Georgian Railway LLC

Condensed Consolidated Interim Financial Statements for the three-month periods ended 31 March 2011 and 2010

Contents

'000 GEL	Note	31 March 2011	31 December 2010	31 March 2010	31 December 2009
		Unaudited Restated		**Unaudited**	
ASSETS					
Non-current assets					
Property, plant and equipment	8	1,727,045	1,725,633	1,702,518	1,699,940
Investment property		9,926	9,926	9,926	9,926
Other non-current assets		174,014	136,375	13,234	12,817
Total non-current assets		**1,910,985**	**1,871,934**	**1,725,678**	**1,722,683**
Current assets					
Inventories		19,700	17,992	22,020	23,725
Trade and other receivables		-	-	22,838	22,194
Prepayments and other current assets		23,938	26,913	35,970	35,061
Cash and cash equivalents		53,381	42,665	18,544	1,361
Bank deposits		258,325	335,855	-	-
Current tax assets		36,896	38,021	577	4,615
Total current assets		**391,700**	**461,446**	**99,949**	**86,956**
Total assets		**2,302,685**	**2,333,380**	**1,825,627**	**1,809,639**
EQUITY AND LIABILITIES					
Equity	9				
Charter capital		985,869	985,376	966,910	967,207
Non-cash owner contribution reserve		35,404	35,404	25,311	25,311
Retained earnings		631,273	612,261	570,478	556,165
Total equity		**1,652,546**	**1,633,041**	**1,562,699**	**1,548,683**
Non-current liabilities					
Loans and borrowings	10	422,089	438,383	24,900	24,900
Trade and other payables		45	45	38,125	28,853
Deferred tax liabilities		66,548	66,521	73,464	74,817
Total non-current liabilities		**488,682**	**504,949**	**136,489**	**128,570**
Current liabilities					
Loans and borrowings		7,744	19,259	1,953	3,855
Trade and other payables		48,761	61,886	59,968	66,035
Liabilities to the owners		26,543	29,241	27,839	26,636
Provisions		20,606	21,597	6,088	6,088
Other Taxes Payable		30,642	27,236	22,579	21,794
Other current liabilities		15,315	15,018	8,012	7,978
Current tax liabilities		11,846	21,153	-	-
Total current liabilities		**161,457**	**195,390**	**126,439**	**132,386**
Total liabilities		**650,139**	**700,339**	**262,928**	**260,956**
Total equity and liabilities		**2,302,685**	**2,333,380**	**1,825,627**	**1,809,639**

The condensed consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the condensed consolidated financial statements set out on pages 7 to 11.

'000 GEL	Note	Three-month period ended 31 March 2011	Three-month period ended 31 March 2010
		Unaudited Restated	**Unaudited**
Revenue		103,396	87,897
Other income		3,989	1,855
Employee benefits expense		(26,310)	(26,246)
Depreciation and amortization expense		(23,034)	(23,323)
Electricity and materials used		(12,669)	(10,763)
Other expenses		(20,464)	(12,155)
Results from operating activities		**24,908**	**17,265**
Finance income		10,869	399
Finance costs		(1,515)	(826)
Net finance income		**9,354**	**(427)**
Profit before income tax		**34,262**	**16,838**
Income tax expense		(5,719)	(2,525)
Profit and total comprehensive income for the period		**28,543**	**14,313**

The condensed consolidated statement of comprehensive income is to be read in conjunction with the notes to, and forming part of, the condensed consolidated financial statements set out on pages 7 to 11.

	Charter capital	**Non-cash owner contribution reserve**	**Retained earnings**	**Total equity**
Balance at 1 January 2010	**967,207**	**25,311**	**556,165**	**1,548,683**
Total comprehensive income for the period:				
Profit and total comprehensive income for the period	-	-	14,313	14,313
Transactions with owners, recorded directly in equity:				
Other non-cash contributions by and distributions to owners	(297)	-	-	(297)
Balance at 31 March 2010	**966,910**	**25,311**	**570,478**	**1,562,699**

'000 GEL	**Charter capital**	**Non-cash owner contribution reserve**	**Retained earnings**	**Total equity**
Balance at 1 January 2011	**985,376**	**35,404**	**612,261**	**1,633,041**
Total comprehensive income for the period				
Profit and total comprehensive income for the period (unaudited, restated)	-	-	28,543	28,543
Transactions with owners, recorded directly in equity				
Non-cash contributions by and distributions to owner (unaudited, restated)	493	-	(9,531)	(9,038)
Balance at 31 March 2011 (unaudited, restated)	**985,869**	**35,404**	**631,273**	**1,652,546**

The condensed consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the condensed consolidated financial statements set out on pages 7 to 11.

'000 GEL	**Three-month period ended 31 March 2011**	**Three-month period ended 31 March 2010**
	Unaudited	**Unaudited**
	Restated	
Cash flows from operating activities		
Cash receipts from customers	111,644	90,604
Cash paid to suppliers and employees	(47,540)	(45,568)
Cash flows from operations before income taxes	**64,104**	**45,036**
Income tax paid	(15,000)	-
Net cash from operating activities	**49,104**	**45,036**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(99,414)	(26,096)
(Increase)/decrease in term deposits	1,125	-
(Increase)/decrease in restricted cash	5,790	-
Interest received	814	134
Net cash used in investing activities	**(91,685)**	**(25,962)**
Cash flows from financing activities		
Proceeds from borrowings	-	(1,902)
Interest paid	(22,330)	(38)
Net cash used in financing activities	**(22,330)**	**(1,940)**
Net decrease in cash and cash equivalents	**(64,911)**	**17,134**
Cash and cash equivalents at 1 January	323,943	1,361
Effect of exchange rate fluctuations on cash and cash equivalents	(6,743)	49
Cash and cash equivalents at 31 March	**252,289**	**18,544**

The condensed consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the condensed consolidated financial statements set out on pages 7 to 11.

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. These consolidated interim condensed 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) Organization 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.

2 Basis of preparation

(a) Statement of compliance

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

(b) 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 interim condensed financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand.

(c) Use of estimates and judgments

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

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

3 Significant accounting policies

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

4 Financial risk management

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

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.

(i) Information about reportable segments for the three-month period ended 31 March (unaudited)

’000 GEL	Freight transportation		Passenger transportation		Total	
	Three-month period ended 31 March 2011	**Three-month period ended 31 March 2010**	**Three-month period ended 31 March 2011**	**Three-month period ended 31 March 2010**	**Three-month period ended 31 March 2011**	**Three-month period ended 31 March 2010**
External revenues	97,716	83,362	3,450	3,372	101,166	86,734
Reportable segment profit/(loss) before infrastructure costs, central overheads, net finance income or costs and income tax	57,943	49,368	(3,217)	(3,373)	54,726	46,095

(ii) Reconciliation of reportable segment profit or loss for the twelve-month period ended 31 March (unaudited)

’000 GEL	2011 Unaudited	2010 Unaudited
Total profit or loss for reportable segments	54,726	46,095
Other profit or loss	(1,300)	151
Payroll expenses – infrastructure and headquarters	(12,768)	(11,570)
Depreciation expenses – infrastructure and headquarters	(12,068)	(11,530)
Net finance costs	9,354	(427)
Other net unallocated (expenses)/income	(3,682)	(4,196)
Consolidated profit/(loss) before income tax	**34,262**	**18,523**

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

6 Seasonality of operations

The Group’s operations are not materially affected by seasonality. The Group’s revenues remain relatively stable during the year with relative increase of around 5 to 10% in March to September on average.

7 Income tax (expense)/benefit

Income tax is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year applied to the pre-tax income of the interim period.

8 Property, plant and equipment

Acquisitions

During the three-month period ended 31 March 2011 the Group acquired assets with a cost of GEL 30,144 thousand (three-month period ended 31 March 2010: GEL 25,706 thousand).

9 Equity

Dividends

No dividends were declared and paid by the Group during the three-month period ended 31 March 2011 (three-month period ended 31 March 2010: Nil). No dividends have been proposed after 31 March 2011.

10 Loans and borrowings

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 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 to the Group up to CHF 146.2 million to partly finance Tbilisi Bypass project. No proceeds were utilized by the Group as at the reporting date and as at the date of issue of these consolidated interim condensed financial statements.

As at 31 March 2011 outstanding loans and borrowings of the Group comprised of only Eurobonds issued in July 2010, with carrying amount of principal and accrued interest of GEL 422,089 thousand and GEL 7,744 thousand respectively.

11 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 characterized 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 interim condensed 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.

Events subsequent to the reporting date

There were no significant events subsequent to the reporting date.