Georgian Railway LLC

Consolidated Interim Condensed Financial Statements for the three-month period ended 31 March 2010

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Independent Auditors' Report

To the Supervisory Board
Georgian Railway LLC

Introduction

We have reviewed the accompanying consolidated interim condensed statement of financial position of Georgian Railway LLC (the "Company") and its subsidiaries (the "Group") as at 31 March 2010, and the related consolidated interim condensed statements of comprehensive income, changes in equity and cash flows for the three-month period ended 31 March 2010 and a summary of selected explanatory notes (the consolidated interim condensed financial information). Management is responsible for the preparation and presentation of this consolidated interim condensed financial information in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on this consolidated interim condensed financial information based on our reviews.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of consolidated interim condensed financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the consolidated interim condensed financial information as at 31 March 2010 and for the three-month period ended 31 March 2010 is not prepared, in all material respects, in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*.

Tbilisi branch of KPMG CIS Limited

Tbilisi Branch of KPMG CIS Limited
31 May 2010

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'000 GEL	**Note**	**31 March 2010**	**31 December 2009**
		Unaudited	
ASSETS			
Non-current assets			
Property, plant and equipment	6	1,702,518	1,699,940
Investment property		9,926	9,926
Other non-current assets		13,234	12,817
Total non-current assets		**1,725,678**	**1,722,683**
Current assets			
Inventories		22,020	23,725
Trade and other receivables		22,838	22,194
Prepayments and other current assets		35,970	35,061
Cash and cash equivalents		18,544	1,361
Current tax assets		577	4,615
Total current assets		**99,949**	**86,956**
Total assets		**1,825,627**	**1,809,639**
EQUITY AND LIABILITIES			
Equity	7		
Charter capital		966,910	967,207
Non-cash owner contribution reserve		25,311	25,311
Retained earnings		570,478	556,165
Total equity		**1,562,699**	**1,548,683**
Non-current liabilities			
Loans and borrowings	8	24,900	24,900
Trade and other payables		38,125	28,853
Deferred tax liabilities		73,464	74,817
Total non-current liabilities		**136,489**	**128,570**
Current liabilities			
Loans and borrowings	8	1,953	3,855
Trade and other payables		59,968	66,035
Liabilities to owners		27,839	26,636
Provisions		6,088	6,088
Other taxes payable		22,579	21,794
Other current liabilities		8,012	7,978
Total current liabilities		**126,439**	**132,386**
Total liabilities		**262,928**	**260,956**
Total equity and liabilities		**1,825,627**	**1,809,639**

The consolidated interim condensed statement of financial position is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 12.

'000 GEL	Note	Three-month period ended 31 March 2010	Three-month period ended 31 March 2009
		Unaudited	**Unaudited**
Revenue		87,897	66,463
Other income		1,855	10,036
Payroll expense		(26,246)	(27,333)
Depreciation and amortization expense		(23,323)	(23,623)
Raw materials and consumables used		(10,763)	(10,331)
Other expenses		(12,155)	(15,699)
Results from operating activities		**17,265**	**(487)**
Finance income		399	18
Finance costs		(826)	(1,369)
Net finance costs		**(427)**	**(1,351)**
Profit/(loss) before income tax		**16,838**	**(1,838)**
Income tax (expense)/benefit	7	(2,525)	276
Profit/(loss) and total comprehensive income for the period		**14,313**	**(1,562)**

These consolidated interim condensed financial statements were approved by the Supervisory Board on 31 May 2010 and were signed on its behalf by:

Irakli Ezugbaia
General Director

Amiran Tevzadze
Acting Chief accountant

The consolidated interim condensed statement of comprehensive income is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 12.

’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
Total comprehensive income for the period				
Loss and total comprehensive income for the period (unaudited)	-	-	(1,562)	(1,562)
Transactions with owners, recorded directly in equity				
Non-cash contributions by and distributions to owners (unaudited)	27,212	(26,654)	-	558
Balance at 31 March 2009 (unaudited)	**960,847**	**7,098**	**574,795**	**1,542,740**
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 (unaudited)	-	-	14,313	14,313
Transactions with owners, recorded directly in equity				
Non-cash contributions by and distributions to owners (unaudited)	(297)	-	-	(297)
Balance at 31 March 2010 (unaudited)	**966,910**	**25,311**	**570,478**	**1,562,699**

The consolidated interim condensed statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 12.

'000 GEL	**Three-month period ended 31 March 2010**	**Three-month period ended 31 March 2009**
	Unaudited	**Unaudited**
Cash flows from operating activities		
Cash receipts from customers	90,604	71,365
Cash paid to suppliers and employees	(45,568)	(47,421)
Cash flows from operations before income taxes and interest paid	**45,036**	**23,944**
Income tax paid	-	(220)
Interest paid	(38)	(678)
Net cash from operating activities	**44,998**	**23,046**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(26,096)	(15,459)
Other	134	-
Net cash used in investing activities	**(25,962)**	**(15,459)**
Cash flows from financing activities		
Repayment of borrowings	(1,902)	(5,096)
Net cash used in financing activities	**(1,902)**	**(5,096)**
Net increase in cash and cash equivalents	**17,134**	**2,491**
Cash and cash equivalents at 1 January	1,361	3,196
Effect of exchange rate fluctuations on cash and cash equivalents	49	114
Cash and cash equivalents at 31 March	**18,544**	**5,801**

The consolidated interim condensed statement of cash flows is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 8 to 12.

1 Background

(a) Business environment

Georgian business environment

Georgia has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. The conflict between Georgia and the Russian Federation in August 2008 has created additional uncertainty. The Group's operations and assets could be at risk as a result of negative changes in the political, economic or business environment within Georgia and between Georgia and the Russian Federation. Consequently, operations in Georgia involve risks that typically do not exist in other markets. In addition, the contraction in the capital and credit markets and its impact on the economy of Georgia have further increased the level of economic uncertainty in the environment. These consolidated 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) 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.

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 judgements, 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 judgements 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.

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.

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

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

	Freight transportation		**Passenger transportation**		**Other**		**Total**	
'000 GEL	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
External revenues	83,362	59,420	3,372	3,674	2,689	2,968	89,423	66,062
Reportable segment profit/(loss) before infrastructure costs, central overheads, interest and income tax	49,368	24,197	(3,273)	(3,468)	151	586	46,246	21,315

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

'000 GEL	**2010**	**2009**
	Unaudited	**Unaudited**
Total profit or loss for reportable segments	46,095	20,729
Other profit or loss	151	586
Payroll expenses – infrastructure and headquarters	(11,570)	(12,240)
Depreciation expenses – infrastructure and headquarters	(11,530)	(11,625)
Net finance costs	(427)	(1,351)
Other net unallocated (expenses)/income	(4,196)	2,063
Consolidated profit/(loss) before income tax	**18,523**	**(1,838)**

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 recognised 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. The Group's consolidated effective tax rate for the three months ended 31 March 2010 was 15 percent (three months ended 31 March 2009: 15 percent).

8 Property, plant and equipment

Acquisitions

During the three-month period ended 31 March 2010 the Group acquired assets with a cost of GEL 25,706 thousand (three-month period ended 31 March 2009: GEL 27,769 thousand).

Capital commitments

As at 31 March 2010 the Group had entered into contracts to purchase plant and equipment for GEL 44,093 thousand (31 March 2009: GEL 77,686 thousand).

9 Equity

Dividends

No dividends were declared and paid by the Group during the three-month period end 31 March 2010 (three-month period ended 31 March 2009: Nil). No dividends have been proposed after 31 March 2010.

10 Loans and borrowings

The following loans and borrowings (non-current and current) were repaid during the three-month period ended 31 March 2010:

’000 GEL	**Currency**	**Nominal interest rate**	**Face value**	**Carrying amount**
Balance at 1 January 2010				28,755
Repayments (unaudited)				
Unsecured bank facility	USD	LIBOR+1%	(1,902)	(1,902)
Balance at 31 March 2010 (unaudited)				**26,853**

On 17 March 2010 a loan agreement was signed between the Group and the European Bank for Reconstruction and Development (“EBRD”), by which EBRD agreed to lend up to CHF 146.2 million to partly finance the EUR 300 million Tbilisi bypass project. The Tbilisi bypass project is intended to relocate certain railway infrastructure components from the centre of Tbilisi to the northern part of the city. The Group has not yet borrowed any funds under this loan facility.

The Group should pay to EBRD a front-end commission of 1.25% of the principal amount of the loan. Such front-end commission shall be due and payable on the earlier of the date falling three days before the date of the first disbursement or 30 days after the date of the agreement.

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

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

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

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 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 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 Events subsequent to the reporting date

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. On 6 April 2010 the Management Board of the Company decided to initiate the process of transferring 100% of shares of the Railway Telecom LLC to the Government of Georgia.