase of four Boeing 737-900 aircraft (valued, in aggregate, at EUR 180 million, of which EUR 115 million was paid during the 2001/02 financial year), two Boeing 737-800 aircraft (valued, in aggregate, at EUR 75 million, of which EUR 31 million was paid during the 2001/02 financial year). Capital expenditures on spare engines and spare parts totaled EUR 61 million. Capital expenditures on other tangible fixed assets totaled EUR 66 million, mainly invested in equipment and buildings. Capital expenditures on intangible fixed assets totaled EUR 7 million. Approximately EUR 130 million (30%) of the capital expenditures were funded externally.

Prepayments were made on three Boeing 747-400 aircraft (EUR 86 million), four Boeing 737-700 aircraft (EUR 37 million) and two Boeing 737-800 aircraft (EUR 1 million).

C. Research and development, patents and licenses etc.

None.

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D. Trend information

The first two months of financial year 2003/04 showed a year-on-year decline in revenue passenger kilometers of 8%. This was mainly due to the outbreak of the SARS-virus, which affected traffic to Asian destinations, and the impact of the war in Iraq. Cargo traffic showed a year-on-year increase of 5% which was mainly due to the deployment of two new full-freighters and the full deployment of our combi fleet on Asia Pacific routes.

On the basis of current economic conditions and uncertainties surrounding the SARS-virus, we do not anticipate a short-term improvement in the operating environment. We are firmly set on implementing necessary measures aimed at a structural reduction of our cost levels as well as short-term measures that contribute immediately to an improvement in results.

E. Off-Balance sheet arrangements

We have entered into several transactions with special purpose entities (SPEs) in connection with fleet financing structures for aircraft. These structures do not qualify as off balance sheet structures. Except for 3 structures which we established in the 2002/03 financial year (the nature and extent of which is described below), we generally transfer aircraft to SPEs and obtain the right to use these assets for our operations based on financial lease agreements. Since we retain the majority of the residual and ownership risks related to these assets in substance, these SPEs are fully consolidated within our financial statements and form an integral part of the disclosures on assets and liabilities that are included in this annual report.

During 2002/03 we entered into 3 off balance sheet structures with SPEs, concerning a total of 10 aircraft. Furthermore we entered into one sale and leaseback transaction (concerning 2 aircraft) which did not involve SPEs. In general, these transactions were conducted to reduce any further residual value risk for certain fleet types. Since we transferred the risks related to these assets in substance to third parties, these transactions result in a reduction of our fleet assets.

The first structure with SPEs was concluded in the first quarter of the 2002/03 fiscal year. We entered into a sale and leaseback transaction of 4 aircraft, which resulted in sales proceeds of US\$65 million. In substance, we transferred the risks related to the aircraft to a SPE in which we have no equity interest or voting interest. The amount of equity provided by third parties is approximately 10% of the SPE's total assets. We lent the SPE an amount of US\$31 million, which is secured by a first mortgage on the aircraft.

The remaining 2 structures with SPEs were concluded in the second and third quarter of the 2002/03 fiscal year and concerned 3 aircraft each. We entered into sale and leaseback transactions, which resulted in sales proceeds of EUR 165 million. In substance, we transferred the risks related to the aircraft to SPEs in which we have no equity interest or voting interest. We did not provide funding to these SPEs.

There are no events, trends or uncertainties that will result or are reasonably likely to result in the termination or material reduction in availability of off-balance sheet arrangements to KLM.

Table of Contents**F. Tabular disclosure of contractual obligations**

Overview of contractual obligations and commitments as of March 31, 2003:

| Contractual Obligations | Payments due by period | | | | |
|--------------------------------------|-------------------------------|-----------------------------|----------------------|----------------------|--------------------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Financial Lease Obligations | 317 | 34 | 140 | 82 | 61 |
| Long-Term Debt Obligations | 3,743 | 316 | 1,049 | 680 | 1,698 |
| Operating Lease Obligations | 1,174 | 190 | 385 | 244 | 355 |
| Total Contractual Obligations | 5,234 | 540 | 1,574 | 1,006 | 2,114 |

| Other Commitments | Expiration per period | | | |
|--------------------------------|--|-----------------------------|----------------------|--------------------------|
| | Total amounts committed | Less than 1 year | 1-5 years | After 5 years |
| Fleet Purchase Commitments | 1,042 | 516 | 526 | 0 |
| Guarantees | 174 | 62 | 21 | 91 |
| Total Other Commitments | 1,216 | 578 | 547 | 91 |

More information is presented in note 8 to our consolidated financial statements

As of the end of May 2003, our contractual obligations and other commitments had not changed materially compared to the information included in the tables above.

The majority of our future fleet purchases are expected to be financed by external borrowings.

G. Safe Harbor

Please see [Warning about Forward-Looking Statements](#) at the beginning of this annual report.

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ITEM 18. FINANCIAL STATEMENTS

See pages F-1 through F-48 and page S-1, which are incorporated by reference in this annual report.

ITEM 19. EXHIBITS

- 12.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a)
- 12.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a)
- 13.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 13.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

The registrant certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

KONINKLIJKE LUCHTVAART MAATSCHAPPIJ
N.V. (KLM Royal Dutch Airlines)

By: LEO M. VAN WIJK

L.M. van Wijk
President and Chief Executive Officer

By: ROBERT A. RUIJTER

R.A. Ruijter
Managing Director and Chief Financial Officer

Date: January 9, 2004

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Independent Auditors report

To the Management Board and Supervisory Board of KLM Royal Dutch Airlines and Subsidiaries:

We have audited the consolidated financial statements of KLM Royal Dutch Airlines and its Subsidiaries (the Company) as listed in the index on page F-1 and included on the pages F-3 through F-48. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the index on page S-1. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial statement schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KLM Royal Dutch Airlines and Subsidiaries at March 31, 2003 and 2002 and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2003, in conformity with generally accepted accounting principles in The Netherlands. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in note 29 to the consolidated financial statements, the earnings per share data for the years ended March 31, 2002 and 2001 have been restated.

As discussed in note 29 to the consolidated financial statements, KLM has changed the method of presenting extraordinary items as a result of the adoption of RJ 270 Revenue Recognition.

Accounting principles generally accepted in The Netherlands vary in certain significant respects from accounting principles generally accepted in the United States of America (US GAAP). Information relating to the nature and effect of such differences is presented in note 28 to the consolidated financial statements. As discussed in note 29 to the consolidated financial statements, the earnings per share data under US GAAP for the years ended March 31, 2002 and 2001 have been restated.

Amstelveen, the Netherlands,
June 12, 2003, except for Note 29,
which is as of January 9, 2004

KPMG Accountants N.V.

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CONSOLIDATED FINANCIAL STATEMENTS

ACCOUNTING POLICIES

General

The company financial data of KLM are incorporated in the consolidated balance sheet and the consolidated statement of earnings. The company statement of earnings is presented in simplified form in accordance with article 402, Title 9, Book 2, of The Netherlands Civil Code. All amounts are in millions of euros unless stated otherwise.

Changes in accounting policies

There were no changes in accounting policies during fiscal year 2002/2003. As of April 1 2003, there was a change of accounting policy with respect to extra-ordinary items. Please refer to note 29 for further explanation of this change.

Basis of consolidation

The consolidation includes the financial data of KLM and its Group companies. Group companies are those holdings with which KLM forms a financial and organizational entity and over which KLM exercises direct or indirect control. Group companies are consolidated in full. The share of third parties in the Group result and Group equity is stated separately.

A list of capital interests within the meaning of articles 379 and 414, Title 9, Book 2, of The Netherlands Civil Code has been filed with the Trade Register of the Chamber of Commerce in Amsterdam.

Accounting Policies

General

The balance sheet and the statement of earnings are prepared under the historical cost convention unless stated otherwise. For information regarding U.S. GAAP please refer to note 28 to the consolidated accounts.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at balance sheet date.

Unearned revenues relating to future transportation commitments included under current liabilities are carried at the euro value at the date on which the transportation commitment was made.

Exchange rate differences arising on the translation of assets and liabilities are taken to the statement of earnings as other operating expenses. Exchange rate differences arising on the translation of purchased goodwill, the share in the permanent financing of foreign holdings and the share in the equity and results of those holdings are taken directly to stockholders' equity.

Amounts in the statement of earnings denominated in foreign currencies are translated at weighted average monthly exchange rates.

The most important exchange rates at balance sheet date were:

| | March 31, 2003 | March 31, 2002 |
|------------------------|---------------------------|---------------------------|
| 1 U.S. dollar (USD) | EUR 0.94 | EUR 1.13 |
| 1 pound sterling (GBP) | EUR 1.47 | EUR 1.61 |
| 1 Swiss franc (CHF) | EUR 0.68 | EUR 0.68 |

100 Japanese yen (JPY)

EUR 0.79

EUR 0.87

Derivatives

KLM uses derivatives to hedge its exposure to fuel prices, foreign currencies and interest rates. In accordance with SFAS 133/138, derivatives are carried in the balance sheet at fair value as financial fixed assets and long-term debt. Revenues or expenses arising from movements in the fair value of derivatives are in principle recognized in the statement of earnings.

Movements in the fair value of derivatives that are held as effective hedges to exposures that influence the fair value of assets, liabilities and unrecognized firm commitments (fair value hedges) are recognized together with the movements in the fair value of the underlying positions in the statement of earnings. Where hedges are no longer effective, the derivatives are carried at fair value without the underlying positions being adjusted for movements in fair value. In such circumstances, only movements in the value of derivatives are recognized in the statement of earnings.

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Movements in the fair value of derivatives that are held as effective hedges of future cash flows (cash flow hedges) are included under Other reserves up to the date on which the effects of the results on the underlying positions materialize. As of that date, value movements included in Other reserves are taken to the statement of earnings together with those effects on the underlying positions.

Where hedges are no longer effective, the derivatives are carried at fair value and value movements are released to the statement of earnings as from that date. The accumulated results included in Other reserves are released to the statement of earnings together with the effects of the results on the remaining underlying exposure. If there is no longer an exposure, the results included in Other reserves are released directly to the statement of earnings.

Intangible fixed assets

Purchased goodwill is capitalized and amortized on a straight-line basis. The amortization period is determined for each individual holding up to a maximum of twenty years based on the period in which the interest acquired is expected to contribute to results. Due account is taken of lower realizable value, defined as the higher of net selling price and value in use. Value in use is defined as discounted estimated future operating cash flow.

Substantial investments in software are capitalized insofar as the software is essential to bring about changes in core business processes that lead directly to future revenue increases or cost savings. Software is carried at cost less amortization, or lower realizable value. Cost includes both expenses incurred internally and expenditure paid to third parties. The amortization period for software is determined on the basis of the useful life of each investment up to a maximum period of ten years. As from the date on which it is taken into service, software is fully amortized on a straight-line basis over the amortization period. Until it is taken into service, software is capitalized as a prepayment under Intangible fixed assets.

Tangible fixed assets

Aircraft, spare engines and spare parts are carried at cost (including purchase expenses, such as financing expenses up to the date aircraft are taken into service) less depreciation, or lower realizable value, defined as the higher of net selling price and value in use. Value in use is defined as discounted estimated future operating cash flow.

Aircraft held under financial lease agreements are also included under this heading following the same valuation policy.

KLM has a foreign Group company that uses the U.S. dollar to value and depreciate aircraft that are purchased in U.S. dollars and related financing. For their inclusion in the consolidated financial statements of KLM, these aircraft are translated into euros at the U.S. dollar exchange rate ruling at balance sheet date. The net book value of these aircraft is included under Tangible fixed assets.

Aircraft are depreciated on a straight-line basis over their useful lives to estimated residual values of 0% to 25%. Depending on the type of aircraft, the useful life varies from 10 to 25 years.

Spare engines are depreciated to their estimated residual value on a straight-line basis over the remaining estimated useful life of the engine type. Spare parts are depreciated to their estimated residual value on a straight-line basis over the remaining estimated useful life of the associated aircraft or engine type.

Heavy maintenance costs are capitalized and depreciated on a straight-line basis over the period to the next heavy maintenance. These costs include both internal costs and external expenditures. Significant modernization and improvement costs are capitalized and depreciated over, at maximum, the remaining life of the aircraft concerned.

Other tangible fixed assets are carried at cost less straight-line depreciation, or lower realizable value. Financing costs for major projects are included in cost until the date of first usage. Straight-line depreciation to residual value is based on the following estimated useful lives:

| | |
|--|---------------|
| Buildings (land is not depreciated) | 10 - 40 years |
| Inventories, machines and installations | 3 - 15 years |
| Vehicles and other tangible fixed assets | 5 - 20 years |

Tangible fixed assets are translated at the exchange rates ruling at the date of payment or at the date deposits in foreign currencies are applied or at the exchange rates of forward exchange contracts.

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Tangible fixed assets on order are carried in the balance sheet at the amount of advance payments made. Remaining balances due are included in the Notes to the consolidated balance sheet under commitments and contingent liabilities.

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Financial fixed assets

Holdings in which KLM exercises a significant influence on the business and financial policies are carried at net-equity value, where possible in accordance with KLM's accounting policies, less any exceptional diminutions in value. Holdings in which KLM does not exercise a significant influence on the business and financial policies are carried at cost less any exceptional diminutions in value.

KLM's share in the holdings carried at net asset value is included under Results of holdings in accordance with KLM's accounting policies. Dividends declared by holdings carried at cost are included in Results of holdings.

Accounts receivable from holdings and other financial fixed assets are carried at face value less necessary provisions. Amounts falling due within one year are included under Current assets.

KLM holds a portfolio of zero-coupon triple A bonds to hedge the foreign exchange exposure on part of the financial lease commitments. These securities are at the free disposal of KLM and are included under Financial fixed assets at cost plus realized interest.

For the valuation of derivatives, reference is made to the notes above.

Other Financial fixed assets are valued at the lower of face value or realizable value.

Operating supplies

Supplies are carried at average cost net of a provision for economic obsolescence where applicable. Supplies are translated at the exchange rates ruling at the date of receipt of the materials.

Accounts receivable

Accounts receivable are carried at face value less necessary provisions for bad debts.

Marketable securities and cash

Marketable securities other than the Triple A bonds recognized under Financial fixed assets are carried at market value. Realized and unrealized results are recognized in the statement of earnings under Financial income and expense.

Cash on hand, demand deposits and time deposits are carried at face value less necessary provisions for transfer risk.

Deferred credits

Deferred credits are carried at face value and are credited to the statement of earnings generally in accordance with movements in the related items. A maximum of twenty years is maintained for investment grants received under the Investment Account Act.

Provisions

Provisions are carried at face value with the exception of the provision for postretirement health insurance costs and the provision for the Frequent Flyer program. These provisions are carried at the present value of future commitments discounted at 5.5% and 9% respectively.

All pension commitments have been placed with independent pension funds. Expenses relating to pension benefits accrued by employees are allocated to the years in which the employees performed the work on which the benefits are based.

Postretirement health insurance costs are determined in accordance with SFAS 106, Postretirement Benefits other than Pensions.

Long-term debt

Long-term debt is carried at face value. Debt hedged by means of fair value hedges, however, is adjusted for movements in the fair value of the positions hedged.

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Financial lease obligations are initially stated at net present value, discounted at the contracted interest rate. Loans to finance companies in this respect are set off against lease obligations, provided offsetting of receivables and debts is legally permitted or agreed upon. Long-term debt falling due within one year is included under Current liabilities.

Current liabilities

Current liabilities are carried at face value.

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Operating revenues

Traffic revenue includes revenues from transportation performed, translated at exchange rates ruling at the date on which the transportation commitment was made. Other revenue comprises proceeds on deliveries and services to third parties at the date that goods are delivered or services performed.

Financial income and expense

Interest payments on long-term debt are included at their effective rates after deduction of finance benefits amortized. Costs relating to financing transactions are also included under Financial income and expense. Financing costs are capitalized under Tangible fixed assets on the basis of the average interest rate on borrowed capital. The ineffective part of the unrealized result on derivatives that do not qualify as effective hedges within the meaning of SFAS 133/138 or that are considered partially ineffective is included under Financial income and expense.

Taxes

Taxes on result are calculated at current income tax rates on the current result. Deferred investment grants, tax-exempt profit components, loss carryforwards and permanent differences between fiscal accounting policies and KLM's accounting policies are taken into account.

Deferred tax assets and liabilities are formed in respect of timing differences between the valuation of assets and liabilities for accounting purposes and for fiscal purposes. Deferred tax assets are recognized insofar as future realization is probable.

Cash flow statement

Cash flow from operating activities is calculated by means of the indirect method. Reported net income is therefore adjusted for non-cash items from both the statement of earnings and movements in the balance sheet.

Table of Contents**KLM ROYAL DUTCH AIRLINES****CONSOLIDATED BALANCE SHEET****In millions of euros***Before appropriation of results*

| | Note ⁽¹⁾ | March 31, 2003 | March 31, 2002 ⁽²⁾ |
|--|---------------------|-------------------|----------------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Fixed assets | | | |
| Intangible fixed assets | 1 | 66 | 56 |
| Tangible fixed assets | 2 | 4,982 | 5,104 |
| Financial fixed assets | 3 | 1,289 | 1,264 |
| | | <u>6,337</u> | <u>6,424</u> |
| Current assets | | | |
| Operating supplies | 4 | 222 | 257 |
| Accounts receivable | 5 | 998 | 1,233 |
| Marketable securities | | | 2 |
| Cash | 6 | 608 | 1,027 |
| | | <u>1,828</u> | <u>2,519</u> |
| Current liabilities | 7 | 2,190 | 2,092 |
| | | <u> </u> | <u> </u> |
| Current assets less current liabilities | | (362) | 427 |
| | | <u> </u> | <u> </u> |
| Assets less current liabilities | | 5,975 | 6,851 |
| | | <u> </u> | <u> </u> |
| Long-term debt | | | |
| | 8 | | |
| Subordinated perpetual debt | | 544 | 591 |
| Other long-term debt | | 3,427 | 3,826 |
| | | <u>3,971</u> | <u>4,417</u> |
| Provisions | 9 | 271 | 177 |
| Deferred credits | 10 | 256 | 265 |
| Group equity | | | |
| Stockholders' equity | 11 | 1,476 | 1,992 |
| Share of third parties | | 1 | |
| | | <u>1,477</u> | <u>1,992</u> |
| | | <u>5,975</u> | <u>6,851</u> |

(1) The accompanying Notes are an integral part of these Consolidated Financial Statements

(2) Prior-year figures have been reclassified with regard to deferred taxes

Table of Contents**KLM ROYAL DUTCH AIRLINES****CONSOLIDATED STATEMENTS OF EARNINGS⁽³⁾**

In millions of euros with the exception of the stock data

| | Note ⁽¹⁾ | For the Years Ended March 31, | | |
|---|---------------------|-------------------------------|------------|------------|
| | | 2003 | 2002 | 2001 |
| Operating revenues | | | | |
| Traffic revenue | 15 | 5,780 | 5,826 | 6,126 |
| Other revenue | 16 | 705 | 706 | 834 |
| | | 6,485 | 6,532 | 6,960 |
| Operating expenses (see note 29) | 17 | 6,969 | 6,626 | 6,683 |
| | | (484) | (94) | 277 |
| Operating income (loss) | | (484) | (94) | 277 |
| Financial income and expense | 20 | (98) | (134) | (138) |
| Results on sale of assets | 21 | (42) | 10 | 27 |
| Results of holdings | 22 | (4) | (15) | (21) |
| Results on sale of holdings | 23 | 6 | 9 | 4 |
| | | (622) | (224) | 149 |
| Pretax income (loss) | | (622) | (224) | 149 |
| Taxes (see note 29) | 24 | 206 | 68 | (73) |
| | | (416) | (156) | 76 |
| Share of third parties | | | 0 | 1 |
| | | (416) | (156) | 77 |
| Net income (loss) | | (416) | (156) | 77 |
| Net income (loss) attributable to common shares | | (418) | (158) | 75 |
| Average number of common shares outstanding ⁽²⁾ (restated, see note 29) | | 45,070,544 | 45,681,707 | 46,133,032 |
| Average number of common shares outstanding, fully diluted ⁽²⁾ (restated, see note 29) | | 45,070,544 | 45,681,707 | 46,133,032 |
| Net income (loss) per common share (restated, see note 29) | | (9.26) | (3.46) | 1.63 |

(1) The accompanying Notes are an integral part of these Consolidated Financial Statements

(2) Taking repurchased shares into account

(3) Operating income has been adjusted for the year ended March 31, 2003 to reflect the changed accounting rules effective for KLM as of April 1, 2003 with respect to the presentation of extra-ordinary items. Please refer to note 29.

Table of Contents**KLM ROYAL DUTCH AIRLINES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

In millions of euros

| | For the Years Ended March 31, | | |
|---|--------------------------------------|--------------|--------------|
| | 2003 | 2002 | 2001 |
| Cash flow from operating activities: | | | |
| Net income (loss) | (416) | (156) | 77 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 535 | 487 | 429 |
| Provision for losses and accounts receivable | (9) | 9 | 12 |
| Results on sale of assets | 42 | (10) | (27) |
| Undistributed earnings of affiliates | 4 | 15 | 19 |
| Gain on sale of affiliates | (6) | (9) | (4) |
| Deferred taxes | (201) | (65) | 73 |
| Change in assets and liabilities: | | | |
| Accounts receivable | 190 | 122 | 72 |
| Supplies | 35 | 40 | (1) |
| Prepaid expenses | 104 | (43) | (25) |
| Change in provisions | 87 | (21) | (63) |
| Current liabilities | (40) | 152 | (32) |
| Taxes and social insurance premiums | (9) | 21 | (21) |
| Deferred credits | (22) | (16) | 20 |
| Marketable securities | 2 | 4 | 57 |
| Share of third parties | 1 | | (5) |
| | <u>297</u> | <u>530</u> | <u>581</u> |
| Net cash provided by operating activities | 297 | 530 | 581 |
| Cash flow from investing activities: | | | |
| Proceeds from sale of tangible fixed assets | 305 | 64 | 167 |
| Capital expenditures | (725) | (430) | (614) |
| Net expansion of other holdings | (26) | 149 | (49) |
| Investment in inventory | 10 | (17) | (15) |
| Changes in the group of consolidated holdings | | | (9) |
| | <u>(436)</u> | <u>(234)</u> | <u>(520)</u> |
| Net cash (used in) provided by investing activities | (436) | (234) | (520) |
| Cash flow from financing activities: | | | |
| Dividend paid | (11) | (30) | (2) |
| Increase in long-term debt | 121 | 365 | 626 |
| Decrease in long-term debts | (259) | (401) | (523) |
| Increase in long-term receivables | (78) | (161) | (225) |
| Decrease in long-term receivables | 62 | 70 | 401 |
| Other | (115) | 49 | (166) |
| | <u>(280)</u> | <u>(108)</u> | <u>111</u> |
| Net cash provided by financing activities | (280) | (108) | 111 |
| Changes in cash | (419) | 188 | 172 |
| Cash, opening balance | 1,027 | 839 | 667 |
| | <u>608</u> | <u>1,027</u> | <u>839</u> |
| Cash, closing balance⁽¹⁾ | 608 | 1,027 | 839 |

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In fiscal 2002 interest paid amounted to EUR 178 million, as compared to fiscal 2001 EUR 211 million and fiscal 2000 EUR 181 million. In fiscal 2002 no income taxes were paid on a preliminary basis. In fiscal 2001 EUR 4 million and in fiscal 2000 EUR 1 million income taxes were paid on a preliminary basis.

-
- (1) Including Triple A bonds and deposits the overall cash position amounts to EUR 919 million as of March 31, 2003 (as of March 31, 2002: EUR 1,383 million, as of March 31, 2001: EUR 1,148 million)

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

In millions of euros

Fixed assets**1. Intangible fixed assets**

| | <u>Goodwill</u> | <u>Software</u> | <u>Advance payments on software on order or under construction</u> | <u>Total</u> |
|--|-------------------|-------------------|--|-------------------|
| Purchase value as of March 31, 2002 | 42 | 56 | 1 | 99 |
| Accumulated amortization through 2001/2002 | 23 | 20 | | 43 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Book value as of March 31, 2002 | 19 | 36 | 1 | 56 |
| Changes in book value | | | | |
| Additions | | 18 | 11 | 29 |
| Disposals | | | | |
| Amortization | (4) | (13) | | (17) |
| Exchange rate differences | (1) | | | (1) |
| Other | | 5 | (6) | (1) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total changes | (5) | 10 | 5 | 10 |
| Purchase value as of March 31, 2003 | 40 | 78 | 6 | 124 |
| Accumulated amortization through 2002/2003 | 26 | 32 | | 58 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Book value as of March 31, 2003 | 14 | 46 | 6 | 66 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

2. Tangible fixed assets

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|--|---------------------------|---------------------------|
| Aircraft, spare engines and spare parts | 3,793 | 4,329 |
| Other tangible fixed assets | 544 | 583 |
| | <u> </u> | <u> </u> |
| | 4,337 | 4,912 |
| Advance payments on tangible fixed assets on order or under construction | 645 | 192 |
| | <u> </u> | <u> </u> |
| | 4,982 | 5,104 |
| | <u> </u> | <u> </u> |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. Tangible fixed assets (Continued)**

| | Aircraft, spare engines and spare parts | Buildings and land | Inventories, machines and installations | Vehicles and other tangible fixed assets | Total |
|--|--|-----------------------|--|--|-------|
| Purchase value as of March 31, 2002 | 7,309 | 734 | 608 | 132 | 8,783 |
| Accumulated depreciation and diminution in value through 2001/2002 | 2,980 | 379 | 440 | 72 | 3,871 |
| Book value as of March 31, 2002 | 4,329 | 355 | 168 | 60 | 4,912 |
| Changes in book value | | | | | |
| Additions | 409 | 2 | 35 | 15 | 461 |
| Disposals | (342) | (2) | | (5) | (349) |
| Depreciation | (382) | (26) | (46) | (12) | (466) |
| Write down/impairment | (78) | | | | (78) |
| Exchange rate differences | (143) | | (1) | | (144) |
| Other | | 2 | (1) | | 1 |
| Total changes | (536) | (24) | (13) | (2) | (575) |
| Purchase value as of March 31, 2003 | 6,925 | 728 | 605 | 132 | 8,390 |
| Accumulated depreciation and diminution in value through 2002/2003 | 3,132 | 397 | 450 | 74 | 4,053 |
| Book value as of March 31, 2003 | 3,793 | 331 | 155 | 58 | 4,337 |

This overview includes aircraft for which financial lease agreements have been concluded. Their book value amounts to EUR 2,538 million (last fiscal year EUR 2,839 million).

Other tangible fixed assets include assets whose availability is based on limited right of use, such as buildings on land held under long-term rental agreements or on leasehold, and assets acquired through financial lease agreements. The book value of these assets amounts to EUR 184 million (last fiscal year EUR 226 million).

In fiscal year 2002/2003 a write down of EUR 78 million was recognized for the Boeing 747-300 fleet in connection with an accelerated phasing out. The remaining book value of the Boeing 747-300 fleet amounted to EUR 60 million as of March 31, 2003.

Advance payments on tangible fixed assets on order or under construction

| | |
|--|-------|
| Balance as of March 31, 2002 | 192 |
| Advance payments | 685 |
| Tangible fixed assets taken into operation | (232) |
| Balance as of March 31, 2003 | 645 |

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Aircraft on order as of March 31, 2003:

2 Boeing 737-700

3 Boeing 747-400ERF

4 Boeing 777-200ER

6 Airbus 330-220

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Financial fixed assets**

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|------------------------------|---------------------------|---------------------------|
| Holdings | 198 | 201 |
| Receivables from holdings | 18 | 22 |
| Triple A bonds/deposits | 311 | 354 |
| Derivatives | 482 | 589 |
| Other financial fixed assets | 152 | 198 |
| Deferred taxes | 128 | (100) |
| | <u>1,289</u> | <u>1,264</u> |

| | <u>Holdings</u> | <u>Receivables from holdings</u> | <u>Triple A bonds/ deposits</u> | <u>Derivatives</u> | <u>Other financial fixed assets</u> | <u>Deferred taxes</u> | <u>Total</u> |
|-------------------------------------|-----------------|--|---|--------------------|---|---------------------------|--------------|
| Balance as of March 31, 2002 | 201 | 22 | 354 | 589 | 198 | (100) | 1,264 |
| New/expansion | 10 | 1 | 19 | 17 | 62 | 237 | 346 |
| Sale/redemption | (2) | (2) | | (33) | (48) | (9) | (94) |
| Share in results | 5 | | | | | | 5 |
| Revaluation | (6) | (4) | (53) | (91) | (42) | | (196) |
| Dividends received | (2) | | | | | | (2) |
| Exchange rate differences and other | (8) | 1 | (9) | | (18) | | (34) |
| | <u>198</u> | <u>18</u> | <u>311</u> | <u>482</u> | <u>152</u> | <u>128</u> | <u>1,289</u> |

Triple A bonds and deposits are available on call to the Company.

Movements relating to revaluations had virtually no effect on the result on account of the hedging policy.

The fair value of Financial fixed assets does not differ materially from the disclosed book value.

KLM has carryforward losses to an amount of EUR 570 million relating to losses incurred in The Netherlands and abroad. These losses may be carried forward and offset against future income indefinitely. A deferred tax asset is recognized to an amount of EUR 188 million under Deferred taxes.

The deferred tax assets and liabilities can be explained as follows:

| | <u>March 31, 2003</u> | | <u>March 31, 2002</u> | |
|--------------|-----------------------|--------------------|-----------------------|--------------------|
| | <u>Assets</u> | <u>Liabilities</u> | <u>Assets</u> | <u>Liabilities</u> |
| Fixed assets | 8 | 69 | 5 | 58 |

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| | | | | |
|--------------------------------|------------|------------|------------|------------|
| Current assets | 3 | 20 | | 53 |
| Deferred liabilities | 30 | | 20 | |
| Provisions | 26 | 66 | | 50 |
| Current liabilities | | | 30 | |
| Carryforward loss compensation | 188 | | | |
| Other items | 86 | 58 | 49 | 43 |
| | <u>341</u> | <u>213</u> | <u>104</u> | <u>204</u> |
| Net tax position | 128 | | | 100 |

Current assets

4. Operating supplies

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|-----------------------|---------------------------|---------------------------|
| Maintenance materials | 160 | 207 |
| Various supplies | 62 | 50 |
| | <u>222</u> | <u>257</u> |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Accounts receivable**

| | March 31, 2003 | March 31, 2002 |
|---------------------------|---------------------------|---------------------------|
| Debtors | 745 | 944 |
| Receivables from holdings | 3 | 2 |
| Value added tax | 37 | 20 |
| Prepaid expenses | 213 | 267 |
| | <u>998</u> | <u>1,233</u> |

Accounts receivable are stated net of a provision for bad debts of EUR 25 million (last fiscal year EUR 34 million).

The item Debtors as of March 31, 2002 included an amount of EUR 100 million receivable from Alitalia in respect of KLM's contribution to the cost of developing Malpensa Airport, Italy. This item was settled in fiscal year 2002/2003 as part of the award in the arbitration between KLM and Alitalia concerning the termination of their alliance as of April 28, 2000.

6. Cash

| | March 31, 2003 | March 31, 2002 |
|----------------------------------|---------------------------|---------------------------|
| Time deposits | 506 | 974 |
| Cash on hand and demand deposits | 102 | 53 |
| | <u>608</u> | <u>1,027</u> |

As a result of transfer formalities and scarcity of foreign currency, EUR 15 million in cash (last fiscal year EUR 6 million) is not freely transferable from foreign establishments.

7. Current liabilities

| | March 31, 2003 | March 31, 2002 |
|--|---------------------------|---------------------------|
| Current maturities of long-term debt: | | |
| - concerning financial lease commitments | 251 | 139 |
| - concerning other long-term debt | 65 | 24 |
| Unearned revenues | 548 | 672 |
| Creditors | 532 | 518 |
| Taxes and benefit premiums | 29 | 38 |
| Accruals and other current liabilities | 765 | 701 |
| | <u>2,190</u> | <u>2,092</u> |



Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Long-term debt**

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|---|-----------------------|-----------------------|
| Perpetual debt | | |
| Subordinated perpetual loans | 544 | 591 |
| Other long-term debt | | |
| Bank loans | 21 | 16 |
| Financial lease commitments | 3,295 | 3,645 |
| Other loans | 427 | 328 |
| | <u>3,743</u> | <u>3,989</u> |
| of which maturing in 2003/2004 and 2002/2003 respectively | <u>316</u> | <u>163</u> |
| | <u>3,427</u> | <u>3,826</u> |
| | <u>3,971</u> | <u>4,417</u> |

Subordinated loans

In certain circumstances, KLM has the right to redeem the subordinated perpetual loans, with or without payment of a premium.

These loans are subordinated to all other existing and future KLM debts. The subordinations are equal in rank.

Financial lease commitments

As of March 31, 2003, loans to financing institutions, which are deducted from the financial lease commitments, amounted to EUR 317 million (last fiscal year EUR 382 million).

Covenants

Several loans, including subordinated perpetual loans, can be called if KLM can no longer be regarded as the most important Dutch international airline. Pari-passu clauses have been agreed for a number of loans. With regard to a number of other loans included under Long-term debt, KLM has undertaken not to encumber the aircraft and real estate legally owned now or in the future without prior consent of the lenders.

| Term | Redemption through 5 years | Redemption after 5 years | Perpetual | Total |
|------------------------------|---|---|------------------|--------------|
| Subordinated perpetual loans | | | 544 | 544 |
| Financial lease commitments | 1,557 | 1,487 | | 3,044 |
| Other loans | 172 | 211 | | 383 |
| | <u>1,729</u> | <u>1,698</u> | <u>544</u> | <u>3,971</u> |
| March 31, 2003 | <u>1,729</u> | <u>1,698</u> | <u>544</u> | <u>3,971</u> |
| | <u>1,482</u> | <u>2,344</u> | <u>591</u> | <u>4,417</u> |
| March 31, 2002 | <u>1,482</u> | <u>2,344</u> | <u>591</u> | <u>4,417</u> |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Long-term debt (Continued)****Interest rates**

The financing benefits including the effects of derivatives amortized are included in the average interest rates.

| | <u>Variable interest loans</u> | <u>Fixed interest loans</u> | <u>Average variable rate</u> | <u>Range of fixed rates</u> | <u>Average rate</u> |
|------------------------------|--|-------------------------------------|--------------------------------------|-------------------------------------|-------------------------|
| Subordinated perpetual loans | 68 | 476 | 2.6 | 4.5 - 5.8 | 4.7 |
| Financial lease commitments | 1,326 | 1,718 | 3.8 | 4.5 - 11.3 | 4.9 |
| Other loans | 58 | 325 | 1.4 | 1.2 - 6.6 | 4.4 |
| | <u>1,452</u> | <u>2,519</u> | | | |
| March 31, 2003 | 1,452 | 2,519 | | | |
| | <u>1,660</u> | <u>2,757</u> | | | |
| March 31, 2002 | 1,660 | 2,757 | | | |

Variable interest rates are based on London and Euro Interbank Offered Rates.

Currencies

The amounts stated in the table below including the effects of derivatives are presented in millions of euros for each currency.

| | <u>EUR</u> | <u>USD</u> | <u>JPY</u> | <u>CHF</u> | <u>GBP</u> | <u>Total</u> |
|------------------------------|--------------|--------------|------------|------------|------------|--------------|
| Subordinated perpetual loans | 259 | | | 285 | | 544 |
| Financial lease commitments | 2,156 | 766 | | | 122 | 3,044 |
| Other loans | 290 | 92 | | | 1 | 383 |
| | <u>2,705</u> | <u>858</u> | | <u>285</u> | <u>123</u> | <u>3,971</u> |
| March 31, 2003 | 2,705 | 858 | | 285 | 123 | 3,971 |
| | <u>2,660</u> | <u>1,199</u> | <u>73</u> | <u>331</u> | <u>154</u> | <u>4,417</u> |
| March 31, 2002 | 2,660 | 1,199 | 73 | 331 | 154 | 4,417 |

Fair value of long-term debt

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|-----------------------------------|---------------------------|---------------------------|
| Subordinated perpetual loans | 499 | 471 |
| Financial lease commitments | 3,222 | 3,373 |
| of which maturing within one year | 251 | 139 |
| Other long-term debt | 177 | 267 |
| of which maturing within one year | 65 | 24 |

The fair value estimates referred to above are based on the present value of the debt (including the effects of derivatives) based on a current interest rate.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Provisions**

| | March 31, 2002 | Charges | Additions | March 31, 2003 |
|----------------------------------|-------------------|-----------|------------|----------------------|
| Postretirement health costs | 67 | 5 | 7 | 69 |
| Early retirement provision | 17 | 8 | 22 | 31 |
| Other staff commitments | 73 | 16 | 15 | 72 |
| Frequent flyer program | 20 | | 4 | 24 |
| Reorganization and restructuring | | | 75 | 75 |
| | <u>177</u> | <u>29</u> | <u>123</u> | <u>271</u> |

The Postretirement health costs provision relates to health insurance contributions payable in respect of retired employees.

In accordance with the collective labor agreement, an Early retirement provision has been formed in respect of existing early retirement entitlements.

Other staff commitments include commitments in respect of redundancy and supplementary schemes.

The provision for the Frequent flyer program represents the estimated commitments in respect of the KLM loyalty program.

The Reorganization and restructuring provision relates to the estimated staff redundancy costs for the plans announced on March 31, 2003, and which had been communicated to those concerned before the preparation of these financial statements.

With the exception of the Reorganization and restructuring provision, provisions are mainly long-term in nature.

10. Deferred credits

| | March 31, 2003 | March 31, 2002 |
|---|-------------------|-------------------|
| Investment incentive grants received under the Investment Account Act | 20 | 30 |
| Items related to aircraft financing | 236 | 235 |
| | <u>256</u> | <u>265</u> |

The investment incentive grants received under the Investment Account Act included under this heading relate to the grants claimed before the amendment of the Act as of May 1, 1986.

Items related to aircraft financing relate to the upfront financing benefits to be amortized.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. Stockholders' equity**

For a break-down of Stockholders' equity, please refer to Note 35.

12. Commitments and contingent liabilities***Commitments for tangible fixed assets on order or under construction***

As of March 31, 2003, KLM had commitments for previously placed orders of EUR 1,087 million (last fiscal year EUR 677 million). Of this amount EUR 1,042 million related to aircraft (last fiscal year EUR 639 million), of which EUR 516 million is due in fiscal year 2003/2004. The remainder of the commitments as of March 31, 2003 amounted to EUR 45 million (last fiscal year EUR 38 million) and related to other tangible fixed assets.

Contingent liabilities regarding fleet retirement

For a number of aircraft held under operational leases, there is a contractual obligation to the lessor to redeliver the aircraft in accordance with an agreed maintenance state. Any costs incurred for the fulfillment of this obligation will depend in part on the flight hours of the aircraft to the end of fiscal year 2008/2009 and cannot be reasonably estimated at present.

Rental agreements

KLM has long-term rental commitments amounting to EUR 1,517 million (last fiscal year EUR 752 million). Commitments for the next five fiscal years and thereafter:

| | Operational leases of aircraft | Rental of buildings |
|-----------------|---|--------------------------------|
| | <hr/> | <hr/> |
| 2003/2004 | 190 | 37 |
| 2004/2005 | 203 | 26 |
| 2005/2006 | 182 | 24 |
| 2006/2007 | 149 | 20 |
| 2007/2008 | 95 | 17 |
| after 2007/2008 | 355 | 219 |

13. Lawsuits

KLM and its consolidated holdings are involved in various legal actions. Although the outcome of these actions cannot be predicted, on the basis of information currently available and views expressed by counsel KLM does not expect their outcome to adversely affect the financial position of the company to any material degree.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****14. Derivatives and risk management**

The table below indicates the notional amounts of forward exchange contracts, interest rate and currency swap contracts and fuel collar and swap contracts. In principle, the terms of the contracts are equal to the terms of the positions hedged. These derivatives are used to ensure that financings are concluded in the currency required and to reduce interest risks resulting from financings and investments to levels acceptable to KLM. Derivatives are also used to hedge the currency risks on all or part of the operating and investment cash flow and to limit the price risk on fuel purchases.

| | Notional amount March 31 | | Fair value March 31 | |
|----------------------------------|-----------------------------|-------|------------------------|------|
| | 2003 | 2002 | 2003 | 2002 |
| Forward exchange contracts | 2,519 | 1,014 | (55) | 47 |
| Interest-currency swap contracts | 1,403 | 1,383 | 274 | 454 |
| Interest rate swap contracts | 1,907 | 1,975 | (11) | 19 |
| Fuel collar and swap contracts | 368 | 545 | (11) | (16) |
| | | | 197 | 504 |

The fair value of the above derivatives is recognized in KLM's balance sheet under Financial fixed assets (EUR 482 million) and Long-term debt (EUR 285 million). In view of the purpose for which they are held, derivatives may be qualified as follows:

| | March 31, 2003 | March 31, 2002 |
|---------------------|-------------------|-------------------|
| Cash flow hedges | 4 | 57 |
| Fair value hedges | 188 | 441 |
| No hedge accounting | 5 | 6 |
| Fair value | 197 | 504 |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Operating revenues****15. Traffic revenue**

| | For the Years Ended March 31, | | |
|--------------------|-------------------------------|--------------|--------------|
| | 2003 | 2002 | 2001 |
| Passengers | 4,210 | 4,267 | 4,527 |
| Cargo | 1,017 | 1,016 | 1,109 |
| Charter / Low Cost | 553 | 543 | 490 |
| | <u>5,780</u> | <u>5,826</u> | <u>6,126</u> |

16. Other revenue

| | For the Years Ended March 31, | | |
|--------------------------------------|-------------------------------|------------|------------|
| | 2003 | 2002 | 2001 |
| Maintenance and other technical work | 280 | 273 | 273 |
| Cargo and mail handling | 40 | 39 | 131 |
| Tax-free sales | 115 | 107 | 104 |
| Aircraft handling | 105 | 92 | 93 |
| Miscellaneous | 165 | 195 | 233 |
| | <u>705</u> | <u>706</u> | <u>834</u> |

These services have been rendered mainly in The Netherlands.

17. Operating expenses

| | For the Years Ended March 31, | | |
|-------------------------------------|-------------------------------|-------|-------|
| | 2003 | 2002 | 2001 |
| Salaries and benefits | 1,907 | 1,747 | 1,675 |
| Aircraft fuel | 886 | 983 | 1,038 |
| Materials and consumables | 448 | 470 | 465 |
| Commercial costs | 499 | 506 | 593 |
| Landing fees and navigation charges | 541 | 524 | 515 |
| Third-party handling costs | 208 | 231 | 222 |
| Work by third parties | 489 | 455 | 535 |
| Depreciation | 535 | 487 | 429 |

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| | | | |
|---|--------------|--------------|--------------|
| Operational aircraft lease expenses | 171 | 226 | 187 |
| Cost of housing, vehicles and inventories | 186 | 180 | 211 |
| Commercial cooperation | 117 | 176 | 214 |
| Ad hoc and short-term aircraft/truck rentals | 99 | 153 | 153 |
| Hired personnel | 108 | 116 | 137 |
| Other operating expenses | 424 | 372 | 309 |
| Reorganization costs ⁽¹⁾ | 75 | | |
| Costs arising from arbitration in legal dispute between KLM and Alitalia ⁽¹⁾ | 276 | | |
| | <u>6,969</u> | <u>6,626</u> | <u>6,683</u> |

(1) These costs of exceptional nature were previously classified as extra-ordinary items, see note 29
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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****18. Salaries**

| | For the Years Ended March 31, | | |
|----------------------------|--------------------------------------|--------------|--------------|
| | 2003 | 2002 | 2001 |
| Salaries | 1,510 | 1,449 | 1,329 |
| Benefits | 167 | 154 | 199 |
| Pension fund contributions | 230 | 144 | 147 |
| | <u>1,907</u> | <u>1,747</u> | <u>1,675</u> |

The increase in Pension fund contributions was due largely to higher basic contributions and higher prepension and retirement charges. Pension fund contributions also include the positive effects of the restitution of ground staff pension fund surpluses to an amount of EUR 46 million (last fiscal year EUR 53 million).

During the fiscal year KLM and its Group companies employed combined average workforce of 33,038 full-time equivalents (last fiscal year 33,265 full-time equivalents), as follows:

| | For the Years Ended March 31, | | |
|--------------------------------------|--------------------------------------|---------------|---------------|
| | 2003 | 2002 | 2001 |
| Ground staff in The Netherlands | 18,255 | 17,951 | 17,600 |
| Ground staff outside The Netherlands | 4,848 | 5,421 | 6,439 |
| Flight staff | 9,935 | 9,893 | 9,724 |
| | <u>33,038</u> | <u>33,265</u> | <u>33,763</u> |

19. Depreciation and amortization

| | For the Years Ended March 31, | | |
|---|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Amortization of intangible fixed assets | 17 | 12 | 10 |
| Depreciation of aircraft and spare components | 382 | 383 | 330 |
| Write down/impairment | 78 | 17 | |
| Depreciation of other tangible fixed assets | 84 | 90 | 99 |
| | <u>561</u> | <u>502</u> | <u>439</u> |
| Amortization of deferred credits | (26) | (15) | (10) |
| | <u>535</u> | <u>487</u> | <u>429</u> |

20. Financial income and expense

| | For the Years Ended March 31, | | |
|---|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Interest income from financial fixed assets | 20 | 39 | 59 |
| Other interest income | 11 | 21 | 12 |
| Changes in the value of marketable securities | 15 | (2) | (1) |
| Interest expense | (155) | (193) | (212) |
| Capitalized interest incurred through advance payments on tangible fixed assets | 11 | 2 | 4 |
| Unrealized results on derivatives | | (1) | |
| | — | — | — |
| | (98) | (134) | (138) |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****21. Results on sale of assets**

The 2002/2003 loss on sale of assets of EUR 42 million relates to principally to the sale of aircraft (EUR 33 million) and the sale of KLM uk s low cost buzz activities (EUR 9 million), which were sold on April 11, 2003.

22. Results of holdings

| | For the Years Ended March 31, | | |
|------------------|-------------------------------|------|------|
| | 2003 | 2002 | 2001 |
| Aviation | 1 | (14) | (17) |
| Aviation-related | (8) | (1) | |
| Other holdings | 3 | | (4) |
| | — | — | — |
| | (4) | (15) | (21) |
| | ■ | ■ | ■ |

23. Results on sale of holdings

Results on sale of holdings relates to the sale of aviation-related holdings and other holdings.

24. Taxes

The effective tax burden differs from the current tax rate (34.5%). For 2002/2003 the effective tax rate was 33%. The difference between the effective and standard rate can be explained as follows:

| | For the Years Ended March 31, | | |
|-----------------------------|-------------------------------|------|------|
| | 2003 | 2002 | 2001 |
| Standard rate taxation | 214 | 79 | (52) |
| Participation exemption | 1 | (1) | (6) |
| Foreign tax issues | (13) | (13) | (12) |
| Other permanent differences | 4 | 3 | (3) |
| | — | — | — |
| Effective rate taxation | 206 | 68 | (73) |
| | ■ | ■ | ■ |

25. Extraordinary items after tax

Note has been deleted, please refer to note 29

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****26. Segmentation**

The segmental breakdown is based on the classification of KLM's four core activities and accountability areas as agreed upon in fiscal year 2002/2003. The classification differs slightly from the segmentation presented in previous fiscal years. Figures for 2001/2002 have been restated for comparative purposes.

The segment Other includes the cost of shared-services, such as overheads and certain expense and revenue items that are not attributable to the core activities. The decline in operating income in this segment was due chiefly to higher pre-pension and retirement costs, higher insurance premiums and the compensation received from the Dutch government in 2001/2002 in connection with the closure of U.S. airspace in the period September 11 - 14, 2001.

| 2002/2003 | Passenger | Cargo | Engineering & Maintenance | Charter / Low Cost | All other | Elimination of inter- segments | Total consolidated |
|--|--------------|--------------|---------------------------------|-----------------------------|--------------|--------------------------------------|-----------------------|
| Operating revenues | | | | | | | |
| Operating revenues from external customers | 4,425 | 1,068 | 329 | 590 | 73 | | 6,485 |
| Intersegment revenues | 553 | 31 | 639 | | 151 | (1,374) | |
| | 4,978 | 1,099 | 968 | 590 | 224 | (1,374) | 6,485 |
| Operating expenses⁽¹⁾ | 5,003 | 1,027 | 927 | 592 | 794 | (1,374) | 6,969 |
| Operating income (loss) | (25) | 72 | 41 | (2) | (570) | | (484) |
| Interest revenue | | | | | | | 46 |
| Results of holdings | | | | | | | 2 |
| Other | | | | | | | (186) |
| Pretax income (loss) | | | | | | | (622) |
| Taxes | | | | | | | 206 |
| After tax income (loss) | | | | | | | (416) |
| Share of third parties | | | | | | | |
| Net income (loss) | | | | | | | (416) |
| Total assets | 4,474 | 254 | 666 | 751 | 2,020 | | 8,165 |
| Total liabilities | 4,308 | 168 | 632 | 614 | 710 | | 6,432 |
| Commitments for tangible fixed assets on order or under construction | 705 | 225 | 11 | 120 | 26 | | 1,087 |
| Capital expenditure | 554 | 222 | 19 | 116 | 28 | | 939 |
| Depreciation and amortization | 426 | 14 | 33 | 28 | 34 | | 535 |

(1) Operating expenses includes a write down of EUR 78 million for the Boeing 747-300 fleet: Passenger EUR 58 million, Cargo EUR 20 million

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Table of Contents**KLM ROYAL DUTCH AIRLINES**

| 2001/2002 | Passenger | Cargo | Engineering & Maintenance | Charter / Low Cost | All other | Elimination of inter- segments | Total consolidated | |
|---|---|--------------|--|----------------------------------|------------------------------------|---|-----------------------------------|-------------------------------|
| Operating revenues | | | | | | | | |
| Operating revenues from external customers | 4,485 | 1,067 | 288 | 565 | 127 | | 6,532 | |
| Intersegment revenues | 567 | | 675 | | 146 | (1,388) | | |
| | 5,052 | 1,067 | 963 | 565 | 273 | (1,388) | 6,532 | |
| Operating expenses | 5,193 | 1,020 | 912 | 574 | 315 | (1,388) | 6,626 | |
| Operating income (loss) | (141) | 47 | 51 | (9) | (42) | | (94) | |
| Interest revenue | | | | | | | 58 | |
| Results of holdings | | | | | | | (6) | |
| Other | | | | | | | (182) | |
| Pretax income (loss) | | | | | | | (224) | |
| Taxes | | | | | | | 68 | |
| After tax income (loss) before extraordinary items | | | | | | | (156) | |
| Extraordinary items after tax | | | | | | | | |
| Net income (loss) | | | | | | | (156) | |
| Total assets | 4,908 | 298 | 641 | 576 | 2,520 | | 8,943 | |
| Total liabilities | 4,866 | 206 | 590 | 413 | 611 | | 6,686 | |
| Commitments for tangible fixed assets on order or under construction | 11 | 423 | 1 | 217 | 25 | | 677 | |
| Capital expenditure | 192 | 3 | 3 | 2 | 35 | | 235 | |
| Depreciation and amortization | 369 | 27 | 31 | 29 | 31 | | 487 | |
| 2000/2001 | Passenger incl. KLM cityhopper | Cargo | Engineering & Maintenance | Consolidated holdings | All other⁽¹⁾ | Cash and marketable securities⁽²⁾ | Eliminations of inter- | Total consolidated |
| Operating revenues | | | | | | | | |
| Operating revenues from external customers | 4,545 | 1,178 | 273 | 964 | | | | 6,960 |
| Intersegment revenues | 540 | | 536 | 350 | | | (1,426) | |
| | 5,085 | 1,178 | 809 | 1,314 | | | (1,426) | 6,960 |
| Operating expenses | 5,117 | 1,047 | 755 | 1,271 | (81) | | (1,426) | 6,683 |
| Operating income | (32) | 131 | 54 | 43 | 81 | | | 277 |
| Interest revenue | | | | | | | | 70 |
| Results of holdings | | | | | | | | (17) |
| Other | | | | | | | | (181) |

| | | | | | | | |
|---|-------|-----|-----|-------|-----|-----|------------|
| Pretax income | | | | | | | 149 |
| Taxes | | | | | | | (73) |
| After tax income | | | | | | | 76 |
| Share of third parties | | | | | | | 1 |
| Net income | | | | | | | 77 |
| Total assets | 3,644 | 278 | 680 | 2,212 | 931 | 845 | 8,590 |
| Commitments for tangible fixed assets on order or under construction | 118 | 0 | 1 | 521 | 8 | | 648 |
| Capital expenditure | 337 | 8 | 15 | 237 | 13 | | 610 |
| Depreciation and amortization | 240 | 15 | 28 | 115 | 31 | | 429 |

- (1) All other includes other KLM Company departments and unallocated gains and losses
- (2) Cash and marketable securities are stated separately because they form a significant part of total assets

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Table of Contents**KLM ROYAL DUTCH AIRLINES****26. Segmentation (Continued)****Consolidated information by geographic area (route areas)**

In millions of euros

| | March 31, 2003 | | | March 31, 2002 | | | March 31, 2001 | | |
|-------------------------------|----------------------|---|---------------------------------------|----------------------|---|---------------------------------------|----------------------|---|---------------------------------------|
| | Operating revenue | Tangible/ Intangible fixed assets ⁽¹⁾ | Capital expenditure ⁽¹⁾ | Operating revenue | Tangible/ Intangible fixed assets ⁽¹⁾ | Capital expenditure ⁽¹⁾ | Operating revenue | Tangible/ Intangible fixed assets ⁽¹⁾ | Capital expenditure ⁽¹⁾ |
| Europe | 2,496 | 1,450 | 138 | 2,427 | 1,980 | 124 | 2,602 | 2,414 | 332 |
| North Atlantic | 1,032 | | | 1,118 | | | 1,338 | | |
| Asia Pacific | 1,200 | | | 1,318 | | | 1,350 | | |
| Central and South Atlantic | 535 | | | 572 | | | 508 | | |
| Middle East/South Asia | 413 | | | 335 | | | 460 | | |
| Africa | 542 | | | 494 | | | 442 | | |
| All Other | 267 | 3,598 | 801 | 268 | 3,180 | 111 | 260 | 2,887 | 278 |
| Total consolidated | 6,485 | 5,048 | 939 | 6,532 | 5,160 | 235 | 6,960 | 5,301 | 610 |

27. Related-party transactions

As part of its normal activities, KLM enters into arm's length transactions with related parties in respect of the temporary chartering of aircraft and the financing of certain minority holdings.

- (1) KLM's tangible fixed assets consist principally of aircraft. The narrow body fleet is flown in the European route area only and can therefore be disclosed separately. The wide body fleet is mobile across geographical markets and is therefore included at book value under Other

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KLM ROYAL DUTCH AIRLINES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

28. Differences between Netherlands GAAP and US GAAP

The Netherlands accounting principles (Netherlands GAAP) applied in the preparation of the Consolidated Financial Statements of the Company differ in some respects from those generally accepted in the United States (US GAAP). It is noted that KLM's accounting policy for post-retirement benefits other than pensions and the policy for derivatives and hedge accounting as applied in the consolidated Financial Statements follow SFAS 106 and SFAS 133/138 respectively.

On April 11, 2003, the company sold KLM UK's low fare business, buzz, to Ryanair. Under Netherlands GAAP, the company recorded a loss of 9 million in fiscal year 2002/03 to reflect the net effect of sales proceeds to be received from Ryanair, costs arising from arrangements under the buzz sales agreement (which can be characterized as impairment losses on certain fleet assets) and staff redundancy costs to be borne by KLM UK in connection with the transaction.

Under Netherlands GAAP the sale of the buzz operation is not considered as a discontinued operation since KLM has not disposed of a significant separate activity as defined under Netherlands GAAP. KLM is still operating a low cost business segment consisting of Transavia's Basiqair. Under US GAAP, buzz is considered as a discontinued operation from April 11, 2003 as it qualifies as a component of an entity under SFAS 144. The financial statements have been amended to reflect this discontinued operation, please refer to note 29 for further explanation thereof. Buzz was part of KLM's charter/low cost business segment.

Certain costs, including impairment charges, totalling 9 million were recognized in 2002/03. The sales proceeds (20 million), less book value of related assets (1 million), less relating operating costs, including termination benefits, were recognized in April 2003 and netted out to be approximately zero.

Operating revenues from the discontinued operation for the years ended March 31, 2003, 2002 and 2001 were 118 million, 120 million and 91 million respectively.

Pretax losses from the discontinued operation for the years ended March 31, 2003, 2002 and 2001 were 33 million, 30 million and 55 million respectively.

Other differences which have a material effect on the financial statements

(1) Under Netherlands GAAP, goodwill acquired prior to March 31, 1994 was charged directly to equity. KLM now amortises goodwill over 5 to 10 years in response to the rapidly evolving environment in the airline industry. Under US GAAP goodwill and intangible assets with indefinite useful lives are no longer amortized but annually tested for impairment.

(2) Pension costs included in the Consolidated Statements of Earnings is computed in accordance with Netherlands GAAP. For the Company's defined benefit plans, those amounts are based on the actuarially determined premiums which the Company is required to pay, adjusted for restitutions of structural surpluses and discounts received by KLM from its pension funds. Pension expense for US GAAP purposes is determined in accordance with FASB Statement No. 87, Employer's Accounting for Pensions. The US GAAP adjustment is the difference between amounts recorded under Netherlands GAAP and pension expense as determined under SFAS No. 87.

SFAS 106 Postretirement benefits is already implemented in the Netherlands GAAP financial statements.

(3) Under Netherlands GAAP, KLM recognises an in-substance defeasance of certain financial lease commitments when the Company places deposits with financial institutions and matches the cash flows from the deposits with scheduled payments on the lease commitments through pledge and escrow agreements. Under US GAAP, debt can not be extinguished by providing arrangements designed to set aside assets dedicated to eventually settling a liability. The US GAAP adjustment increases financial fixed assets and lease commitments classified as other long-term debt. These financial fixed assets are restricted solely for the payment of the related lease commitments.

(4) Under Netherlands GAAP, KLM formed a provision for reorganization and restructuring related to the estimated staff redundancy costs for the plans announced on March 31, 2003. Under US GAAP costs of this nature generally are recorded when they are incurred. The reorganization costs recognized under Netherlands GAAP do not meet the criteria of recognition under US GAAP. Consequently charges against this provision in later years are reconciled in net income for US GAAP purposes.

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(5) Under Netherlands GAAP the cumulative effects of changes in accounting policies were included as direct movements in Other reserves in fiscal year 2001/2002. Under US GAAP the effects of changes in accounting policies are included in income. Furthermore, Netherlands GAAP allows direct equity movements in a limited number of circumstances. US GAAP however has severe restrictions with respect to the application of direct equity movements. Consequently some direct equity movements under Netherlands GAAP need to be included in earnings under US GAAP. Retroactive application of the accounting change would have had a limited impact on (pro forma) net income for the year 2000/2001.

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)**

The following tables summarise the effects of US GAAP differences on the net income, stockholders' equity, intangible fixed assets, financial fixed assets, deferred taxes, prepaid expenses, current liabilities, long-term debt and provisions (in millions, except per share data):

| | For the years ended March 31, | | |
|--|-------------------------------|---------------------------|---------------|
| | 2003 | 2002 | 2001 |
| Net income | | | |
| Net income in conformity with Netherlands GAAP | (416) | (156) | 77 |
| (1) Goodwill | (1) | (3) | (3) |
| (2) Pensions | 172 | 168 | 211 |
| (4) Reorganization provision | 75 | (25) | (88) |
| (5) Adjustment in respect of direct equity movements | (12) | (9) | |
| (5) Changes in accounting policies | | 109 | |
| (6) Income tax effect | (85) | (86) | (43) |
| | <u>149</u> | <u>154</u> | <u>77</u> |
| Total adjustments | | | |
| Net income in conformity with US GAAP | (267) | (2) | 154 |
| | <u>(234)</u> | <u>28</u> | <u>209</u> |
| Result from continuing operations | | | |
| Result from discontinued operations | (33) | (30) | (55) |
| | <u>(267)</u> | <u>(2)</u> | <u>154</u> |
| Net income in conformity with US GAAP | | | |
| Net Income per common share ^(1,2) (restated, see note 29) | | | |
| Basic | (5.97) | (0.08) | 3.30 |
| Diluted | (5.97) | (0.08) | 3.30 |
| Income from continuing operations per common share ^(1,2) | | | |
| Basic | (5.23) | 0.57 | 4.49 |
| Diluted | (5.23) | 0.57 | 4.49 |
| Income from discontinued operations per common share ⁽²⁾ | | | |
| Basic | (0.74) | (0.65) | (1.19) |
| Diluted | (0.74) | (0.65) | (1.19) |
| Average number of common shares outstanding ⁽²⁾ (restated, see note 29) | | | |
| (in thousands of shares) | | | |
| Basic | 45,071 | 45,682 | 46,133 |
| Diluted | 45,071 | 45,682 | 46,133 |
| | <u>45,071</u> | <u>45,682</u> | <u>46,133</u> |
| Stockholders' equity | March 31, 2003 | March 31, 2002 | |
| Stockholders' equity in conformity with Netherlands GAAP | 1,476 | 1,992 | |
| (1) Goodwill | 4 | 5 | |
| (2) Pensions | 2,010 | 1,876 | |
| (4) Reorganization provision | 75 | 0 | |
| (6) Income tax effect | (738) | (653) | |
| | <u>1,351</u> | <u>1,228</u> | |
| Total adjustments | | | |
| Stockholders' equity in conformity with US GAAP | 2,827 | 3,220 | |
| | <u>2,827</u> | <u>3,220</u> | |

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The results of sale of assets and results of sale of holdings are presented as separate line items below operating income under Netherlands GAAP. Under US GAAP, these results are included in operating income.

- (1) Taking account of other beneficiaries in results and equity
- (2) Earnings per share calculations for the year ended March 31, 2003 are exclusive of any shares held by KLM. Outstanding shares used for the earnings per share calculations are based on the weighted average outstanding shares during the year. The earnings per share figures for each of the years ended March 31, 2002 and March 31, 2001 have been restated as explained in note 29.

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)**

| | March 31, 2003 | March 31, 2002 |
|--|---------------------------|---------------------------|
| Intangible fixed assets | | |
| Intangible fixed assets in conformity with Netherlands GAAP | 66 | 56 |
| (1) Goodwill | 4 | 5 |
| Intangible fixed assets in conformity with US GAAP | 70 | 61 |
| Financial fixed assets | | |
| Financial fixed assets in conformity with Netherlands GAAP | 1,289 | 1,264 |
| Reclassification of deferred tax position | (128) | 100 |
| (3) In-substance defeasance of lease obligations | 317 | 382 |
| Financial fixed assets in conformity with US GAAP | 1,478 | 1,746 |
| Deferred taxes | | |
| Net deferred tax position in conformity with Netherlands GAAP | 128 | (100) |
| (2) Income tax effect on OCI movement with regard to minimum pension liability | 13 | |
| (6) Income tax effect | (738) | (653) |
| Net deferred tax liability in conformity with US GAAP | (597) | (753) |
| Prepaid expenses | | |
| Prepaid expenses in conformity with Netherlands GAAP | 213 | 267 |
| (2) Pension costs | 1,973 | 1,876 |
| Prepaid expenses in conformity with US GAAP | 2,186 | 2,143 |
| Current liabilities | | |
| Current liabilities in conformity with Netherlands GAAP | 2,190 | 2,092 |
| (2) Pension costs | (7) | |
| Current liabilities in conformity with US GAAP | 2,183 | 2,092 |

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| Long-term debt | March 31, 2003 | March 31, 2002 |
|--|---------------------------|---------------------------|
| Other long-term debt in conformity with Netherlands GAAP | 3,427 | 3,826 |
| (3) In-substance defeasance of lease obligations | 317 | 382 |
| Other long-term debt in conformity with US GAAP | 3,744 | 4,208 |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)**

| Provisions | March 31, 2003 | March 31, 2002 |
|--|-------------------|-------------------|
| Provisions in conformity with Netherlands GAAP | 271 | 177 |
| (2) Early retirement provision | (17) | |
| (5) Reorganization provision | (75) | |
| | 179 | 177 |

The following are additional disclosures to comply with generally accepted accounting principles in the United States of America:

Accounting for leases (SFAS 13 / SFAS 125)

KLM has entered into several cross-border financial lease transactions. In general these transactions involve the purchase of an aircraft by a tax paying investor (the lessor) and the simultaneous contracting by KLM (lessee) for the use of the aircraft in return for specified rental payments over a specific term of 12 to 15 years. Notwithstanding the ownership of the aircraft by the lessor, KLM wants to be able to control and operate the aircraft in the same manner as it would if it was the owner.

The leveraged cross-border lease is a variation that introduces a third party lender into the transaction. The lessor, in conjunction with the lessee, will seek to finance 50-90 per cent of the asset's cost by borrowing the funds on a non-recourse basis from banks. While the lessor actually invests only 10-50 percent of the cost of the aircraft, it will be entitled to 100 per cent of the tax benefits of ownership and thus can be said to have leveraged its equity investment by utilizing the non-recourse borrowing. The advantage of the lessor in such circumstances is in part transferred to KLM resulting in lower rental payments.

KLM concluded (leveraged) cross-border capital leases for a total of 72 aircraft, where the risk and return of ownership remains with KLM as lessee.

As per March 31, 2003 and 2002 the Company had financial lease commitments for EUR 3,612 million and EUR 4,027 million, respectively.

The redemption of financial leases for each of the following fiscal years are (in millions):

| | |
|-----------------|-------|
| 2003/2004 | 285 |
| 2004/2005 | 152 |
| 2005/2006 | 399 |
| 2006/2007 | 493 |
| 2007/2008 | 700 |
| after 2007/2008 | 1,583 |

As of March 31, 2003 and 2002 the book value of assets (aircraft) for which financial lease commitments have been concluded amounted to EUR 2,538 million and EUR 2,839 million, respectively.

The majority of the financial lease commitments had fixed interest rates which ranged from 4.5% to 11.3%. Variable rate commitments averaged, after taking interest rate contracts into account, 3.8% for fiscal 2002/2003. The overall average interest percentage on financial lease commitments was 4.9%.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Disclosure on the fair value of financial instruments (SFAS 107)**

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price, if one exists. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. Although management uses its best judgement in estimating the fair value of these financial instruments, there are inherent weaknesses in any estimation technique. Therefore the estimates presented are not necessarily indicative of the amounts that the Company could realise in a current market exchange or the value that ultimately will be realised by the Company upon maturity or disposition.

The following table summarises the carrying amounts and estimated fair values of the Group's financial instruments:

| | March 31, 2003 | | March 31, 2002 | |
|--------------------------------|-----------------|----------------------|-----------------|----------------------|
| | Carrying amount | Estimated fair value | Carrying amount | Estimated fair value |
| Assets | | | | |
| Financial fixed assets | | | | |
| - Receivables from holdings | 18 | 18 | 22 | 22 |
| - Triple A bonds/deposits | 311 | 371 | 354 | 395 |
| - Derivatives | 482 | 482 | 589 | 589 |
| - Other financial fixed assets | 152 | 152 | 198 | 217 |
| Marketable securities | | | 2 | 2 |
| Cash | 608 | 608 | 1,027 | 1,027 |
| Liabilities | | | | |
| Perpetual debt | 544 | 499 | 591 | 471 |
| Financial lease commitments | 3,295 | 3,222 | 3,645 | 3,373 |
| - maturing within one year | (251) | (251) | (139) | (139) |
| Other long-term debt | 448 | 177 | 344 | 267 |
| - maturing within one year | (65) | (65) | (24) | (24) |
| Current liabilities | 2,190 | 2,190 | 2,092 | 2,092 |

Concentration of credit risk (SFAS 105)

Most of the holdings are air transport related holdings. As of March 31, 2003 and 2002 total holdings and receivables from holdings in air transport or related industries amounted to EUR 164 million and EUR 171 million respectively.

Of the commitments for tangible fixed assets on order or under construction, EUR 1,042 million and EUR 639 million as of March 31, 2003 and 2002 respectively, relates to aircraft. The advance payments on aircraft amounted to EUR 604 million and EUR 23 million as of March 31, 2003 and 2002, respectively.

Other disclosures concerning these statements are included in Item 11-Quantitative and qualitative disclosures about market risk.

Interest rates

Interest rates excluding the effects of derivatives are as follows:

| Average variable | Range of fixed | Average |
|------------------|----------------|---------|
|------------------|----------------|---------|

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| | <u>rate</u> | <u>rates</u> | <u>rate</u> |
|------------------------------|-------------|--------------|-------------|
| <i>2002/2003</i> | | | |
| Subordinated perpetual loans | | 5.25 - 5.75 | 5.44 |
| Financial lease commitments | 3.66 | 4.4 - 11.3 | 7.04 |
| Other loans | 1.40 | 1.2 - 6.6 | 4.40 |
| <i>2001/2002</i> | | | |
| Subordinated perpetual loans | | 5.25 - 5.75 | 5.43 |
| Financial lease commitments | 4.13 | 4.5 - 11.4 | 6.94 |
| Other loans | 2.55 | 1.15 - 9.25 | 5.55 |

See pages F-1 through F-48 and page S-1, which are incorporated by reference in this annual report.

Income Taxes

Income before taxes based on Netherlands GAAP, but discussed in accordance with SFAS 109, is analysed over its component parts as follows:

| | For the years ended March 31, | | |
|-----------------|--------------------------------------|--------------|-------------|
| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| The Netherlands | (555) | (195) | 182 |
| Foreign | (67) | (29) | (32) |
| | <u>(622)</u> | <u>(224)</u> | <u>150</u> |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and U.S. GAAP (Continued)**

The components of income tax are as follows:

| | For the years ended March 31, | | |
|-----------------|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| The Netherlands | | | |
| Current taxes | (133) | (17) | |
| Deferred taxes | (63) | (54) | 74 |
| Foreign | | | |
| Current taxes | (10) | | |
| Deferred taxes | | 3 | |
| | <u>(206)</u> | <u>(68)</u> | <u>74</u> |

The components of income tax entirely relate to taxation on continuing operations.

A deferred tax benefit of EUR 20 million was recorded through other comprehensive income in 2002/2003.

The weighted average statutory tax rates reflected in the following table are computed by applying the applicable current rates to the Company's earnings in each country.

A reconciliation of the provision for income taxes based on the weighted average rates with the effective tax rate is summarised below:

| | For the years ended March 31, | | |
|---|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| | % | % | % |
| Weighted average percentage, based on current tax rates (benefit) | 34.5 | 35.0 | 35.0 |
| Tax effect of exempt income and non-deductible expenses | (2.5) | (5.0) | 14.0 |
| Effective tax (benefit) rates | <u>33.0</u> | <u>30.0</u> | <u>49.0</u> |

Deferred tax assets are recognized for net operating losses as it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets. Deferred tax balances relate substantially to continuing operations. The net tax benefits on the discontinued operation for the years ended March 31, 2003, 2002 and 2001 amounted to 15 million, 10 million and 19 million respectively and have been fully provided for.

The net deferred tax assets or liabilities are determined per fiscal entity. Offsetting of deferred tax assets and deferred tax liabilities within the same fiscal entity is restricted to deferred tax assets and liabilities that reverse in the same period.

Current and non-current deferred taxes, are included in the balance sheet under receivables in the event, and to the extent, that per fiscal entity total deferred tax assets exceed total deferred tax liabilities. Conversely, current and non-current deferred tax liabilities are included under provisions in the event, and to the extent, that per fiscal entity total deferred tax liabilities exceed total deferred tax assets.

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More detailed information concerning tax effects is disclosed in Note 3 Financial fixed assets of the Notes to the Consolidated Financial Statements .

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Pension Costs (SFAS 87/SFAS 132)**

Pension benefits of the Company's staff in The Netherlands as well as those of expatriate Dutch employees are covered by one of three separate contributory pension plans depending on the category of personnel. Separate plans for ground staff, cockpit staff and cabin staff are carried out by an independent foundation. Each plan is administered by a separate independent Board. The Company has no influence on investments and no direct influence on funding. Plan assets consist primarily of government and corporate debt securities, marketable equity securities, real estate (funds) and money market fund shares. No investment exist in KLM shares or in KLM real estate. For UK based staff two separate contributory pension plans exist with different sections for different groups of employees. Each plan is administered by an independent trustee. Other plans, which principally relate to defined contribution schemes, provide pension benefits for personnel in various countries outside The Netherlands and the UK.

For Netherlands GAAP for fiscal 2003 a net pension expense of EUR 230 million is included, for fiscal 2002 EUR 144 million and for fiscal 2001 EUR 147 million was included. Participation in the respective plans is mandatory. Pension costs, which are actuarially determined, are funded and with minor exceptions fully vested.

The Company's benefit plans cost and funded status for 2002, 2001 and 2000 were also computed in accordance with Statement of Financial Accounting Standards No. 87 (SFAS 87) Employers' Accounting for Pensions and disclosed in accordance with SFAS 132 Employers' disclosures about pensions and other postretirement benefits as follows:

| | For the years ended March 31, | | |
|--|--------------------------------------|--------------------|--------------|
| | 2003 | 2002 | 2001 |
| Net Periodic Pension Cost | | | |
| Net service cost | 245 | 236 | 201 |
| Interest cost | 353 | 330 | 297 |
| Expected return | (545) | (518) | (526) |
| Amortization of Transition (asset/ obligation) | (49) | (48) | (48) |
| Prior service cost | 22 | 22 | 15 |
| Net actuarial gains | 25 | (18) | (60) |
| Net periodic pension cost | 51 | 4 | (121) |
| | March, 2003 | March, 2002 | |
| Change in benefit obligation | | | |
| Benefit obligation at beginning year | 6,252 | 5,888 | |
| Service cost | 245 | 236 | |
| Interest cost | 353 | 330 | |
| Plan amendments | | | |
| Benefits paid | (207) | (200) | |
| Effect of change of assumptions | 81 | | |
| Actuarial result | 29 | (2) | |
| Benefit obligation at end of year | 6,753 | 6,252 | |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)**

| | <u>March, 2003</u> | <u>March, 2002</u> |
|--|--------------------|--------------------|
| Change in plan assets | | |
| Fair value at beginning of year | 7,786 | 7,915 |
| Plan amendments | | |
| Actual return | (288) | (97) |
| Contributions | 146 | 168 |
| Benefits paid | (207) | (200) |
| | <u>7,437</u> | <u>7,786</u> |
| | 7,437 | 7,786 |
| | | |
| | <u>March, 2003</u> | <u>March, 2002</u> |
| Funded status | 684 | 1,534 |
| Unrecognised net losses | 1,328 | 357 |
| Unrecognised prior service cost | 137 | 159 |
| Unrecognised net assets at transition | (125) | (174) |
| | <u>2,024</u> | <u>1,876</u> |
| Net amount recognized | 2,024 | 1,876 |
| | | |
| Amounts recognized in the balance sheet consists of: | | |
| Prepaid pension costs | 1,973 | 1,876 |
| Accumulated other comprehensive income | 51 | |
| | <u>2,024</u> | <u>1,876</u> |
| | 2,024 | 1,876 |

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans of KLM UK's staff with accumulated benefit obligations in excess of plan assets, included in the prepaid pension costs disclosed above, were EUR 209 million, EUR 143 million and EUR 106 million, respectively, as of March 31, 2003. A minimum pension liability of EUR 51 million is recognized through Other Comprehensive Income in the current year.

| | <u>March, 2003</u> | <u>March, 2002</u> |
|-----------------------|--------------------|--------------------|
| Assumptions | | |
| Discount rate | 5.5% | 5.5% |
| Total salary increase | 4.0% | 4.0% |
| Rate of return | 7.0% | 7.0% |

Postretirement Benefits (SFAS 106/SFAS 132)

SFAS 106 Postretirement Benefits is already implemented in The Netherlands GAAP financial statements.

For Netherlands GAAP for fiscal 2003 a net provision of EUR 69 million is included, for fiscal 2002 EUR 67 million and for fiscal 2001 EUR 61 million was included.

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The Company's benefit plans cost and funded status for 2003, 2002 and 2001 were computed in accordance with Statement of Financial Accounting Standards No. 106 (SFAS 106) Postretirement Benefits and disclosed in accordance with SFAS 132 Employers disclosures about pensions and other postretirement benefits as follows:

| | For the years ended March 31, | | |
|----------------------------------|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Net Periodic Benefit Cost | | | |
| Net service cost | 3 | 2 | 2 |
| Interest cost | 6 | 7 | 6 |
| Expected return | | | |
| Amortization of | | | |
| Transition amount | 1 | 2 | 2 |
| Actuarial gains/losses | 2 | 1 | |
| | — | — | — |
| Net periodic benefit cost | 12 | 12 | 10 |
| | — | — | — |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and U.S. GAAP (Continued)**

| | March, 2003 | March, 2002 |
|---------------------------------------|------------------------|------------------------|
| | <u> </u> | <u> </u> |
| Change in benefit obligation | | |
| Benefit obligation at beginning year | 102 | 95 |
| Service cost | 3 | 2 |
| Interest cost | 6 | 7 |
| Plan amendments | | |
| Benefits paid | (4) | (4) |
| Effect of change of assumptions | (3) | (6) |
| Actuarial result | 8 | 8 |
| Foreign currency effect | (5) | |
| | <u> </u> | <u> </u> |
| Benefit obligation at end of year | 107 | 102 |
| | <u> </u> | <u> </u> |
| | March, 2003 | March, 2002 |
| | <u> </u> | <u> </u> |
| Change in plan assets | | |
| Fair value at beginning of year | | |
| Actual return | | |
| Contributions | 4 | 3 |
| Benefits paid | (4) | (3) |
| | <u> </u> | <u> </u> |
| Fair value at end of year | | |
| | <u> </u> | <u> </u> |
| | March, 2003 | March, 2002 |
| | <u> </u> | <u> </u> |
| Funded status | | |
| | (107) | (102) |
| Unrecognised net losses | 36 | 23 |
| Unrecognised prior service cost | (9) | |
| Unrecognised obligation at transition | 11 | 12 |
| | <u> </u> | <u> </u> |
| Net amount recognized | (69) | (67) |
| | <u> </u> | <u> </u> |
| | March, 2003 | March, 2002 |
| | <u> </u> | <u> </u> |
| Assumptions | | |
| Discount rate | 5.5% | 5.5% |
| Increase rate benefit | 3.0% | 2.5% |

For measurement purposes, a 3.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2003/2004 and the years thereafter.

Disclosure of Certain Risks and Uncertainties (SOP 94-6)

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Preparation of KLM's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Table of Contents**KLM ROYAL DUTCH AIRLINES****28. Differences between Netherlands GAAP and U.S. GAAP (Continued)****Guarantees**

Guarantees have been provided up to an amount of EUR 174 million (last fiscal year EUR 120 million). EUR 114 million relates to various guarantees provided by KLM on behalf of consolidated holdings (last fiscal year EUR 95 million). No obligation has been recorded in relation to these guarantees.

Guarantees were further provided for a number of consolidated holdings in accordance with Article 403, Book 2, of The Netherlands Civil Code. This information is part of the information on capital interests which has been filed with the Trade Register of the Chamber of Commerce in Amsterdam. The debts of the companies, which are included in the consolidated balance sheet as of March 31, 2003 amounted to EUR 74 million (last fiscal year EUR 48 million). The maximum undiscounted amount of guarantees by expiry date are:

| | |
|-----------------|----|
| 2003/2004 | 62 |
| 2004/2005 | 2 |
| 2005/2006 | 17 |
| 2006/2007 | 0 |
| 2007/2008 | 2 |
| after 2007/2008 | 91 |

Goodwill and Other Intangible Assets

In connection with the annual goodwill impairment evaluation required by SFAS 142, we determined an impairment loss of EUR 1 million in the 2002/2003 US GAAP income statement.

The following table shows US GAAP net income in prior years on a pro forma basis to show the effects of non-amortisation of goodwill:

| | For the years ended March 31, | | |
|--|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Net income in conformity with US GAAP | (267) | (2) | 154 |
| Add back: Amortization of goodwill | 0 | 7 | 11 |
| Pro forma net income | (267) | 5 | 165 |
| Basic and diluted earnings per share (restated, see note 29) | (5.97) | (0.08) | 3.30 |
| Add back: Amortization of goodwill (restated, see note 29) | 0.00 | 0.15 | 0.24 |
| Pro forma earnings per share (restated, see note 29) | (5.97) | 0.07 | 3.54 |

The aggregate amortization expense for the year ended March 31, 2003 was EUR 13 million. The following table summarises the estimated amortization expense for the coming five years:

| Advance payments | | |
|-------------------------|------------------------|--------------|
| Software | on software | Total |
| | | |

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| | | | |
|-----------|----|---|----|
| 2003/2004 | 12 | 2 | 14 |
| 2004/2005 | 11 | 2 | 13 |
| 2005/2006 | 6 | 2 | 8 |
| 2006/2007 | 5 | | 5 |
| 2007/2008 | 5 | | 5 |
| | — | — | — |
| | 39 | 6 | 45 |
| | ■ | ■ | ■ |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Reporting Comprehensive Income (SFAS 130)**

The figures stated in the table below are net of tax amounts.
(in millions of euros)

| | Foreign currency translation adjustments | Unrealized gains/losses derivatives | Minimum pension liability | Total accumulated other com- prehensive income (loss) |
|---|---|---|---------------------------------|--|
| | _____ | _____ | _____ | _____ |
| Balance sheet at March 31, 2000 | (21) | | | (21) |
| Current-period change | 5 | | | 5 |
| | _____ | _____ | _____ | _____ |
| Balance sheet at March 31, 2001 | (16) | | | (16) |
| Impact of first time application SFAS 133/138 | | (23) | | (23) |
| Current-period change | 30 | 23 | | 53 |
| | _____ | _____ | _____ | _____ |
| Balance sheet at March 31, 2002 | 14 | | | 14 |
| Current-period change | (27) | (39) | (38) | (104) |
| | _____ | _____ | _____ | _____ |
| Balance sheet at March 31, 2003 | (13) | (39) | (38) | (90) |
| | _____ | _____ | _____ | _____ |

Summary of changes in stockholders equity in conformity with US-GAAP:**Years ended March 31, 2001, 2002 and 2003**

| In thousands of euros | Capital paid-in and called | | | | | Accumulated other com- prehensive income | Other reserves | Total stockholders equity |
|---|----------------------------|--------------------------------------|--------------------------------------|------------------|--------------------|---|-------------------|---------------------------------|
| | Priority shares | A-cumulative preference shares | C-cumulative preference shares | Common shares | Paid-in surplus | | | |
| Balance sheet at March 31, 2000 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | (21,377) | 2,504,542 | 3,082,248 |
| Own shares | | | | | | | (10,973) | (10,973) |
| Allocation from net income 2000/2001 | | | | | | | 154,394 | 154,394 |
| Distributed on priority/pref. shares | | | | | | | (1,760) | (1,760) |
| Other comprehensive income | | | | | | 4,938 | | 4,938 |
| | _____ | _____ | _____ | _____ | _____ | _____ | _____ | _____ |
| Balance sheet at March 31, 2001 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | (16,439) | 2,646,203 | 3,228,847 |
| Distribution from net income 2000/2001 | | | | | | | (29,846) | (29,846) |
| Own shares | | | | | | | (6,752) | (6,752) |
| Other comprehensive income | | | | | | 30,539 | | 30,539 |
| | _____ | _____ | _____ | _____ | _____ | _____ | _____ | _____ |

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| | | | | | | | | |
|--|----------|---------------|---------------|---------------|----------------|-----------------|----------------------|----------------------|
| Net loss 2001/2002 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | 14,100 | 2,609,605 (2,495) | 3,222,788 (2,495) |
| Equity as of March 31, 2002 | | | | | | | 2,607,110 | 3,220,293 |
| Distribution from net income 2001/2002 | | | | | | | (11,122) | (11,122) |
| Own shares | | | | | | | (10,678) | (10,678) |
| Other comprehensive income | | | | | | (104,067) | | (104,067) |
| | <u>3</u> | <u>17,625</u> | <u>14,100</u> | <u>93,619</u> | <u>473,736</u> | <u>(89,967)</u> | <u>2,585,310</u> | <u>3,094,426</u> |
| Net loss 2002/2003 | | | | | | | | (267,145) |
| Equity as of March 31, 2003 | | | | | | | | <u>2,827,281</u> |

For fiscal year 2002/2003 a distribution will be made to holders of common shares of EUR 0.10 per share, charged to Other reserves, involving an amount of EUR 4,418,816. The following distributions will be made to holders of cumulative preference shares and charged to Other reserves:

- A-cumulative preference shares: EUR 0.12 per share, involving an amount of EUR 1,057,500
- C-cumulative preference shares: EUR 0.10 per share, involving an amount of EUR 702,180

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Earnings per common share**

The computational components of basic and diluted net income (loss) per share and net income (loss) per share from continuing operations are as follows (based on US GAAP figures):

The earnings per common share have been restated, please refer to page F37.

Net income (loss) per share (restated, see note 29)

| | <u>Numerator (income)</u> | <u>Denominator (shares)</u> | <u>Per share amount</u> |
|---|-------------------------------|---------------------------------|-----------------------------|
| Shares outstanding as of March 31, 2003 | | 46,809,699 | |
| Effect of purchased own shares (weighted average during the year 2002/2003) | | (1,739,155) | |
| Net income | (267) | | |
| Attributable to holders of preference shares | (2) | | |
| | <u>(269)</u> | <u>45,070,544</u> | <u>(5.97)</u> |

Income (loss) per share from continuing operations

| | <u>Numerator (income)</u> | <u>Denominator (shares)</u> | <u>Per share amount</u> |
|---|-------------------------------|---------------------------------|-----------------------------|
| Shares outstanding as of March 31, 2003 | | 46,809,699 | |
| Effect of purchased own shares (weighted average during the year 2002/2003) | | (1,739,155) | |
| Net income from continuing operations | (234) | | |
| Attributable to holders of preference shares | (2) | | |
| | <u>(236)</u> | <u>45,070,544</u> | <u>(5.23)</u> |

Income (loss) per share from discontinued operations

| | <u>Numerator (income)</u> | <u>Denominator (shares)</u> | <u>Per share amount</u> |
|---|-------------------------------|---------------------------------|-----------------------------|
| Shares outstanding as of March 31, 2003 | | 46,809,699 | |
| Effect of purchased own shares (weighted average during the year 2002/2003) | | (1,739,155) | |
| Net income from continuing operations | (33) | | |
| | <u>(33)</u> | <u>45,070,544</u> | <u>(0.74)</u> |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)**

Basic and diluted earnings per share have been restated (we refer to footnote 29 for further explanation)

Effect of Restatement

This restatement does not reflect any change to previously reported net earnings, but rather computation errors in the determination of weighted average shares used to calculate earnings per share. The increase of diluted EPS results from the exclusion of treasury stock in the computation of weighted average shares outstanding. The impact of the treasury stock was excluded from the previous computations of average shares outstanding.

Basic and diluted EPS according to US GAAP as previously reported and restated are as follows (in thousands):

| Fiscal year | Basic EPS | | Diluted EPS | |
|-------------|---------------------|----------|---------------------|----------|
| | previously reported | Restated | previously reported | Restated |
| 2000/2001 | 3.26 | 3.30 | 3.26 | 3.30 |
| 2001/2002 | (0.08) | (0.08) | (0.08) | (0.08) |
| 2002/2003 | (5.97) | (5.97) | (5.97) | (5.97) |

Shares outstanding for basic and diluted EPS as previously reported and restated are as follows:

| Fiscal year | Basic EPS | | Diluted EPS | |
|-------------|---------------------|----------|---------------------|----------|
| | previously reported | Restated | previously reported | Restated |
| 2000/2001 | 46,810 | 46,133 | 46,810 | 46,133 |
| 2001/2002 | 46,810 | 45,682 | 46,810 | 45,682 |
| 2002/2003 | 45,070 | 45,071 | 45,070 | 45,071 |

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Disclosure about Accounting for Stock-Based Compensation (SFAS 123)**

The Company's remuneration and share option plans are disclosed in the Notes to the Company Financial Statements (See Note 36 Remuneration and share options). Awards in the context of the share option plan are accounted for under APB 25.

The pro forma net income, calculated as if the fair value of the options granted to option holders would have been considered as compensation costs, is as follows:

| | For the years ended March 31, | | |
|--|--------------------------------------|---------------|-------------|
| | 2003 | 2002 | 2001 |
| Net income (loss) in accordance with US GAAP (as reported) | (267) | (2) | 154 |
| Add back: Stock-based employee compensation included in reported net income | | | |
| Stock-based employee compensation that would have been included in the determination of net income | (1) | (2) | (2) |
| Pro forma net income (loss) | <u>(268)</u> | <u>(4)</u> | <u>152</u> |
| Basic and diluted earnings per share in accordance with US GAAP: | | | |
| as reported (restated, see note 29) | (5.97) | (0.08) | 3.30 |
| Add back: Stock-based employee compensation included in reported net income | | | |
| Stock-based employee compensation that would have been included in the determination of net income | (0.02) | (0.05) | (0.04) |
| Pro forma earnings per share (restated, see note 29) | <u>(5.99)</u> | <u>(0.13)</u> | <u>3.26</u> |

The fair value of the Company's 2003, 2002 and 2001 option grants was estimated using a Black-Scholes option pricing model and the following assumptions:

| | For the years ended March 31, | | |
|--|--------------------------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Risk-free interest rate | 3.3 | 4.8 | 5.6 |
| Expected dividend yield | 1.5 | 1.4 | 3.2 |
| Expected option life | 5.0 | 5.0 | 5.0 |
| Expected stock price volatility | 53.4 | 38.4 | 57.7 |
| Weighted average fair value of options granted during the year in EUR ⁽¹⁾ | 2.17A | 2.66A | 5.24 |
| | 2.57B | 3.59B | |

(1) As of fiscal year 2001/2002 Option A and Option B differ in weighted average fair value (see notes to share option plan, note 36 F-42)

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****28. Differences between Netherlands GAAP and US GAAP (Continued)****Disclosure about Derivative and hedge accounting (SFAS 133/138)***Currency risks*

In its operating cash flow, the Company has a substantial surplus in all major foreign currencies, with the exception of the US dollar, in which it has a virtually neutral position. KLM hedges a part of its non-US Dollar cash flows by cash flow hedges. Changes in the fair value of these contracts are included in Other Comprehensive Income up to the date on which the effects of the results on the underlying positions materialize, in general when traffic occurs. Some currencies that have a strong correlation with the US dollar are not being hedged to euros but to US dollars instead. For this category of derivatives hedge accounting is not applied.

In its cash flow from investing activities, the Company has a short position. KLM uses fair value hedges to hedge these cash flows.

It is KLM's intention to match assets and liabilities accurately. KLM uses cross currency swaps either as cash flow hedge or fair value hedge in order to achieve this matching.

Interest rate risks

It is KLM's policy to minimize long-term net funding costs within the agreed framework of interest rate sensitivity. KLM uses cross currency interest rate swaps, in combination with its hedging policies on foreign currencies, to create a favorable mix of fixed and floating interest-bearing positions. In this respect the Company uses both cash flow hedges and fair value hedges.

Fuel price risks

KLM is significantly exposed to price risk on its fuel requirements. The Company uses cash flow hedges to reduce this price risk. Changes in the fair value of these derivatives are included in Other Comprehensive Income and are released in the profit and loss account (as a part of fuel expenses) when the hedged fuel consumption materializes.

Impact on equity and earnings

The result on derivatives, which did not qualify for hedge accounting under SFAS 133/138 during fiscal 2002/2003, amounted to EUR 11 million positive. The positive impact on earnings of the ineffective part of cash flow hedges and fair value hedges is EUR 5 million. None of the derivatives, which initially qualified as hedges, exceeded its effectiveness criteria before expiration.

The debit balance of Other Comprehensive Income as of March 31, 2003 with respect to effective cash flow hedges amounted EUR 39 million. During the fiscal year 2003/04 it is expected that an amount of EUR 16 million will be credited in earnings. The remainder (debit amount of EUR 23 million) will be released in earnings over a period of 16 years.

Movements in Other Comprehensive Income during fiscal 2002/2003

In million of euros, net of tax

| | |
|---------------------------------------|-------|
| Balance as of March 31, 2002 | 0 |
| Released to profit and loss account | 2 |
| Changes in fair value during the year | (41) |
| | <hr/> |
| Balance as of March 31, 2003 | (39) |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****29. Amendments to the consolidated financial statements**

1. Compared to the consolidated financial statements included in the annual report filed on Form 20-F on June 12, 2003 a number of amendments were made of which the nature and background are explained below:

We have restated earnings per share figures under Netherlands GAAP and U.S. GAAP for each of the fiscal years ended in the period from April 1, 2000 through March 31, 2002 to reflect the exclusion from the calculation of earnings per share of treasury shares held by KLM. This restatement does not reflect any change to previously reported net earnings, but rather corrections of computational errors in the determination of weighted average shares outstanding used to calculate earnings per share. Basic and diluted earnings per share according to Netherlands GAAP were previously reported and restated as follows:

| Fiscal year | Basic EPS previously reported | Restated | Diluted EPS previously reported | Restated |
|-------------|-------------------------------------|----------|---------------------------------------|----------|
| 2000/2001 | 1.61 | 1.63 | 1.61 | 1.63 |
| 2001/2002 | (3.37) | (3.46) | (3.37) | (3.46) |
| 2002/2003 | (9.26) | (9.26) | (9.26) | (9.26) |

Shares outstanding for basic and diluted EPS as previously reported and restated are as follows (in thousands):

| Fiscal year | Basic EPS previously reported | Restated | Diluted EPS previously reported | Restated |
|-------------|-------------------------------------|----------|---------------------------------------|----------|
| 2000/2001 | 46,810 | 46,133 | 46,810 | 46,133 |
| 2001/2002 | 46,810 | 45,682 | 46,810 | 45,682 |
| 2002/2003 | 45,070 | 45,071 | 45,070 | 45,071 |

We refer to footnote 28 for further explanation of the changes under US GAAP.

2. The following reclassifications have been made to the consolidated financial statements included in the original Form 20-F filed with the Securities and Exchange Commission on June 12, 2003. These reclassifications arise from matters that occurred subsequent to March 31, 2003, and which were therefore not reflected in such originally filed financial statements.
- (a) As described more fully in note 28 to the consolidated financial statements we have reclassified the results of KLM's low-cost buzz business to reflect the business as a discontinued operation under US GAAP in light of its disposal to Ryanair in April 2003.
- (b) We have also reclassified operating income under Netherlands GAAP to reflect new accounting rules with respect to the presentation of extraordinary items that became effective as of April 1, 2003. Retroactive application, as required by Netherlands GAAP, of the new accounting policy leads to a downward adjustment of operating income in the year ended March 31, 2003 of EUR 351 million with no impact on operating income for the years ended March 31, 2002 and March 31, 2001. The impact on net income for all three years is nil.

Table of Contents**KLM ROYAL DUTCH AIRLINES****COMPANY BALANCE SHEET**

In millions of euros

Before appropriation of results

| | Note(1) | March 31, 2003 | March 31, 2002(2) |
|--|-------------------|-------------------|----------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Fixed assets | | | |
| Intangible fixed assets | | 60 | 54 |
| Tangible fixed assets | 30 | 3,589 | 3,398 |
| Financial fixed assets | 31 | 2,141 | 2,379 |
| | | <u>5,790</u> | <u>5,831</u> |
| Current assets | | | |
| Operating supplies | | 196 | 230 |
| Accounts receivable | 32 | 1,039 | 1,208 |
| Marketable securities | | | 2 |
| Cash | | 559 | 969 |
| | | <u>1,794</u> | <u>2,409</u> |
| Current liabilities | | <u>2,191</u> | <u>2,216</u> |
| Current assets less current liabilities | | (397) | 193 |
| | | <u>5,393</u> | <u>6,024</u> |
| Assets less current liabilities | | | |
| | | <u>5,393</u> | <u>6,024</u> |
| Long-term debt | | | |
| Subordinated perpetual debt | | 544 | 591 |
| Other long-term debt | 33 | 2,900 | 3,074 |
| | | <u>3,444</u> | <u>3,665</u> |
| Provisions | 34 | 261 | 166 |
| Deferred credits | | 212 | 201 |
| Stockholders' equity | 35 | | |
| Paid-in and called capital | | 125 | 125 |
| Paid-in surplus | | 474 | 474 |
| Other reserves | | 1,293 | 1,549 |
| Net loss | | (416) | (156) |
| | | <u>1,476</u> | <u>1,992</u> |
| | | <u>5,393</u> | <u>6,024</u> |

COMPANY STATEMENT OF EARNINGS

In millions of euros

For the Years Ended March 31,

| | 2003 | 2002 | 2001 |
|-------------------------------------|-------|-------|------|
| Results of holdings | (22) | (7) | (17) |
| KLM company income after tax | (394) | (149) | 94 |
| Net income (loss) | (416) | (156) | 77 |

(1) The accompanying Notes are an integral part of these Consolidated Financial Statements

(2) Prior-year figures have been reclassified with regard to deferred taxes

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS****In millions of euros****General**

Reference is made to the Notes to the consolidated financial statements unless stated otherwise.

Fixed assets**30. Tangible fixed assets**

| | March 31, 2003 | March 31, 2002 |
|--|---------------------------|---------------------------|
| Aircraft, spare engines and spare parts | 2,518 | 2,816 |
| Other tangible fixed assets | 483 | 517 |
| | <u>3,001</u> | <u>3,333</u> |
| Advance payments on tangible fixed assets on order or under construction | 588 | 65 |
| | <u>3,589</u> | <u>3,398</u> |

| | Aircraft, spare engines and spare parts | Buildings and land | Inventories, and machines and installations | Vehicles and other tangible fixed assets | Total |
|--|--|-------------------------------|--|---|--------------|
| Purchase value as of March 31, 2002 | 5,095 | 710 | 502 | 96 | 6,403 |
| Accumulated depreciation and diminution in value through 2001/2002 | 2,279 | 370 | 369 | 52 | 3,070 |
| Book value as of March 31, 2002 | 2,816 | 340 | 133 | 44 | 3,333 |
| Changes in book value | | | | | |
| Additions | 275 | 2 | 27 | 9 | 313 |
| Disposals | (260) | (2) | 1 | (3) | (264) |
| Depreciation | (260) | (25) | (36) | (9) | (330) |
| Write down/impairment | (59) | | | | (59) |
| Other | 6 | 1 | 1 | | 8 |
| Total changes | (298) | (24) | (7) | (3) | (332) |
| Purchase value as of March 31, 2003 | 4,885 | 704 | 508 | 94 | 6,191 |
| Accumulated depreciation and diminution in value through 2002/2003 | 2,367 | 388 | 382 | 53 | 3,190 |
| Book value as of March 31, 2003 | 2,518 | 316 | 126 | 41 | 3,001 |

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This overview includes aircraft for which financial lease agreements have been concluded. Their book value amounts to EUR 1,838 million (last fiscal year EUR 1,880 million).

Other tangible fixed assets include assets whose availability is based on limited right of use, such as buildings on land held under long-term rental agreements or on leasehold, and assets acquired through financial lease agreements. The book value of these assets amounts to EUR 180 million (last fiscal year EUR 220 million).

In fiscal year 2002/2003 a write down of EUR 59 million was recognized for the Boeing 747-300 fleet in connection with an accelerated phasing out. The remaining book value of the Boeing 747-300 fleet amounted to EUR 25 million as of March 31, 2003.

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****31. Financial fixed assets**

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|--|-----------------------|-----------------------|
| Consolidated holdings | 574 | 639 |
| Other holdings | 197 | 202 |
| Receivables from consolidated holdings | 487 | 673 |
| Receivables from other holdings | 18 | 22 |
| | <u>1,276</u> | <u>1,536</u> |
| Other financial fixed assets | 865 | 843 |
| | <u>2,141</u> | <u>2,379</u> |

| | <u>Consolidated holdings</u> | <u>Other holdings</u> | <u>Receivables from con- solidated holdings</u> | <u>Receivables from other holdings</u> | <u>Other financial fixed assets</u> | <u>Total</u> |
|-------------------------------------|----------------------------------|---------------------------|---|--|---|--------------|
| Balance as of March 31, 2002 | 639 | 202 | 673 | 22 | 843 | 2,379 |
| New/expansion | | 9 | 56 | 1 | 254 | 320 |
| Sale/redemption | | (2) | (168) | (2) | (93) | (265) |
| Share in results | (29) | 3 | | | | (26) |
| Revaluation | (24) | (6) | | | (134) | (164) |
| Dividends received | (3) | (1) | | | | (4) |
| Exchange rate differences and other | (9) | (8) | (74) | (3) | (5) | (99) |
| | <u>574</u> | <u>197</u> | <u>487</u> | <u>18</u> | <u>865</u> | <u>2,141</u> |

Current assets**32. Accounts receivable**

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|--|-----------------------|-----------------------|
| Debtors | 690 | 878 |
| Receivables from consolidated holdings | 154 | 80 |
| Receivables from other holdings | 3 | 2 |
| Value added tax | 33 | 16 |
| Prepaid expenses | 159 | 232 |
| | <u>1,039</u> | <u>1,208</u> |

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****Long-term debt****33. Other long-term debt**

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|---|-----------------------|-----------------------|
| Reference is made to page F-14 (Note 8) | 3,427 | 3,826 |
| Loans obtained or repaid by consolidated holdings | (527) | (752) |
| | <u>2,900</u> | <u>3,074</u> |

34. Provisions

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|----------------------------------|-----------------------|-----------------------|
| Postretirement health costs | 69 | 67 |
| Early retirement provision | 21 | 6 |
| Other staff commitments | 72 | 73 |
| Frequent flyer program | 24 | 20 |
| Reorganization and restructuring | 75 | |
| | <u>261</u> | <u>166</u> |

35. Stockholders equity

The authorized capital of the Company is EUR 600 million. Of this amount, EUR 125.3 million is issued and fully paid-in.

In connection with the minority interest of the State of The Netherlands in KLM's share capital, KLM and the State of The Netherlands are parties to an option agreement. Pursuant to the terms of this agreement, KLM grants the State of the Netherlands the right to acquire such a number of B-preference shares, with a par value of EUR 2.00, as is necessary to provide the State with a majority interest of 50.1%, when exercising the option, irrespective of the total issued capital at any given moment.

If deemed reasonable by the State, after consultation with KLM, the State will exercise its option insofar as necessary if a country imposes or contemplates imposing restrictions or onerous conditions on KLM in the operation of scheduled air services as a consequence of that country's view that a substantial or majority part of the share capital of KLM cannot demonstrably be Netherlands owned.

The State of The Netherlands currently holds 8,812,500 A-cumulative preference shares and 975 priority shares, to which a voting right attaches of nearly 14.1%.

As of March 31, 2003, the Company held 2,621,542 purchased common shares with a total value of EUR 38 million. This amount has been deducted from Other reserves. The repurchase of own shares is related to cover future commitments arising from option rights granted to members of the Board of Managing Directors and senior managers as well as to the own share repurchase program announced on February 11, 2003.

In 2002/2003 1,307,358 common shares were purchased to this end at an average purchase price of EUR 8.16.

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The nominal value of the purchased common shares amounts to EUR 3 million.

In line Exchange rate differences and other in Other reserves includes a decrease of EUR 37 million in respect of the fair value of cash flow hedges arising from the application of SFAS 133/138. The accumulated movement in value as of March 31, 2003 amounted to EUR 39 million. Of this amount, EUR 16 million is expected to be charged to the statement of earnings in 2003/2004. The remainder (EUR 23 million) will be charged to the statement of earnings over a period of 16 years.

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Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****35. Stockholders equity (Continued)**

Years ended March 31, 2001, 2002, 2003

| In thousands of euros | Capital paid-in and called | | | | | | Total stockholders' equity |
|---|----------------------------|--------------------------------|--------------------------------|---------------|-----------------|----------------|----------------------------|
| | Priority shares | A-cumulative preference shares | C-cumulative preference shares | Common shares | Paid-in surplus | Other reserves | |
| Balance as of March 31, 2000 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | 1,420,413 | 2,019,496 |
| Own shares | | | | | | (10,973) | (10,973) |
| Net income 2000/2001 | | | | | | 77,106 | 77,106 |
| Dividend 2000/2001 | | | | | | (29,846) | (29,846) |
| Exchange rate differences and other | | | | | | 4,938 | 4,938 |
| Balance as of March 31, 2001 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | 1,461,638 | 2,060,721 |
| Own shares | | | | | | (6,752) | (6,752) |
| Change in accounting policies for heavy maintenance costs | | | | | | 77,396 | 77,396 |
| Change in accounting policies for derivatives | | | | | | (6,258) | (6,258) |
| Exchange rate differences and other | | | | | | 23,211 | 23,211 |
| Balance as of March 31, 2002 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | 1,549,235 | 2,148,318 |
| Net result 2001/2002 | | | | | | (156,293) | (156,293) |
| Dividend paid 2001/2002 | | | | | | (11,122) | (11,122) |
| Own shares | | | | | | (10,678) | (10,678) |
| Exchange rate differences and other | | | | | | (78,214) | (78,214) |
| Balance as of March 31, 2003 | 3 | 17,625 | 14,100 | 93,619 | 473,736 | 1,292,928 | 1,892,011 |
| Net result 2002/2003 | | | | | | | (415,641) |
| Equity as of March 31, 2003 | | | | | | | 1,476,370 |

The paid-in surplus is fiscally exempt.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****36. Remuneration and share option plan***Supervisory Board*

The remuneration of the members of the Supervisory Board consists of a fixed fee per annum (EUR 36,302 for the Chairman, EUR 29,495 for the Vice-Chairman and EUR 22,689 for the other Board members) and a fee for each meeting of the Board's Committees attended (EUR 1,361 for the Chairman of the Committee concerned, unless also the Vice-Chairman or Chairman of the Board, and EUR 453 for the other members of the Board's Committees). In connection with KLM's situation following the events of September 11, 2001, it was decided in October 2001 to voluntarily reduce the Supervisory Board members' remuneration by 15% for a period of five months. The total remuneration of current and former Supervisory Board members for the fiscal year was EUR 205,557 (last fiscal year EUR 187,007). Individually, the remuneration of the current and former Supervisory Board members was as follows:

| | 2002/2003 | | | 2001/2002 | | |
|-----------------------|------------------------------------|-------------------------|----------------|------------------------------------|-------------------------|----------------|
| | As member of the Supervisory Board | As member of Committees | Total | As member of the Supervisory Board | As member of Committees | Total |
| F.A. Maljers | 36,302 | 907 | 37,209 | 35,394 | | 35,394 |
| A. Maas | 29,495 | 1,361 | 30,856 | 28,758 | 1,361 | 30,119 |
| M. Albrecht | 22,689 | | 22,689 | 22,121 | | 22,121 |
| L.A.A. van den Berghe | 22,689 | 2,268 | 24,957 | 8,886 | | 8,886 |
| D.G. Eustace | 22,689 | 6,352 | 29,041 | 22,121 | 5,445 | 27,566 |
| B. Geersing | 22,689 | 1,815 | 24,504 | 22,121 | 1,361 | 23,482 |
| J. Stekelenburg | 22,689 | 1,815 | 24,504 | 22,121 | 2,722 | 24,843 |
| K.J. Storm | 11,344 | 453 | 11,797 | | | |
| G.L. Wilson former | | | | | | |
| J.W. Oosterwijk | | | | 13,235 | 1,361 | 14,596 |
| | <u>190,586</u> | <u>14,971</u> | <u>205,557</u> | <u>174,757</u> | <u>12,250</u> | <u>187,007</u> |

None of the Supervisory Board members held securities in KLM as of March 31, 2003. Supervisory Board members may not participate in the share option plan described below. As of March 31, 2003, the Supervisory Board members had no commitments in respect of loans, advances or guarantees granted to them by KLM.

Board of Managing Directors

The Supervisory Board determines the remuneration package, targets and performance of the members of the Board of Managing Directors each year. In addition to a fixed annual salary, the members of the Board of Managing Directors receive an annual variable remuneration up to a maximum of 50% of the fixed salary (30% relating to targets with respect to company results, 20% relating to targets with respect to personal performance). The variable remuneration paid and recognized in a year relates to the targets realized in the previous year. Members of the Board of Managing Directors are also granted options on KLM shares each year. The receipt of options is based on the achievement of targets with respect to company results and personal performance. Options also serve to increase longer-term commitment to the company. The maximum number of options that a member of the Board of Managing Directors may receive each year is 25,000.

In connection with KLM's situation following the events of September 11, 2001, it was decided in October 2001 to voluntarily reduce the remuneration of the members of the Board of Managing Directors by 15% for a period of five months.

The total remuneration, including employer pension contributions, of members of the Board of Managing Directors for the fiscal year, amounted to EUR 4,614,561 (last fiscal year EUR 5,293,767).

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Individually, the remuneration of the Board of Managing Directors was as follows:

| | 2002/2003 | Variable | Targets realized | Pension⁽¹⁾ | Upon standing down | Total |
|-------------------|---------------------|-----------------|-------------------------|------------------------------|---------------------------|--------------|
| | Fixed salary | | | | | |
| L.M. van Wijk | 628,193 | 317,802 | partially | 388,078 | | 1,334,073 |
| P.F. Hartman | 514,321 | 271,289 | partially | 568,118 | | 1,353,728 |
| C. van Woudenberg | 447,733 | 227,335 | partially | 365,367 | | 1,040,435 |
| R.A. Ruijter | 447,733 | 151,398 | partially | 287,194 | | 886,325 |
| | <hr/> | <hr/> | | <hr/> | <hr/> | <hr/> |
| | 2,037,980 | 967,824 | | 1,608,757 | | 4,614,561 |
| | <hr/> | <hr/> | | <hr/> | <hr/> | <hr/> |
| | 2001/2002 | Variable | Targets realized | Pension⁽¹⁾ | Upon standing down | Total |
| | Fixed salary | | | | | |
| L.M. van Wijk | 560,725 | 294,960 | yes | 1,477,702 | | 2,333,387 |
| P.F. Hartman | 452,898 | 238,230 | yes | 942,669 | | 1,633,797 |
| C. van Woudenberg | 401,134 | 189,910 | partially | 309,320 | | 900,364 |
| R.A. Ruijter | 267,273 | 10,550 | partially | 148,396 | | 426,219 |
| | <hr/> | <hr/> | | <hr/> | <hr/> | <hr/> |
| | 1,682,030 | 733,650 | | 2,878,087 | | 5,293,767 |

(1) including past service commitments

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****36. Remuneration and share option plan (Continued)**

As of March 31, 2003, the members of the Board of Managing Directors together held no securities in KLM other than the options below. As of March 31, 2003, the members of the Board of Managing Directors had no commitments in respect of loans, advances or guarantees granted to them by KLM.

The current and former members of the Board of Managing Directors had the following positions with respect to options on KLM shares as of March 31, 2003:

| <u>Year granted</u> | <u>Options granted (number of shares that can be obtained)</u> | <u>Exercise price per share</u> | <u>Expiry date</u> | <u>Number of options exercised</u> | <u>Total number as of March 31, 2003</u> |
|---------------------|--|---|---------------------|--|--|
| L.M. van Wijk | | | | | |
| 1998 | 25,500 | 36.52 | August 18, 2003 | | 25,500 |
| 1999 | 25,500 | 30.26 | October 15, 2004 | | 25,500 |
| 2000 | 25,000 | 37.70 | October 21, 2005 | | 25,000 |
| 2001 | 25,000A | 23.45A | October 20, 2006 | | 25,000A |
| 2002 | 25,000A | 14.69A | October 19, 2007 | | 25,000A |
| | <u>126,000</u> | | | <u></u> | <u>126,000</u> |
| P.F. Hartman | | | | | |
| 1998 | 25,500 | 36.52 | August 18, 2003 | | 25,500 |
| 1999 | 25,500 | 30.26 | October 15, 2004 | | 25,500 |
| 2000 | 25,000 | 37.70 | October 21, 2005 | | 25,000 |
| 2001 | 25,000A | 23.45A | October 20, 2006 | | 25,000A |
| 2002 | 25,000A | 14.69A | October 19, 2007 | | 25,000A |
| | <u>126,000</u> | | | <u></u> | <u>126,000</u> |
| C. van Woudenberg | | | | | |
| 1998 | 25,500 | 36.52 | August 18, 2003 | | 25,500 |
| 1999 | 25,500 | 30.26 | October 15, 2004 | | 25,500 |
| 2000 | 25,000 | 37.70 | October 21, 2005 | | 25,000 |
| 2001 | 25,000A | 23.45A | October 20, 2006 | | 25,000A |
| 2002 | 25,000A | 14.69A | October 19, 2007 | | 25,000A |

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| | | | | |
|------------------------------------|---------|--------|---------------------|---------|
| | 126,000 | | | 126,000 |
| R.A. Ruijter | | | | |
| 2001 | 25,000A | 23.45A | October 20, 2006 | 25,000A |
| 2002 | 25,000A | 14.69A | October 19, 2007 | 25,000A |
| | 50,000 | | | 50,000 |
| <i>former</i> R.J.N. Abrahamsen | | | | |
| 1998 | 25,500 | 36.52 | August 18, 2003 | 25,500 |
| 1999 | 25,500 | 30.26 | October 15, 2004 | 25,500 |
| 2000 | 25,000 | 37.70 | October 21, 2005 | 25,000 |
| | 76,000 | | | 76,000 |

Senior officers

Options on KLM shares had also been granted to approximately 120 senior officers as of March 31, 2003:

| Year granted | Options granted (number of shares that can be obtained) | Exercise price per share | Expiry date | Number of options exercised | Number of options withdrawn | Total number as of March 31, 2003 |
|--------------|--|--------------------------------|---------------------|--------------------------------------|--------------------------------------|---|
| 1998 | 326,400 | 36.52 | August 18, 2003 | | 3,570 | 322,830 |
| 1999 | 358,530 | 30.26 | October 15, 2004 | | 3,570 | 354,960 |
| 2000 | 332,700 | 37.70 | October 21, 2005 | | 3,500 | 329,200 |
| 2001 | 203,500A | 23.45A | October 20, 2006 | | 1,000 | 202,500A |
| 2001 | 104,500B | 18.61B | October 20, 2006 | | 5,000 | 99,500B |
| 2002 | 200,500A | 14.69A | October 19, 2007 | | | 200,500A |
| 2002 | 124,000B | 11.56B | October 19, 2007 | | 2,500 | 121,500B |
| | 1,650,130 | | | | 19,140 | 1,630,990 |

The receipt of options is based on achievement of targets with respect to Company results, business unit results and personal performance; options also serve to increase longer-term commitment to the Company. The maximum number of options that may be received is related to the recipient's job grade.

Table of Contents**KLM ROYAL DUTCH AIRLINES****NOTES TO THE COMPANY FINANCIAL STATEMENTS (Continued)****36. Remuneration and share option plan (Continued)****Notes to the share option plan**

The main features of the share option plan under which option rights are granted to members of the Board of Managing Directors and senior officers each year are as follows. The exercise price of the options is based on a vesting price equal to the weighted average quote as calculated by Bloomberg for KLM shares on the tenth working day after the day of KLM's Annual General Meeting of Stockholders.

Until 1998, the exercise price of the option rights was equal to the vesting price. As a result of amended tax rates, the exercise price of the option rights in 1999 and 2000 consisted of an amount equal to such a percentage of the vesting price that the fiscal value of the option was 4% of the value of the KLM share.

Following the introduction of fiscal legislation enabling option recipients to elect for taxation upon the vesting of an option or upon the exercise of an option, the share option plan allows option recipients to elect with effect from 2001 for (i) an exercise price that is equal to a percentage of the vesting price such that the fiscal value of the option is 4% of the value of the KLM share (Option A, as indicated in the above tables), or (ii) an exercise price that is equal to the vesting price (Option B, as indicated in the above table). Options may be exercised at any moment during the exercise period, subject to applicable regulations on the prevention of insider trading and a waiting period of two years in the case of options granted in 1998 and three years in the case of options granted onwards from 1999.

To settle the tax liability on options received in 1998, option recipients were offered a five-year loan carrying interest at the rate referred to in article 59 of the Salary Tax Act 1969 Implementation Regulations with a repayment commitment on the exercise of the option rights. To settle any possible tax liability on options received from 1999 onwards, option recipients have been offered a six-month interest-free loan with a commitment to repay one sixth of the loan per month.

As of March 31, 2003 obligations in connection with options granted had been covered through the repurchase of own shares and the purchase of share options. Such hedging transactions take place at the moment options are granted. The purchase price of the KLM shares is charged to Other reserves (see note to Stockholders' equity). The premium paid for the share options (EUR 1.3 million) is amortized through salaries and benefits on a straight-line basis over five years.

37. Commitments and contingent liabilities***Tangible fixed assets on order***

Commitments relating to orders of tangible fixed assets amount to EUR 965 million (last fiscal year EUR 37 million), of which EUR 441 million is due in fiscal year 2003/2004.

Rental agreements

KLM has long-term rental commitments amounting to EUR 1,521 million (last fiscal year EUR 1,030 million). Commitments for the next five fiscal years and thereafter:

| | Operational leases of aircraft | Rental of buildings |
|-----------------|---|--------------------------------|
| 2003/2004 | 191 | 31 |
| 2004/2005 | 195 | 22 |
| 2005/2006 | 180 | 20 |
| 2006/2007 | 148 | 16 |
| 2007/2008 | 111 | 13 |
| after 2007/2008 | 397 | 197 |

Guarantees

Guarantees have been provided up to an amount of EUR 174 million (last fiscal year EUR 120 million). EUR 114 million relates to consolidated holdings (last fiscal year EUR 95 million).

Guarantees were further provided for a number of consolidated holdings in accordance with Article 403, Book 2, of The Netherlands Civil Code. This information is part of the information on capital interests which has been filed with the Trade Register of the Chamber of Commerce in Amsterdam. The debts of the companies, which are included in the consolidated balance sheet as of March 31, 2003 amounted to EUR 74 million (last fiscal year EUR 48 million).

The Company is a member of a fiscal unity and is accordingly jointly and separately liable for taxes payable by the fiscal unity as a whole.

Table of Contents**SCHEDULE VIII VALUATION AND QUALIFYING ACCOUNTS**

In millions of euros

| | Years ended March 31, 2001, 2002 and 2003 | | | | |
|---|---|--|-------------------------------------|--------------|------------------------|
| | Balance at beginning of year | Additions Charged to cost and expenses | Additions Charged to other accounts | Deductions * | Balance at End of year |
| Year ended March, 2001 | | | | | |
| Allowance for doubtful accounts (deducted from accounts receivable) | 37 | 4 | | 16 | 25 |
| Year ended March, 2002 | | | | | |
| Allowance for doubtful accounts (deducted from accounts receivable) | 25 | 12 | | 3 | 34 |
| Year ended March, 2003 | | | | | |
| Allowance for doubtful accounts (deducted from accounts receivable) | 34 | 6 | | 15 | 25 |

* Accounts deemed to be uncollectable

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