Georgian Railway LLC

Financial Statements prepared in accordance with
International Financial Reporting Standards

as of December 31, 2004 and 2003 and for the years then ended
together with independent auditors' report

Georgian Railway LLC

Financial statements

Years ended December 31, 2004, 2003 and 2002

Contents

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Independent Auditors' Report

To the Owner and Management of Georgian Railway LLC:

1. We were engaged to audit the accompanying balance sheets of the Georgian Railway LLC (hereinafter the "Company") as of December 31, 2004 and 2003 and the related statements of operations and changes in equity for the years then ended. These financial statements are the responsibility of the Company's management.

2. Due to inadequacy of the system of accounting and the underlying accounting records, we were unable to satisfy ourselves as to the following (all amounts are in thousands of Georgian Lari – GEL):

   a) property and equipment of 416,767 GEL and 436,736 GEL as of December 31, 2004 and 2003, respectively, and the related depreciation expense of 44,508 GEL and 47,024 GEL for the years ended December 31, 2004 and 2003, respectively;

   b) the existence of ownership rights of the Company with regard to equity investments with the aggregate value of 2,204 GEL as of December 31, 2004 (before impairment of 183 GEL) and 2,445 GEL as of December 31, 2003 (before impairment of 209 GEL). Moreover, the Company's books of account do not contain any records regarding investments in several entities listed in Note 1, which in accordance with their charter documents represent the Company's fully owned subsidiaries;

   c) the accuracy of recognition of the effects of additions and disposals of the Company's subsidiaries and associated entities listed in Notes 1 and 5 to the financial statements;

   d) accounts receivable (before allowance for doubtful debts) and prepayments of 68,531 GEL and 63,876 GEL as of December 31, 2004 and 2003, respectively;

   e) the allowance for doubtful debts of 5,258 GEL and 5,192 GEL as of December 31, 2004 and 2003, respectively, and the related expense of 314 GEL and 120 GEL for the years ended December 31, 2004 and 2003, respectively;

   f) cash and cash equivalents of 475 GEL and 624 GEL as of December 31, 2004 and 2003, respectively;

   g) liabilities for income tax and other taxes of 2,560 GEL and 5,252 GEL as of December 31, 2004 and 2003, respectively, and the related tax expenses of 17,673 GEL (including income tax expense of 15,061 GEL) for the year ended December 31, 2004 and 20,872 GEL (including income tax expense of 16,437 GEL) for the year ended December 31, 2003;

   h) accounts payable, accruals and other liabilities of 37,045 GEL and 47,327 GEL as of December 31, 2004 and 2003;

i) the amounts and classification of individual equity components. In particular, the amount of 3,986 GEL as of December 31, 2004 and 2003 reported as revaluation reserve; the debit balance of 2,130 GEL and the credit balance of 12,729 GEL as of December 31, 2004 and 2003, respectively, reported as other reserves; the charge of 14,859 GEL and a credit entry of 524 GEL reported in the statements of changes in equity for the years ended December 31, 2004 and 2003, respectively, and classified as transfers; the amounts of dividends paid of 7,000 GEL and 8,850 GEL for the years ended December 31, 2004 and 2003, respectively; and further, the amount of charter capital reported as of December 31, 2004 and 2003, which is lower than the share capital amount as stated and registered in the Company's charter documents by 5,578 GEL as of the both dates;

j) freight and passenger transportation revenues of 228,477 GEL and 8,339 GEL, respectively, for the year ended December 31, 2004, and 278,719 GEL and 5,873 GEL, respectively, for the year ended December 31, 2003;

k) revenues and expenses from rental of carriages of 13,453 GEL and 13,847 GEL, respectively, for the year ended December 31, 2004, and 14,937 GEL and 16,047 GEL, respectively, for the year ended December 31, 2003;

l) other operating revenues for the years ended December 31, 2004 and 2003 of 14,250 GEL and 27,820 GEL, respectively;

m) wages, salaries and other employee benefits expenses for the years ended December 31, 2004 and 2003 of 50,084 GEL and 48,021 GEL and the related salaries payable of 3,261 GEL and 3,336 GEL as of December 31, 2004 and 2003;

n) social expenses of 15,341 GEL and 14,310 GEL for the years ended December 31, 2004 and 2003, respectively;

o) materials and supplies for the years ended December 31, 2004 and 2003 of 39,856 GEL and 47,393 GEL, respectively;

p) fuel expenses for the years ended December 31, 2004 and 2003 of 7,667 GEL and 7,776 GEL, respectively;

q) other operating expenses for the years ended December 31, 2004 and 2003 of 31,179 GEL and 55,828 GEL, respectively;

r) charity and donations for the years ended December 31, 2004 and 2003 of 1,831 GEL and 3,335 GEL, respectively;

s) other provisions of 660 GEL for the year ended December 31, 2004, and recovery of other provisions of 578 GEL for the year ended December 31, 2003;

t) foreign exchange gain of 3,429 GEL for the year ended December 31, 2004, and foreign exchange loss of 3,577 GEL for the year ended December 31, 2003;

u) other expenses for the years ended December 31, 2004 of 715 GEL and 2,170 GEL, respectively.

Our auditors' report dated August 16, 2004 on the financial statements of the Company as of December 31, 2002 and 2001 and for the years then ended was qualified with regard to the same matters as described in a) – u) above, and further the amount of electricity expense reported in the statement of operations for the year ended December 31, 2002.

3. We did not observe the physical inventory as of December 31, 2004, 2003, 2002 and 2001 since our appointment as auditors for the years ended on the dates above was made subsequent to these dates. Owing to the nature of the Company's accounting records we were unable to obtain sufficient evidence to satisfy ourselves regarding accuracy of inventory balances reported by the Company in the amount of 27,519 GEL, 22,962 GEL, 25,892 GEL and 26,786 GEL as of December 31, 2004, 2003, 2002 and 2001, respectively, through application of alternative procedures. These inventory balances enter materially into the determination of income.

   Further, no provision for inventory obsolescence was recorded by the Company as of December 31, 2004, 2003 and 2002. Owing to the nature of the accounting records, we were unable to obtain sufficient evidence regarding such estimate made by management.

4. The Company did not prepare the analysis of significant litigations involving the Company as either plaintiff or defendant, which was pending or threatened as of December 31, 2004, 2003 and 2002. This represents a departure from IAS 37 "Provisions, Contingent Liabilities and Contingent Assets". The effect of this departure on the accompanying financial statements has not been determined.

5. The Company did not perform consolidation of its subsidiaries, nor apply the equity method of accounting regarding its investments in associated undertakings. This represents departures from IAS 27 "Consolidated and Separate Financial Statements" and IAS 28 "Investments in Associates". The effects of these departures on the accompanying financial statements have not been determined.

6. The Company reported 1,449 GEL, 3,205 GEL, 802 GEL and 728 GEL in its balance sheets as "Receivable from inter-branch settlements" as of December 31, 2004, 2003, 2002 and 2001, respectively. These balances should have been eliminated by the Company. Additionally, because of the fact that the Company's system of accounting regarding the preparation of the financial statements does not ensure complete identification and elimination of inter-branch transactions and balances, we were unable to satisfy ourselves as to whether the above mentioned balances represent all non-eliminated inter-branch balances as of those dates. We were unable to determine the effects of these non-eliminated balances and related transactions on the Company's financial position and results of operations.

7. As discussed in Note 3, in accordance with the Company's accounting policy, subsequent to initial recognition, property and equipment are carried at cost adjusted for the effects of statutory revaluations made based on the requirements of the regulatory bodies of Georgia. These revaluations were not in accordance with IAS 16 "Property, Plant and Equipment". The effect of this matter on the accompanying financial statements has not been determined.

8. The Company did not recognize tax effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases as of December 31, 2004, 2003, 2002 and 2001. This represents a departure from IAS 12 "Income Taxes". The effect of this matter on the accompanying financial statements has not been determined.

9. The accompanying financial statements do not include the statements of cash flows for the years ended December 31, 2004 and 2003 including the corresponding figures, which presentation is required in accordance with IAS 1 "Presentation of Financial Statements".

10. The Company did not prepare all financial statements footnote disclosures required by IFRS. In particular, the Company did not present footnote disclosures as required by IAS 1 "Presentation of Financial Statements", IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies", IAS 10 "Events after the Balance Sheet Date", IAS 12 "Income Taxes", IAS 16 "Property, Plant and Equipment", IAS 24 "Related Party Disclosures", IAS 32 "Financial Instruments: Disclosure and Presentation", IAS 36 "Impairment of Assets", IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".

11. Because of the significance of the matters discussed in paragraphs 2-3 above, we do not express, an opinion on the financial statements of the Company referred to above. Moreover, although we do not express an opinion on the accompanying financial statements, we draw your attention to the matters discussed in paragraphs 4-10, which represent significant departures from International Financial Reporting Standards.

Ernst & Young Audit LLC

April 20, 2007

Georgian Railway LLC

Balance Sheets

(Amounts in thousands of Georgian Lari)

	Notes	2004	2003	2002
ASSETS				
Non-current assets				
Property and equipment, net	4	416,767	436,736	437,625
Intangible assets, net		11	12	13
Investments, net	5	2,021	2,236	2,236
Total non-current assets		**418,799**	**438,984**	**439,874**
Current assets				
Inventory		27,519	22,962	25,892
Receivables from inter-branch settlements		1,449	3,205	802
Prepayments and other current assets	6	14,108	17,277	25,416
Accounts receivable, net	7	49,165	41,407	26,200
Cash and cash equivalents	8	3,497	3,456	1,796
Total current assets		**95,738**	**88,307**	**80,106**
Total assets		**514,537**	**527,291**	**519,980**
EQUITY AND LIABILITIES				
Equity		**447,359**	**439,127**	**401,750**
Non-current liabilities				
Long-term borrowings	9	20,260	27,642	32,479
Total non-current liabilities		**20,260**	**27,642**	**32,479**
Current liabilities				
Current portion of long-term borrowings	9	4,052	4,607	4,644
Salaries payable		3,261	3,336	3,158
Liabilities for income tax and other taxes		2,560	5,252	10,005
Accruals and other liabilities		15,627	13,434	13,426
Accounts payable		21,418	33,893	54,518
Total current liabilities		**46,918**	**60,522**	**85,751**
Total equity and liabilities		**514,537**	**527,291**	**519,980**

Irakli Ezugbaia General Director

Giorgi Gagnidze Deputy General Director

April 20, 2007

Georgian Railway LLC

Statements of Operations
For the years ended December 31, 2004 and 2003

(Amounts in thousands of Georgian Lari)

	Notes	2004	2003	2002
Revenues				
Freight revenues		228,477	278,719	227,069
Passenger revenues		8,339	5,873	5,183
Revenues from rental of carriages		13,453	14,937	7,551
Other operating revenues		14,250	27,820	31,444
Total revenues		**264,519**	**327,349**	**271,247**
Operating expenses				
Materials and supplies		(39,856)	(47,393)	(55,875)
Depreciation		(44,508)	(47,024)	(41,416)
Wages, salaries and other employee benefits		(50,084)	(48,021)	(40,575)
Electricity		(13,324)	(14,886)	(12,042)
Other provisions		(660)	578	(9,680)
Expenses from rental of carriages		(13,847)	(16,047)	(8,254)
Fuel		(7,667)	(7,776)	(6,787)
Taxes other than income tax		(2,612)	(4,435)	(5,364)
Social expenses		(15,341)	(14,310)	(4,711)
Charity and donations		(1,831)	(3,335)	(1,841)
Provision for (recovery of provision) for doubtful debts		(314)	(120)	770
Other		(31,179)	(55,828)	(39,905)
Total operating expenses		**(221,223)**	**(258,597)**	**(225,680)**
Income from operations		**43,296**	**68,752**	**45,567**
Interest expense, net		(858)	(865)	(1,471)
Other expense		(715)	(2,170)	-
Foreign exchange gain / (loss), net		3,429	(3,577)	5,960
Income before taxation		**45,152**	**62,140**	**38,136**
Income tax		(15,061)	(16,437)	(15,959)
Net income		**30,091**	**45,703**	**22,177**

Georgian Railway LLC

Statements of Changes in Equity

For the years ended December 31, 2004 and 2003

(Amounts in thousands of Georgian Lari)

	Charter capital	**Retained earnings**	**Revaluation reserve of property and equipment**	**Other reserves**	**Total**
December 31, 2001	**356,750**	**3,751**	**3,957**	**18,165**	**382,623**
Current year income	-	22,177	-	-	22,177
Contributions to capital	422	-	-	-	422
Withdrawals from capital	(292)	-	-	-	(292)
Transfers	-	388	29	(3,597)	(3,180)
December 31, 2002	**356,880**	**26,316**	**3,986**	**14,568**	**401,750**
Current year income	-	45,703	-	-	45,703
Dividends		(8,850)	-	-	(8,850)
Transfers	2,363	-	-	(1,839)	524
December 31, 2003	**359,243**	**63,169**	**3,986**	**12,729**	**439,127**
Current year income	-	30,091	-	-	30,091
Dividends	-	(7,000)	-	-	(7,000)
Transfers	-	-	-	(14,859)	(14,859)
December 31, 2004	**359,243**	**86,260**	**3,986**	**(2,130)**	**447,359**

Georgian Railway LLC

Notes to financial statements

(Amounts in thousands of Georgian Lari)

1. Description of business

Company information
The state limited liability company Georgian Railway (the "Company") was established in accordance with Decree of the President of Georgia No. 929 dated December 8, 1998. The Company is now fully owned by the State of Georgia represented by the State Enterprise Managing Agency.

The Company operates nationwide railway system providing freight and passenger railway transportation, maintenance of railway infrastructure and construction of railway lines within Georgia.

During 2004 and 2003 the Company employed approximately 17 thousand employees. The Company's legal address is 15, Queen Tamar Ave., Tbilisi 0112, Georgia. These financial statements were authorized for issuance by management of the Company on May 31, 2006.

Subsidiaries and associates
The Company controls a number of entities that can be treated as subsidiaries for the purposes of reporting under International Financial Reporting Standards ("IFRS").

These entities as of December 31, 2004 were as follows:

Name of Company	Legal form	Nature of business	Share in equity based on charter documents
Reinforced Concrete Tie Factory	LLC	Manufacturing	100%
Chkhenisi Crushed Stone Factory	LLC	Manufacturing	100%
Tbilisi Cross Melding Factory	LLC	Manufacturing	100%
Durnuki Crushed Stone Factory	LLC	Manufacturing	100%
Gori Tie Factory	LLC	Manufacturing	100%
Borjomi Rehabilitation Centre	LLC	Medical	100%
Railway Central Clinical Hospital	LLC	Medical	100%
Sak Rkinigza Project	LLC	Construction	100%
Railway Central Clinical Hospital	LLC	Medical	100%
Kutaisi Multi Profile Hospital	LLC	Medical	100%
Railways Maternity House	LLC	Medical	100%
Railway Telecom	LLC	Communication	100%
Railway Insurance	LLC	Insurance	100%

(Amounts in thousands of Georgian Lari)

1. Description of business (continued)

These entities as of December 31, 2003 were as follows:

Name of Company	Legal form	Nature of business	Share in equity based on charter documents
Reinforced Concrete Tie Factory	LLC	Manufacturing	100%
Chkhenisi Crushed Stone Factory	LLC	Manufacturing	100%
Tbilisi Cross Melding Factory	LLC	Manufacturing	100%
Durnuki Crushed Stone Factory	LLC	Manufacturing	100%
Gori Tie Factory	LLC	Manufacturing	100%
Borjomi Rehabilitation Centre	LLC	Medical	100%
Railway Central Clinical Hospital	LLC	Medical	100%
Sak Rkinigza Project	LLC	Construction	100%
Railway Central Clinical Hospital	LLC	Medical	100%
Kutaisi Multi Profile Hospital	LLC	Medical	100%
Railways Maternity House	LLC	Medical	100%
Football club Locomotive	LLC	Sport	100%

These entities as of December 31, 2002 were as follows:

Name of Company	Legal form	Nature of business	Share in equity based on charter documents
Gori Reinforced Concrete Tie Factory	LLC	Manufacturing	100%
Chkhenisi Crushed Stone Factory	LLC	Manufacturing	100%
Tbilisi Cross Melding Factory	LLC	Manufacturing	100%
Durnuki Crushed Stone Factory	LLC	Manufacturing	100%
Gori Tie Factory	LLC	Manufacturing	100%
Borjomi Rehabilitation Centre	LLC	Medical	100%
Railway Central Clinical Hospital	LLC	Medical	100%
Sak Rkinigza Project	LLC	Construction	100%
Central Clinical Hospital Road	LLC	Medical	100%
Kutaisi Multi Profile Hospital	LLC	Medical	100%
Railways Maternity House	LLC	Medical	100%

In addition, the Company has equity investments in associated undertakings with ownership interest ranging from 25% to 48.5%.

1. Description of business (continued)

Pricing policy
Although, the Company has certain level of independence in different aspects of is operations and their management, the Company's operations are closely regulated by the state. Tariff rates are finally approved by the Ministry of Transport and Communications.

a. Tariffs for domestic freight transportation
Domestic freight transportation is a natural monopoly subject to regulation in accordance with The Law on the Railway Code of Georgia dated December 28, 2002.

Tariffs for domestic freight transportation services are prescribed by Decrees:

- No. 74 approved by the Minister of Georgian Transport and Communications on Amendments and Additions to Decree No.1 approved by the Minister of Georgian Transport and Communications on Tariff Policy of the Georgian Railway during Freight Years of 2002;

- No. 112/n approved by the Deputy General Director of Georgian Railway on the Measures and Undertakes to Attract Cargo for Georgian Railway.

Domestic freight tariffs are denominated in Georgian Lari.

b. Tariffs for domestic transportation of passengers and baggage
Domestic transportation of passengers and baggage is a natural monopoly subject to regulation in accordance with the Law on the Railway Code of Georgia dated December 28, 2002.

Tariffs for domestic transportation of passengers and baggage are prescribed by Decrees approved by the General Director/Commercial Director of the Georgian Railway, and denominated in Georgian Lari.

c. Tariffs for international transportation of freight and passengers
CIS rail tariffs apply to:

- Freight transit via CIS railways;
- Third country freight transportation to/from the CIS;
- Freight transportation between CIS rail terminals.

1. Description of business (continued)

Pricing policy (continued)

Tariffs for international freight transportation services are prescribed by Decrees:

- No. 74 approved by the Minister of Georgian Transport and Communications on Amendments and Additions to Decree No.1 approved by the Minister of Georgian Transport and Communications on Tariff Policy of the Georgian Railway during Freight Years of 2002;
- No. 112/n approved by the Deputy General Director of Georgian Railway on the Measures and Undertakes to Attract Cargo for Georgian Railway.

Tariffs are based on the International Rail Transit Tariff and Unified Transit Tariff denominated in Swiss Francs.

Technical terms and conditions for transportation of freight through the territory of CIS are based on the International Freight Transportation Agreement ("IFTA") issued by the Organization of Cooperation Between Railways.

Technical terms and conditions for transportation of freight through the territory of Georgia are based on the Rules of Freight Transportation by Railway approved by Decree No. 26 of Minister of Transport and Communications of Georgia..

1. Description of business (continued)

Currency exchange and control

Foreign currencies, in particular the US Dollar ("USD"), play a significant role in the underlying economics of many business transactions in Georgia. The following table summarizes exchange rates of Georgian Lari, ("GEL") to 1 USD for the years ended December 31, 2004, 2003 and 2002:

December 31,	Exchange rate
2004	1.8250
2003	2.0750
2002	2.0900

As of April 20, 2007 the exchange rate was 1.691 GEL to 1 USD.

GEL is not a convertible currency outside Georgia. Market rates may differ from the official rates but the differences are, generally, within narrow parameters monitored by the National Bank of Georgia.

2. Basis of presentation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company is required to maintain their records and prepare its financial statements for regulatory purposes in Georgian Lari in accordance with IFRS.

The financial statements are prepared under the historical cost convention except for the statutory revaluations of property and equipment. Revaluations of property and equipment are conducted in accordance with the requirements of the regulatory bodies of Georgia.

These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. Transactions in currencies other than the Lari are treated as transactions in foreign currencies.

3. Summary of significant accounting policies

Investments in associates

Associates are entities in which the Company generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost including goodwill. Subsequent changes in the carrying value reflect the post acquisition changes in the Company's share of net assets of the associate. The Company's share of its associates' profits or losses is recognised in the statement of operations and its share of movements in reserves is recognised in equity. However, when the Company's share of losses in an associate equals or exceeds its interest in the associate the Company does not recognise further losses, unless the Company is obligated to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Company and its associated undertakings are eliminated to the extent of the Company's interest in the associated undertakings; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Recognition and classification of financial instruments

The Company recognizes financial assets and financial liabilities on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument.

Financial assets and liabilities are initially recognized at cost, which is the fair value of consideration given or received, respectively, including or net of any transaction costs incurred, respectively.

The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

Financial assets

Financial assets of the Company consist of cash, accounts receivable and prepayments and are initially recognized in accordance with the policy stated above. The Company believes that the carrying values of its financial assets approximate their fair values.

The Company further holds equity interests in various Georgian legal entities. These investments represent investments in the entities where the Company holds less than 20% ownership interest and does not exert significant influence or control. These investments are recorded at acquisition cost.

3. Summary of significant accounting policies (continued)

Recognition and classification of financial instruments (continued)

Financial assets (continued)

The Company classifies its investments in financial instruments into the following categories: trading, held-to-maturity and available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets. Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets; during the period the Company did not hold any investments in this category. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Company.

Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments and of available-for-sale investments are included in the statement of operations in the period in which they arise.

For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost.

3. Summary of significant accounting policies (continued)

Recognition and classification of financial instruments (continued)

Financial liabilities
Financial liabilities of the Company consist of long-term borrowings, accounts payable and accrued and other liabilities.

Long-term borrowings are initially recognized in accordance with the policy stated above. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the statement of operations over the period of the borrowings using the effective yield method.

The Company believes that the carrying values of its financial liabilities approximate their fair values.

Cash and cash equivalents
Cash consists of cash on hand and balances with banks. Cash equivalents comprise highly liquid investments with original maturities of three months or less.

Accounts receivable
Trade receivables are carried at original invoice amount less allowance made for impairment of these receivables. An allowance for impairment of accounts receivable is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers. The amount of the allowance is recognised in the statement of operations.

Value added tax

VAT Payable
Value added tax payable represents VAT related to sales payable to tax authorities upon collection of receivables from customers net of VAT on purchases which have been settled at the balance sheet date. In addition, VAT related to sales which have not been settled at the balance sheet date (VAT deferred) is also included in VAT payable. Where allowance has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

VAT Recoverable
VAT recoverable relates to purchases which have not been settled at the balance sheet date. VAT recoverable is reclaimable against sales VAT upon payment for the purchases.

3. Summary of significant accounting policies (continued)

Value added tax (continued)

The tax authorities permit the settlement of sales and purchases value added tax ("VAT") on a net basis.

Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

Property and equipment

Initial recognition of property and equipment

Property, plant and equipment that qualifies for recognition as an asset is initially recognised at acquisition cost.

Subsequent to initial recognition, property and equipment are carried at revalued amounts less any subsequent accumulated depreciation and subsequent accumulated impairment loss.

Subsequent expenditures

Subsequent expenditures relating to an item of property and equipment that qualify for recognition as asset are capitalized. Costs other than those referred to above are recognized as an expense when incurred.

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

Depreciation/amortization of property and equipment
Depreciation is calculated on a diminishing balance basis, i.e. applying standard annual rates to the net book value of the asset group. The following depreciation rates are used:

Group of assets	**Annual rate**
Cars; vehicles for road repair; special instruments and equipment; computers and other data processing and professional equipment	20%
Lories, busses, special vehicles and trailers; machinery and equipment for manufacturing; electricity related equipment; construction equipment; agricultural vehicles and equipment; office furniture	15%
Rail transport; power machines and equipment; electricity, turbine and other engines and diesel generator; electricity transmission and telecommunication equipment; pipelines	8%
Buildings and constructions	7%
Other	10%

When assets are sold or retired, their carrying value is eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of operations.

Land occupied by the Company facilities is owned by the state of Georgia and is not included in property and equipment.

Construction-in-progress comprises costs directly related to construction and acquisition of property and equipment plus an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Construction-in-progress is depreciated once the asset is put into operation.

3. Summary of significant accounting policies (continued)

Intangible assets
Intangible assets are initially recognised at their cost of acquisition.

Amortization of intangible assets is calculated on a diminishing balance basis, by applying standard annual rates to the net book value of the asset group. With regard to intangible assets, a standard amortization rate of 10% is applied.

Intangible assets primarily comprise software and licences.

When assets are sold or retired, their carrying value is eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of operations. Where an indication of impairment exists, the carrying amount of any intangible asset, is assessed and, when impaired, the asset is written down immediately to its recoverable amount.

Current income taxes
The income tax charge is based on taxable profit for the year as determined in accordance with the tax regulations of Georgia by applying the statutory tax rate of 20%.

Deferred income taxes
Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from goodwill amortization or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

3. Summary of significant accounting policies (continued)

Intangible assets
Intangible assets are initially recognised at their cost of acquisition.

Amortization of intangible assets is calculated on a diminishing balance basis, by applying standard annual rates to the net book value of the asset group. With regard to intangible assets, a standard amortization rate of 10% is applied.

Intangible assets primarily comprise software and licences.

When assets are sold or retired, their carrying value is eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of operations. Where an indication of impairment exists, the carrying amount of any intangible asset, is assessed and, when impaired, the asset is written down immediately to its recoverable amount.

Current income taxes
The income tax charge is based on taxable profit for the year as determined in accordance with the tax regulations of Georgia by applying the statutory tax rate of 20%.

Deferred income taxes
Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from goodwill amortization or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

3. Summary of significant accounting policies (continued)

Foreign currency transactions
The functional and presentation currency of the Company is the national currency of Georgia Georgian Lari. Transactions in foreign currencies are initially recorded in the functional currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the statement of operations. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

Provisions
Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

If the effect of the time value of money is material, 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 where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

Revenue and expense recognition
Revenues are recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenues can be measured reliably.

Revenues and expenses are accounted for at the time the actual flow of related goods and services occurs and transfer of risks and rewards has been completed, regardless of when cash or its equivalent is received or paid, and are reported in the statement of operations in the period to which they relate.

For the services related to freight transportation, revenue is recognized upon completion of the respective services.

Revenues are measured at the fair value of the consideration received or receivable. Expenses are measured at the fair value of the consideration paid or payable. When the fair value of consideration received or paid cannot be measured reliably, the revenue or expense is measured at the fair value of the goods or services given up or received (for expenses).

(Amounts in thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Social contributions and long-term employee benefits

The Company is obligated to pay certain social insurance taxes on behalf of its employees. The Company also withholds and contributes 1% of the salary of its employees as the employees' contribution to their designated pension funds. Under Georgian legislation, employees are responsible for their retirement benefits and the Company has no present or future obligation to pay its employees upon their retirement.

The Company has no other program or obligation for payment of post-retirement benefits to its employees.

Use of estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to the realisability ad depreciable lives of property and equipment, allowance for doubtful accounts, provision for tax contingencies and deferred taxation. Actual results could differ from these estimates.

Borrowing costs

Borrowing costs are recognised as an expense when incurred in accordance with the benchmark accounting treatment under IAS 23.

4. Property and equipment, net

Property and equipment, net, comprised the following as of December 31:

	2004	2003	2002
Net book value			
Buildings	225,641	238,785	226,447
Transport and vehicles	101,233	110,851	107,221
Construction-in-progress	40,776	38,990	58,084
Machinery and equipment	45,810	44,606	42,932
Office furniture and equipment	1,680	1,521	1,368
Other	1,627	1,983	1,573
	416,767	**436,736**	**437,625**

(Amounts in thousands of Georgian Lari)

5. Investments, net

Investments comprised the following as of December 31:

	2004	2003	2002
Investments	2,204	2,445	2,445
Less: Impairment	(183)	(209)	(209)
	2,021	**2,236**	**2,236**

Investments as of December 31, 2004 are analyzed as follows:

Company name	Nature of business	Share in equity	Historical cost	Impairment	Net value
JSC "Borjomi Chitakhevi"	Energy	25%	2,021	-	2,021
JSC "Abslolute Bank"	Banking	-	183	(183)	-
LLC "Imedi"	Insurance	48.5%	-	-	-
			2,204	**(183)**	**2,021**

Investments as of December 31, 2003 are analyzed as follows:

Company name	Nature of business	Share in equity	Historical cost	Impairment	Net value
JSC "Borjomi Chitakhevi"	Energy	25%	2,021	-	2,021
JSC "United Georgian Bank"	Banking	0.78%	215	-	215
JSC "Abslolute Bank"	Banking	-	209	(209)	-
LLC "Imedi"	Insurance	48.5%	-	-	-
			2,445	**(209)**	**2,236**

Investments as of December 31, 2002 are analyzed as follows:

Company name	Nature of business	Share in equity	Historical cost	Impairment	Net value
JSC "Borjomi Chitakhevi"	Energy	25%	2,021	-	2,021
JSC "United Georgian Bank"	Banking	0.78%	215	-	215
JSC "Abslolute Bank"	Banking	2.5%	209	(209)	-
LLC "Caucasus Trans Terminal"	Transportation	20%	-	-	-
JSC "Bank of Railway Transport"	Baking	-	-	-	-
LLC "Imedi"	Insurance	48%	-	-	-
JSC "United Transport Stock Exchange"	Markets	50%	-	-	-
LLC "Trans Service"	Transportation	-	-	-	-
JSC Caucasus Stock Exchange	Markets	-	-	-	-
Total			**2,445**	**(209)**	**2,236**

(Amounts in thousands of Georgian Lari)

6. Prepayments and other current assets

Prepayments and other current assets comprised the following as of December 31::

	2004	2003	2002
Input value added tax	790	718	14,160
Advances paid to suppliers	1,251	5,100	9,301
Prepaid taxes other than income tax	11,821	11,411	592
Other current assets	246	48	1,363
	14,108	**17,277**	**25,416**

7. Accounts receivable, net

Accounts receivable, net comprised the following as of December 31:

	2004	2003	2002
Accounts receivable from rendering services	54,423	46,599	32,146
Less: Allowance for doubtful debts	(5,258)	(5,192)	(5,946)
	49,165	**41,407**	**26,200**

8. Cash and cash equivalents

Cash and cash equivalents comprised the following as of December 31:

	2004	2003	2002
Cash on hand	95	161	38
Cash in banks	3,402	3,295	1,758
	3,497	**3,456**	**1,796**

9. Long-term borrowings

Long-term borrowings as of December 31, 2004, 2003 and 2002 comprised an outstanding balance of a USD denominated loan obtained by the Company under a non-revolving credit line agreement signed with the European Bank for Reconstruction and Development ("EBRD") on December 22, 1998 and ratified by the Parliament of Georgia on July 30, 1999.

The total amount of the credit line equates to USD 20 million. The outstanding balance drawn by the Company as of December 31, 2004 equated to USD 13,322 thousand (2003: USD 15,542 thousand, 2002: USD 17,762 thousand) that is 24,312 GEL at the exchange rate as of December 31, 2004 (2003: 32,249 GEL at the exchange rate as of December 31, 2003; 2002: 37,123 GEL at the exchange rate as of December 31, 2002). The current portion of the loan equated to 4,052 GEL, 4,607 GEL and 4,644 GEL as of December 31, 2004, 2003 and 2002, respectively. The final instalment is due in August 2010.

The interest rate equates to LIBOR + 1%. The loan is not secured. Repayment schedule set forth under the loan agreement requires payment of semi-annual equal instalments of USD 1,110 thousand.

10. Contingencies

Operating environment

Georgia continues to undergo substantial political, economic and social changes. As an emerging market, Georgia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Furthermore, the Georgian Government has not yet fully implemented the reforms necessary to create banking, judicial, taxation and regulatory systems that usually exist in more developed markets. As a result, operations in Georgia involve risks that are not typically associated with those in developed markets. Such risks persist in the current environment with results that include but are not limited to, a currency that is not freely convertible outside of the country, onerous currency controls and low liquidity levels for debt and equity markets.

The Company could be affected, for the foreseeable future, by these risks and their consequences. As a result, there are significant uncertainties that may affect future operations, the recoverability of the Company's assets, and the ability of the Company to maintain or pay its debts as they mature. The accompanying financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Company's financial statements in the period when they become known and estimable.

10. Contingencies (continued)

Recoverability of input VAT

As discussed in Note 6, prepayments and other current assets of the Company as of December 31, 2004 and 2003 include input VAT of 790 KGEL and 718 KGEL, respectively, to be claimed for reimbursement or offset against current tax liabilities. Frequently, due to inability of the state to refund the claimed VAT, and, also due the vague and unclear nature of the provision in tax legislation, tax payers are necessitated to carry on negotiations with the tax authorities on the manner and timing for the actual recover of input VAT. Accordingly, management believes that an uncertainty exists as to whether the Company will realise this asset. The accompanying financial statements do not include any adjustments that might arise from the outcome of the uncertainty concerning to the recoverability of input VAT.

Taxation

Georgia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax, profit tax, a number of turnover based taxes, and social tax, together with others. Implementing regulations are often unclear or nonexistent and few precedents have been established. Often, differing opinions regarding legal interpretation exist both among and within government ministries and organizations (like the Ministry of Finance, Tax Department and its various inspectorates); thus creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters) are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Georgia substantially more significant than typically found in countries with more developed tax systems.

The Company believes that it has accrued taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management's best estimate.

10. Contingencies (continued)

Litigations

In the ordinary course of business, the Company is subject to legal actions 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 of the Company.

The Company did not declare and pay withholding taxes on revenues received from the Company by non-resident (foreign) railways from rental of carriages. Such practice continued until 2003. This issue was raised in 2004 and a law suite was launched against the Company. Tax authorities applied taxes to the full scope of taxable transactions. The related tax sanctions and fines were charged to the Company. The Company recognized above mentioned accruals in its accounting records as of December 31, 2004 and for the year then ended in the aggregate amount of 502 GEL, and partially repaid such additional obligations. Further, a part of these obligations was offset against other taxes receivable from the state. Notwithstanding this, the Company still continues disputing this issue and litigation case is in progress.

The outcome of the above mentioned litigation as of the date of these financial statements cannot be estimated.