Georgian Railway LLC

Consolidated Financial Statements
for the year ended 31 December 2009

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Tbilisi Branch of KPMG CIS Limited
6, Khetagurov Street,
Tbilisi, 0102,
Georgia

Telephone +995 (32) 935695
Fax +995 (32) 935713
Internet www.kpmg.ge

Independent Auditors' Report

To the Supervisory Board
Georgian Railway LLC

We have audited the accompanying consolidated financial statements of Georgian Railway LLC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2009, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free of 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 principles 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 opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2009, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

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

Emphasis of Matter

Without qualifying our opinion, we draw attention to the fact that the corresponding figures presented, excluding the adjustments described in note 27, are based on the consolidated financial statements of the Group as at and for the year ended 31 December 2008, which were audited by other auditors whose report dated 7 December 2009 expressed a qualified opinion on those statements because the auditor did not observe the counting of inventories as at 31 December 2006 because the other auditors were engaged as auditors of the Group only after that date. We have audited the adjustments described in Note 27 that were applied to restate the 2008 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Tbilisi branch of KPMG CIS Limited

Tbilisi Branch of KPMG CIS Limited
14 May 2010

'000 GEL	Note	2009	2008	1 January 2008
			Restated	Restated
ASSETS				
Non-current assets				
Property, plant and equipment	11	1,699,940	1,635,482	1,635,190
Investment property		9,926	13,287	13,247
Other non-current assets		12,817	14,454	9,309
Total non-current assets		**1,722,683**	**1,663,223**	**1,657,746**
Current assets				
Inventories	12	23,725	33,734	27,858
Current tax assets		4,615	-	-
Trade and other receivables	13	22,194	19,220	7,968
Prepayments and other current assets	14	35,061	28,555	33,178
Restricted cash		-	-	9,868
Cash and cash equivalents		1,361	3,196	4,211
Total current assets		**86,956**	**84,705**	**83,083**
Total assets		**1,809,639**	**1,747,928**	**1,740,829**
EQUITY AND LIABILITIES				
Equity	15			
Charter capital		967,207	933,635	935,588
Non-cash owner contribution reserve		25,311	33,752	9,397
Retained earnings		556,165	576,357	500,294
Total equity		**1,548,683**	**1,543,744**	**1,445,279**
Non-current liabilities				
Loans and borrowings	16	24,900	3,701	7,068
Trade and other payables	17	28,853	-	-
Deferred tax liabilities	18	74,817	81,783	90,564
Total non-current liabilities		**128,570**	**85,484**	**97,632**
Current liabilities				
Loans and borrowings	16	3,855	18,379	3,832
Trade and other payables	17	66,035	41,877	32,711
Liabilities to the owners	15	26,636	25,881	32,389
Provisions		6,088	7,904	7,414
Other taxes payable	19	21,794	14,226	13,466
Other current liabilities		7,978	6,492	105,905
Current tax liabilities		-	3,941	2,201
Total current liabilities		**132,386**	**118,700**	**197,918**
Total liabilities		**260,956**	**204,184**	**295,550**
Total equity and liabilities		**1,809,639**	**1,747,928**	**1,740,829**

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 41.

'000 GEL	Note	2009	2008
			Restated
Revenue	6	318,838	340,888
Other income		10,678	18,714
Payroll expenses		(106,113)	(108,747)
Depreciation and amortization expenses		(96,111)	(98,885)
Raw materials and consumables used	7	(40,315)	(45,887)
Other expenses	8	(64,139)	(52,687)
Results from operating activities		**22,838**	**53,396**
Finance income	9	610	884
Finance costs	9	(4,771)	(11,905)
Net finance costs		**(4,161)**	**(11,021)**
Profit before income tax		**18,677**	**42,375**
Income tax expense	10	(2,869)	(6,312)
Profit and total comprehensive income for the year		**15,808**	**36,063**

These consolidated financial statements were approved by Supervisory Board on 14 May 2010 and were signed on its behalf by:

Irakli Ezugbaia
General Director

Amiran Tevzadze
Acting Chief accountant

The consolidated statement of comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 41.

’000 GEL	Charter capital	Non-cash owner contribution reserve	Retained earnings	Total equity
Balance at 1 January 2008, as previously reported	935,588	9,397	484,332	1,429,317
Restatement (see note 27)	-	-	15,962	15,962
Restated balance at 1 January 2008	935,588	9,397	500,294	1,445,279
Total comprehensive income for the year				
Restated profit and total comprehensive income for the year	-	-	36,063	36,063
Transactions with owners, recorded directly in equity				
Decrease of dividends declared in 2007	-	-	40,000	40,000
Other non-cash contributions by and distributions to owners (see note 15)	(1,953)	24,355	-	22,402
Total contributions by and distributions to owners	(1,953)	24,355	40,000	62,402
Restated balance at 31 December 2008	**933,635**	**33,752**	**576,357**	**1,543,744**
Balance at 1 January 2009	933,635	33,752	576,357	1,543,744
Total comprehensive income for the year				
Profit and total comprehensive income for the year	-	-	15,808	15,808
Transactions with owners, recorded directly in equity				
Dividends to equity holders	-	-	(36,000)	(36,000)
Other non-cash contributions by and distributions to owners (see note 15)	33,572	(8,441)	-	25,131
Total contributions by and distributions to owners	33,572	(8,441)	(36,000)	(10,869)
Balance at 31 December 2009	**967,207**	**25,311**	**556,165**	**1,548,683**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 41.

'000 GEL	**2009**	**2008**
Cash flows from operating activities		
Cash receipts from customers	336,695	353,934
Cash paid to suppliers and employees	(200,350)	(222,799)
Cash flows from operations before income taxes and interest paid	**136,345**	**131,135**
Income tax paid	(18,043)	(13,661)
Interest paid	(1,604)	(1,913)
Net cash from operating activities	**116,698**	**115,561**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(89,976)	(78,021)
Other	622	387
Net cash used in investing activities	**(89,354)**	**(77,634)**
Cash flows from financing activities		
Proceeds from borrowings	27,900	24,014
Repayment of borrowings	(21,146)	(12,891)
Decrease in restricted cash	-	9,868
Dividends paid	(36,000)	(60,000)
Net cash used in financing activities	**(29,246)**	**(39,009)**
Net decrease in cash and cash equivalents	**(1,902)**	**(1,082)**
Cash and cash equivalents at 1 January	3,196	4,211
Effect of exchange rate fluctuations on cash and cash equivalents	67	67
Cash and cash equivalents at 31 December	**1,361**	**3,196**

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 41.

1 Background

(a) Business environment

Georgian business environment

Georgia has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. The conflict between Georgia and the Russian Federation in August 2008 has created additional uncertainty. The Group's operations and assets could be at risk as a result of negative changes in the political, economic or business environment within Georgia and between Georgia and the Russian Federation. Consequently, operations in Georgia involve risks that typically do not exist in other markets. In addition, the contraction in the capital and credit markets and its impact on the economy of Georgia have further increased the level of economic uncertainty in the environment. These 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 LLC (the "Company") and its subsidiaries (the "Group") comprise Georgian 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 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 Group is wholly owned by the State of Georgia represented by the State Enterprise Management Agency of the Ministry of Economic Development of Georgia. Related party transactions are disclosed in note 24.

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 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 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 3(d) – useful lives of property, plant and equipment
- Note 11 – impairment of property, plant and equipment
- Note 20(b) – impairment allowances for trade and other receivables

In the opinion of management, there are no other areas where critical judgements are involved in applying accounting policies that have a significant effect on amounts recognised in the consolidated financial statements.

(e) Changes in accounting policies and presentation and adoption of new standards

With effect from 1 January 2009, the Group changed its accounting policies and adopted new standards in the following areas:

- accounting for borrowing costs;
- determination and presentation of operating segments; and
- presentation of financial statements.

(i) Accounting for borrowing costs

In respect of borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009, the Group capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Previously the Group immediately recognised all borrowing costs as an expense. This change in accounting policy was due to the adoption of IAS 23 *Borrowing Costs* (2007) in accordance with the transitional provisions of such standard; comparative figures have not been restated.

(ii) Determination and presentation of operating segments

As at 1 January 2009 the Group determined and presented operating segments based on the information that internally is provided to the Management Board, which is the Group's chief operating decision maker. This policy is due to the adoption of International Financial Reporting Standard 8 *Operating Segments*. Previously the Group was not required to disclose information about operating segments. The new accounting policy in respect of operating segment disclosures is presented as follows.

Comparative segment information has also been presented in accordance with International Financial Reporting Standard 8 *Operating Segments*.

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. An operating segment's operating results are reviewed regularly by the 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 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.

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

(iii) Presentation of financial statements

The Group applies revised IAS 1 *Presentation of Financial Statements* (2007), which became effective as at 1 January 2009. The revised standard requires a presentation of all owner changes in equity to be presented in the statement of changes in equity, whereas all non-owner changes in equity are presented in the consolidated statement of comprehensive income.

Comparative information has been re-presented so that it also is in conformity with the revised standard.

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, except as explained in note 2(e), which addresses changes in accounting policies.

Certain comparative amounts have been restated to adjust for prior period errors identified by management in the current year (see note 27).

(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.

(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 functional currency 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. Foreign currency differences arising in retranslation are recognised in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(c) Financial instruments

Financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade payables.

(i) Non-derivative financial assets

The Group initially recognises loans and receivables and cash and cash equivalents on the date that they are originated.

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.

Loans and receivables are 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. Loans and receivables comprise trade and other receivables.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(ii) Non-derivative financial liabilities

The Group initially recognises debt securities issued on the date that they are originated. All other financial liabilities 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 liability when its contractual obligations are discharged or cancelled or expire.

The Group has the following non-derivative financial liabilities: loans and borrowings and trade and other payables.

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.

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.

(iii) Charter capital

Charter capital is classified as equity.

Reduction of charter capital

Charter capital reductions and non-cash distributions are recognised at the carrying amount of the assets distributed.

Increase of charter capital

When charter capital is increased, any difference between the registered amount of charter capital and the fair value of the assets contributed is recognised as a separate component of equity as non-cash owner contribution reserve.

(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. Items of property, plant and equipment contributed by the shareholder are initially measured at fair value. The cost of property, plant and equipment at 1 January 2007, the date of transition to IFRSs, 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 (see note 2(e)(i)). 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.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within “other income” in profit or loss.

(ii) Subsequent costs

The cost of replacing part 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 part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part 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 on spare parts and replacement of unusable and missing parts) are recorded 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;
− overhauls performed near the end of the useful life of an asset, together with refurbishment and transformation costs, 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

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost.

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 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 and useful lives 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, 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) Financial assets

A financial asset not carried at fair value through profit or loss 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, indications that a debtor or issuer will enter bankruptcy, the disappearance of an active market for a security.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant 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. Receivables that are not individually significant are collectively assessed for impairment by grouping together 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 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.

The recoverable amount of an asset or cash-generating unit 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. 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 groups of assets (the "cash-generating unit").

The Group's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the cash generating unit to which the corporate asset belongs.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the assets in the unit (group of units) 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) Revenue

(i) Transportation activities

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, unwinding of the discount on provisions, 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.

(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 a business combination, or items recognised directly in equity or in other comprehensive income.

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 the following temporary differences: 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 differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. 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 (see note 2(e)(ii)).

There are no inter-segment charges.

(n) 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 2009, 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.

- Revised IAS 24 *Related Party Disclosures* (2009) introduces an exemption from the basic disclosure requirements in relation to related party disclosures and outstanding balances, including commitments, for government-related entities. Additionally, the standard has been revised to simplify some of the presentation guidance that was previously non-reciprocal. The revised standard is to be applied retrospectively for annual periods beginning on or after 1 January 2011. The Group has not yet determined the potential effect of the amendment.
- IFRS 9 *Financial Instruments* will be effective for annual periods beginning on or after 1 January 2013. The new standard is to be issued in several phases and is intended to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement* once the project is completed by the end of 2010. The first phase of IFRS 9 was issued in November 2009 and relates to the recognition and measurement of financial assets. 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.
- IFRIC 17 *Distributions of Non-cash Assets to Owners* addresses the accounting for non-cash dividend distributions to owners. The interpretation clarifies when and how a non-cash dividend should be recognised and how the difference between the dividend paid and the carrying amount of the net assets distributed should be recognised. IFRIC 17 became effective for annual periods beginning on or after 1 July 2009.
- 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 not earlier than 1 January 2010. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

4 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 shareholder 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 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) Trade and other receivables

The fair value of trade and other receivables 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.

5 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.

Other operations include provision of internet services, leasing of fibre-optic and other cable and telephone services.

There are no inter-segment charges. The accounting policies of the reportable segments are the same as described in notes 2 and 3.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, central over heads, 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 2009	Freight transportation 2008	Passenger transportation 2009	Passenger transportation 2008	Other 2009	Other 2008	Total 2009	Total 2008
External revenues	291,334	312,420	15,560	18,078	11,231	9,710	318,125	340,208
Depreciation and amortization	(40,033)	(41,448)	(8,387)	(9,263)	(651)	(326)	(49,071)	(51,037)
Reportable segment profit/(loss) before infrastructure costs, central over heads, interest and income tax	155,408	163,511	(13,001)	(12,247)	614	2,379	143,021	153,643
Reportable segment assets	379,167	332,428	98,895	96,350	8,494	3,329	486,556	432,107
Capital expenditure and other additions to non-current assets	89,860	34,886	12,011	12,221	2,285	3,208	104,156	50,315

(ii) Geographical information

Substantially all of the Group’s revenue is from and the non-current assets of the Group are located in Georgia.

(iii) Major customers

In 2009 two customers of the Group’s freight transportation segment represented approximately 35% of the Group’s total revenue (GEL 69,399 thousand and GEL 42,079 thousand). In 2008, revenue from one customer of the Group’s freight transportation segment represented approximately 23% (GEL 79,260 thousand) of the Group’s total revenue.

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

'000 GEL	2009	2008
Revenues		
Total revenue for reportable segments	306,894	330,498
Other revenue	11,944	10,390
Consolidated revenue	**318,838**	**340,888**
Profit or loss		
Total profit or loss for reportable segments	142,407	151,264
Other profit or loss	614	2,379
Payroll expenses – infrastructure and headquarters	(45,411)	(46,789)
Depreciation expenses – infrastructure and headquarters	(47,040)	(47,848)
Net finance costs	(4,161)	(11,905)
Other net unallocated expenses	(27,732)	(4,726)
Consolidated profit before income tax	**18,677**	**42,375**
Assets		
Total assets for reportable segments	478,062	428,778
Other assets	8,494	3,329
Property, plant and equipment - infrastructure and headquarters	1,221,911	1,215,041
Other unallocated assets	101,172	100,780
Consolidated total assets	**1,809,639**	**1,747,928**

(v) Other material items 2009

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Other	Consolidated totals
Capital expenditure and other additions to non-current assets	101,871	61,550	2,285	165,706
Depreciation and amortization	48,420	47,040	651	96,111

(vi) Other material items 2008

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Other	Consolidated totals
Capital expenditure and other additions to non-current assets	47,107	51,857	3,208	102,172
Depreciation and amortization	50,711	47,848	326	98,885

6 Revenue

'000 GEL	**2009**	**2008**
Freight traffic	274,150	294,764
Freight car rental	16,543	16,590
Passenger traffic	13,952	16,615
Revenue from internet services	5,677	4,697
Revenue from fiber-optic cable lease	4,785	4,019
Other	3,731	4,203
	318,838	**340,888**

Railroad transportations in Georgia is a natural monopoly, however the pricing policy is not subject to government regulation. According to clause 64, which came into force on 1 July 2005, of the Railway Code of Georgia, the Government of Georgia has delegated the Group independence in setting of the pricing policy for all types of services provided, including freight transportation, freight transportation related additional services, 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 member parties of the Agreement hold annual conferences to work out the tariff policy for the following year: each party declares tariffs denominated in Swiss Francs for railway transportation and states general rules that apply to and modify tariffs. The agreed tariffs indicate the maximum level of tariffs applicable.

7 Raw materials and consumables used

'000 GEL	**2009**	**2008**
Electricity	19,311	22,319
Materials	13,345	11,793
Fuel	7,659	11,775
	40,315	**45,887**

8 Other expenses

'000 GEL	**2009**	**2008**
Taxes other than income tax	16,591	3,633
Repairs and maintenance	9,176	10,573
Write off of property, plant and equipment and investment property	6,622	-
Security	6,541	6,238
Freight car rental	6,378	10,746
Internet expenses	3,894	3,227
Cable lease expenses	3,222	1,844
Inventory write-downs due to obsolescence	2,668	96
Other	9,047	16,330
	64,139	**52,687**

9 Finance income and finance costs

'000 GEL	**2009**	**2008**
Recognised in profit or loss		
Interest income	610	884
Finance income	**610**	**884**
Impairment loss on trade receivables	(3,235)	(8,937)
Interest expense on financial liabilities measured at amortised cost	(1,525)	(1,800)
Net foreign exchange loss	(11)	(1,168)
Finance costs	(4,771)	(11,905)
Net finance costs recognised in profit or loss	**(4,161)**	**(11,021)**

10 Income tax expense

The Group's applicable income tax rate is the income tax rate of 15% for Georgian companies (2008: 15%).

’000 GEL	2009	2008
		Restated
Current tax expense		
Current year	9,835	15,093
Deferred tax expense		
Origination and reversal of temporary differences	(6,966)	(8,781)
	2,869	**6,312**

Reconciliation of effective tax rate:

	2009		2008	
	’000 GEL	%	’000 GEL	%
			Restated	
Profit before income tax	18,677	100	42,375	100
Income tax at applicable tax rate	2,802	15	6,356	15
Net non-deductible expenses	67	-	-	-
Net non-taxable income	-	-	(44)	-
	2,869	**15**	**6,312**	**15**

11 Property, plant and equipment

'000 GEL	Land	Buildings and constructions	Rail track infrastructure	Transport, machinery, equipment and other	Construction in progress	Total
Cost or deemed cost						
Balance at 1 January 2008	427,834	125,693	639,141	417,765	131,406	1,741,839
Additions	27,131	447	1	3,648	70,945	102,172
Disposals	(152)	(2,129)	(78)	(829)	-	(3,188)
Transfers	-	12,133	21,946	65,811	(99,890)	-
Balance at 31 December 2008	454,813	136,144	661,010	486,395	102,461	1,840,823
Balance at 1 January 2009	454,813	136,144	661,010	486,395	102,461	1,840,823
Additions	27,144	656	107	105,249	32,550	165,706
Disposals	(740)	(4)	-	(1,172)	-	(1,916)
Transfers	-	1,767	20,559	777	(23,103)	-
Write offs	-	-	-	-	(3,261)	(3,261)
Balance at 31 December 2009	481,217	138,563	681,676	591,249	108,647	2,001,352
Depreciation						
Balance at 1 January 2008	-	3,748	36,631	66,270	-	106,649
Depreciation for the year	-	3,930	36,251	58,694	-	98,875
Disposals	-	(129)	(7)	(47)	-	(183)
Balance at 31 December 2008	-	7,549	72,875	124,917	-	205,341
Balance at 1 January 2009	-	7,549	72,875	124,917	-	205,341
Depreciation for the year	-	3,996	36,155	56,243	-	96,394
Disposals	-	-	-	(323)	-	(323)
Balance at 31 December 2009	-	11,545	109,030	180,837	-	301,412
Carrying amounts						
At 1 January 2008	427,834	121,945	602,510	351,495	131,406	1,635,190
At 31 December 2008	454,813	128,595	588,135	361,478	102,461	1,635,482
At 31 December 2009	**481,217**	**127,018**	**572,646**	**410,412**	**108,647**	**1,699,940**

(a) Impairment assessment

At 31 December 2009, following the decline in the volume of freight transportation, the Group determined that there was an indication of impairment of its property, plant and equipment. The Group estimated the recoverable amount of the property, plant and equipment based on its value in use. In assessing the value in use, the Group estimated future cash flows and discounted them to their present value using a pre-tax discount rate that reflected current market assessment of the time value of money and the risks specific to the assets. The estimated recoverable amount did not result in an impairment loss being recognized in these consolidated financial statements.

For the impairment testing purposes the management considered Freight transportation and Passenger transportation operations as one cash generating unit as these operations are interdependent and a substantial part of cash outflows cannot be allocated to these operations on a reasonable basis for impairment testing purposes.

The following key assumptions were used in estimating the recoverable amount:

- cash flows are projected based on the operating plan for the next 12 years and excluded the effects of inflation. Forecasted prices for transportation were based on prices prevailing in 2009.
- anticipated annual traffic volume growth included in the cash flow projections is based on average growth levels experienced from 2004 to 2009 and an analysis of the regional demand for railroad transportation, reflecting an expectation of recovery in the economy at the end of 2010.
- the terminal value of expected cash flows after 12 years was estimated by discounting for perpetuity with a growth rate of 1.5%.
- a discount rate of 10.6% was applied, which excludes the effects of inflation. The discount rate was estimated based on the weighted average cost of capital, which was based on a debt financing of approximately 25% of the total invested capital, a cost of equity of approximately 13% and a borrowing rate of approximately 9%.

The values assigned to key assumptions represent management's assessment of future trends in the business and are based on both external and internal sources.

The estimates above are particularly sensitive in the following areas:

- an increase of one percentage point in the discount rate used would have resulted in an impairment of GEL 73,243 thousand.
- a 10% decrease in the forecasted volume of freight transportation would have resulted in an impairment of GEL 99,407 thousand.

(b) Security

At 31 December 2009 properties with a carrying amount of GEL 3,954 thousand (2008: nil) were pledged as collateral to secure trade payables under the settlement agreement between the Group, Vagonmshenebeli Company LLC and TBC Bank JSC, Bank Republic JSC and Bank of Georgia JSC (see note 17).

12 Inventories

'000 GEL	2009	2008
Materials	17,365	22,343
Rails	6,528	12,562
Fuel	3,215	1,041
Other	2,103	606
	29,211	36,552
Allowance for inventory obsolescence	(5,486)	(2,818)
	23,725	**33,734**

Inventory write-downs during the year are disclosed in note 8.

13 Trade and other receivables

'000 GEL	2009	2008
Trade receivables	87,307	81,890
Other receivables	1,224	432
	88,531	82,322
Impairment loss on trade receivables	(66,337)	(63,102)
	22,194	**19,220**

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 20.

14 Prepayments and other current assets

'000 GEL	2009	2008
VAT recoverable	31,448	23,443
Prepaid taxes other than income tax	2,600	4,377
Advances paid to suppliers	1,001	723
Other current assets	12	12
	35,061	**28,555**

15 Equity and liabilities to the owners

(a) Charter capital

Charter capital represents the nominal amount of capital in the founding documentation of the Company and is subject to state registration.

The owners of charter capital are entitled to receive dividends as declared from time to time and are entitled to the number of votes corresponding to the percentage of shareholding in the Company at meetings of the Company.

’000 GEL	**2009**	**2008**
Balance at 1 January	933,635	935,588
Contribution of property, plant and equipment	35,843	2,445
Withdrawal of property, plant and equipment	(2,271)	(4,398)
	967,207	**933,635**

(b) Non-cash owner contribution reserve

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

Non-cash assets registered in the charter capital as future contribution by the shareholder but not yet registered under the ownership of the Group are recorded in the non-cash owner contribution reserve until the ownership registration is complete.

’000 GEL	**2009**	**2008**
Balance at 1 January	33,752	9,397
Fair value adjustment of non-cash owner contributions	18,686	20,871
Registration under the ownership of the Group of the contributed property, plant and equipment	-	3,484
Contribution of property, plant and equipment not registered under the ownership of the Group	(27,127)	-
	25,311	**33,752**

(c) Liabilities to the owners

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

(d) Dividends

In accordance with Georgian legislation the Company’s distributable reserves are limited to the balance of retained earnings as recorded in the Company’s statutory financial statements prepared in accordance with IFRSs. As at 31 December 2009 the Company had retained earnings, including the profit for the current year, of GEL 552,872 thousand (2008: GEL 573,880 thousand - restated).

16 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 20.

'000 GEL	**2009**	**2008**
Non-current liabilities		
Unsecured bond issue	24,900	-
Unsecured bank loan	-	3,701
	24,900	**3,701**
Current liabilities		
Unsecured bank loan	3,773	18,379
Unsecured bond issue	82	-
	3,855	**18,379**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				31 December 2009		**31 December 2008**	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Unsecured bond issue	GEL	13.50%	2011	24,982	24,982	-	-
Unsecured bank facility	USD	LIBOR+1%	2010	3,773	3,773	7,527	7,527
Unsecured bank facility	GEL	17.00%	2009	-	-	8,018	8,018
Unsecured bank facility	GEL	15.25%	2009	-	-	6,535	6,535
				28,755	**28,755**	**22,080**	**22,080**

17 Trade and other payables

’000 GEL	**2009**	**2008**
Non-current liabilities		
Trade payables	28,853	-
	28,853	**-**
Current liabilities		
Trade payables	56,540	31,820
Advances received from customers	9,495	10,057
	66,035	**41,877**

Included in trade payables are amounts payable to TBC Bank JSC, Bank Republic JSC and Bank of Georgia JSC (the “Banks”) of GEL 23,917 thousand which were transferred to the Banks under a factoring agreement with rolling-stock repair companies with a total amount of GEL 30,798 thousand. The Group has mortgaged its own real estate (land and buildings) located at Queen Tamar Avenue, Tbilisi to secure these liabilities towards the banks (see note 11(b)).

The Group’s exposure to currency and liquidity risk related to trade and other payables is disclosed in note 20.

18 Deferred tax assets and liabilities

(a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		**Liabilities**		**Net**	
’000 GEL	**2009**	**2008**	**2009**	**2008**	**2009**	**2008**
		Restated		**Restated**		**Restated**
Property, plant and equipment and investment property	-	-	(93,586)	(99,046)	(93,586)	(99,046)
Inventories	5,613	4,350	-	-	5,613	4,350
Trade and other receivables	9,836	9,347	-	-	9,836	9,347
Prepayments and other current assets	2,261	2,343	-	-	2,261	2,343
Other non-current assets	146	35	-	-	146	35
Loans and borrowings	-	-	-	(8)	-	(8)
Provisions	913	1,186	-	-	913	1,186
Trade and other payables	-	10	-	-	-	10
Net tax assets/(liabilities)	**18,769**	**17,271**	**(93,586)**	**(99,054)**	**(74,817)**	**(81,783)**

(b) Movement in temporary differences during the year

'000 GEL	1 January 2009 Restated	Recognised in income	31 December 2009
Property, plant and equipment and investment property	(99,046)	5,460	(93,586)
Inventories	4,350	1,263	5,613
Trade and other receivables	9,347	489	9,836
Prepayments and other current assets	2,343	(82)	2,261
Other non-current assets	35	111	146
Loans and borrowings	(8)	8	-
Provisions	1,186	(273)	913
Trade and other payables	10	(10)	-
	(81,783)	**6,966**	**(74,817)**

'000 GEL	1 January 2008 Restated	Recognised in income Restated	31 December 2008 Restated
Property, plant and equipment and investment property	(105,412)	6,366	(99,046)
Inventories	2,935	1,415	4,350
Trade and other receivables	8,007	1,340	9,347
Prepayments and other current assets	1,881	462	2,343
Other non-current assets	537	(502)	35
Loans and borrowings	-	(8)	(8)
Provisions	1,112	74	1,186
Trade and other payables	-	10	10
Other current liabilities	376	(376)	-
	(90,564)	**8,781**	**(81,783)**

19 Other taxes payable

'000 GEL	2009	2008
Property tax liabilities	11,463	3,328
Personal income tax payable	1,407	1,967
Other taxes payable	8,924	8,931
	21,794	**14,226**

20 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.

(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.

(i) Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Approximately 22% (2008: 23%) 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 other railways. Credit risk related to receivables from other railways is managed through the monthly monitoring of the respective receivable balances and requiring immediate repayment of the debt when the balance approaches specific limits set for each individual counterparty. 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.

(ii) 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:

	Carrying amount	
’000 GEL	**2009**	**2008**
Trade receivables	20,970	18,788
Cash and cash equivalents	1,264	3,025
Other receivables	1,224	432
	23,458	**122,245**

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

	Carrying amount	
’000 GEL	**2009**	**2008**
CIS countries	12,706	11,298
Domestic	8,202	7,490
United States	62	-
	20,970	**18,788**

The Group’s most significant 5 customers account for GEL 13,367 thousand of the trade receivables carrying amount at 31 December 2009 (2008: GEL 15,263 thousand).

Impairment losses

The aging of trade receivables at the reporting date was:

’000 GEL	**Gross 2009**	**Impairment 2009**	**Gross 2008**	**Impairment 2008**
Not past due	199	-	-	-
Past due 0-90 days	4,788	-	5,319	1,760
Past due 91-180 days	3,178	-	1,459	647
Past due 181-365 days	7,769	2,709	5,354	2,968
Past due more than one year	71,373	63,628	69,758	57,727
	87,307	**66,337**	**81,890**	**63,102**

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

’000 GEL	2009	2008
Balance at beginning of the year	63,102	54,165
Increase during the year	3,235	8,937
Balance at end of the year	**66,337**	**63,102**

Based on historic default rates, the Group believes that no impairment allowance is necessary in respect of trade receivables not past due or past due by up to 180 days; 39% of the net balance, which includes the amount owed by the Group’s most significant customers (see above), relates to customers that have a good track record with the Group.

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. At 31 December 2009 the Group does not have any collective impairments on its trade receivables (2008: nil).

(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 following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements. It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

2009

’000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years
Non-derivative financial liabilities					
Unsecured bond issues	24,982	31,750	1,688	1,688	28,374
Unsecured bank facility	3,773	3,876	52	3,824	-
Trade and other payables	85,393	85,393	38,300	18,240	28,853
Other current liabilities	7,978	7,978	7,978	-	-
	122,126	**128,997**	**48,018**	**23,752**	**57,227**

2008

’000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years
Non-derivative financial liabilities					
Unsecured bank facility	22,080	23,658	7,677	12,130	3,851
Trade and other payables	31,820	31,820	28,691	3,129	-
Other current liabilities	6,492	6,492	6,492	-	-
	60,392	**61,970**	**42,860**	**15,259**	**3,851**

(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.

The Group incurs financial liabilities in order to manage market risks. The Group does not apply hedge accounting in order to manage volatility in profit or loss.

(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).

In respect of monetary assets and liabilities denominated in foreign currencies, the Group ensures that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short-term imbalances.

Exposure to currency risk

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

'000 GEL	USD-denominated	CHF - denominated	USD-denominated	CHF-denominated
	2009	2009	2008	2008
Cash and cash equivalents	387	45	902	-
Trade receivables	233	13,477	527	11,297
Unsecured bank facility	(3,773)	-	(7,527)	-
Trade payables	(16,770)	(1,813)	(403)	(151)
Net exposure	**(19,923)**	**11,709**	**(6,501)**	**11,146**

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2009	2008	2009	2008
USD 1	1.67	1.49	1.69	1.67
CHF 1	1.54	1.38	1.63	1.59

Sensitivity analysis

A strengthening of the GEL, as indicated below, against the following currencies at 31 December would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2008.

’000 GEL	Equity	Profit or loss
2009		
USD (10% strengthening)	1,693	1,693
CHF (10% strengthening)	(995)	(995)
2008		
USD (10% strengthening)	553	553
CHF (10% strengthening)	(947)	(947)

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:

	Carrying amount	
’000 GEL	**2009**	**2008**
Fixed rate instruments		
Financial liabilities	**24,982**	**14,553**
Variable rate instruments		
Financial liabilities	**3,773**	**7,527**

Fair value sensitivity analysis for fixed rate instruments

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

(e) Fair values versus carrying amounts

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 4.

(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. With these measures the Group aims for steady profits growth.

The Group's debt to capital ratio at the end of the reporting period was as follows:

’000 GEL	2009	2008	1 January 2008
Total liabilities	260,956	204,184	295,550
Less: cash and cash equivalents	(1,361)	(3,196)	(4,211)
Net debt	259,595	200,988	291,339
Total equity	**1,548,683**	**1,543,744**	**1,445,279**
Debt to capital ratio at 31 December	0.17	0.13	0.20

There were no changes in the Group's approach to capital management during the year.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

21 Operating leases

Non-cancellable operating lease receivables are to be received as follows:

’000 GEL	2009	2008
Less than one year	3,378	3,198
Between one and five years	7,266	14,344
More than five years	37,403	57,424
	48,047	**74,966**

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

22 Capital commitments

As at 31 December 2009 the Group had entered into contracts to purchase plant and equipment for GEL 36,234 thousand (2008: GEL 62,207 thousand).

23 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.

24 Related party transactions

(a) Control relationships

The Group is wholly owned by the State of Georgia represented by the State Enterprise Management Agency of the Ministry of Economic Development of Georgia.

(b) Transactions with management

Key management received the following remuneration during the year (included in payroll expenses):

'000 GEL	2009	2008
Salaries and bonuses	**880**	**830**

(c) Transactions with other related parties

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

(i) Revenue

'000 GEL	Transaction value 2009	Transaction value 2008	Outstanding balance 2009	Outstanding balance 2008
Services provided:				
State-owned companies and government bodies	**6**	**1,251**	**2**	**816**

All outstanding balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured.

(ii) Expenses and purchases

'000 GEL	Transaction value 2009	Transaction value 2008	Outstanding balance 2009	Outstanding balance 2008
Purchase of goods:				
State-owned companies and government bodies	2,479	4,014	436	2,388
Services received:				
State-owned companies and government bodies	9,614	9,698	1,083	1,275
	12,093	**13,712**	**1,519**	**3,663**

All outstanding balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured.

(iii) Other balances

’000 GEL	**2009**	**2008**
Liabilities to the owners	**26,636**	**25,881**

Liabilities to the owners relate to 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.

25 Significant subsidiaries

		2009	**2008**
Subsidiary	**Country of incorporation**	**Ownership/voting**	**Ownership/voting**
Railway Telecom LLC	Georgia	100%	100%

26 Events subsequent to the reporting date

On 12 February 2010 the Group signed an agreement with J.P. Morgan Securities Ltd. and Bank of America Merrill Lynch International in connection with:

- assisting the Group in relation to its proposal to obtain initial credit ratings from Standard & Poor’s Ratings Group, a division of McGraw-Hill Companies, Inc, and Fitch ratings Ltd.; and
- the proposed issuance, offering and sale by the Group in the international capital markets of up to USD 550 million of debt securities.

This issuance is to be used for the implementation of a large scale modernization project, including upgrading the Group’s infrastructure assets, including, through the rehabilitation of tracks and electric cables, the installation and upgrading of signaling equipment, the improvement of safety features and level crossings, the procurement of new rolling stock and the improvement of tunnels and bridges; increasing freight transit capacity; upgrading the Group’s engineering technology; and reducing operating costs and otherwise optimizing operations.

On 17 March 2010 a loan agreement was signed between the Group and the European Bank for Reconstruction and Development (“EBRD”), by which EBRD agreed to lend up to CHF 146.2 million to partly finance the EUR 300 million Tbilisi bypass project. The Tbilisi bypass project is intended to relocate certain railway infrastructure components from the centre of Tbilisi to the northern part of the city.

On 16 November 2009 an auction for the sale of 100% of shares of the Railway Telecom LLC was held. The winner of the auction was Linx Telecom Georgia LLC. As at 31 December 2009 the sale transaction had not been finalised. In accordance with the auction terms the sales transaction was to have been completed by 1 April 2010. The sales transaction was not completed by 1 April 2010 and the transaction was, accordingly, cancelled. On 6 April 2010 the Management Board of the Company decided to initiate the process of transferring 100% of shares of the Railway Telecom LLC to the Government of Georgia.

27 Correction of prior period error

In 2009 management identified errors relating to the calculation of deferred taxes for property, plant and equipment and prepayments given as at 31 December 2007 and 31 December 2008. The Group's management restated the comparative information in these consolidated financial statements. This has resulted in the following changes in the comparative information reported previously:

	GEL'000
Consolidated statement of financial position as at 1 January 2008	
Liabilities	
Deferred tax liabilities as previously reported	106,526
Restatement	(15,962)
Restated deferred tax liabilities as at 1 January 2008	**90,564**
Equity	
Retained earnings as previously reported	484,332
Restatement	15,962
Restated retained earnings as at 1 January 2008	**500,294**
Consolidated statement of financial position as at 31 December 2008	
Liabilities	
Deferred tax liabilities as previously reported	99,496
Restatement	(17,713)
Restated deferred tax liabilities as at 31 December 2008	**81,783**
Equity	
Retained earnings as previously reported	558,644
Restatement	17,713
Restated retained earnings as at 31 December 2008	**576,357**
Consolidated statement of comprehensive income for the year ended 31 December 2008	
Income tax expense as previously reported	8,063
Restatement	(1,751)
Restated income tax expense for the year ended 31 December 2008	**6,312**
Profit for the year, as previously reported	34,312
Restatement	1,751
Restated profit for the year ended 31 December 2008	**36,063**