Management Discussion and Analysis of Twelve month period ended 31 December 2012

Contents

1. Executive Summary

Net income of Georgian Railway JSC for the twelve month period ended 31 December 2012 amounted to GEL 97.2 million compared to GEL 174.4 million in the twelve month period ended 31 December 2011, representing a decrease of 44.3 per cent. It should be noted that expenses include Eurobond buy-back premium (GEL 41 million), which represents a financial expenditure rather than an operational expense. Revenue decreased by 1.6 per cent to GEL 469.8 million, whereas operating expenses increased by 7.9 per cent. Adjusted EBITDA (earnings before interest, tax, depreciation and amortization) in the twelve month period ended 31 December 2012 amounted to GEL 247.4 million compared to GEL 261.6 million in the twelve month period ended 31 December 2011.

The main contributor to the reduction in revenue was a decrease in average FX rate between the years by approximately 5 per cent, causing revenue in GEL terms to decrease. Other factor was a decrease in freight handling services by 17.9 per cent (GEL 11.1 million), which was caused by the decrease of the penalties received for the delay of railcars by company's clients. Revenue from freight transportation in the twelve month period ended 31 December 2012 increased by 0.6 per cent (GEL 2.0 million) compared the twelve month period ended 31 December 2011. The increase was caused by the increase in dry cargo transportation revenue and increased tariffs for liquid cargo transportation.

Increase in expenses was mainly due to the increase in security and other operating expenses by 65.9 per cent (GEL 13.9 million). Apart from these there was an increase in materials expense by 49.9 per cent (GEL 6.9 million).

2. Profit & Loss Statement

’000 GEL	12 month period ended 31 December			
	2012	***% Change***	***Abs. Change***	**2011**
Revenues	469,819	-1.6%	(7,558)	477,377
Other income	31,953	165.7%	19,928	12,025
Payroll expenses	(108,467)	0.0%	26	(108,493)
Depreciation and amortization expense	(97,082)	5.4%	(4,945)	(92,137)
Electricity and materials used	(52,973)	10.9%	(5,210)	(47,763)
Other expenses	(88,446)	20.8%	(15,227)	(73,219)
Result From Operating Activities	**154,804**	-7.7%	(12,986)	**167,790**
Finance Income	19,106	-29.3%	(7,930)	27,036
Finance Cost	(59,309)	465.3%	(48,817)	(10,492)
Net finance income/(cost)	**(40,203)**	-343.0%	(56,747)	**16,544**
Profit before income tax	**114,601**	-37.8%	(69,733)	**184,334**
Income tax	(17,383)	75.2%	(7,463)	(9,921)
Net income	**97,217**	-44.3%	(77,196)	**174,413**
Adjusted EBITDA	**247,378**	-5.4%	(14,240)	**261,618**
Adjusted EBITDA margin	**52.7%**		-2.1%	**54.8%**

Net income amounted to GEL 97.2 million in the twelve month period ended 31 December 2012 compared to GEL 174.4 million in the twelve month period ended 31 December 2011.

Adjusted EBITDA of Georgian Railway for the twelve month period ended 31 December 2012 decreased by 5.4 per cent (GEL 14.2 million) compared to the twelve month period ended 31 December 2011.

3. P&L Analysis

Following paragraphs present the analysis of the profit and loss statement of Georgian Railway JSC for the twelve month period ended 31 December 2012.

3.1. Revenues

Revenues in 12 month period ended 31 December, 2012 amounted to GEL 469.8 million, representing a decrease of 1.6 per cent (GEL 7.6 million) compared to the same period in the previous year. Revenue from freight transportation increased by 0.6 per cent (GEL 1.9 million), which was caused by the increase in dry cargo transportation. This was offset by the decrease in liquid cargo transportation. The decrease was caused by the deficit of tank cars in the corridor. Decrease in freight handling by 17.6 per cent (GEL 11.1 million) was caused by the decrease in the penalties received by the company for the delay of railcars by company's clients. Revenue from freight car rental increased by 5.5 per cent (GEL 2.4 million), which was caused by the increased usage of GR's owned railcars by other railways. Passenger revenues increased by 14.3 per cent (GEL 2.2 million) due to the additional railcars and improved services. Other revenues decreased by 41.9 per cent (GEL 3.0 million) which was caused by the delay in scrap realisation.

The following table sets forth revenue breakdown and comparison of 12 month-periods ended 31 December 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Freight transportation	350,866	0.6%	1,942	348,924
Freight handling	50,925	-17.9%	(11,066)	61,991
Freight car rental	46,382	5.5%	2,425	43,957
Passenger transportation	17,432	14.3%	2,175	15,257
Other revenue	4,214	-41.9%	(3,034)	7,248
Total Revenue	**469,819**	**-1.6%**	**(7,558)**	**477,377**
Other Income	**31,953**	**165.7%**	**19,928**	**12,025**

3.1.1 Freight revenues

Freight transportation revenues:

Freight transportation revenues increased by GEL 1.9 million or by 0.6 per cent in year 2012 compared to the previous year. Increase in foreign currency (currently company's tariffs are in USD) was much higher. In fact exchange rate has a significant impact on Company's revenues as most of the tariffs are quoted in foreign currency, while significant part of the expenses is fixed in Georgian Lari. In 2011 for example most of the freight tariffs were set in CHF, which was constantly appreciating through the year 2011. This was causing substantial increase of revenue in GEL terms while the expenses remained largely the same. Starting from September 2011, CHF exchange rate began to go down. As Swiss Franc did not prove to be a stable and reliable currency, Georgian Railway JSC changed its tariff policy and starting from February 2012 began quoting its freight tariffs in USD, which has shown more stability. The reason for the move was also to better align the revenues and costs of the company's customers, which mainly trade in USD or GEL. The transition was made using the exchange rate of 1.1 meaning that for every 1 Swiss Franc, company set USD 1.1 as a new tariff.

As anticipated, USD proved to be stable, which resulted in the absence of significant gains and losses from the fluctuations. However, as a negative side, significant appreciation which was experienced in 2011 was not present in 2012, thus decreasing revenue in GEL terms. Should the exchange rate remain the same as in 2011, revenues would increase by approximately 5%.

For the year 2012 freight transportation revenues, liquid cargoes contributed ca. 49.2 per cent and dry cargoes ca. 50.8 per cent, while in 2011 liquid cargos contributed ca. 52.0% and dry cargos ca. 48.0%. The types of freight that positively contributed to the twelve-month period-over-period change in freight transportation revenue were mainly Construction freight, Sugar and Crude oil. However this was offset by the decrease in revenue from transportation of liquid cargo.

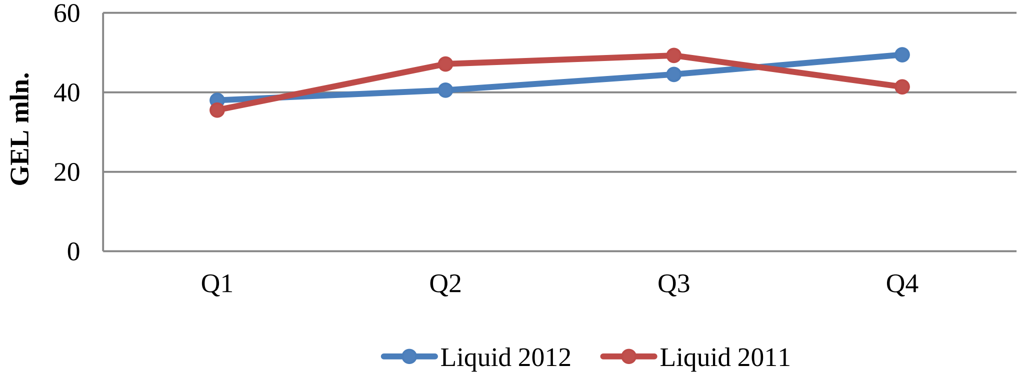
The following table sets forth freight transportation revenue by types of freight for the twelve-month periods ended 31 December 2011 and 2012:

GEL, Millions	**12 month period ended 31 December**			
	2012	***% Change***	***Abs. Change***	**2011**
Liquid Cargoes	172.5	-0.5%	(0.9)	173.4
of *which*				
Crude Oil	73.6	3.2%	2.3	71.3
Oil Products	98.9	-3.0%	(3.1)	102.0
Dry Cargoes	178.3	1.5%	2.7	175.6
of *which*				
Grain	38.0	-8.9%	(3.7)	41.7
Construction Freight	21.8	44.4%	6.7	15.1
Cement	3.5	-5.4%	(0.2)	3.7
Industrial Freight	39.8	-5.9%	(2.5)	42.3
Ferrous Metals and Scrap	20.8	4.5%	0.9	19.9
Ores	25.7	-3.4%	(0.9)	26.6
Sugar	5.1	54.5%	1.8	3.3
Chemicals, fertilizers	14.7	4.3%	0.6	14.1
Other	8.9	2.3%	0.2	8.7
Total	350.9	0.6%	2.0	348.9

Liquid cargo revenues:

Liquid cargo volumes decreased by 9.5 per cent (1.0 million ton) in year 2012 compared to the previous year. Revenue from transportation of liquid cargo decreased by 0.5 per cent.. The disproportion between liquid freight volume change and liquid freight revenue change was caused by the increase in transportation tariffs for liquid cargo.

The following graph presents distribution of revenue from liquid cargo transportation by quarters, for twelve-month periods ended 31 December 2012 and 2011:

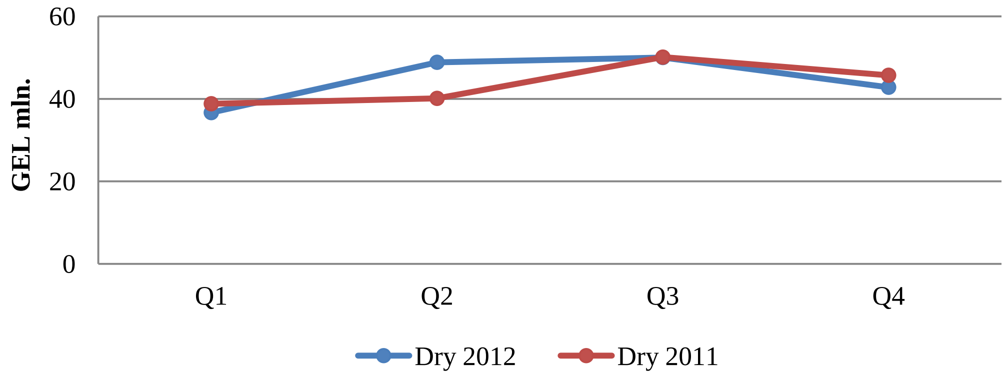


The graph shows that in the fourth quarter of 2012, liquid cargo revenue exceeded the revenue from the same period in previous year. This is caused by the reduction of deficit for tank cars in the corridor by additionally rented 425 liquid railcars by the Company in the mid 2012.

Dry cargo revenues:

Dry cargo volumes in twelve-month period ended 31 December 2012 increased by 9.7 per cent and revenues increased by 1.6 per cent compared to the previous year.

The following graph shows distribution of revenues from dry cargo transportation by quarters in twelve-month periods ended 31 December 2012 and 2011:



In the fourth quarter 2012, revenue from dry cargo was less than in the same period in the previous year, which was a result of decrease in transportation volumes in the end of the year, mainly caused by the slowing down of construction projects within Georgia after parliamentary elections and the strikes in several mines as well as at the Poti port on the Black Sea shore.

Freight handling and freight car rental revenues:

The following table sets forth the revenues from freight handling and freight car rental for the periods ended 31 December 2012 and 2011:

	12 month period ended 31 December			
’000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Freight handling	50,925	-17.9%	(11,066)	61,991
Freight car rental	46,382	5.5%	2,425	43,957

Revenue from freight handling decreased by 17.9 per cent (GEL 11.1 million) in the twelve-month period ended 31 December 2012 compared to the same period of the previous year. This is mostly attributable to the decrease in penalties received by the company for the delay of the railcars by company’s clients, as the clients began to operate with more efficiency and less delays due to the increased charges. Revenue from freight car rental increased by 5.5 per cent (GEL 2.4 million) in 12 month period ended 31 December 2012 compared to the same period in 2011. The increase was primarily due to the increased usage of company’s own railcars by other railways. Additionally rented 425 tank cars in the mid 2012 in order to decrease the deficit of liquid railcars in the corridor contributed to such increase, as the liquid cargo transportation is for the most part transit.

3.1.2. Passenger revenues

The following table sets forth the revenues from passenger transportation for 12 month period ended 31 December 2012 and 2011:

	12 month period ended 31 December			
’000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Passenger revenues	17,432	14.3%	2,175	15,257

Passenger revenues increased by 14.3 per cent (GEL 2.2 million) in the twelve-month period ended 31 December 2012 compared to the same period of the previous year, which was caused by the increased quality of service provided and additionally purchased railcars.

3.1.3. Other revenues

The following table sets forth other revenue for 12 month period ended 31 December 2012 and 2011:

	12 month period ended 31 December			
’000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Other revenue	4,214	-41.9%	(3,034)	7,248

Other revenues comprise such items as: revenue from rent of space in buildings, sale of scrap, repair services and such. Decrease in twelve-month period ended 31 December 2012 compared to the same period in 2011 was caused by the delay of scrap realization to the later periods.

3.1.4. Other income

The following table sets forth other income for 12 month period ended 31 December 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Other Income	**31,953**	***165.7%***	***19,928***	**12,025**
Of which:				
Continuing Operations	12,660	35.1%	3,288	9,372
Non-Continuing Operations	19,293	627.2%	16,640	2,653

Other income mostly comprises of items such as penalties accrued on debtors or creditors, gain on inventory revaluation, revenue from communication services, revenue for inflicted loss on company from third parties, revenue from the surplus of inventory and other. In 12 month period ended 31 December 2012 other income increased by 165.7% (GEL 19.9 million), compared to the same period of previous year. The increase was caused by the increase in non-continuing operations by 627.2% (GEL 16.6 million) this increase was mainly caused guarantee and damage provisions (GEL 14.4 million), revenue from surplus of inventory (GEL 2.2 million) and revenue from revaluation of inventory (GEL 0.6 million). Also total increase in other income was caused by increase in continuing operations by 35.1% (GEL 3.2 millions). This increase was mainly caused by increase in other revenues (GEL 3 million) and revenue from service of heavy equipment (GEL 0.7 million).

3.2. Operational expenses

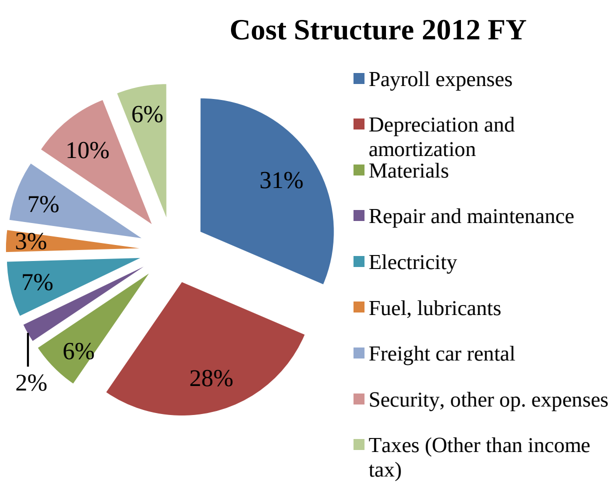
3.2.1. Main operational expenditure items

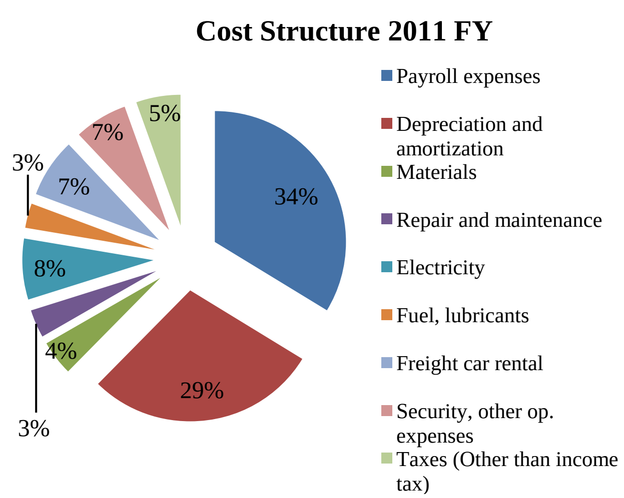
The following table sets forth total expenses of Georgian Railway JSC, excluding Finance Costs, Interest Income/Expense and Profit Tax, for the twelve month period ended 31 December of years 2012 and 2011:

	12 month period ended 31 December			
	2012	***% Change***	**Abs. Change**	**2011**
Staff costs	(108,467)	-0.0%	26	(108,493)
Depreciation and amortization	(97,082)	5.4%	(4,945)	(92,137)
Materials	(20,758)	49.9%	(6,909)	(13,849)
Repair and maintenance	(7,729)	-30.4%	3,371	(11,100)
Electricity	(23,127)	-4.4%	1,053	(24,180)
Fuel, lubricants	(9,088)	-6.6%	646	(9,734)
Freight car rental	(25,038)	7.0%	(1,638)	(23,400)
Security, other op. expenses	(34,950)	65.9%	(13,889)	(21,061)
Property and land tax	(20,729)	17.4%	(3,071)	(17,658)
Total	**(346,968)**	7.9%	(25,356)	**(321,612)**

Total expenses for twelve month period ended 31 December 2012 increased by 7.9 per cent (GEL 25.4 million) compared to the twelve month period ended 31 December 2011, the main reasons of which was the increase in security and other operating expenses.

The following charts sets forth the cost structure for the twelve month period ended 31 December of years 2012 and 2011:





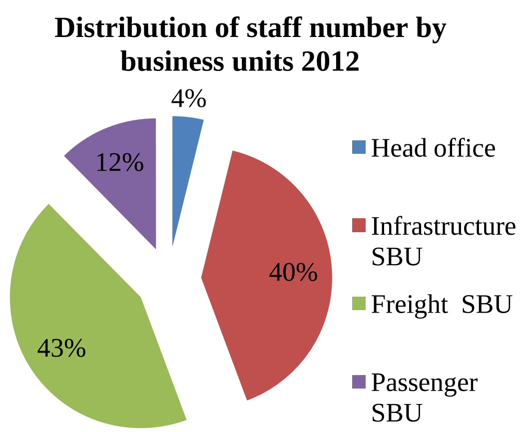
__3.2.2. Staff cost__

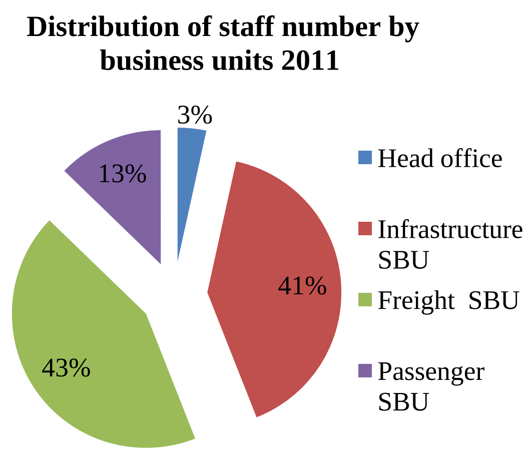
The following table sets forth staff costs for the twelve month period ended 31 December for years 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Staff cost	(108,467)	-0.02%	26	(108,493)

There is only an insignificant decrease in total staff cost, however taking into account the fact that in expense of 2011 there is included bonus payment of approximately GEL 8 million, while for 2012 such bonus payment has not been made, thus the salary expense increased in 2012. Employee number at the end of 2011 was equal to 13,063 and accordingly in the end of 2012 the number of employees was 12,494. This was the offsetting factor of the increased salary levels for the staff members who remained at the company. The main increases took place in the fourth quarter of 2012, thus the full effect of the increase will be only visible in 2013.

Following charts show the distribution of staff number by strategic business units and head office of the company (excluding subsidiaries):





The following table sets forth average salaries for the twelve month period ended 31 December for years 2012 and 2011:

	12 month period ended 31 December			
'GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Average Salary	708	*7.3%*	*48*	660

3.2.3. Materials, Repair and Maintenance Expenses

The following table sets forth materials and repair and maintenance expenses for the twelve month period ended 31 December for years 2012 and 2011:

	12 month period ended 31 December			
’000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Materials	(20,758)	*49.9%*	*(6,909)*	(13,849)
Repair and maintenance	(7,729)	*-30.4%*	*3,371*	(11,100)
TOTAL	**(28,487)**	***14.2%***	***3,538***	**(24,949)**

Total expense for materials and repair and maintenance services for the twelve month period ended 31 December 2012 increased by 14.2 per cent (GEL 3,5 million) compared to the twelve month period ended 31 December 2011. Materials expenses increased by 33 per cent (GEL 6,9 million) as in the year 2012 Company bought materials which were in deficit in the year 2011 and thus performed types of repairs which were not made in the previous year. Repair and maintenance expense decreased by 30.4 per cent in year 2012 compared to 2011. Main reason of the decrease was reduced number of TwinHead repairs in 2012, because the company signed an agreement for capital repairs of railcars, thus TwinHeads were replaced as part of the contract, thus did not appear in operating expenses. The Company is also planning to redesign the repair depot in Samtredia, which will be able to perform TwinHead repairs, thus the Company is trying to avoid making such types of repairs through third parties until then.

3.2.4. Consumption of utility – Electricity and Fuel Expenses

The following table sets forth electricity expense for the twelve month period ended 31 December for years 2012 and 2011:

Electricity Expense:

	12 month period ended 31 December			
’000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Electricity	(23,127)	*-4.4%*	*1053*	(24,180)

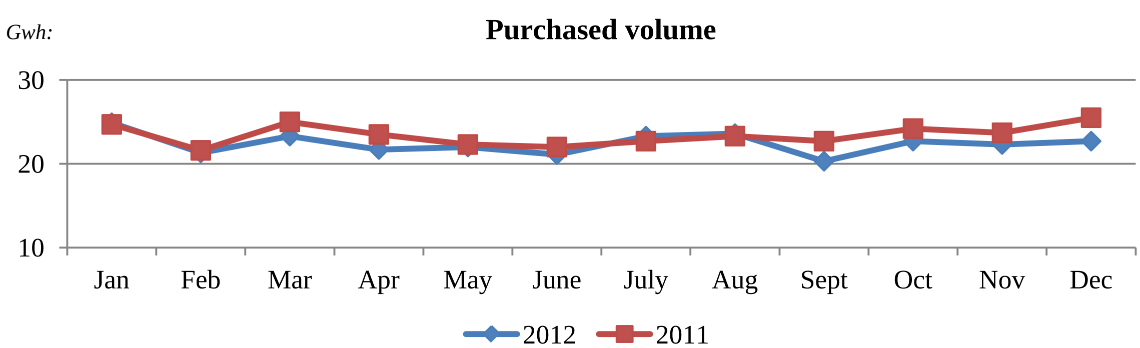
Electricity expense for the twelve month period ended 31 December 2012 decreased by 4.4 per cent (GEL 1.1 million) compared to the twelve month period ended 31 December 2011. Change in electricity expense is a function of two major variables: price per purchased KWh and consumed electricity, which in the twelve month period ended 31 December 2012 decreased by 4.3 per cent (12 GWh), to ca. 269.3 GWh compared to the consumption in the twelve month period ended 31 December 2011. The decrease was caused by the decrease of the distance of cargo transportation (resulting from the decreased share of transit traffic). As for the price of KWh, until September 2011 the company was purchasing electricity with tariffs provided by ESCO (Electricity System Commercial Operator), which was the sole provider of electricity to Georgian Railway JSC. Tariffs were ranging from 4 Tetri (one hundredth of Lari) to 12 Tetri per KWh according to the seasonality. Since September 2011 Energo-Pro Georgia became a main provider of electricity to Georgian Railway JSC (providing more than 90 per cent of electricity for

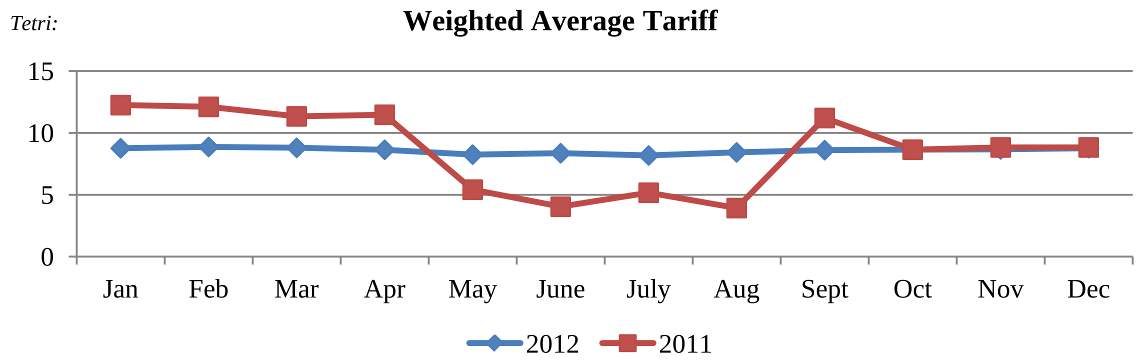
Company's needs. It must be noted that a small portion of electricity is still purchased without a fixed tarff). Energo-Pro Georgia has set fixed tariff of 8.56 Tetri per KWh. Hence electricity expense in twelve month period ended 31 December 2012 decreased by GEL 1.05 million and amounted to GEL 23.1 million.

The following table shows purchased electricity and weighted average tariff paid by Georgian Railway JSC:

	2012			**2011**		
	GWh	**Amount paid (GEL m.)**	**WA.tariff (Tetri per KWh)**	**GWh**	**Amount paid (GEL m.)**	**WA tariff (Tetri per KWh)**
January	24.9	2.19	8.76	24.7	3.02	12.25
February	21.3	1.89	8.87	21.6	2.61	12.11
March	23.3	2.05	8.80	25.0	2.83	11.34
April	21.7	1.87	8.64	23.5	2.69	11.47
May	22.0	1.81	8.25	22.3	1.21	5.42
June	21.1	1.77	8.36	22.0	0.89	4.04
July	23.3	1.91	8.18	22.7	1.18	5.17
August	23.6	1.99	8.43	23.3	0.92	3.93
September	20.3	1.75	8.61	22.7	2.55	11.21
October	22.7	1.96	8.65	24.2	2.09	8.65
November	22.3	1.93	8.67	23.7	2.09	8.83
December	22.7	1.99	8.77	25.5	2.25	8.83
Total	**269.3**	**23.11**	**8.58**	**281.2**	**24.33**	**8.60**

The following graphs show comparison of purchased volumes and weighted average tariffs by months for the twelve month period ended 31 December of years 2012 and 2011:





Fuel expenses:

The following table sets forth fuel expense for the twelve month period ended 31 December for years 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Fuel, lubricants	(9,088)	*-6.6%*	*646*	(9,734)

Fuel (and lubricants) expense in the twelve month period ended 31 December 2012 decreased by 6.6 per cent compared to the twelve month period ended 31 December 2011. The main reason for decrease was the decrease in revenue from freight handling services (a result of decreased local transportation). As diesel locomotives are mainly used for freight handling operations, fuel expense is closely tied to the level of their operations.

3.2.5. Freight car rental expense

The following table sets forth freight car rental expense for the twelve month period ended 31 December for years 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Freight car rental	(25,038)	*7.0%*	*(1638)*	(23,400)

Freight car rental expenses for the twelve month period ended 31 December 2012 increased by 6.5 per cent compared to the twelve month period ended 31 December 2011. The increase was mainly due to the rental of additional 425 tank cars by Georgian Railway in the middle of the year 2012 to decrease the deficit of tank cars in the corridor.

3.2.6. Security and other expenses

The following table sets forth security and other operational expenses for the twelve month period ended 31 December for years 2012 and 2011:

’000 GEL	12 month period ended 31 December			
	2012	***% Change***	***Abs. Change***	**2011**
Security	(7,156)	*-3.0%*	*219*	(7,375)
Other op. expenses	(27,794)	*103.1%*	*(14,108)*	(13,686)
Total	**(34,950)**	***65.9%***	***(13,889)***	**(21,061)**

Total security and other operating expenses for the twelve month period ended 31 December 2012 increased by 65.9 per cent (GEL 13.9 million) compared to the twelve month period ended 31 December 2011. Other operating expenses mainly consist of such items as: municipal, communication, legal costs, consultancy, membership fees, administrative expenses and etc. increase of write offs of Construction in Progress and Fixed assets of GEL 10.7 million caused the increase of other operating expenses in the full year 2012 by 103.1 per cent.

3.2.7. Property and land taxes

The following table sets forth the breakdown of Property and Land taxes for the twelve month periods ended 31 December 2012 and 2011:

’000 GEL	12 month period ended 31 December			
	2012	***% change***	**Abs. change**	**2011**
Property tax	(10,575)	*29.5%*	*(2,406)*	(8,169)
Land Tax	(9,826)	*7.4%*	*(679)*	(9,147)
Other taxes	(329)	*-3.8%*	*13*	(342)
Total	**(20,729)**	***17.4%***	***(3,071)***	**(17,658)**

Property tax increased due to the increase in Construction in Progress and land tax increased due to the purchased land plots for Modernization and Bypass projects. Other taxes consists unpaid VAT and customs fees.

3.3. Financial costs and income

The following table sets forth the breakdown of financial costs and income for the twelve month periods ended 31 December 2012 and 2011:

’000 GEL	12 month period ended 31 December			
	2012	***% Change***	***Abs. Change***	**2011**
Provisions	(7,681)	*3.7%*	*(276)*	(7,405)
FX gain/loss	3,204	*-80.1%*	*(12,891)*	16,095
Interest income	15,902	*45.3%*	*4,961*	10,941
Loss on Eurobond buy-back	(41,178)	-	*(41,178)*	-
Interest expense	(10,451)	*238.4%*	*(7,363)*	(3,088)
Net finance income/(cost)	**(40,204)**	*-343.0%*	*(56,746)*	**16,542**

Finance income in the twelve month period ended 31 December 2012 decreased by GEL 56.7 million compared to the twelve month period ended 31 December 2011 and resulted in a financial cost. The decrease was mainly caused by the fact that financial expenses include Eurobond buy-back premium, which comprised approximately GEL 41 million which took place in year 2012 but was absent in year 2011. FX gain has also decreased significantly as the depreciation of USD against GEL causes FX gain for the company as Eurobond liability is in USD. As in 2011 USD depreciated against GEL by approximately 6%, while in 2012 the depreciation was less than 1%, FX gain was subsequently less in 2012. This caused reduction of net foreign exchange gain from GEL 16.1 million to GEL 3.2 million and finance income decreased. Decrease of finance income was partly offset by increased interest income on the company's cash balances.

3.4. Income Tax Expense

The following table shows the Income Tax Expense for the twelve month period ended 31 December of years 2012 and 2011:

	12 month period ended 31 December			
'000 GEL	**2012**	***% change***	**Abs. change**	**2011**
Income Tax Expense	(17,384)	75.2%	(7,463)	(9,921)

The increase in income tax expense in the twelve month period ended 31 December 2012 is caused by the fact that in the twelve month period ended 31 December 2011 there was a reversal of a tax liability in the amount of GEL 13.0 million as a result of a favourable court ruling. Following the resolution of a tax dispute, the Revenue Service under the Ministry of Finance of Georgia has returned approximately GEL 13 million to the Company. The Revenue Service affected this return by recording an equivalent surplus on the Company's taxpayer card. The Company set this surplus off against future taxes it would otherwise owe until the amount has been reduced in full. If we take this into consideration it will be apparent that in the full year 2012 income tax expense has decreased compared to full year 2011, which is the direct result of decreased profit before tax.

3.5. Profitability

The following Table show the calculation of Adjusted EBITDA and Adjusted EBITDA margin:

	12 month period ended 31 December			
'000 GEL	**2012**	***% Change***	***Abs. Change***	**2011**
Revenues	469,819	-1.6%	(7,558)	477,377
Other income	31,953	165.7%	19,928	12,025
Expenses	(346,968)	7.9%	(25,356)	(321,612)
Result from Operating Activities	**154,804**	**-7.7%**	**(12,986)**	**167,790**
Depreciation add-back	97,082	5.4%	4,945	92,137
Non-continuing operations from other income	(19,293)	627.2%	(16,640)	(2,653)
Wright-offs	14,785	261.1%	10,691	4,094
Adjusted EBITDA	**247,378**	**-5.4%**	**(14,240)**	**261,618**
Adjusted EBITDA Margin	**52.7%**			**54.8%**

Adjusted EBIDA for the twelve-month period ended 31 December 2012 amounted to GEL 247.4 million, representing a decrease of 5.4 per cent (GEL 14.2 million) compared to the same period of previous year. Adjusted EBITDA margin reached 52.7 per cent, compared to the 54.8 per cent for the twelve-month period ended 31 December 2011.

4. Cash flows

’000 GEL	Note	2012	2011
Cash flows from operating activities			
Cash receipts from customers		470,825	480,859
Cash paid to suppliers and employees		(245,997)	(224,670)
VAT tax refund from the State		23,000	
Cash flows from operations before income taxes and interest paid		**247,828**	**256,189**
Income tax paid		(8,220)	(30,259)
Net cash from operating activities		**239,608**	**225,930**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(401,168)	(436,028)
Proceeds from sale of property, plant and equipment		3,032	
Increase in term deposits		(23,872)	(38,428)
Decrease in restricted cash		2,963	8,949
Interest received		11,300	9,883
Net cash used in investing activities		**(407,745)**	**(455,624)**
Cash flows from financing activities			
Proceeds from borrowings		396,182	1,144
Penalty paid for early redemption of issued bonds		(41,178)	-
Repayment of borrowings		(635)	(477)
Interest paid		(22,915)	(43,080)
Dividends paid		(150,725)	-
Contribution of cash by owners		-	20,000
Distribution of cash to owners		(3,101)	(1,528)
Net cash from /(used in) financing activities		**218,806**	**(23,941)**
Net increase/(decrease) in cash and cash equivalents		**50,669**	**(253,635)**
Cash and cash equivalents at 1 January		61,553	323,943
Effect of exchange rate fluctuations on cash and cash equivalents		2,854	(8,755)
Cash and cash equivalents at 31 December	17	**115,076**	**61,553**

The Company’s cash flow management policies focus on maintaining a flexible capital expenditure programs and maximizing cash flow generation, in line with potential future changes in passenger numbers and freight volumes transported. Through these policies, management aims to permit both the maintenance of infrastructure and the pursuit of selective growth opportunities. Management seeks to rely on operating cash flows to finance capital expenditures, but also seeks to maintain a diversified funding structure for strategic initiatives.

4.1. Net cash from operating activities

Following table shows cash from operating activities for the twelve- month periods ended 31 December 2012 and 2011:

’000 GEL	**2012**	Abs. change	% change	**2011**
Cash flows from operating activities				
Cash receipts from customers	470,825	*(10,034)*	*-2.1%*	480,859
Cash paid to suppliers and employees	(245,997)	*(21,327)*	*9.5%*	(224,670)
VAT refund from the State	23,000	*23,000*	*100.0%*	0
Cash flows from operations before income taxes and interest paid	**247,828**	***(7,983)***	***-3.1%***	**256,189**
Income tax paid	(8,220)	*22,039*	*-72.8%*	(30,259)
Net cash from operating activities	**239,608**	***13,678***	***6.1%***	**225,930**

Net cash from operating activities in twelve month period ended 31 December 2012 has increased by 6.1 per cent compared to the same period in 2011. This was mainly a result of increase in VAT refund from the state. In April and May 2012, the Company received GEL 13 million and GEL 10 million, respectively, from the Government by way of a reimbursement of VAT surplus accumulated by the Company in respect of capital projects undertaken in 2011. Given the level of the accumulated surplus, Georgian Railway applied for a return of these funds and received it according to the officially stated procedures. Another reason for the increase was decrease in income tax paid by 72.8 per cent (or GEL 22.0 million) caused by accumulation of the surpluses of prepaid income taxes in earlier periods.

The increase was partly offset by the decrease in cash receipts from customers of 2.1 per cent (GEL 10.0 million), mainly as a result of decreased revenue. Another reason reducing the increase was increase in cash paid to suppliers and employees, which was a result of increased operating expenses in twelve-month period 2012 compared to the same period in 2011.

4.2. Net cash used in investing activities

Following table shows cash from investing activities for the twelve- month periods ended 31 December 2012 and 2011:

’000 GEL	2012	Abs. change	% change	2011
Cash flows from investing activities				
Acquisition of property, plant and equipment	(401,168)	34,860	-8.0%	(436,028)
Proceeds from sale of property, plant and equipment	3,032	3,032	100.0%	0
Increase in term deposits	(23,873)	14,555	-37.9%	(38,428)
Decrease in restricted cash	2,963	(5,986)	-66.9%	8,949
Interest received	11,300	1,417	14.3%	9,883
Net cash used in investing activities	**(407,745)**	**47,879**	**-10.5%**	**(455,624)**

The Company’s total net cash used in investing activities was GEL 407.7 million for the twelve-month period ended 31 December 2012, as compared to GEL 455.6 million for the twelve-month period ended 31 December 2011, representing a decrease of 10.5 per cent (or GEL 47.9 million). This decrease was principally due to a decrease in additions to property, plant and equipment by 8.0 per cent (or GEL 34.9 million).

Cash paid for Bypass project was GEL 132.1 million in the twelve-month period ended 31 December 2012 and GEL 152.6 million in the twelve-month period ended 31 December 2011. Cash paid for Modernization Project was GEL 94.7 million in the twelve-month period ended 31 December 2012 and GEL 87.2 million in the twelve-month period ended 31 December 2011.

4.3. Net cash used in financing activities

Following table shows cash from financing activities for the twelve- month periods ended 31 December 2012 and 2011:

’000 GEL	2012	Abs. change	% change	2011
Cash flows from financing activities				
Proceeds from borrowings	396,182	395,038	34531.3%	1,144
Repayment of borrowings	(635)	(158)	33.1%	(477)
Interest paid	(22,915)	20,165	-46.8%	(43,080)
Dividends paid	(150,725)	(150,725)	100.0%	0
Contribution of cash by owners	0	(20,000)	-100.0%	20,000
Distribution of cash to owners	(3,101)	(1,573)	102.9%	(1,528)
Net cash from /(used in) financing activities	**218,806**	**242,747**	**-1013.9%**	**(23,941)**

The Company’s total net cash used in financing activities was GEL 218.8 million for the twelve-month period ended 31 December 2012, as compared to a negative GEL 23.9 million for the twelve-month period ended 31 December 2011, representing an increase by GEL 242.7 million. This was principally caused by the increase in proceeds from borrowings of GEL 395.0 million. The reason for such increase of proceeds from borrowings was that in July 2012 the company issued bonds with a face value of USD 500 millions, which was used in order to refinance previous bond issue (USD 250 million), extend maturity of the loan and create some extra cash for Company needs.

This was partially offset by the increase in dividends paid. In 2012 Georgian Railway JSC (the Company) has declared a total dividend payment of GEL 359.6 million out of consolidated profit and total comprehensive income for prior periods ended 31 December 2011 and later a dividend payment of GEL 22.7 million. During the nine-month period ended 31 September 2012 the Company made a dividend payment in the amount of GEL 150.7 million, as GEL 231.6 million was deducted from the announced dividends and retained within a company pursuant to the terms of the Tbilisi Bypass Project Memorandum of Understanding, to reimburse the Company for expenses incurred by it in connection with the Tbilisi Bypass Project. Another factor decreasing the effect of increased borrowings was premium paid for the early redemption of 2010 year USD 250 million bond issue of GEL 41.2 million.

5. Balance Sheet

'000 GEL	2012	% change	Abs. change	2011
ASSETS				
Non-current assets				
Property, plant and equipment	2,197,235	15%	284,040	1,913,195
Investment property	-	-100%	(6,838)	6,838
Deferred tax assets	1,557	100%	1,557	-
Other non-current assets	280,884	2%	4,845	276,039
Total non-current assets	**2,479,676**	**13%**	**283,604**	**2,196,072**
Current assets				
Inventories	35,571	50%	11,834	23,737
Current tax assets	-	-100%	(511)	511
Trade and other receivables	39,253	43%	11,898	27,355
Prepayments and other current assets	61,648	122%	33,934	27,714
Term deposits	100,321	31%	23,872	76,449
Cash and cash equivalents	115,076	78%	50,560	64,516
Total current assets	**351,869**	**60%**	**131,587**	**220,282**
Total assets	**2,831,545**	**17%**	**415,191**	**2,416,354**
EQUITY AND LIABILITIES				
Equity				
Share capital	1,049,751	5%	49,288	1,000,463
Non-cash owner contribution reserve	31,673	-17%	(6,370)	38,043
Retained earnings	449,376	-41%	(314,126)	763,502
Total equity	**1,530,800**	**-15%**	**(271,208)**	**1,802,008**
Non-current liabilities				
Loans and borrowings	870,934	110%	456,871	414,063
Advance received from the Government	231,592	100%	231,592	-
Trade and other payables	52	16%	7	45
Deferred tax liabilities	57,302	-6%	(3,623)	60,925
Total non-current liabilities	**1,159,880**	**144%**	**684,847**	**475,033**
Current liabilities				
Loans and borrowings	33,420	80%	14,813	18,607
Trade and other payables	81,645	78%	35,691	45,954
Liabilities to the Government	12,956	-2%	(232)	13,188
Provisions	4,132	-80%	(16,141)	20,273
Other taxes payable	-	-100%	(26,867)	26,867
Current tax liabilities	1,542	100%	1,542	-
Other current liabilities	7,170	-50%	(7,254)	14,424
Total current liabilities	**140,865**	**1%**	**1,552**	**139,313**
Total liabilities	**1,300,745**	**112%**	**686,399**	**614,346**
Total equity and liabilities	**2,831,545**	**17%**	**415,191**	**2,416,354**

5.1. Non-current Assets

The following table sets forth breakdown of non-current assets as of December 31 2012 and 2011:

’000 GEL	**2012**	**% change**	**Abs. change**	**2011**
Property, plant and equipment	2,197,235	15%	284,040	1,913,195
Investment property	-	-100%	-6,838	6,838
Deferred tax assets	1,557	100%	1,557	-
Other non-current assets	280,884	2%	4,845	276,039
Total non-current assets	**2,479,676**	**13%**	**283,604**	**2,196,072**

Total non-current assets increased by 13 per cent (GEL 283.6 million) in 2012 comparing to the same period of the previous year. The increase was mainly caused by increase in property, plant and equipment by 15 per cent (GEL 284.0 million). This increase was due increase in construction in progress within the framework of Modernization and Tbilisi Bypass project. Acquisition of other railway assets contributed to the increase in PPE.

5.2. Current Assets

The following table sets forth breakdown of current assets as of ended December 31 2012 and 2011:

’000 GEL	**2012**	**% change**	**Abs. change**	**2011**
Inventories	35,571	50%	11,834	23,737
Current tax assets	-	-100%	(511)	511
Trade and other receivables	39,253	43%	11,898	27,355
Prepayments and other current assets	61,648	122%	33,934	27,714
Term deposits	100,321	31%	23,872	76,449
Cash and cash equivalents	115,076	78%	50,560	64,516
Total current assets	**351,869**	**60%**	**131,587**	**220,282**

Total current assets increased by 60 per cent (GEL 131.6 million) for the period ended December 31 2012, comparing to the same period in the previous year. The increase was mainly caused by the increase in cash, term deposits and prepayments. Increase in cash and cash equivalents and term deposits was mainly due to the issue of new Euro-bond issue in July 2012 with par value USD 500 million. Increase in prepayments and other current assets also contributed to the increase, which in its turn was caused by an increase in VAT refundable asset, as a result of the ongoing capital investment projects and other capital acquisitions.

5.3. Equity

The following table sets forth breakdown of equity as of December 31 2012 and 2011:

’000 GEL	2012	% change	Abs. change	2011
Share capital	1,049,751	5%	49,288	1,000,463
Non-cash owner contribution reserve	31,673	-17%	(6,370)	38,043
Retained earnings	449,376	-41%	(314,126)	763,502
Total equity	**1,530,800**	**-15%**	**-271,208**	**1,802,008**

Total equity decreased by 15 per cent (GEL 271.2 million) for the period ended December 31 2012 comparing to the same period of the previous year. The decrease was mainly caused by large dividends distributed in 2012.

5.4. Non-current liabilities

The following table sets forth breakdown of non-current liabilities as of December 31 2012 and 2011:

’000 GEL	2012	% change	Abs. change	2011
Loans and borrowings	870,934	110%	456,871	414,063
Advance received from the Government	231,592	100%	231,592	-
Trade and other payables	52	16%	7	45
Deferred tax liabilities	57,302	-6%	(3,623)	60,925
Total non-current liabilities	**1,159,880**	**144%**	**684,847**	**475,033**

Total increase in non-current liabilities was 144 per cent (GEL 684.8 million), which was mainly caused by the issue of new Eurobonds with par value of USD 500 millions. The proceeds were used to refinance previous issue with 5 year maturity (par value USD 250 million). Another factor contributing to the increase was a presale of Bypass land to the government for CHF 138 million, which were received by the company in form of returned dividends.

5.5. Current liabilities

The following table sets forth breakdown of current liabilities as of December 31 2012 and 2011:

'000 GEL	2012	% change	Abs. change	2011
Loans and borrowings	33,420	80%	14,813	18,607
Trade and other payables	81,645	78%	35,691	45,954
Liabilities to the Government	12,956	-2%	(232)	13,188
Provisions	4,132	-80%	(16,141)	20,273
Other taxes payable	-	-100%	(26,867)	26,867
Current tax liabilities	1,542	100%	1,542	-
Other current liabilities	7,170	-50%	(7,254)	14,424
Total current liabilities	**140,865**	**1%**	**1,552**	**139,313**

Total current liabilities increased by 1 per cent (GEL 1.6 million), which was caused by the increase in trade and other payables and loans and borrowings. Main contributor of the increase in trade and other payables was temporary increase in payables to the contractor for the works conducted in connection with Modernization project. Current loans and borrowings increased due to the increased accrued interest on USD 500 million Eurobonds by the end of the year 2012. In 2011

6. Operational Performance Report

6.1. Traffic report

6.1.1. Freight traffic data

The following table sets forth breakdown of the freight transportation volumes, by type of freight transported, for the twelve-month periods ended 31 December 2012 and 2011:

Ton, Millions	**12 month period ended 31 December**			
	2012	***% Change***	***Abs. Change***	**2011**
Liquid Cargoes	**9.47**	**-9.50%**	**-0.99**	**10.46**
of which:				
Crude Oil	4.72	-12.60%	-0.68	5.4
Oil Products	4.75	-6.10%	-0.31	5.06
Dry Cargoes	**10.61**	**9.80%**	**0.95**	**9.66**
of which:				
Grain	1.42	14.73%	0.18	1.24
Construction Freight	1.59	-2.46%	(0.04)	1.63
Cement	0.67	31.12%	0.16	0.51
Industrial Freight	0.71	55.86%	0.25	0.45
Ferrous Metals and Scrap	1.10	-5.15%	(0.06)	1.16
Ores	2.18	13.06%	0.25	1.92
Sugar	0.69	29.11%	0.16	0.53
Chemicals, fertilizers	0.51	-2.21%	(0.01)	0.52
Other	1.73	3.01%	0.05	1.68
Total	**20.08**	**-0.20%**	**-0.04**	**20.12**

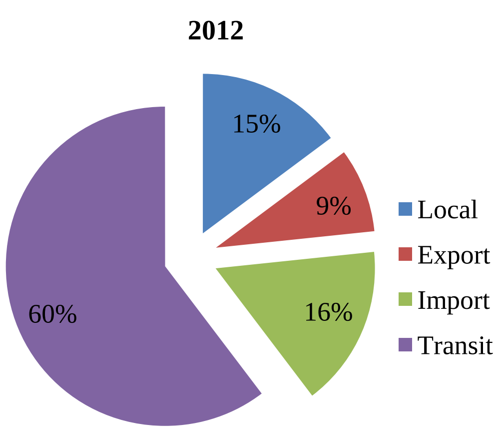
In the twelve months of 2012, total freight transportation volumes decreased by 0.2 per cent, compared to the previous year. The decrease was mainly caused by the decrease in liquid cargo transportation by 9.5 per cent, due to the lack of rolling stock and severe weather conditions in the beginning of the year and maintenance repair works on Tengizchevroil production field, which started in August 2012 and ended in late September. The decrease was partially offset by the increase in dry cargo transportation by 9.8 per cent (0.95 million tons) which in its turn was due to the increase in cement, grain, sugar and Industrial freight transportation.

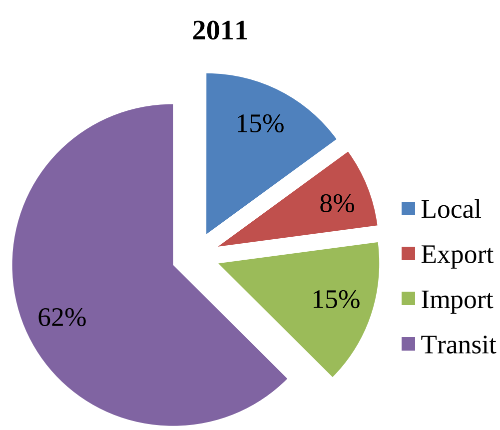
The following table sets forth the breakdown of freight transportation volumes by types of freight transported for months of 12 months 2012:

Tons, Millions	2012												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	12M Total
Liquid Cargoes	**0.82**	**0.68**	**0.72**	**0.76**	**0.81**	**0.81**	**0.94**	**0.79**	**0.59**	**0.91**	**0.94**	**0.70**	**9.47**
of which													
Crude Oil	0.43	0.34	0.38	0.37	0.39	0.4	0.51	0.38	0.2	0.50	0.54	0.28	**4.72**
Oil Products	0.4	0.33	0.34	0.39	0.42	0.41	0.43	0.42	0.39	0.41	0.40	0.42	**4.75**
Dry Cargoes	**0.85**	**0.64**	**0.84**	**0.99**	**0.98**	**0.88**	**0.93**	**1.07**	**0.98**	**0.85**	**0.76**	**0.84**	**10.61**
of which													
Grain	0.14	0.08	0.13	0.08	0.11	0.09	0.17	0.17	0.15	0.15	0.07	0.07	**1.42**
Construction Freight	0.14	0.10	0.14	0.14	0.16	0.16	0.13	0.14	0.14	0.12	0.12	0.10	**1.59**
Cement	0.03	0.02	0.04	0.06	0.07	0.06	0.07	0.08	0.07	0.07	0.06	0.05	**0.67**
Industrial Freight	0.03	0.03	0.04	0.04	0.07	0.06	0.07	0.09	0.09	0.08	0.07	0.05	**0.71**
Ferrous Metals and Scrap	0.09	0.08	0.11	0.09	0.12	0.07	0.10	0.10	0.09	0.08	0.09	0.08	**1.10**
Ores	0.22	0.14	0.16	0.25	0.23	0.17	0.18	0.22	0.20	0.13	0.10	0.18	**2.18**
Sugar	0.05	0.04	0.02	0.06	0.04	0.08	0.04	0.09	0.05	0.05	0.07	0.09	**0.69**
Chemicals, fertilizers	0.02	0.03	0.04	0.10	0.03	0.04	0.04	0.05	0.05	0.02	0.05	0.05	**0.51**
Other	0.14	0.12	0.16	0.17	0.17	0.14	0.13	0.13	0.14	0.16	0.13	0.15	**1.73**
Total	**1.67**	**1.31**	**1.56**	**1.75**	**1.79**	**1.69**	**1.87**	**1.86**	**1.58**	**1.76**	**1.70**	**1.53**	**20.08**

As mentioned above, increase in total transportation volumes was offset by the decrease in Liquid Cargo volumes. It must be noted that in July 2012 the transportation of liquid cargo improved by 5.0 per cent compared to the July of 2011 as a result of additionally leased tank cars. Despite this, in August and September as a result of Tengizchevroil's maintenance repairs at the production field, the volume of liquids has decreased by 8.5 per cent and 31.9 per cent respectively compared to the same months in 2011. As the production on Tengizchevroil field resumed in October, the company has seen that the volumes of liquid cargo transportation had increased significantly to the high levels of July of 2012.

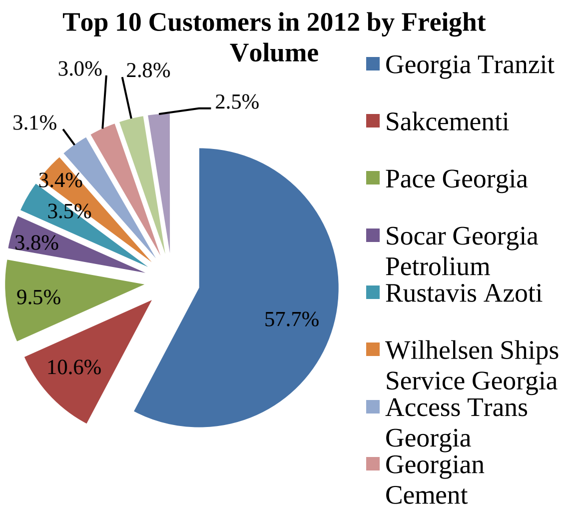
The following graphs show the freight transportation volumes by type of destination:



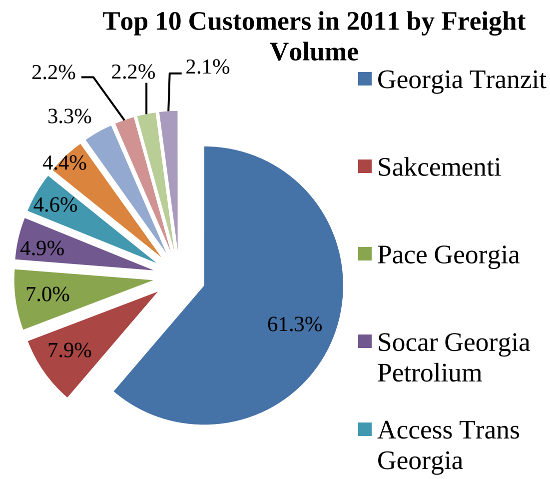


Top 10 freight customers, 12 month period ended 31 December 2012 and 2011:

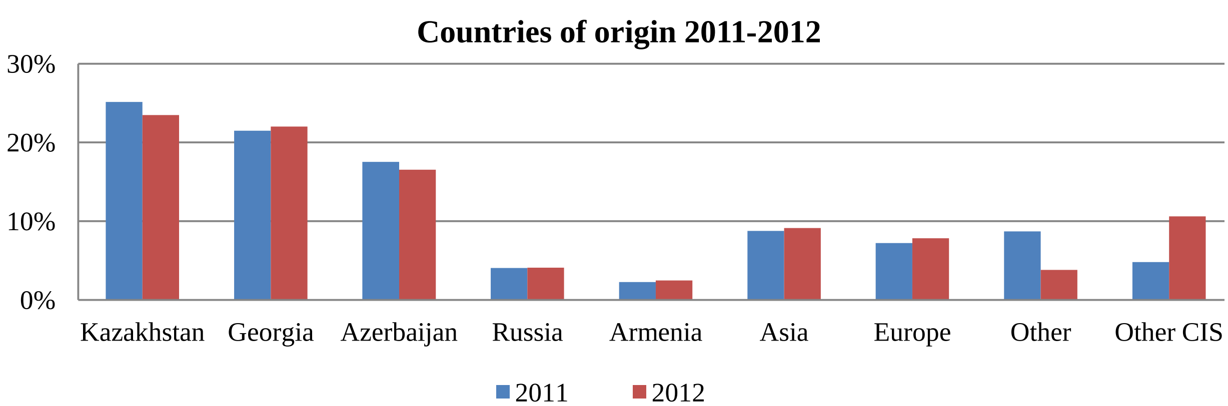
In 12M 2012 top ten freight customers transported 66.7% (13.36 million ton) of total freight volume – 20.08 million ton:



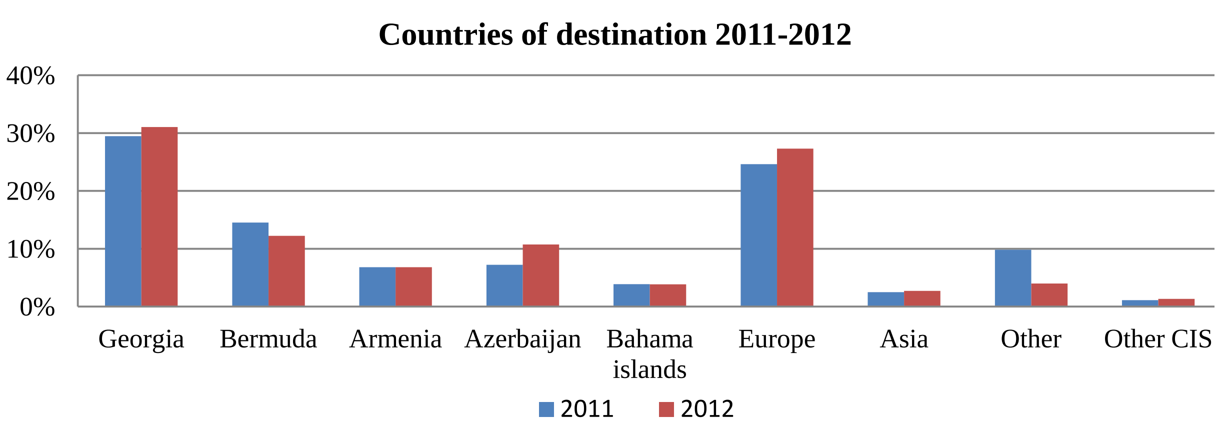
In 12M 2011 top ten freight customers transported 69.7% (14.03 million ton) of total freight volume – 20.12 million ton:



The following graphs show the breakdown of countries of origin of freight transported:



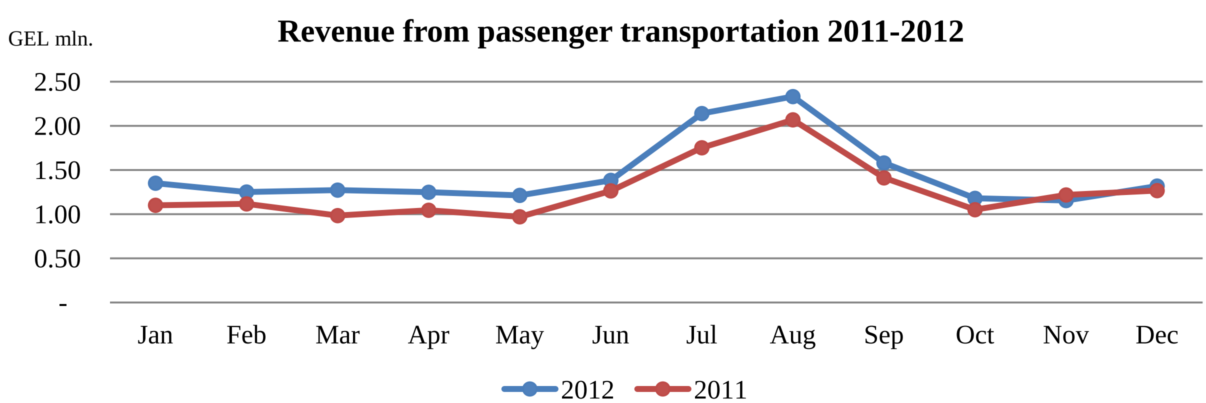
The following graphs show the breakdown of countries of destination of freight transported:



6.1.2. Passenger transportation data

The following table sets forth the passenger transportation volumes by months of 12 month periods ended 31 December 2012 and 2011:

Number of Passengers ('000)	**2012**	***% Change***	***Abs. Change***	**2011**
January	242	*2.11%*	*5.0*	237
February	224	*3.23%*	*7.0*	217
March	246	*7.42%*	*17.0*	229
April	250	*-4.21%*	*-11.0*	261
May	242	*-7.28%*	*-19.0*	261
June	258	*-10.73%*	*-31.0*	289
July	339	*-7.12%*	*-26.0*	365
August	346	*-8.22%*	*-31.0*	377
September	270	*-7.85%*	*-23.0*	293
October	223	*-9.35%*	*-23.0*	246
November	214	*-13.01%*	*-32.0*	246
December	234	*-7.87%*	*-20.0*	254
Total	**3,088**	***-5.71%***	*-187.0*	**3,275**



6.1.3. Freight transportation tariffs

Average revenue per thousand ton-kilometers for liquid cargo has shown a significant increase by 15% on average in full year 2012 compared to full year 2011. Below we can see the reasons of variations in average revenue per thousand ton-kilometers for liquid cargo.

- Starting from April 2011, the company has decreased discounts for transportation of crude oil and oil products by 33% and 23% respectively.
- There was a decrease of discounts from February 2012, when the company decreased discounts for transportation of crude oil and oil products by USD 0.5 per ton of transported discounted liquid cargo.
- Starting From July 2012, the company adopted additional decrease of discounts for transportation of crude oil and oil products by USD 1.5 and USD 1.0 per ton respectively. This increase was done to enable the company to cover the costs associated with the rental of additional tank cars to serve the needs of the corridor.

Starting from February, 2013, Georgian Railway has increased all of its base tariffs for transportation by 3%. This does not have its effect on discounted transportation of liquid cargo as the tariffs set there remained the same. This increase of approximately 3% has already shown its effect in February.

Apart from the changes mentioned above, there were no other variations in tariff structure for liquid and dry cargo transportation.

6.1.4. Wagon utilization

Following Table sets forth estimated utilization levels for different types of railcars owned by Georgian Railway JSC:

Utilisation	**2012**	***Abs. Change***	**2011**
Platform	53%	*1%*	52%
Box Car	82%	*15%*	68%
Open Top Box	71%	*13%*	57%
Refrigerator	71%	*-3%*	74%
Fitting	80%	*12%*	68%
Cement Hopper	66%	*4%*	61%
Tank Car	83%	*-12%*	95%
Grain Hopper	75%	*-6%*	81%
Other	72%	*18%*	53%
Total	**75%**	***5%***	**70%**

Utilisation of box cars, fitting and other wagons increased due to increased transportation volumes of dry cargo. Utilisation of tank cars decreased as a result of maintenance repairs at the production field in autumn of 2012 and as a result of increased number of tank cars due to additionally rented 425 units, which were successfully used in order to satisfy the deficit of liquid railcars in the corridor in 2012.

7. Railway safety indicators

Company distinguishes several types of accidents on its rail network: crash of trains, either going off the rail, rolling stock disconnection and others.

The following table sets forth number of accidents per billion ton-kilometres by years:

Accidents per billion ton km.	2008	2009	2010	2011	2012
Crash of trains or going off the rail	3.9	5.0	7.1	7.7	4.9
rolling stock disconnection	0.9	1.7	2.3	2.3	0.5
Other	0.3	0.6	0.3	0.2	0.8
Total	**5.1**	**7.2**	**9.7**	**10.2**	**6.2**

The following table sets forth share of employees who received health damages in years 2010-2012:

	2010	2011	2012
Share of damages in total number of employees	2.7%	2.6%	1.8%

For the twelve-month period of 2012, share of damages in total number of employee decreased to 1.8%, from the 2.7% the same period of 2010. It should be noted that in 2010 and 2011 calculations there are included employees who received health damage in earlier periods, but the compensation began only in 2010 or 2011.

8. Strategic Projects

8.1. Bypass Project

The Bypass Project's objective is to relocate certain railway infrastructure components from the centre of Tbilisi to the northern part of the city. Management estimates its completion in 2013. Remaining payment to be made for the Bypass project is approximately USD 100.9 million. After the project is completed, Georgian Railway has to transfer the freed-up land plot in Tbilisi to the state as part of the agreement on the pre-sale of land to the state for CHF 138 million, which was received in form of returned dividends in 2012.

8.2. Modernization Project

The Modernization Project focuses primarily on the mainline that runs from Tbilisi to the Black Sea, in particular to the terminals at Poti and Batumi. As part of the project, the Company intends to modernize the railroad and electric supply infrastructure between Tbilisi and Batumi (315 kilometers), including the 40-kilometre mountainous gorge region in Central Georgia, with the aim of achieving passenger train speeds of 80 km/h on the gorge section and 120 km/h on the 117 rest of the mainline, as compared to current average speeds of approximately 55 km/h in the gorge section and approximately 65-90 km/h on the rest of the mainline.

The Company expects to complete the project by 2016. Remaining payment to be made for the Modernization project is approximately USD 253.4 million, which is expected to be financed through the proceeds from 2012 notes and internally generated cash flows.

8.3. Baku-Tbilisi-Kars Railway

In February 2007, the governments of Georgia, Turkey and Azerbaijan signed an agreement in connection with the construction of a new railway connection linking Azerbaijan, Georgia and Turkey (the Baku-Tbilisi-Kars project). Construction began in 2008. On the recent meeting held in Tbilisi Georgian and Turkish government representatives announced that by the end of 2013 the first test train will run through the BTK line.

In connection with the construction of the new railway connection linking Azerbaijan, Georgia and Turkey (the Baku-
Tbilisi-Kars project), the existing Marabda-Akhalkalaki rail line, which was a secondary line in need of refurbishment, was withdrawn from the capital of the Company and contributed by the State to a project-related special purpose entity established and owned by the Government. The special purpose entity obtained a U.S.$775 million loan from the government of Azerbaijan to finance the rehabilitation of the existing Marabda-Akhalkalaki line and the construction of the connecting line from Akhalkalaki to the Turkish border. The Company has been granted the exclusive right to operate the Georgian portion of the new line.

It is expected that after completion of the project, the line will be maintained by a separate entity, which is expected to be a 50:50 joint venture between Azerbaijan Railway and the Company, although it is possible that Azerbaijan will become a member of the existing special purpose entity. It is expected that the joint venture shall be operational until the loan from the Azerbaijani government has been repaid and that the entity owning the line will charge the Company for access to the line not owned by the Company, but no charging scheme has been determined yet. Management expects that the Company will be able to set tariffs on the Georgian portion of the line.

The Baku-Tbilisi-Kars project will effectively open a new rail-only corridor from the Caspian Sea to Europe via Turkey, eventually excluding the need for sea transportation once the planned rail tunnel under the Bosporus Strait in Istanbul is complete. The Baku-Tbilisi-Kars project could also open a North-South rail corridor linking Russia to Turkey. This line will transport both freight and passengers and is expected to provide an alternative freight transport route to routes that transit through Iran. Management believes this line will be an important driver of future incremental transport volumes, particular containerized cargo, although, as it is a new route, management believes it may take time to attract significant volumes. Based on current cargo flows and assuming operations on the line commence as scheduled, management believes that, by 2015, the Company will be able to re-route at least two million tons of existing cargo flows (principally dry cargo currently transported by truck) with an overall increase in transportation capacity of five to 15 million tons between Turkey, the Caucasus, Russia and Central Asia to this route.

Management believes that increasing trade between Turkey and Central Asia provides it with a significant opportunity to capture trade flows, particularly raw materials imported into Turkey from Central Asia and finished goods exported by Turkey. With respect to Turkey-Russian trade, management believes there is an opportunity to capture additional volumes, particularly of dry cargo, that are currently shipped via Iran or the Russia-Black Sea route.