Georgian Railway LLC

Consolidated Financial Statements for the year ended 31 December 2010

Contents

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Independent Auditors' Report

To the Management 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 2010, 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 2010, 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

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Tbilisi Branch of KPMG CIS Limited
13 May 2011

’000 GEL	Note	2010	2009
ASSETS			
Non-current assets			
Property, plant and equipment	11	1,725,633	1,699,940
Investment property		9,926	9,926
Other non-current assets	12	136,375	12,817
Total non-current assets		**1,871,934**	**1,722,683**
Current assets			
Inventories	13	17,992	23,725
Current tax assets		-	4,615
Trade and other receivables	14	26,913	22,194
Prepayments and other current assets	15	42,665	35,061
Cash and cash equivalents	16	335,855	1,361
Bank deposits		38,021	-
Total current assets		**461,446**	**86,956**
Total assets		**2,333,380**	**1,809,639**
EQUITY AND LIABILITIES			
Equity	17		
Charter capital		985,376	967,207
Non-cash owner contribution reserve		35,404	25,311
Retained earnings		612,261	556,165
Total equity		**1,633,041**	**1,548,683**
Non-current liabilities			
Loans and borrowings	18	438,383	24,900
Trade and other payables	19	45	28,853
Deferred tax liabilities	21	66,521	74,817
Total non-current liabilities		**504,949**	**128,570**
Current liabilities			
Loans and borrowings	18	19,259	3,855
Trade and other payables	19	61,886	66,035
Liabilities to owners	17	29,241	26,636
Provisions	20	21,597	6,088
Other taxes payable	22	27,236	21,794
Other current liabilities		15,018	7,978
Current tax liabilities		21,153	-
Total current liabilities		**195,390**	**132,386**
Total liabilities		**700,339**	**260,956**
Total equity and liabilities		**2,333,380**	**1,809,639**

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 8 to 39.

'000 GEL	**Note**	**2010**	**2009**
Revenue	6	404,687	318,838
Other income		17,818	10,678
Employee benefits expense		(111,257)	(106,113)
Depreciation and amortization expense		(98,749)	(96,111)
Electricity and materials used	7	(44,620)	(40,315)
Other expenses	8	(71,815)	(64,139)
Results from operating activities		**96,064**	**22,838**
Finance income	9	45,411	610
Finance costs	9	(17,669)	(4,771)
Net finance income/(costs)		**27,742**	**(4,161)**
Profit before income tax		**123,806**	**18,677**
Income tax expense	10	(22,273)	(2,869)
Profit and total comprehensive income for the year		**101,533**	**15,808**

These consolidated financial statements were approved by the Management Board on 13 May 2011 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 8 to 39.

'000 GEL	**Charter capital**	**Non-cash owner contribution reserve**	**Retained earnings**	**Total equity**
Balance at 1 January 2009	933,635	33,752	576,357	1,543,744
Profit and total comprehensive income for the year	-	-	15,808	15,808
Transactions with owners, recorded directly in equity				
Non-cash contributions by and distributions to owners, net (see note 17)	33,572	(8,441)	-	25,131
Dividends to owners	-	-	(36,000)	(36,000)
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**
Balance at 1 January 2010	967,207	25,311	556,165	1,548,683
Total comprehensive income for the year				
Profit and total comprehensive income for the year	-	-	101,533	101,533
Transactions with owners, recorded directly in equity				
Dividends to owners	-	-	(36,000)	(36,000)
Net non-cash contributions by and distributions to owners, net (see note 17)	14,278	10,093	(5,546)	18,825
Transfer of retain earnings to charter capital (see note 17)	3,891	-	(3,891)	-
Total contributions by and distributions to owners	18,169	10,093	(45,437)	(17,175)
Balance at 31 December 2010	**985,376**	**35,404**	**612,261**	**1,633,041**

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 8 to 39.

'000 GEL	Note	2010	2009
Cash flows from operating activities			
Cash receipts from customers		433,749	336,695
Cash paid to suppliers and employees		(195,162)	(200,350)
Cash flows from operations before income taxes and interest paid		**238,587**	**136,345**
Income tax paid		(4,923)	(18,043)
Interest paid		(2,163)	(1,604)
Net cash from operating activities		**231,501**	**116,698**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(281,738)	(89,976)
Proceeds from sale of investments		6,300	-
Increase in term deposits		(38,021)	-
Increase in restricted cash		(11,912)	-
Interest received		3,350	622
Net cash used in investing activities		**(322,021)**	**(89,354)**
Cash flows from financing activities			
Proceeds from borrowings		455,109	27,900
Repayment of borrowings		(28,975)	(21,146)
Dividends paid		(36,000)	(36,000)
Net cash from/(used) in financing activities		**390,134**	**(29,246)**
Net increase/(decrease) in cash and cash equivalents		**299,614**	**(1,902)**
Cash and cash equivalents at 1 January		1,361	3,196
Effect of exchange rate fluctuations on cash and cash equivalents		22,968	67
Cash and cash equivalents at 31 December	**16**	**323,943**	**1,361**

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 8 to 39.

1 Background

(a) Business environment

Georgian business environment

The Group's operations are primarily located in Georgia. Consequently, the Group is exposed to the economic and financial markets of Georgia which display characteristics of an emerging market. The conflict between Georgia and the Russian Federation has created additional uncertainty in the environment. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The 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 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 judgements in applying accounting policies that have a significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

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

In the opinion of management, there are no assumptions or estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year.

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.

(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.

Non-monetary items in a foreign currency that are measured in terms of 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) Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

(i) Non-derivative financial assets

The Group initially recognises loans and receivables 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.

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

Loans and receivables

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 category comprise the following classes of assets: trade and other receivables as presented in note 14 and cash and bank balances as presented in note 16.

Cash and cash equivalents

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 financial liabilities 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.

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 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 and trade and other payables.

(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 at the date of the distribution where the asset is ultimately controlled by the same parties both before and after the distribution.

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. 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.

The 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 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 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

Depreciation is based on the cost of an asset less its residual value. Significant components of individual assets are assessed and if a component has a useful life that is different from the remainder of that asset, that component is depreciated separately.

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 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, 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) 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, indications that a debtor will enter bankruptcy, adverse changes in the payment status of borrowers in the Group or economic conditions that correlate with defaults.

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 groups of 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 amount of assets in the CGU (group of CGUs) 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.

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 recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees are recognised when losses are considered probable and can be measured reliably.

(i) Revenue

(i) Transportation activities

Revenue from feight 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, 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 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 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:

- 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.

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 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 and intangible assets other than goodwill.

(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 2010, 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 (2010)* 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 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 the first half of 2011. 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.

- 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 2011. 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 the 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 approach 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. None of these segments meets any of the quantitative thresholds for determining reportable segments in 2010 or 2009.

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 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

	Freight transportation		**Passenger transportation**		**Total**	
'000 GEL	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
External revenues	377,868	291,334	17,343	15,560	395,211	306,894
Depreciation and amortization	(39,522)	(40,033)	(7,840)	(8,387)	(47,362)	(48,420)
Reportable segment profit/(loss) before infrastructure costs, net interest cost and income tax	237,419	155,408	(10,798)	(13,001)	226,621	142,407
Reportable segment assets	340,474	379,167	90,126	98,895	430,600	478,062
Capital expenditure and other additions to non-current assets	20,722	89,860	20,976	12,011	41,698	101,871

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

'000 GEL	**2010**	**2009**
Revenues		
Total revenue for reportable segments	395,211	306,894
Other revenue	9,476	11,944
Consolidated revenue	**404,687**	**318,838**
Profit or loss		
Total profit or loss for reportable segments	226,621	142,407
Other profit or loss	(537)	614
Payroll expenses – infrastructure and headquarters	(48,920)	(45,411)
Depreciation expenses – infrastructure and headquarters	(51,116)	(47,040)
Net finance income/(costs)	27,742	(4,161)
Other net unallocated expenses	(29,984)	(27,732)
Consolidated profit before income tax	**123,806**	**18,677**
Assets		
Total assets for reportable segments	430,600	478,062
Other assets	-	8,494
Property, plant and equipment - infrastructure and headquarters	1,365,672	1,221,911
Other unallocated assets, principally cash	537,108	101,172
Consolidated total assets	**2,333,380**	**1,809,639**

(iii) Other material items 2010

'000 GEL	**Reportable segment totals**	**Infrastructure and headquarters**	**Other**	**Consolidated totals**
Capital expenditure and other additions to non-current assets	41,698	231,122	-	272,820
Depreciation and amortization	47,362	51,116	271	98,749

(iv) 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

(v) Geographical information

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

(vi) Major customer

In 2010 one customer of the Group's freight transportation segment represented approximately 30% of the Group's total revenue (GEL 119,684 thousand). 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).

6 Revenue

'000 GEL	**2010**	**2009**
Freight traffic	354,583	274,150
Freight car rental	23,285	16,543
Passenger traffic	14,685	13,952
Communication services	4,413	10,462
Other	7,721	3,731
	404,687	**318,838**

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

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

7 Electricity and materials used

'000 GEL	**2010**	**2009**
Electricity	21,386	19,311
Materials	13,565	13,345
Fuel	9,669	7,659
	44,620	**40,315**

8 Other expenses

’000 GEL	2010	2009
Taxes other than income tax	16,277	16,591
Guarantee provisions (see note 20)	15,509	-
Freight car rental	9,046	6,378
Security	7,650	6,541
Repairs and maintenance	5,009	9,176
Write off of non-current assets	4,831	6,622
Communication services	3,611	7,116
Inventory write-downs due to obsolescence	-	2,668
Other	9,882	9,047
	71,815	**64,139**

9 Finance income and finance costs

’000 GEL	2010	2009
Recognised in profit or loss		
Interest income	3,229	610
Net foreign exchange gain	42,182	-
Finance income	**45,411**	**610**
Impairment loss on trade receivables	(6,053)	(3,235)
Interest expense on financial liabilities	(11,616)	(1,525)
Net foreign exchange loss	-	(11)
Finance costs	(17,669)	(4,771)
Net finance costs recognised in profit or loss	**27,742**	**(4,161)**

10 Income tax expense

The Group's applicable income tax rate is the income tax rate of 15% (2009: 15%) for Georgian companies.

'000 GEL	**2010**	**2009**
Current tax expense		
Current year	30,569	9,835
Deferred tax expense		
Origination and reversal of temporary differences	(8,296)	(6,966)
	22,273	**2,869**

Reconciliation of effective tax rate:

	2010		**2009**	
	'000 GEL	**%**	**'000 GEL**	**%**
Profit before income tax	123,806	100	18,677	100
Income tax at applicable tax rate	18,571	15	2,802	15
Net non-deductible expenses	3,702	3	67	-
	22,273	**18**	**2,869**	**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 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
Balance at 1 January 2010	481,217	138,563	681,676	591,249	108,647	2,001,352
Additions	36,818	281	461	21,413	87,291	146,264
Disposals	(4,779)	(1,863)	(6,142)	(5,637)	(2,924)	(21,345)
Transfers	5,175	1,678	28,776	22,738	(58,367)	-
Write offs	-	-	-	-	(4,831)	(4,831)
Balance at 31 December 2010	518,431	138,659	704,771	629,763	129,816	2,121,440
Depreciation						
Balance at 1 January 2009	-	7,549	72,875	124,917	-	205,341
Depreciation for the year	-	3,996	36,155	55,920	-	96,071
Balance at 31 December 2009	-	11,545	109,030	180,837	-	301,412
Balance at 1 January 2010	-	11,545	109,030	180,837	-	301,412
Depreciation for the year	-	4,539	40,840	53,342	-	98,721
Disposals	-	(384)	(1,347)	(2,595)	-	(4,326)
Balance at 31 December 2010	-	15,700	148,523	231,584	-	395,807
Carrying amounts						
At 1 January 2009	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
At 31 December 2010	**518,431**	**122,959**	**556,248**	**398,179**	**129,816**	**1,725,633**

(a) Impairment assessment

At 31 December 2009, following the decline in the volume of freight transported, 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. The estimated recoverable amount did not result in an impairment loss being recognized. Management has assessed that there are no impairment indications as at 31 December 2010.

(b) Property, plant and equipment under construction

During the year ended 31 December 2010 the Group started two large capital projects: the Main Line Modernization and 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 (see note 18). All the borrowing costs of the unsecured bond allocated to each project on a 59%/41% basis were capitalized upon starting to incur expenditures for the projects. Capitalised borrowing costs related to the projects amounted to GEL 10,388 thousand (2009: nil).

12 Other non-current assets

’000 GEL	**2010**	**2009**
Prepayments for non-current assets	102,810	9,585
Construction materials	33,333	-
Other	232	3,232
	136,375	**12,817**

13 Inventories

’000 GEL	**2010**	**2009**
Materials	14,569	17,365
Rails	4,884	6,528
Fuel	1,922	3,215
Other	1,810	2,103
	23,185	29,211
Allowance for inventory obsolescence	(5,193)	(5,486)
	17,992	**23,725**

14 Trade and other receivables

’000 GEL	**2010**	**2009**
Trade receivables	95,131	87,307
Other receivables	4,172	1,224
	99,303	88,531
Impairment allowance on trade receivables	(72,390)	(66,337)
	26,913	**22,194**

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

15 Prepayments and other current assets

’000 GEL	**2010**	**2009**
VAT recoverable	37,869	31,448
Prepaid taxes other than income tax	2,508	2,600
Advances paid to suppliers	2,266	1,001
Other current assets	22	12
	42,665	**35,061**

16 Cash and cash equivalents

’000 GEL	**2010**	**2009**
Current accounts	335,716	1,264
Petty cash	139	97
Cash and cash equivalents in the statement of financial position	**335,855**	**1,361**
Restricted cash	(11,912)	-
Cash and cash equivalents in the statement of cash flows	**323,943**	**1,361**

The Group holds GEL 141,330 thousand (2009: nil) in an escrow account included in current accounts based on a loan agreement according to which the cash can be used by the Group only after consent by the lender and for the Tbilisi Bypass project (see note 11). No funds were drawn down under the loan agreement as at the reporting date.

17 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	**2010**	**2009**
Balance at 1 January	967,207	933,635
Contribution of property, plant and equipment	22,423	35,843
Transfer of retained earnings to charter capital	3,891	-
Withdrawal of property, plant and equipment	(8,145)	(2,271)
	985,376	**967,207**

(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 is recognised in the non-cash owner contribution reserve.

Non-cash assets registered in the charter capital as future contributions 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	**2010**	**2009**
Balance at 1 January	25,311	33,752
Fair value adjustment of non-cash owner contributions	10,093	18,686
Contribution of property, plant and equipment not registered under the ownership of the Group	-	(27,127)
	35,404	**25,311**

(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 shareholder. These liabilities are recorded at the carrying amount of assets to be transferred to the shareholder.

(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 2010 the Company had retained earnings, including the profit for the current year, of GEL 591,670 thousand (2009: GEL 552,872 thousand).

18 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	**2010**	**2009**
Non-current liabilities		
Unsecured bond issue	438,383	24,900
	438,383	**24,900**
Current liabilities		
Unsecured bank loans	-	3,773
Unsecured bond issue	19,259	82
	19,259	**3,855**

Terms and debt repayment schedule

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

				31 December 2010		31 December 2009	
’000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Unsecured bond issue	USD	9.9%	2015	443,200	457,642	-	-
Unsecured bond issue	GEL	13.5%	2011	-	-	24,982	24,982
Unsecured bank facility	USD	Libor+1%	2010	-	-	3,773	3,773
Total interest-bearing liabilities				**443,200**	**457,642**	**28,755**	**28,755**

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

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 the Group up to CHF 146.2 million to partly finance the Tbilisi Bypass project. No funds have been drawn down under this facility as at the reporting date or as at the date of issue of these consolidated financial statements.

19 Trade and other payables

’000 GEL	**2010**	**2009**
Non-current liabilities		
Trade payables	45	28,853
	45	**28,853**
Current liabilities		
Trade payables	44,720	56,540
Advances received from customers	17,166	9,495
	61,886	**66,035**

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

20 Provisions

’000 GEL	**Guarantees**	**Other**	**Total**
Balance at 1 January	-	6,088	6,088
Provisions made during the year	15,305	204	15,509
Balance at 31 December	15,305	6,292	21,597

The provision for guarantees relates to a guarantee by the Group to a party for the repayment of a loan to 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. The provision is based on the full amount of the loan. The Group expects to incur most of the liability over the next 2 years.

21 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	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
Property, plant and equipment and investment property	-	-	(89,532)	(93,586)	(89,532)	(93,586)
Inventories	5,327	5,613	-	-	5,327	5,613
Trade and other receivables	10,740	9,836	-	-	10,740	9,836
Prepayments and other current assets	1,488	2,261	-	-	1,488	2,261
Other non-current assets	30	146	-	-	30	146
Other current liabilities	1,231	-	-	-	1,231	-
Provisions	3,239	913	-	-	3,239	913
Trade and other payables	956	-	-	-	956	-
Net tax assets/(liabilities)	**23,011**	**18,769**	**(89,532)**	**(93,586)**	**(66,521)**	**(74,817)**

(b) Movement in temporary differences during the year

’000 GEL	1 January 2010	Recognised in profit or loss	31 December 2010
Property, plant and equipment and investment property	(93,586)	4,054	(89,532)
Inventories	5,613	(286)	5,327
Trade and other receivables	9,836	904	10,740
Prepayments and other current assets	2,261	(773)	1,488
Other non-current assets	146	(116)	30
Other current liabilities	-	1,231	1,231
Provisions	913	2,326	3,239
Trade and other payables	-	956	956
	(74,817)	**8,296**	**(66,521)**

’000 GEL	1 January 2009	Recognised in profit or loss	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)**

22 Other taxes payable

’000 GEL	2010	2009
Property tax liabilities	17,076	11,463
Personal income tax payable	1,226	1,407
Other taxes payable	8,934	8,924
	27,236	**21,794**

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.

(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) Cash and bank balances

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.

(ii) Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Approximately 30% (2009: 22%) 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 the respective receivable balances and requiring immediate repayment of the 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.

(iii) 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	**2010**	**2009**
Cash and cash equivalents - 5 largest Georgian banks (not impaired or past due)	335,716	1,264
Bank deposits - 5 largest Georgian banks (not impaired or past due)	38,021	-
Trade receivables	22,741	20,970
Other receivables	4,172	1,224
	400,650	**23,458**

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

	Carrying amount	
'000 GEL	**2010**	**2009**
CIS countries	14,223	12,706
Domestic	8,518	8,202
United States	-	62
	22,741	**20,970**

The Group's five most significant customers account for GEL 12,857 thousand of the trade receivables carrying amount at 31 December 2010 (2009: GEL 13,367 thousand).

Impairment losses

The aging of trade receivables at the reporting date was:

'000 GEL	Gross 2010	Impairment 2010	Gross 2009	Impairment 2009
Not past due	-	-	199	-
Past due 0- 90 days	5,622	572	4,788	-
Past due 91-180 days	4,097	1,104	3,178	-
Past due 181-365 days	6,712	1,301	7,769	2,709
Past due more than one year	78,700	69,413	71,373	63,628
	95,131	**72,390**	**87,307**	**66,337**

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

'000 GEL	2010	2009
Balance at beginning of the year	66,337	63,102
Increase during the year	6,053	3,235
Balance at end of the year	**72,390**	**66,337**

Most of the impairment loss at 31 December 2010 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.

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 2010 the Group does not have any collective impairment on its trade receivables (2009: 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.

In addition the Group has an undrawn loan facility from EBRD to partly finance the Tbilisi Bypass project (see note 18).

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.

2010

'000 GEL	**Carrying amount**	**Contractual cash flows**	**0-6 months**	**6-12 months**	**1-2 years**	**2-5 years**
Unsecured bond issues	457,642	662,030	21,883	21,883	43,766	574,498
Trade and other payables	44,765	44,765	39,215	5,505	45	-
Other current liabilities	15,018	15,018	15,018	-	-	-
Guarantees issued	15,305	15,305	15,305	-	-	-
	532,730	**737,118**	**91,421**	**27,388**	**43,811**	**574,498**

2009

'000 GEL	**Carrying amount**	**Contractual cash flows**	**0-6 months**	**6-12 months**	**1-2 years**	**2-5 years**
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	-	-	-
Guarantees issued	-	15,305	15,305	-	-	-
	122,126	**144,302**	**63,323**	**23,752**	**57,227**	**-**

(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 is denominated in CHF. The Group's policy is to conclude significant purchase contracts in CHF 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 - denominated	CHF - denominated	USD- denominated	CHF - denominated
	2010	2010	2009	2009
Cash and cash equivalents	14,979	312,535	387	45
Bank deposits	10,637	27,384	-	-
Trade receivables	84	14,139	233	13,477
Unsecured bank facility	-	-	(3,773)	-
Unsecured bond issues	(457,642)	-	-	-
Trade and other payables	(12,270)	-	(16,770)	(1,813)
Net exposure	**(444,212)**	**354,058**	**(19,923)**	**11,709**

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2010	2009	2010	2009
USD 1	1.78	1.67	1.77	1.69
CHF 1	1.71	1.54	1.89	1.63

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 2009.

'000 GEL	Profit or loss
2010	
USD (10% strengthening)	37,758
CHF (10% strengthening)	(30,095)
2009	
USD (10% strengthening)	1,693
CHF (10% strengthening)	(995)

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	**2010**	**2009**
Fixed rate instruments		
Financial assets	38,021	-
Financial liabilities	(457,642)	(24,982)
	(419,621)	**(24,982)**
Variable rate instruments		
Financial liabilities	-	(3,773)
	-	**(3,773)**

Bank deposits (included in financial assets above) have a maturity of up to six months from the reporting date and bear annual interest from 3.5% to 8.25%.

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 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 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	**2010**	**2009**
Total liabilities	700,339	260,956
Less: cash and cash equivalents	(323,943)	(1,361)
Net debt	**376,396**	**259,595**
Total equity	**1,633,041**	**1,548,683**
Debt to capital ratio at 31 December	0.23	0.17

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.

24 Operating leases

Non-cancellable operating lease rentals are receivable as follows:

'000 GEL	**2010**	**2009**
Less than one year	1,408	3,378
Between one and five years	5,341	7,266
More than five years	37,627	37,403
	44,376	**48,047**

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.

25 Capital commitments

As at 31 December 2010 the Group had entered into contracts for construction works and the purchase of plant and equipment for GEL 653,370 thousand (2009: GEL 36,234 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) Control relationships

The Company 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 and close family members

(i) Management remuneration

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

'000 GEL	**2010**	**2009**
Salaries and bonuses	**911**	**880**

(c) Transactions with other related parties

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

(i) Revenue

'000 GEL	Transaction value 2010	Transaction value 2009	Outstanding balance 2010	Outstanding balance 2009
Services provided:				
State-owned companies and government bodies	2	6	-	2

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 2010	Transaction value 2009	Outstanding balance 2010	Outstanding balance 2009
Purchase of goods:				
State-owned companies and government bodies	11,564	2,479	1,548	436
Services received:				
State-owned companies and government bodies	8,072	9,614	1,209	1,083
	19,636	**12,093**	**2,757**	**1,519**

Goods purchased from related parties mainly relate to contruction materials purchased from state-owned companies. Services received mainly relate to security services provided by government bodies.

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	2010	2009
Liabilities to the owners	29,352	26,636

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.

28 Significant subsidiaries

Subsidiary	Country of incorporation	Principal activities	2010 Ownership/ voting	2009 Ownership/ voting
Georgian Railway Property Management LLC	Georgia	Property management and development	100%	100%
Georgian Railway Transcontainer LLC	Georgia	Container transportation	100%	100%
Georgian Railway Construction LLC	Georgia	Construction and other projects	100%	100%
Borjomi Bakuriani Railway LLC	Georgia	Passenger transportation	100%	100%