

Georgian Railway JSC
(formerly Georgian Railway LLC)

Consolidated Financial Statements
for the year ended 31 December 2012

Contents

Independent Auditors' Report	3
Consolidated Statement of Financial Position	4
Consolidated Statement of Comprehensive Income	5
Consolidated Statement of Changes in Equity	6
Consolidated Statement of Cash Flows	7
Notes to the Consolidated Financial Statements	8



Tbilisi Branch of KPMG CIS Limited
4 Besiki Street,
Tbilisi, 0108,
Georgia

Telephone +995 (32) 2935695
Fax +995 (32) 2935713
Internet www.kpmg.ge

Independent Auditors' Report

To the Management Board
Georgian Railway JSC (formerly Georgian Railway LLC)

We have audited the accompanying consolidated financial statements of Georgian Railway JSC (formerly Georgian Railway LLC) (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Tbilisi branch of KPMG CIS Limited

Tbilisi Branch of KPMG CIS Limited
4 April 2013

Tbilisi Branch of KPMG CIS Limited, a branch incorporated under the Laws of Georgia, a subsidiary of KPMG Europe LLP, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss Entity.



'000 GEL	Note	2012	2011
ASSETS			
Non-current assets			
Property, plant and equipment	12	2,197,235	1,913,195
Investment property		-	6,838
Deferred tax assets	21	1,557	-
Other non-current assets	13	280,884	276,039
Total non-current assets		2,479,676	2,196,072
Current assets			
Inventories	14	35,571	23,737
Current tax assets		-	511
Trade and other receivables	15	39,253	27,355
Prepayments and other current assets	16	61,648	27,714
Term deposits		100,321	76,449
Cash and cash equivalents	17	115,076	64,516
Total current assets		351,869	220,282
Total assets		2,831,545	2,416,354
EQUITY AND LIABILITIES			
Equity			
Share capital	18	1,049,751	1,000,463
Non-cash owner contribution reserve		31,673	38,043
Retained earnings		449,376	763,502
Total equity		1,530,800	1,802,008
Non-current liabilities			
Loans and borrowings	19	870,934	414,063
Advance received from the Government	18	231,592	-
Trade and other payables		52	45
Deferred tax liabilities	21	57,302	60,925
Total non-current liabilities		1,159,880	475,033
Current liabilities			
Loans and borrowings	19	33,420	18,607
Trade and other payables	20	81,645	45,954
Liabilities to the Government	18	12,956	13,188
Provisions	22	4,132	20,273
Other taxes payable		-	26,867
Current tax liabilities		1,542	-
Other current liabilities		7,170	14,424
Total current liabilities		140,865	139,313
Total liabilities		1,300,745	614,346
Total equity and liabilities		2,831,545	2,416,354

Georgian Railway JSC
Consolidated Statement of Comprehensive Income for the year ended 31 December 2012

'000 GEL	Note	2012	2011
Revenue	7	469,819	477,377
Other income		31,953	12,025
Employee benefits expense		(108,467)	(108,493)
Depreciation and amortization expense		(97,082)	(92,137)
Electricity and materials used	8	(52,973)	(47,763)
Other expenses	9	(88,446)	(73,219)
Results from operating activities		154,804	167,790
Finance income	10	19,106	27,036
Finance costs	10	(59,310)	(10,492)
Net finance (costs)/income		(40,204)	16,544
Profit before income tax		114,600	184,334
Income tax expense	11	(17,383)	(9,921)
Profit and total comprehensive income for the year		97,217	174,413

These consolidated financial statements were approved by the Management Board on 4 April 2013 and were signed on its behalf by:



 Mamuka Bakhtadze
 General Director



 Tamaz Jgerenava
 Chief Accountant



Georgian Railway JSC
Consolidated Statement of Changes in Equity for the year ended 31 December 2012

'000 GEL	Share capital/ 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 year				
Profit and total comprehensive income for the year	-	-	174,413	174,413
Transactions with owners, recorded directly in equity				
Net non-cash contributions by and distributions to owners (see note 18)	(3,385)	2,639	(23,172)	(23,918)
Cash contributions by and distributions to owners (see note 18)	18,472	-	-	18,472
Total transactions with owners, recorded directly in equity	15,087	2,639	(23,172)	(5,446)
Balance at 31 December 2011	1,000,463	38,043	763,502	1,802,008
Balance at 1 January 2012	1,000,463	38,043	763,502	1,802,008
Total comprehensive income for the year				
Profit and total comprehensive income for the year	-	-	97,217	97,217
Transactions with owners, recorded directly in equity				
Dividends to equity holders	-	-	(382,317)	(382,317)
Net non-cash contributions by and distributions to owners net of tax of GEL 1,557 thousand (see note 18)	49,288	(6,370)	(25,925)	16,993
Cash contributions by and distributions to owners	-	-	(3,101)	(3,101)
Total transactions with owners, recorded directly in equity	49,288	(6,370)	(411,343)	(368,425)
Balance at 31 December 2012	1,049,751	31,673	449,376	1,530,800

*In April 2012, the Company changed its legal form from a Limited Liability Company to a Joint Stock Company.

'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	-
		247,828	256,189
Cash flows from operations before income taxes and interest paid			
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
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

During 2012, the Group set off income tax of GEL 10,376 thousand with VAT recoverable (2011: nil).

The proceeds from borrowings were received net of the early redemption of the USD 250 million unsecured bonds issued in 2010 and net of the related accrued interest and penalty on the early redemption (see note 19).

During 2012 the Group received non-cash contributions and made non-cash distributions to the Government of Georgia. In addition during 2012 dividends of GEL 231,592 thousand declared by the Company were classified as an advance received from the Government for the sale of land (see notes 12 and 18).

1. Background

(a) Business environment

The Group's operations are located in Georgia. Consequently, the Group is exposed to the economic and financial markets of Georgia which display characteristics of an emerging market. 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 the Georgia. The consolidated 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) Organisation and operations

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 Company was established as a state-owned enterprise in December 1998 by the Decree of the President of Georgia # 929 as an entity engaged in the provision of railway transportation services in Georgia.

The Company's registered office is 15 Queen Tamar Avenue, Tbilisi 0112, 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 Government of Georgia represented by the State Enterprise Management Agency of the Ministry of Economy and Sustainable Development of Georgia as at 30 September 2011. On 25 October 2011, 7 May 2012 and 15 August 2012 24%, 1.5% and 74.5% of the Company's share capital, respectively, were transferred to the Partnership Fund JSC, a wholly state-owned company, which became the 100% shareholder of the Group. The ultimate controlling party of the Group is the Government of Georgia. Related party transactions are disclosed in note 27.

2. Basis of preparation

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that property, plant and equipment was revalued to determine deemed cost as part of the adoption of IFRSs.

(c) 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 consolidated financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

- Note 3(d) – useful lives and residual values of property, plant and equipment;
- Note 23(b) – impairment allowances for trade and other receivables.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Note 12 – impairment of suspended construction in progress.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

(a) Basis of consolidation**(i) Subsidiaries**

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

(ii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency**(i) Foreign currency transactions**

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising in retranslation are recognised in profit or loss.

(c) Financial instruments

(i) Non-derivative financial assets

Non-derivative financial assets comprise trade and other receivables, term deposits and cash and cash equivalents.

The Group initially recognises receivables and deposits on the date that they are originated. All other financial assets are recognised initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group classifies non-derivative financial assets into the loans and receivables category.

Loans and receivables

Loans and receivables are a category of financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses (see note 3(f)(i)).

Loans and receivables category comprise trade and other receivables, term deposits and cash and cash equivalents.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and highly liquid investments with maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value.

(ii) Non-derivative financial liabilities

The Group initially recognises debt securities issued on the date that they are originated. All other financial liabilities are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortised cost using the effective interest method.

Other financial liabilities comprise loans and borrowings, trade and other payables and other current liabilities.

(iii) Share capital

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

Reduction of share capital

Share capital reductions and non-cash distributions are recognized at the carrying amount of the assets distributed. Non-cash distributions of the Company are out of scope of IFRIC 17 *Distributions of Non-cash Assets to Owners* since the ultimate controlling party controls the assets before and after the distribution.

Increase of share capital

Share capital increase is affected through the issuance of new shares. When share capital is increased, any difference between the registered amount of share capital and the fair value of the assets contributed is recognized as a separate component of equity as a fair value adjustment reserve for non-cash owner contributions.

(d) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 1 January 2007, the date of transition to IFRS, was determined by reference to its fair value at that date.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalised borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Any gain or loss on disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and is recognised net within other income/other expenses in profit or loss.

(ii) Subsequent costs

The cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced component is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

Maintenance and repair expenses are recognised as follows:

- Rolling stock:
 - current maintenance expenses during the useful life of equipment (repair work and replacement of unusable and missing parts) are recognised as operating expenses in profit or loss as incurred;
 - expenses under multi-year major overhaul programmes are capitalised as a separate overhaul component and depreciated separately from the main asset;
 - overhauls performed near the end of the useful life of an asset, together with refurbishment, are capitalised when they extend the useful life of the underlying asset.
- Fixed installations:
 - current maintenance and repair expenses (technical inspections, maintenance contracts, etc.) are recognised as operating expenses in profit or loss as incurred;
 - labour, materials and other costs (associated with the installation of rails, sleepers and ballast) under multi-year major building or infrastructure maintenance programmes are capitalised through the partial or total replacement of each component concerned;
 - costs associated with infrastructure improvements are capitalized to the extent that they increase the functionality (traffic working speed) of the asset.

(iii) Depreciation

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its residual value.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Land is not depreciated.

The estimated average useful lives of significant items of property, plant and equipment for the current and comparative periods are as follows:

- | | |
|---|----------|
| • buildings and constructions | 44 years |
| • rail track infrastructure | 23 years |
| • transport, machinery, equipment and other | 12 years |

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(e) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(f) Impairment**(i) Non-derivative financial assets**

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise or indications that a debtor will enter bankruptcy.

The Group considers evidence of impairment for loans and receivables at both a specific asset and collective level. All individually significant loans and receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and receivables that are not individually significant are collectively assessed for impairment by grouping together loans and receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset or its related cash-generating unit (CGU) exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated to reduce the carrying amounts of assets in the CGU on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(g) Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(h) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(i) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee liability is recognized initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognized less cumulative amortization or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees are recognized when losses are considered probable and can be measured reliably.

(i) Revenue

(i) Transportation activities

Revenue from freight and passenger transportation is measured at the fair value of the consideration received or receivable. Freight and passenger transportation revenue is recognized in profit or loss according to the percentage of completed service method based on transit time of freight and passengers moving from the original location to the final destination.

Revenue from services rendered in stations is recognised in profit or loss when the service is rendered.

(ii) Rental income

Rental income from investment property or other assets rented is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

(j) Other expenses**(i) Lease payments**

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(ii) Social expenditure

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in profit or loss as incurred.

(k) Finance income and costs

Finance income comprises interest income on funds invested and foreign currency gains. Interest income is recognised as it accrues in profit or loss, using the effective interest method.

Finance costs comprise interest expense on borrowings, penalties for redemption of issued bonds, foreign currency losses and impairment losses recognised on financial assets.

Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

(l) Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised directly in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss; and
- temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(m) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. All operating segments' operating results are reviewed regularly by the Group's Management Board to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the Group's Management Board include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly railway infrastructure, corporate assets (primarily the Group's headquarters), head office expenses, financial income and expenses, tax expenses and tax assets and liabilities. Items related to infrastructure are not allocated as the Group has not implemented systems for such allocations. The Group's Management Board does not monitor segment liabilities.

Segment capital expenditure is the total cost incurred during the year to acquire property, plant and equipment and intangible assets.

4. New standards and interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2012, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- IFRS 9 *Financial Instruments* will be effective for annual periods beginning on or after 1 January 2015. The new standard is to be issued in phases and is intended ultimately to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement*. The first phase of IFRS 9 was issued in November 2009 and relates to the classification and measurement of financial assets. The second phase regarding classification and measurement of financial liabilities was published in October 2010. The remaining parts of the standard are expected to be issued during 2012. The Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on Group's consolidated financial statements. The impact of these changes will be analysed during the course of the project as further phases of the standard are issued. The Group does not intend to adopt this standard early.
- IFRS 12 *Disclosure of Interests in Other Entities* will be effective for annual periods beginning on or after 1 January 2013. The new standard contains disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. The expanded and new disclosure requirements aim to provide information to enable the users to evaluate the nature of risks associated with an entity's interests in other entities and the effects

of those interests on the entity's financial position, financial performance and cash flows. Entities may early present some of the IFRS 12 disclosures early without a need to early-adopt the other new and amended standards. However, if IFRS 12 is early-adopted in full, then IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) must also be early-adopted. The new Standard will not have any impact on the Group's financial position or performance.

- IFRS 13 *Fair Value Measurement* will be effective for annual periods beginning on or after 1 January 2013. The new standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It provides a revised definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurement that currently exist in certain standards. The standard is applied prospectively with early adoption permitted. Comparative disclosure information is not required for periods before the date of initial application. The new Standard is not expected to have a significant effect on the consolidated financial statements of the Group.
- Various *Improvements to IFRSs* have been dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect for annual periods beginning after 1 January 2013. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

5. Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and for disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Property, plant and equipment

The fair value of property, plant and equipment contributed by the owners is based on market values. The market value of property is the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably and willingly. The fair value of items of plant, equipment, fixtures and fittings is based on the market approach and cost approaches using quoted market prices for similar items when available.

When no quoted market prices are available, the fair value of property, plant and equipment is primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence.

(b) Financial assets

The fair value of financial assets is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. This fair value is determined for disclosure purposes.

(c) Financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

6. Operating segments

The Group has two reportable segments, as described below, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the Group's Management Board reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the Group's reportable segments:

- *Freight transportation.* Includes transportation of goods and commodities and related services.
- *Passenger transportation.* Includes transportation of passengers and luggage.

There are no inter-segment charges.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, central overheads, interest and income tax, as included in the internal management reports that are reviewed by the Group's Management Board. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries.

(i) Information about reportable segments

'000 GEL	Freight transportation		Passenger transportation		Total	
	2012	2011	2012	2011	2012	2011
External revenues	448,173	454,872	18,301	17,629	466,474	472,501
Depreciation and amortization	(39,445)	(38,044)	(6,767)	(6,696)	(46,212)	(44,740)
Reportable segment profit/(loss) before infrastructure costs, net interest cost and income tax	278,409	289,190	(10,219)	(10,906)	268,190	278,284
Reportable segment assets	407,541	353,766	108,411	106,823	515,952	460,589
Capital expenditure and other additions to non-current assets	76,950	34,495	7,795	28,157	84,745	62,652

(ii) Reconciliations of reportable segment revenues, profit or loss, assets and other material items

'000 GEL	2012	2011
Revenues		
Total revenue for reportable segments	466,474	472,501
Other revenue	3,345	4,876
Consolidated revenue	469,819	477,377
Profit or loss		
Total profit or loss for reportable segments	268,190	278,284
Other profit or loss	(910)	(835)
Payroll expenses – infrastructure and headquarters	(40,394)	(41,464)
Depreciation expenses – infrastructure and headquarters	(50,870)	(45,392)
Net finance (costs)/income	(40,204)	16,544
Other net unallocated expenses	(21,212)	(22,803)
Consolidated profit before income tax	114,600	184,334
Assets		
Total assets for reportable segments	515,952	460,589
Property, plant and equipment - infrastructure and headquarters	1,798,345	1,522,671
Other unallocated assets, principally cash and non-current assets	517,248	433,094
Consolidated total assets	2,831,545	2,416,354

(iii) Other material items 2012

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Consolidated totals
Capital expenditure and other additions to non-current assets	84,745	375,785	460,530
Depreciation and amortization	46,212	50,870	97,082

(iv) Other material items 2011

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Consolidated totals
Capital expenditure and other additions to non-current assets	62,652	355,625	418,277
Depreciation and amortization	44,740	47,397	92,137

(v) Geographical information

Approximately 90% of the Group's revenue is generated in Georgia with the remainder generated in CIS countries. The non-current assets of the Group are located in Georgia.

(vi) Major customer

In 2012 one customer of the Group's freight transportation segment represented approximately 30% of the Group's total revenue (GEL 142,989 thousand). In 2011 one customer of the Group's freight transportation segment represented approximately 30% of the Group's total revenue (GEL 142,899 thousand).

7. Revenue

'000 GEL	2012	2011
Freight traffic	401,791	410,915
Freight car rental	46,382	43,957
Passenger traffic	17,432	15,257
Other	4,214	7,248
	469,819	477,377

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 (CHF) 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 due to the volatility of the exchange rates between the CHF and other currencies and also to better align costs and revenues from its customers, which mainly trade in USD or GEL.

8. Electricity and materials used

'000 GEL	2012	2011
Electricity	23,127	24,180
Materials	20,758	13,849
Fuel	9,088	9,734
	52,973	47,763

9. Other expenses

'000 GEL	2012	2011
Freight car rental	25,038	23,400
Taxes other than income tax	20,729	17,658
Write off of non-current assets	14,785	4,094
Repairs and maintenance	7,729	11,100
Security	7,156	7,375
Other	13,009	9,592
	88,446	73,219

During 2012 the Group identified impairment indicators leading to the write off of several items of of the Group's construction in progress and rail track infrastructure with a carrying amount of GEL 14,785 thousand (GEL 4,094 thousand).

10. Finance income and finance costs

'000 GEL	2012	2011
Recognised in profit or loss		
Interest income on bank deposits	15,902	10,941
Net foreign exchange gain	3,204	16,095
Finance income	19,106	27,036
Impairment loss on trade receivables (note 23 (b)(ii))	(7,681)	(7,405)
Prepaid finance costs written off	-	(3,047)
Interest expense on financial liabilities	(10,451)	(40)
Premium on the early redemption of issued bonds	(41,178)	-
Finance costs	(59,310)	(10,492)
Net finance (costs)/income recognised in profit or loss	(40,204)	16,544

11. Income tax expense

The Group's applicable income tax rate is the income tax rate of 15% (2011: 15%) for Georgian companies.

'000 GEL	2012	2011
Current tax expense		
Current year	20,779	30,221
Under/(over-provided) in prior years	227	(14,704)
	<u>21,006</u>	<u>15,517</u>
Deferred tax expense		
Origination and reversal of temporary differences	(3,623)	(5,596)
	<u>17,383</u>	<u>9,921</u>

Reconciliation of effective tax rate:

	2012		2011	
	'000 GEL	%	'000 GEL	%
Profit before income tax	114,600	100	184,334	100
Income tax at applicable tax rate	17,190	15	27,650	15
(Net non-taxable income)/non-deductible expenses	(34)	-	(3,025)	(2)
Under/(over-provided) in prior years	227	-	(14,704)	(8)
	<u>17,383</u>	<u>15</u>	<u>9,921</u>	<u>5</u>

During 2011 the Group won a case in the Supreme Court of Georgia related to additional tax liabilities assessed by the Georgian Tax Authorities for the years 1998 to 2003, and accrued by the Group before 2007, of approximately GEL 13 million. The case was finalised in September 2011. The Georgian Tax Authorities recognised the decision of the Supreme Court of Georgia and the amount of the assessment, which had been paid by the Group, was recorded as a prepayment on the Group's tax card. The Group reversed the provision for the assessment and recognised a related current tax asset as at 31 December 2011.

12. Property, plant and equipment

'000 GEL	Land	Buildings and constructions	Rail track infrastructure	Transport, machinery, equipment and other	Construction in progress	Total
<i>Cost or deemed cost</i>						
Balance at 1 January 2011	518,431	138,659	704,771	629,763	129,816	2,121,440
Additions	10,926	-	627	27,895	290,644	330,092
Disposals	(3,253)	(8,138)	(26,400)	(11,673)	(6,813)	(56,277)
Transfers	10,052	3,294	22,998	38,667	(75,011)	-
Write offs	-	(82)	(5,733)	(3,715)	(4,095)	(13,625)
Balance at 31 December 2011	<u>536,156</u>	<u>133,733</u>	<u>696,263</u>	<u>680,937</u>	<u>334,541</u>	<u>2,381,630</u>
Balance at 1 January 2012	536,156	133,733	696,263	680,937	334,541	2,381,630
Additions	8,082	1,231	41,478	39,415	321,525	411,731
Disposals	(5,051)	(5,956)	(109)	(2,981)	(9,186)	(23,283)
Transfers	835	149	16,043	37,701	(54,728)	-
Transfers from investment property	1,426	5,412	-	-	-	6,838
Write offs	(158)	(678)	(13,166)	(24,088)	(8,931)	(47,021)
Balance at 31 December 2012	<u>541,290</u>	<u>133,891</u>	<u>740,509</u>	<u>730,984</u>	<u>583,221</u>	<u>2,729,895</u>
<i>Depreciation</i>						
Balance at 1 January 2011	-	15,700	148,523	231,584	-	395,807
Depreciation for the year	-	4,263	36,158	51,582	-	92,003
Disposals	-	(1,108)	(5,537)	(3,200)	-	(9,845)
Write offs	-	(82)	(5,733)	(3,715)	-	(9,530)
Balance at 31 December 2011	<u>-</u>	<u>18,773</u>	<u>173,411</u>	<u>276,251</u>	<u>-</u>	<u>468,435</u>
Balance at 1 January 2012	-	18,773	173,411	276,251	-	468,435
Depreciation for the year	-	4,506	36,143	56,148	-	96,797
Disposals	-	(104)	(47)	(185)	-	(336)
Write offs	-	(36)	(8,117)	(24,083)	-	(32,236)
Balance at 31 December 2012	<u>-</u>	<u>23,139</u>	<u>201,390</u>	<u>308,131</u>	<u>-</u>	<u>532,660</u>
<i>Carrying amounts</i>						
At 1 January 2011	518,431	122,959	556,248	398,179	129,816	1,725,633
At 31 December 2011	<u>536,156</u>	<u>114,960</u>	<u>522,852</u>	<u>404,686</u>	<u>334,541</u>	<u>1,913,195</u>
At 31 December 2012	<u>541,290</u>	<u>110,752</u>	<u>539,119</u>	<u>422,853</u>	<u>583,221</u>	<u>2,197,235</u>

- (a) During the year ended 31 December 2010 the Group started two large capital projects (included in construction in progress): the Main Line Modernization and the Tbilisi Bypass and started to incur expenditures for the projects in September 2010 and November 2010 respectively. To partly finance the projects the Group issued unsecured bonds in 2010. In 2012, the Group redeemed the bonds issued in 2010 by issuing new bonds for general corporate and liquidity management purposes (see note 19).

All the borrowing costs of the 2010 unsecured bonds allocated to each project on a 59%/41% basis were capitalized upon starting to incur expenditures for the projects. The interest on the bonds issued in 2012 were capitalized to the two projects in proportion to the costs incurred on the projects based on a capitalization rate of 8%. Capitalised borrowing costs related to the projects amounted to GEL 47,918 thousand (2011: GEL 42,141 thousand).

- (b) Included in construction in progress are assets with a carrying amount of GEL 48,793 thousand which were suspended due to prioritisation of the above two capital projects. Management believes that these assets are not impaired and the construction will be completed within the next two years.
- (c) Property, plant and equipment of the Group with a carrying value of GEL 3,526 thousand are pledged for the secured bank facility (see note 19).
- (d) During 2012 the Government of Georgia contributed certain property, plant and equipment in the form of an increase in share capital. The share capital has been increased by the nominal amount of these assets of GEL 59,236 thousand. The fair value of these assets was GEL 55,133 thousand (2011: nominal value of GEL 8,133 thousand; fair value of GEL 10,772 thousand). The basis for determining fair values is disclosed in note 5.
- (e) Included in total disposals with a carrying amount of GEL 23,752 thousand (2011: GEL 46,432 thousand) are assets with a carrying amount of GEL 19,532 thousand (2011: GEL 11,518 thousand) which have been withdrawn by the Government of Georgia.

13. Other non-current assets

'000 GEL	2012	2011
Prepayments for non-current assets	207,450	157,694
Construction materials	72,134	71,991
VAT recoverable (note 16)	-	45,000
Other	1,300	1,354
	280,884	276,039

14. Inventories

'000 GEL	2012	2011
Materials	27,529	20,838
Rails	3,907	3,559
Fuel	6,912	2,143
Other	1,608	2,184
	39,956	28,724
Allowance for inventory obsolescence	(4,385)	(4,987)
	35,571	23,737
Reversal of previous write-down of inventories	602	206

15. Trade and other receivables

'000 GEL	2012	2011
Trade receivables	126,067	105,363
Impairment allowance on trade receivables	(87,476)	(79,795)
	<u>38,591</u>	<u>25,568</u>
Other receivables	662	1,787
	<u>39,253</u>	<u>27,355</u>

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

16. Prepayments and other current assets

'000 GEL	2012	2011
VAT recoverable	44,702	25,720
Advances paid to suppliers	16,946	25
Prepaid taxes other than income tax	-	1,969
	<u>61,648</u>	<u>27,714</u>

In 2012, the Group revised its approach to the use of the VAT recoverable. Consequently, the Group changed the presentation of the VAT recoverable and presents VAT recoverable net of other taxes payable as at 31 December 2012 as the Group has the legal right to offset and intends to settle the tax liabilities on a net basis.

17. Cash and cash equivalents

'000 GEL	2012	2011
Current accounts in banks	56,983	64,351
Call deposits	57,985	-
Petty cash	108	165
Cash and cash equivalents in the statement of financial position	<u>115,076</u>	<u>64,516</u>
Restricted cash	-	(2,963)
Cash and cash equivalents in the statement of cash flows	<u>115,076</u>	<u>61,553</u>

Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the deposits within a few days of providing notification without incurring significant penalties or loss of interest. Consequently, these term deposits have been classified in accordance with their nature which is that of a call deposit.

The Group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 23.

18. Equity and liabilities to the Government

(a) Share capital

In April 2012 the Company changed its legal form from a limited liability company, whose charter capital is not divided into shares, to a joint stock company with an authorised and issued share capital of 1,049,751,200 shares having a par value of GEL 1 per share.

Ordinary shares

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company.

Movement in the charter capital before change in the legal form

'000 GEL	2012	2011
Balance at 1 January	1,000,463	985,376
Contribution of property, plant and equipment	59,236	8,133
Contribution of cash and cash equivalents	-	20,000
Distribution of cash and cash equivalents	-	(1,528)
Withdrawal of property, plant and equipment	(9,948)	(11,518)
	1,049,751	1,000,463

(b) Non-cash owner contribution reserve

The difference between the nominal amount of registered share capital for non-cash assets contributed by the owner and the fair value of the contributed assets is recognised in the non-cash owner contribution reserve.

'000 GEL	2012	2011
Balance at 1 January	38,043	35,404
Distribution of property, plant and equipment	(2,267)	-
Fair value adjustment of non-cash owner contributions	(4,103)	2,639
	31,673	38,043

(c) Liabilities to the Government

Liabilities to the owners represent liabilities in the form of property, plant and equipment which are withdrawn as a reduction in share capital but not yet transferred formally to the owners. These liabilities are recorded at the carrying amount of assets to be transferred to the owner.

'000 GEL	2012	2011
Liabilities to Government	12,956	13,188

(d) Dividends and advance received from the Government

In April 2012, the Company and the Government entered into the Bypass Project Memorandum. According to the Bypass Project Memorandum the Government is interested and aims to purchase from the Group approximately 70.1 hectares of land plots which will be freed up as a result of the removal of railway infrastructure from Tbilisi city centre and construction of a new bypass railway route for the purposes of further development of the land plots. The Government agrees to pay to the Group CHF 138 million equivalent in national currency through the reduction in the amount of dividends payable to the Government.

In 2012, the Company declared dividends of GEL 382,317 thousand, out of which GEL 150,725 thousand was paid in cash and GEL 231,592 thousand (CHF 138 million) was classified as an advance received from the Government for the sale of land in accordance with the Bypass Project Memorandum.

19. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 23.

'000 GEL	2012	2011
<i>Non-current liabilities</i>		
Unsecured bonds	870,934	414,027
Secured bank facility	-	36
Loans and borrowings	870,934	414,063
<i>Current liabilities</i>		
Current portion of unsecured bonds	33,387	17,972
Secured bank facility	33	-
Unsecured bank facility	-	635
Loans and borrowings	33,420	18,607

Terms and debt repayment schedule

Terms and conditions of outstanding loans and borrowings were as follows:

'000 GEL	Currency	Nominal interest rate	Year of maturity	31 December 2012		31 December 2011	
				Face value	Carrying amount	Face value	Carrying amount
Unsecured bonds	USD	7.8%	2022	828,350	857,025	-	-
Unsecured bonds	USD	9.9%	2015	45,592	47,296	414,028	431,999
Secured bank facility	USD	11.5%	2013	33	33	36	36
Unsecured bank facility	GEL	11%	2012	-	-	635	635
Total interest-bearing liabilities				873,975	904,354	414,699	432,670

In July 2012 the Group carried out the issuance, placement and registration (listing) on the London Stock Exchange of unsecured bonds of USD 500 million and the early redemption of the unsecured bonds of USD 250 million due in 2015 issued by the Group in July 2010 (the 2010 Notes). As a result of the above transaction, the Group has issued USD 500 million 7.75% Notes due 2022 and redeemed 88.99% of the outstanding 2010 Notes with a face value of USD 222 million. The Group redeemed the existing 2010 Notes at a price of USD 1,112.50 for each USD 1,000 note. The total premium paid in connection with the early redemption amounted to USD 25 million (see Note 10).

20. Trade and other payables

'000 GEL	2012	2011
Trade payables	63,373	28,390
Advances received from customers	18,272	17,564
	81,645	45,954

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 23.

21. Deferred tax assets and liabilities

(a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

'000 GEL	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
Property, plant and equipment and investment property	-	-	(90,341)	(87,639)	(90,341)	(87,639)
Inventories	12,153	8,374	-	-	12,153	8,374
Trade and other receivables	13,003	11,826	-	-	13,003	11,826
Prepayments and other current assets	1,641	1,335	-	-	1,641	1,335
Other non-current assets	30	30	-	-	30	30
Other current liabilities	1,047	2,123	-	-	1,047	2,123
Provisions	620	3,041	-	-	620	3,041
Loans	4,557	-	-	-	4,557	-
Trade and other payables	-	-	(12)	(15)	(12)	(15)
Tax loss carry-forwards	1,557	-	-	-	1,557	-
Tax assets/(liabilities)	34,608	26,729	(90,353)	(87,654)	(55,745)	(60,925)
Set off of tax	(33,051)	(26,729)	33,051	26,729	-	-
Net tax assets/(liabilities)	1,557	-	(57,302)	(60,925)	(55,745)	(60,925)

(b) Movement in temporary differences during the year

'000 GEL	1 January 2012	Recognised in profit or loss	Recognised in equity	31 December 2012
Property, plant and equipment and investment property	(87,639)	(2,702)	-	(90,341)
Inventories	8,374	3,779	-	12,153
Trade and other receivables	11,826	1,177	-	13,003
Prepayments and other current assets	1,335	306	-	1,641
Other non-current assets	30	-	-	30
Other current liabilities	2,123	(1,076)	-	1,047
Provisions	3,041	(2,421)	-	620
Trade and other payables	(15)	3	-	(12)
Loans	-	4,557	-	4,557
Tax losses carried forward	-	-	1,557	1,557
	(60,925)	3,623	1,557	(55,745)

'000 GEL	1 January 2011	Recognised in profit or loss	31 December 2011
Property, plant and equipment and investment property	(89,532)	1,893	(87,639)
Inventories	5,327	3,047	8,374
Trade and other receivables	10,740	1,086	11,826
Prepayments and other current assets	1,488	(153)	1,335
Other non-current assets	30	-	30
Other current liabilities	1,231	892	2,123
Provisions	3,239	(198)	3,041
Trade and other payables	956	(971)	(15)
	(66,521)	5,596	(60,925)

22. Provisions

'000 GEL	Guarantees	Other	Total
Balance at 1 January 2011	16,594	5,003	21,597
Reversals of provisions during 2011	(960)	(364)	(1,324)
Balance at 1 January 2012	15,634	4,639	20,273
Reversals of provisions during 2012	(15,634)	(507)	(16,141)
Balance at 31 December 2012	-	4,132	4,132

The provision for guarantees at 1 January 2012 related to the Group's guarantee of a third party's loan from a Georgian bank. In 2010 the Group recognised a provision for the guarantee as there were indications that the beneficiary of the guarantee will not be able to discharge its liabilities.

On 5 November 2012 the Group received a notification from the bank that the beneficiary of the guarantee had discharged its liabilities to the bank and the provision in the amount of GEL 15.6 million was fully reversed in 2012. The reversal of the provision was recognised in other income in the statement of comprehensive income.

23. Financial instruments and risk management

(a) Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

Risk management framework

The Management Board has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(b) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers, term deposits and cash and cash equivalents.

(i) Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was as follows:

'000 GEL	Carrying amount	
	2012	2011
Cash and cash equivalents - 5 largest Georgian banks (not impaired or past due)	114,968	64,351
Term deposits - 5 largest Georgian banks (not impaired or past due)	100,321	76,449
Trade receivables	38,591	25,568
Other receivables	662	1,787
	254,542	168,155

(ii) Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry and country, in which customers operate, as these factors may have an influence on credit risk, particularly in the current economic circumstances. Approximately 30% (2011: 30%) of the Group's revenue is attributable to sales transactions with a single customer.

Credit risk is managed by requesting prepayments from freight and passenger transportation customers. Accordingly the Group's trade receivables mainly consist of receivables from foreign railway companies. Credit risk related to receivables from foreign railway companies is managed through the monthly monitoring of receivable balances and requiring immediate repayment of a debt when the balance approaches specific limits set for each individual counterparty.

More than 90% of the Group's foreign railway customers have been transacting with the Group for over four years, and losses have occurred infrequently. In monitoring customer credit risk, customers are grouped according to their credit characteristics, including aging profile, maturity and existence of previous financial difficulties.

No collateral in respect of trade and other receivables is generally required.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main component of this allowance is a specific loss component that relates to individually significant exposures.

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

'000 GEL	Carrying amount	
	2012	2011
CIS countries	32,639	18,695
Domestic	5,952	6,873
	38,591	25,568

The Group's two most significant customers account for GEL 26,922 thousand of the trade receivables carrying amount as at 31 December 2012 (2011: GEL 12,601 thousand).

Impairment losses

The aging of trade receivables at the reporting date was:

'000 GEL	Gross	Impairment	Gross	Impairment
	2012	2012	2011	2011
Not past due	-	-	-	-
Past due 0- 90 days	11,472	2,409	14,178	2,000
Past due 91-180 days	10,032	1,888	8,725	1,393
Past due 181-365 days	14,119	3,047	6,283	2,137
Past due more than one year	90,444	80,132	76,177	74,265
	126,067	87,476	105,363	79,795

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

'000 GEL	2012	2011
Balance at beginning of the year	79,795	72,390
Increase during the year	7,681	7,405
Balance at end of the year	87,476	79,795

Most of the impairment loss at 31 December 2012 relates to several customers that have indicated that they are not expecting to be able to pay their outstanding balances either because of economic circumstances or as a result of bankruptcy. The Group believes that the unimpaired amounts that are past due are still collectible, based on historic payment behaviour and analyses on the underlying customers' credit ratings, when available.

The allowance account in respect of trade receivables is used to record impairment losses until all possible opportunities for recovery have been exhausted; at that point the amounts are written off against the financial asset directly.

Based on historic default rates, the Group believes that, apart from the above, no impairment allowance is necessary in respect of trade receivables.

(iii) Cash and cash equivalents and term deposits

To mitigate the credit risk of cash and bank balances, the Group holds its funds with the largest five Georgian banks. The Group does not expect any counterparty to fail to meet its obligations.

(c) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of three months, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. The Group maintains a GEL 40,000 thousand unused overdraft facility that is unsecured. Interest on this facility is payable at the rate of 12%-14.5%.

The Group's term deposits include GEL 57,156 thousand (2011: nil) whose use has been temporarily restricted for the purpose of providing a guarantee of payment as per terms of payment under an agreement to purchase property, plant and equipment. The restriction will be released when the supplier has either provided a performance guarantee or met their obligations under the contract and payment has been made by the Group. In any event deposit shall be released by the end of 2013.

The Group has significant contractual commitments to purchase property, plant and equipment (see note 25) for the Main Line Modernization and Tbilisi Bypass projects expected to be completed by the end of 2016 and 2014 respectively. Management believes that the proceeds from the bonds issued by the Group in July 2012 (see note 19) and cash flows from operating activities will be sufficient to finance these two projects.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements.

2012

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Unsecured bonds	904,321	1,530,489	35,418	34,350	68,699	242,686	1,149,336
Trade payables	63,425	63,425	59,054	4,319	-	52	-
Other current liabilities	7,170	7,170	7,170	-	-	-	-
Secured bank facility	33	37	18	19	-	-	-
	974,949	1,601,121	101,660	38,688	68,699	242,738	1,149,336

2011

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Unsecured bonds	431,999	582,517	20,617	20,618	41,236	123,708	376,338
Trade payables	28,435	28,435	21,659	6,731	-	45	-
Other current liabilities	14,424	14,424	14,424	-	-	-	-
Guarantees issued	14,345	14,345	14,345	-	-	-	-
Unsecured bank facility	635	635	635	-	-	-	-
Secured bank facility	36	42	2	3	37	-	-
	489,874	640,398	71,682	27,352	41,273	123,753	376,338

(d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

(i) Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than GEL. The currencies in which these transactions primarily are denominated are U.S. Dollars (USD) and Swiss Francs (CHF).

A majority of the Group's revenue was denominated in CHF. Effective from 1 February 2012, the Group changed the basic currency of freight tariffs from CHF to USD. The Group also changed the significant purchase contracts to USD to match the cash flows generated from operations.

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows based on notional amounts:

'000 GEL	USD -	CHF -	USD -	CHF -
	denominated	denominated	denominated	denominated
	2012	2012	2011	2011
Cash and cash equivalents	76,409	23,919	26,143	24,180
Term deposits	100,321	-	13,362	63,087
Trade receivables	-	32,639	633	19,049
Secured bank facility	(33)	-	(36)	-
Unsecured bonds	(904,321)	-	(431,999)	-
Trade and other payables	(992)	-	(78)	(39)
Net exposure	(728,616)	56,558	(391,975)	106,277

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2012	2011	2012	2011
USD 1	1.65	1.69	1.66	1.67
CHF 1	1.76	1.91	1.73	1.78

Sensitivity analysis

A strengthening of the GEL, as indicated below, against the following currencies at 31 December would have increased (decreased) profit or loss net of taxes by the amounts shown below. There would have been no impact directly on equity. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2011.

'000 GEL	Profit or loss
2012	
USD (10% strengthening)	61,932
CHF (10% strengthening)	(4,807)
2011	
USD (10% strengthening)	33,318
CHF (10% strengthening)	(9,034)

A weakening of the GEL against the above currencies at 31 December would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

(ii) Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

'000 GEL	Carrying amount	
	2012	2011
Fixed rate instruments		
Financial assets	158,306	76,449
Financial liabilities	(904,354)	(432,670)
	(746,048)	(356,221)

Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets and liabilities as fair value through profit or loss or as available for sale. Therefore a change in interest rates at the reporting date would not affect profit or loss or equity.

(e) Fair values versus carrying amount

Management believes that the fair value of the Group's financial assets and liabilities approximates their carrying amounts.

The basis for determining fair values is disclosed in note 5.

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve at the reporting date plus an adequate credit spread, and were as follows:

	2012	2011
Financial assets and liabilities	7.5%-10.5%	9%-12%

(f) Capital management

The Group has no formal policy for capital management but management seeks to maintain a sufficient capital base for meeting the Group's operational and strategic needs, and to maintain confidence of market participants. This is achieved with efficient cash management, constant monitoring of the Group's revenues and profit, and long-term investment plans mainly financed by the Group's operating cash flows and unsecured bonds. With these measures the Group aims for steady profits growth.

24. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

'000 GEL	2012	2011
Less than one year	1,390	2,284
Between one and five years	5,061	8,601
More than five years	35,584	64,795
	42,035	75,680

Operating leases relate to investment property, rent of other buildings, containers, locomotives and fittings owned by the Group with lease terms of between 10 to 50 years. Lessees do not have an option to purchase the property at the end of the lease term.

25. Capital commitments

As at 31 December 2012 the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 692,679 thousand (2011: GEL 961,014 thousand) mainly relating to the Main Line Modernization (GEL 433,121 thousand) and Tbilisi Bypass projects (GEL 163,286 thousand).

26. Contingencies

(a) Insurance

The insurance industry in Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

(b) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after six years have passed since the end of the year in which the breach occurred.

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

(c) Litigation

In the ordinary course of business, the Group is subject to legal actions, litigations and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

27. Related party transactions

(a) Parent and ultimate controlling party

The Company was wholly owned by the Government of Georgia represented by the Ministry of Economic Development of Georgia as at 30 September 2011. In October 2011, 24%, in May 2012, 1.5% and in August 2012, the remaining 74.5% interest in Georgian Railway JSC was transferred to the Partnership Fund JSC, a wholly state-owned entity. At 31 December 2012 the ultimate parent of the Group is the Partnership Fund JSC. The ultimate controlling party of the Group is the Government of Georgia.

(b) Transactions with key management personnel

(i) Key management remuneration

Key management received the following remuneration during the year, which is included in employee benefits expenses:

'000 GEL	2012	2011
Salaries and bonuses	1,120	1,181

(c) Other related party transactions

(i) Transactions with the government

The Group transacts in its daily operations with a number of entities that are either controlled, jointly controlled or under significant influence of the Government of Georgia. The Group has opted to apply the exemption in IAS 24 *Related Party Disclosures* that allows the presentation of reduced related party disclosures regarding transactions with government-related entities.

The Group's other related party transactions are disclosed below.

(ii) Revenue, purchases and expenses

Until September 2011 the Group purchased most of its electricity from a State-owned operator which amounted to GEL 1,873 thousand for the year ended 31 December 2012 (year ended 31 December 2011: GEL 13,885 thousand). The Group also purchases security services from a state agency which amounted to GEL 7,453 thousand for the year ended 31 December 2012 (year ended 31 December 2011: GEL 7,631 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.

28. Significant subsidiaries

Subsidiary	Country of incorporation	Principal activities	2012 Ownership/ voting	2011 Ownership/ voting
Georgian Railway Property Management LLC	Georgia	Property management and development	100%	100%
Trans Caucasus Terminals LLC (former Georgian Railway Transcontainer LLC)	Georgia	Container transportation	100%	100%
Georgian Railway Construction JSC	Georgia	Construction and other projects	100%	100%
Borjomi Bakuriani Railway LLC	Georgia	Passenger transportation	100%	100%
Rail Parking LLC	Georgia	Parking service	100%	-