Georgian Railway LLC

Consolidated Condensed Interim Financial Statements for the nine month period ended 30 September 2010

Contents

'000 GEL

	Note	30 September 2010 Unaudited	31 December 2009 Audited
ASSETS			
Non-current assets			
Property, plant and equipment	8	1,699,240	1,699,940
Investment property		9,926	9,926
Other non-current assets		35,195	12,817
Total non-current assets		**1,744,361**	**1,722,683**
Current assets			
Inventories		26,693	23,725
Current tax assets		-	4,615
Trade and other receivables		18,337	22,194
Prepayments and other current assets		77,808	35,061
Cash and cash equivalents		475,598	1,361
Total current assets		**598,436**	**86,956**
Total assets		**2,342,797**	**1,809,639**
EQUITY AND LIABILITIES			
Equity	9		
Charter capital		977,490	967,207
Non-cash owner contribution reserve		25,312	25,311
Retained earnings		596,283	556,165
Total equity		**1,599,085**	**1,548,683**
Non-current liabilities			
Loans and borrowings	10	446,422	24,900
Trade and other payables		29,818	28,853
Deferred tax liabilities		74,831	74,817
Total non-current liabilities		**551,071**	**128,570**
Current liabilities			
Loans and borrowings	10	8,371	3,855
Trade and other payables		67,738	66,035
Liabilities to the owners		32,639	26,636
Provisions		6,088	6,088
Other taxes payable		33,608	21,794
Other current liabilities		44,197	7,978
Total current liabilities		**192,641**	**132,386**
Total liabilities		**743,712**	**260,956**
Total equity and liabilities		**2,342,797**	**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 12.

'000 GEL	Note	**Nine-month period ended 30 September**		**Three-month period ended 30 September**	
		2010	**2009**	**2010**	**2009**
Revenue		293,702	220,339	110,204	85,473
Other income		8,534	6,727	4,781	1,466
Employee benefit expense		(79,598)	(81,120)	(26,650)	(26,834)
Depreciation		(70,468)	(71,595)	(23,565)	(23,865)
Raw materials and consumables used		(31,436)	(29,303)	(11,203)	(10,041)
Other expenses		(44,970)	(37,750)	(21,064)	(11,446)
Results from operating activities		**75,764**	**7,298**	**32,503**	**14,753**
Finance income		1,778	353	790	126
Finance costs		12,553	(4,632)	16,032	(1,558)
Net finance costs		**14,331**	**(4,279)**	**16,822**	**(1,432)**
Profit/(loss) before income tax		**90,095**	**3,019**	**49,325**	**13,321**
Income tax (expense)/benefit	7	(12,432)	(8,464)	(7,596)	(2,821)
Profit/(loss)and total Comprehensive income for the period		**77,663**	**(5,445)**	**41,729**	**10,500**

Irakli Ezugbaia
General Director

Giorgi Gurgenidze
Infrastructure SBU Director

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 12.

	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	-	-	77,663	77,663
Transactions with owners, recorded directly in equity:				
Non-cash contributions by owners (Land)	18,380	-	-	18,380
Non-cash distributions to owners (Railway Telecom)	(2,056)	-	-	(2,056)
Other non-cash distributions to owners(Other fixed assets)	(6,090)	-	-	(6,090)
Changes in equity	49	0	(49)	0
Dividends to equity holders	-	-	(37,496)	(37,496)
Total contributions by and distributions to owners	10,283	0	(37,545)	(27,261)
Balance at 30 September 2010	**977,490**	**25,311**	**596,283**	**1,599,085**

	Charter capital	**Non-cash owner contribution reserve**	**Retained earnings**	**Total equity**
Balance at 1 January 2009	933,634	33,739	573,608	1,540,981
Total comprehensive income for the period:				
Profit and total comprehensive income for the period	-	-	(5,445)	(5,445)
Transactions with owners, recorded directly in equity:				
Non-cash contributions by owners (Land)	33,820	-	-	33,820
Changes in equity	49	0	826	875
Total contributions by and distributions to owners	33,869	0	826	34,695
Balance at 30 September 2009	**967,503**	**33,739**	**568,989**	**1,570,231**

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 12.

'000 GEL	**30-Sep-10**	**30-Sep-09**
Cash flows from operating activities		
Cash receipts from customers	308,029	237,793
Cash paid to suppliers and employees	(132,278)	(147,956)
Cash flows from operations before income taxes and interest paid	**175,751**	**89,838**
Income tax paid	(2,378)	(12,083)
Interest paid	(5,631)	(1,561)
Net cash from operating activities	**167,742**	**76,195**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(135,704)	(65,008)
Other		
Net cash used in investing activities	**(135,704)**	**(65,008)**
Cash flows from financing activities		
Repayment of borrowings	(31,078)	(7,284)
Proceeds from borrowings	455,109	0
Net cash used in financing activities	**424,031**	**(7,284)**
Net increase in cash and cash equivalents	**456,069**	**3,903**
Cash and cash equivalents at 1 January	1,023	1,358
Effect of exchange rate fluctuations on cash and cash equivalents	18,506	0
Cash and cash equivalents at 30 September	**475,598**	**5,261**

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 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 2009.

(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 2009.

With effect from 24 May 2010, the Company transferred 100% of its shares in Railway Telecom LLC to the Ministry of Economic Development in exchange for an undertaking by the Ministry to increase the capital of the Company by an amount equal to the fair value of the shares following a further auction, but in any event within three years of the transfer. In this respect Railway Telecom LLC financial statements will not be consolidated with the Georgian Railway's financial statements in year 2010. And, correspondingly, to ensure the comparability between 2009 and 2010 consolidated interim financial statements, the interim consolidated financial statements for the year 2009 (except for Audited Statement of Financial Position ending 31 December 2009 presented in this report) of Georgian Railway LLC have also been prepared by not consolidating Railway Telecom LLC's financial statements (*See Section - "Significant Subsidiaries"*).

Railway Telecom LLC is a Georgian limited liability company established in August 2004, which has as its corporate objective providing cable leasing and internet services using its own fiber-optic infrastructure.

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 2009.

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 2009.

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 nine-month period ended 30 September (unaudited)

'000 GEL	Freight SBU		Passenger SBU		Total	
	2010	2009	2010	2009	2010	2009
External Revenues	276,519	207,308	13,646	12,224	290,164	219,532
Reportable segment profit/(loss) before infrastructure costs central overheads, interest and income tax	176,734	106,239	(6,430)	(8,987)	170,305	97,252

(ii) Reconciliation of reportable segment profit or loss for the three-month period ended 30 September (unaudited)

'000 GEL	2010	2009
Revenues		
Total revenues for reportable segments	290,164	219,532
Other revenue	3,538	807
Total consolidated revenue	**293,702**	**220,339**
Profit or loss		
Total profit or loss for reportable segments	170,305	97,252
Other profit or loss	3,538	807
Payroll expenses (infrastructure and headquarters)	(35,715)	(35,878)
Depreciation expenses (infrastructure and headquarters)	(35,189)	(35,280)
Net finance costs	14,331	(4,279)
Other net unallocated expenses	(27,174)	(19,603)
Consolidated profit before income tax	**90,095**	**3,019**

There have been no changes to the basis of segmentation or the measurement basis for the segment profit or loss since 31 December 2009.

There have been no material changes in segment assets from the amounts disclosed in the consolidated financial statements of the Group as at and for the year ended 31 December 2009.

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 nine-month period ended 30 September 2010 the Group acquired assets with a cost of GEL 82,864 thousand (nine-month period ended 30 September 2009: GEL 98,139 thousand).

9 Equity

Dividends

During nine-month period ended 30 September 2010 the shareholder declared dividends of GEL 37,496 thousand payable till the end of 2010, however this was a mechanical error in document processing because the Government (the shareholder) restricted itself of requesting dividends in year 2010 of more than GEL 36,000 according to the direct agreement for the support of Tbilisi Bypass Project undertaken by the Group, signed on 17 March 2010 between Ministry of Economic Development, Enterprise Management Agency, Georgian Railway and European Bank for Reconstruction and Development. Correspondingly, in order to not to breach the terms of the above-mentioned agreement the shareholder will issue corrective decree for decreasing the declared dividend to GEL 36,000 till the end of year 2010. For nine-month period ended 30 September 2009 there has not been declared any dividends.

10 Loans and borrowings

On 22 July 2010 the Group issued Eurobonds with the US$ 250,000 thousand face value, 9.875% coupon payable semiannually, maturing on 22 July 2015. JP Morgan Securities and Bank of America Merrill Lynch acted as joint lead managers of the issue. Carrying amount of the Eurobonds in the statement of financial position is stated at amortized value using the effective interest rate calculation method. "Loans and borrowings" in the current liabilities section represents accrued interest on the Eurobonds. As at 30 September 2010 Eurobonds and accrued interest represented the only outstanding financial indebtedness of the Group as it made an early redemption of its local currency denominated bonds with a face value of GEL 25,000 thousand.

The intended use of the proceeds is to finance the two large-scale projects undertaken by the Group: Modernization and Tbilisi Bypass projects. The modernization project includes 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.

The Tbilisi bypass project is intended to relocate certain railway infrastructure components from the centre of Tbilisi to the northern part of the city. To partly finance the CHF 270 million Tbilisi bypass project a loan agreement was signed between the Group and the European Bank for Reconstruction and Development ("EBRD") On 17 March, by which EBRD agreed to lend up to CHF 146.2 million. The Group has paid to EBRD a front-end commission of 1.25% of the principal amount of the loan. The Group has not yet borrowed any funds under this loan facility

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.

12 Significant Subsidiaries

Before May 2010 the Company, through its 100% subsidiary Railway Telecom LLC was engaged in providing cable leasing and internet services using its own fiber-optic infrastructure. On 16 November 2009 an auction for the sale of 100% of shares of the Railway Telecom LLC (a subsidiary of the Company) was held. The winner of the auction was Linx Telecom Georgia LLC. 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. With effect from 24 May 2010, the Company transferred its shares in Railway Telecom LLC to the Ministry of Economic Development in exchange for an undertaking by the Ministry to increase the capital of the Company by an amount equal to the fair value of the shares following a further auction, but in any event within three years of the transfer.

In year 2009 annual revenue of Railway Telecom LLC amounted to GEL 11,404 thousand, expenses – GEL 10,964 thousand, and correspondingly net income amounted to GEL 438 thousand.

Events subsequent to the reporting date

The Group has started negotiations with international investment banks to enter into a cross-currency swap transaction and hedge its currency mismatches between Swiss Franc revenues and US Dollar denominated Eurobonds. The transaction is expected to be till the end of 2010.