Georgian Railway JSC

Condensed Consolidated Interim Financial Statements for the six-month periods ended 30 June 2012 and 2011

Contents

’000 GEL	Note	30 June 2012	31 December 2011	30 June 2011	31 December 2010
		Unaudited		**Unaudited**	
ASSETS					
Non-current assets					
Property, plant and equipment	11	2,108,555	1,913,195	1,767,697	1,725,633
Investment property	11	-	6,838	6,838	9,926
Other non-current assets	11	228,002	276,039	201,002	136,375
Total non-current assets		**2,336,557**	**2,196,072**	**1,975,537**	**1,871,934**
Current assets					
Inventories		26,973	23,737	21,193	17,992
Current tax assets		-	511	-	-
Trade and other receivables		33,341	27,355	26,557	26,913
Prepayments and other current assets		70,122	27,714	56,699	42,665
Cash and cash equivalents	13	54,479	64,516	235,400	335,855
Bank deposits		8,725	76,449	49,421	38,021
Total current assets		**193,640**	**220,282**	**389,270**	**461,446**
Total assets		**2,530,197**	**2,416,354**	**2,364,807**	**2,333,380**
EQUITY AND LIABILITIES					
Equity	12				
Share capital		1,049,751	1,000,463	1,009,432	985,376
Non-cash owner contribution reserve		35,776	38,043	35,404	35,404
Retained earnings		772,920	763,502	696,394	612,261
Total equity		**1,858,447**	**1,802,008**	**1,741,230**	**1,633,041**
Non-current liabilities					
Loans and borrowings	13	408,304	414,063	412,587	438,383
Trade and other payables		45	45	45	45
Deferred tax liabilities		62,174	60,925	63,525	66,521
Total non-current liabilities		**470,523**	**475,033**	**476,157**	**504,949**
Current liabilities					
Loans and borrowings	13	17,927	18,607	18,261	19,259
Trade and other payables		94,807	45,954	34,953	61,886
Liabilities to the owners	14	22,291	13,188	26,529	29,241
Provisions		19,694	20,273	19,639	21,597
Other taxes payable		38,814	26,867	23,780	27,236
Other current liabilities		6,635	14,424	7,001	15,018
Current tax liabilities		1,059	-	17,257	21,153
Total current liabilities		**201,227**	**139,313**	**147,420**	**195,390**
Total liabilities		**671,750**	**614,346**	**623,577**	**700,339**
Total equity and liabilities		**2,530,197**	**2,416,354**	**2,364,807**	**2,333,380**

The condensed consolidated interim statements of financial position are to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 14.

’000 GEL	**Note**	**2012**	**2011**
		Unaudited	**Unaudited**
Revenue	6	225,130	224,115
Other income		12,333	7,733
Employee benefits expense		(50,186)	(52,771)
Depreciation and amortization expense		(52,675)	(46,277)
Electricity and materials used	7	(24,553)	(22,355)
Other expenses	8	(64,068)	(39,679)
Results from operating activities		**45,981**	**70,766**
Finance income	9	11,229	40,939
Finance costs		(6,248)	(2,407)
Net finance income/(costs)		**4,981**	**38,532**
Profit before income tax		**50,962**	**109,298**
Income tax expense	10	(13,544)	(15,736)
Profit and total comprehensive income for the period		**37,418**	**93,562**

The condensed consolidated interim statements of comprehensive income are to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 14.

'000 GEL	**Charter capital**	**Non-cash owner contribution reserve**	**Retained earnings**	**Total equity**
Balance at 1 January 2011	**985,376**	**35,404**	**612,261**	**1,633,041**
Total comprehensive income for the period				
Profit and total comprehensive income for the period (unaudited)	-	-	93,562	93,562
Transactions with owners, recorded directly in equity				
Non-cash contributions by and distributions to owners (unaudited)	4,056	-	(9,429)	(5,373)
Cash contributions by owners (unaudited)	20,000	-	-	20,000
Balance at 30 June 2011 (unaudited)	**1,009,432**	**35,404**	**696,394**	**1,741,230**
Balance at 1 January 2012	**1,000,463**	**38,043**	**763,502**	**1,802,008**
Total comprehensive income for the period				
Profit and total comprehensive income for the period (unaudited)	-	-	37,418	37,418
Transactions with owners, recorded directly in equity				
Dividends to owners (unaudited)	-	-	(28,000)	(28,000)
Non-cash contributions by and distributions to owners (unaudited)	49,288	(2,267)	-	47,021
Balance at 30 June 2012 (unaudited)	**1,049,751**	**35,776**	**772,920**	**1,858,447**

The condensed consolidated interim statements of changes in equity are to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 14.

'000 GEL	**2012**	**2011**
	Unaudited	**Unaudited**
Cash flows from operating activities		
Cash receipts from customers	237,040	221,043
Cash paid to suppliers and employees	(107,930)	(106,551)
Cash flows from operations before income taxes and interest paid	**129,110**	**114,492**
Income tax paid	-	(22,630)
Net cash from operating activities	**129,110**	**91,862**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(161,432)	(191,158)
Increase/Decrease in term deposits	67,723	(11,400)
Increase/Decrease in restricted cash	(219)	11,912
Interest received	6,385	2,562
Net cash used in investing activities	**(87,543)**	**(188,084)**
Cash flows from financing activities		
Proceeds from borrowings	190	-
Repayment of borrowings	(489)	-
Interest paid	(20,660)	(22,330)
Dividends paid	(28,000)	-
Cash contribution by owner	-	20,000
Cash distribution to the owner	(3,101)	-
Net cash from/(used in) financing activities	**(52,060)**	**(2,330)**
Net (decrease)/increase in cash and cash equivalents	**(10,493)**	**(98,552)**
Cash and cash equivalents at 1 January	61,553	323,943
Effect of exchange rate fluctuations on cash and cash equivalents	236	10,009
Cash and cash equivalents at 30 June	**51,296**	**235,400**

The condensed consolidated interim statements of cash flows are to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 14.

1 Background

(a) Business environment

Georgian business environment

The Group's operations are primarily located in Georgia. Consequently, the Group is exposed to the economic and financial markets of Georgia which display characteristics of an emerging market. The conflict between Georgia and the Russian Federation has created additional uncertainty in the environment. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The condensed consolidated interim financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

(b) Reporting entity

Georgian Railway JSC (the "Company"), formerly incorporated as an LLC, and its subsidiaries (the "Group") comprise Georgian joint stock and limited liability companies as defined in the Civil Code of Georgia.

The Group's principal activity is the operation of a nationwide railway system providing freight and passenger transportation services, maintenance and development of railway infrastructure and construction of railway lines within Georgia.

The Company was wholly owned by the State of Georgia represented by the State Enterprise Management Agency of the Ministry of Economy and Sustainable Development of Georgia as at 31 March 2011. On 25 October 2011 24% of the Company's charter capital was transferred to Partnership Fund JSC which is wholly owned by the State of Georgia.

2 Basis of preparation

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. These do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Group as at and for the years ended 31 December 2011 and 2010.

(b) Functional and presentation currency

The national currency of Georgia is the Georgian Lari ("GEL"), which is the Company's functional currency and the currency in which these condensed consolidated interim financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand.

(c) Use of estimates and judgments

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the years ended 31 December 2011 and 2010.

3 Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the years ended 31 December 2011 and 2010.

4 Financial risk management

The Group's financial risk management objectives and policies are consistent with those disclosed in the consolidated financial statements as at and for the years ended 31 December 2011 and 2010.

5 Operating segments

Information about reportable segments as at and for the six-month periods ended 30 June (unaudited)

	Freight transportation		**Passenger transportation**		**Total**	
'000 GEL	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
External revenues	215,409	213,033	8,221	7,152	223,630	220,185
Reportable segment profit/(loss) before infrastructure costs, central overheads, net finance income or costs and income tax	136,106	136,206	(6,582)	(7,766)	129,524	128,440
Reportable segment assets	375,576	343,317	114,291	98,120	489,867	441,437

Reconciliation of reportable segment profit or loss for the six-month periods ended 30 June (unaudited)

’000 GEL	**2012**	**2011**
Total profit or loss for reportable segments	129,524	128,440
Other profit or loss	(420)	1,164
Payroll expenses – infrastructure and headquarters	(18,717)	(24,941)
Depreciation expenses – infrastructure and headquarters	(25,943)	(23,135)
Net finance income/(costs)	4,981	38,532
Other net unallocated expenses	(38,463)	(10,762)
Consolidated profit before income tax	**50,962**	**109,298**

There have been no changes to the basis of segmentation or the measurement basis for the segment profit or loss since 31 December 2011 and 31 December 2010.

6 Revenue

’000 GEL	**2012**	**2011**
Freight traffic	189,794	192,641
Freight car rental	25,258	20,321
Passenger traffic	7,502	6,470
Other	2,576	4,683
	225,130	**224,115**

Railroad transportation in Georgia is a natural monopoly; however the prices are not subject to government regulation. According to clause 64 of the Railway Code of Georgia, which came into force on 1 July 2005, the Government of Georgia allowed the Group to set the prices for all services provided including freight transportation, freight transportation-related additional services, and passenger and luggage transportation.

Tariffs for freight transportation are based on the International Rail Transit Tariff. The Group is a co-signatory of the Tariff Agreement together with CIS countries, Latvia, Lithuania and Estonia. The parties to the Agreement hold annual conferences to determine the tariff policy for the following year: each party declares tariffs denominated in Swiss Francs for railway transportation and states the general rules that apply to and modify tariffs. The agreed tariffs indicate the maximum level of tariffs applicable.

Effective from 1 February 2012, the Group changed the freight tariff currency from CHF to USD.

7 Electricity and materials used

’000 GEL	**2012**	**2011**
Electricity	11,578	13,261
Materials	8,480	4,294
Fuel	4,495	4,800
	24,553	**22,355**

8 Other expenses

’000 GEL	**2012**	**2011**
Freight car rental	9,497	11,197
Taxes other than income tax	9,810	8,029
Security	3,636	3,840
Repairs and maintenance	1,929	8,839
Write off of non-current assets	-	4,094
Other	5,501	3,680
Batumi Tower Disposal	33,695	-
	64,068	**39,679**

9 Foreign currency exchange rate fluctuations

Included in finance income for the six-month period ended 30 June 2012 is a net foreign exchange gain of GEL 5,352 thousand mainly as a result of the GEL depreciation against Swiss Francs (“CHF”) and GEL appreciation against U.S. Dollars (“USD”) as the Group held a significant part of its bank balances in CHF and the Group’s loans and borrowing were denominated in USD during the six-month period ended 30 June 2012. In the six-month period ended 30 June 2011, the Group incurred a foreign exchange gain of GEL 38,376 thousand due to GEL appreciation against USD partly offset by the impact of GEL appreciation against CHF.

10 Income tax expense

Income tax is recognised based on management’s best estimate of the weighted average annual income tax rate expected for the full financial year applied to the pre-tax income of the interim periods. The Group’s consolidated effective tax rate for the six-month period ended 30 June 2012 was 26 percent (six-month period ended 30 June 2011: 14 percent). The statutory tax rate is 15 percent.

11 Property, plant and equipment and other non-current assets

(a) Acquisitions and disposals of property, plant and equipment

During the six-month period ended 30 June 2012 the Group acquired assets with a cost, excluding capitalized borrowing costs, of GEL 235,385 thousand (30 June 2011: GEL 76,338 thousand).

Capitalized borrowing costs related to the Main Line Modernisation project for the six-month period ended 30 June 2012 amounted to GEL 12,103 thousand (30 June 2011: 12,350) and capitalized borrowing costs related to the Tbilisi Bypass project for the six-month period ended 30 June 2012 amounted to GEL 8,485 thousand (30 June 2011: 8,690).

During the six-month period ended 30 June 2012 assets with a carrying amount of GEL 14,235 (GEL 13,408 thousand out of this sum refer to Batumi Tower transfer) thousand were transferred to the owner (30 June 2011: GEL 12,158 thousand).

(b) Investment property

In March 2012 the decision was made to transfer the Tbilisi Central Station building to the Government of Georgia. In the six month period ended 30 June 2012, Investment property of 6,838 thousand, mainly relating to the Tbilisi Central Station, was reclassified to Property, plant and equipment.

(c) Other non-current assets

Increase in other non-current assets is mainly related to prepayments made and materials and equipment purchased for the Main Line Modernisation and Tbilisi Bypass projects.

(d) Capital commitments and major projects

As at 30 June 2012 the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 735,663 thousand mainly relating to the Main Line Modernization (GEL 435,423 thousand) and Tbilisi Bypass projects (GEL 237,141 thousand) (30 June 2011: GEL 733,656 thousand), excluding prepayments made for the contracts.

12 Equity

Dividends

During the six-month period ended 30 June 2012 the Company made a dividend payment in the amount of GEL 28,000 thousand (six-month period ended 30 June 2011: nil). In July 2012 the Company proposed dividends of GEL 331,592 thousand.

13 Loans and borrowings

No significant issues or repayments of loans and borrowings occurred during the six-month period ended 30 June 2012. Changes in the carrying amounts are attributable to interest accruals and payments and foreign currency translation differences.

In July 2010 the Group issued bonds with a face value of USD 250 million maturing in July 2015. The proceeds are to be used for the implementation of two capital projects: the Main Line Modernization and the Tbilisi Bypass.

Cash and cash equivalents includes restricted cash of GEL 3,181 thousand as at 30 June 2012 (30 June 2011: nil).

14 Related parties

(a) Parent and ultimate controlling party

The Company was wholly owned by the State of Georgia represented by the State Enterprise Management Agency of the Ministry of Economy and Sustainable Development of Georgia as at 31 March 2011. On 25 October 2011 24 per cent. of the Company's charter capital was transferred to Partnership Fund JSC which is wholly owned by the State of Georgia. Pursuant to Government Resolution No. 789 of 30 April 2012 on "Contributing the Shares of JSC "Georgian Railway" owned by the State into the capital of JSC Partnership Fund", on 3 May 2012 the State transferred additional shares in the Company representing 1.5 per cent. of the Company's authorised capital, by way of capital contribution, to the JSC Partnership Fund.

(b) Transactions with key management personnel

Key management received the following remuneration during the six-month periods ended 30 June 2012 and 2011, which is included in employee benefits expenses:

'000 GEL	**2012**	**2011**
Salaries and bonuses	**535**	**571**

(c) Other related party transactions

(i) Revenue, purchases and expenses

Until September 2011 the Group purchased most of its electricity from a State owned operator which amounted to GEL 1,012 thousand for the six-month period ended 30 June 2012 (30 June 2011: GEL 10,093 thousand). In September 2011, the Company signed an agreement for the purchase and sale of electricity from another provider. The Group also purchases security services from a state agency which amounted to GEL 3,752 thousand for the six-month period ended 30 June 2012 (30 June 2011: GEL 3,776 thousand). During the six-month period ended 30 June 2012 the Group purchased goods of GEL 1,315 thousand from a State owned company (30 June 2011: GEL 1,019 thousand). The Group usually does not have significant balances for these purchases.

Management estimates that the aggregate amounts of other income and expenses and the related balances with other government-related entities are not significant.

(ii) Other balances

’000 GEL	**30 June 2012**	**31 December 2011**	**30 June 2011**	**31 December 2010**
Liabilities to the owners	22,291	13,188	26,529	29,241

Liabilities to the owners relate to non-core property, plant and equipment that has been withdrawn but not yet transferred formally to the Government of Georgia. These liabilities are recognised at the carrying amount of assets to be transferred to the Government of Georgia.

15 Subsequent events

In July, 2012 Georgian Railway JSC (the Company) has declared a total dividend payment of GEL 331.6 million out of consolidated profit and total comprehensive income for prior periods ended 31 December 2011. The dividend declaration was approved by an extraordinary general meeting of the shareholders of the Company and the Government of Georgia (the GoG). From the GEL 247.0 million of dividend to be paid to the State of Georgia in respect of its holding of 74.5% of shares in the Company, GEL 231.6 million have been applied, 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. This application of dividends otherwise payable to the State of Georgia has satisfied the GoG’s reimbursement obligation in full under such Memorandum of Understanding. Remaining part of declared dividends in the amount of GEL 100 million were paid in August 2012

In July 2012 the Company carried out issuance, placement and registration (listing) of the Notes Denominated in Foreign Currency and the redemption of the U.S.$250,000,000 9.875% Notes due 2015 (ISIN: XS0523947751) issued by the Company on July 20, 2010 (the 2010 Notes). As a result of the above transaction the company has issued U.S.$500,000,000 7.75% Notes due 2022 and bought back 88.99%of the 2010 Notes in the amount of USD 222 million.

On the basis of GoG Resolution No. 326 dated August 2012 the State of Georgia has transferred all of its remaining shares in the Company comprising the 75.5 per cent of the Company’s share capital (directly held by the State and controlled by the Ministry of Economy and Sustainable Development of Georgia through Enterprise Management Agency) to JSC Partnership Fund.

Following registration of the transfer, JSC Partnership Fund will hold 100 per cent of the Company's share capital. JSC Partnership Fund is wholly-owned by the State of Georgia.