Georgian Oil and Gas Corporation JSC

Unaudited Interim Consolidated Condensed Financial Statements for the six months ended 30 June 2012

Contents

'000 GEL	**Note**	**30 June 2012 Unaudited**	**31 December 2011 Audited**
Assets			
Property, plant and equipment	11	269,716	271,606
Intangible assets		150	222
Prepayment for non-current assets		-	684
Finance lease receivable	12	44,448	43,074
Other non-current assets		268	-
Non-current assets		**314,581**	**315,586**
Non-current assets held for distribution	13	27,557	20,728
Inventories		1,640	735
Current tax assets		4,482	756
Prepayments for current assets and expenses		30,199	23,290
Trade and other receivables		58,453	30,370
Cash and cash equivalents		443,407	35,079
Current assets		**565,738**	**110,958**
Total assets		**880,319**	**426,544**
Equity			
Share capital	14	479,835	478,772
Additional paid in capital		71,718	71,718
Fair value adjustment reserve for non-cash owner contributions		(282,181)	(282,181)
Retained earnings		118,320	90,160
Total equity		**387,693**	**358,469**
Liabilities			
Loans and borrowings	15	407,105	654
Deferred tax liabilities		10,635	10,635
Non-current liabilities		**417,740**	**11,289**
Loans and borrowings	15	4,696	10,362
Trade and other payables		12,546	2,685
Dividend payable		50,500	41,700
Income tax payable		1,507	-
Value added tax payable		1,657	1,623
Other taxes payable		3,981	416
Current liabilities		**74,886**	**56,786**
Total liabilities		**492,626**	**68,075**
Total equity and liabilities		**880,319**	**426,544**

The interim consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 7 to 17.

		Six month ended	
		June 2012	**June 2011***
'000 GEL	**Note**	**Unaudited**	
Revenue	6	144,931	121,297
Cost of gas		(74,609)	(62,221)
Depreciation and amortization		(10,588)	(10,088)
Personnel costs		(4,316)	(3,810)
Taxes, other than on income		(2,743)	(2,747)
Other expenses	7	(5,997)	(3,472)
Other income	8	4,600	2,400
Results from operating activities		**51,278**	**41,359**
Finance income	9	7,843	6,575
Finance costs	9	(4,064)	(511)
Net finance income/(costs)		**3,779**	**6,064**
Profit before income tax		**55,057**	**47,423**
Income tax expense	10	(6,896)	(7,141)
Net profit		**48,160**	**40,282**

These condensed consolidated interim financial statements were approved by management on 8 August 2012 and were signed on its behalf by:

Zurab Janjgava
General Director

Alexander Sakandelidze
Financial Director

*information in this column has been re-presented to show only continuing operations and exclude operations that were subsequently discontinued in August 2011 (transfer of Georgian Gas Transportation Company)

The consolidated statement of comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 7 to 17.

'000 GEL	**Share capital/charter capital**	**Fair value adjustment reserve for non-cash owner contributions**	**Additional paid-in capital**	**Retained earnings**	**Total**
Balance at 1 January 2011	**495,532**	**(282,181)**	**74,570**	**58,523**	**346,444**
Total comprehensive income for the year					
Profit for the year	-	-	-	40,382	40,382
Contributions by and distributions to owners					
Other cash distributions	-	-	-	(4,200)	(4,200)
Distributions of non-cash assets	-	-	-	(538)	(538)
Distributions of non-cash assets	-	-	(2,852)	-	(2,852)
Increase in charter capital	10,453	-	-	-	10,453
Balance at 30 June 2011	**505,985**	**(282,181)**	**71,718**	**94,067**	**389,589**
Balance at 1 January 2012	**478,772**	**(282,181)**	**71,718**	**90,160**	**358,469**
Total comprehensive income for the year					
Profit for the year	-	-	-	48,160	48,160
Contributions by and distributions to owners					
Dividends to equity holders (see note 16)	-	-	-	(20,000)	(20,000)
Increase in share capital	1,063	-	-	-	1,063
Balance at 30 June 2012	**479,835**	**(282,181)**	**71,718**	**118,320**	**387,693**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 7 to 17.

	Six months ended June 2012	Six months ended June 2011*
Cash flows from operating activities		
Cash receipts from customers	125,980	120,881
Cash paid to suppliers and employees	(86,601)	(61,684)
Cash flows from operations before income taxes and interest paid	**39,380**	**59,197**
Income tax paid	(3,601)	(13,500)
Net interest paid	565	3,994
Cash flows from operating activities	**36,344**	**49,691**
Cash flows from investing activities		
Acquisition of property, plant and equipment	(5,898)	(22,745)
Acquisition of non-current assets held for distribution	(6,643)	(4,249)
Investing in other companies	(266)	(135)
Cash flows used in investing activities	**(12,807)**	**(27,129)**
Cash flows from financing activities		
Proceeds from borrowings	398,692	-
Repayment of borrowings	(8,260)	-
Dividends paid	(11,200)	-
Net cash from/(used in) financing activities	**379,231**	**-**
Effect of exchange rate fluctuations on cash and cash equivalents	5,561	(11)
Net increase/(decrease) in cash and cash equivalents	**408,328**	**22,552**
Cash and cash equivalents at the beginning of the period	35,079	42,717
Cash and cash equivalents at 30 June	**443,407**	**65,269**

*information in this column has been re-presented to show only continuing operations and exclude operations that were subsequently discontinued in August 2011 (transfer of Georgian Gas Transportation Company)

The entity chose to report cash flow by direct method, as compared with indirect method cash flow used in recent annual financial statements. Direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 7 to 17.

1. Background

(a) Organisation and operations

Georgian Oil and Gas Corporation JSC (the "Company"), formerly incorporated as a LLC, and its subsidiaries (the "Group") comprise Georgian Joint Stock and Limited Liability Companies as defined in the "Law of Georgia on Entrepreneurs". In September 2011 the Company changed its legal form from a Limited Liability Company to a Joint Stock Company. The Company was established as a 100% state-owned enterprise by the order of the Ministry of Economy of Georgia on 21 March 2006, on the basis of three Georgian state-owned companies: Georgian International Oil Corporation JSC, Georgian Gas International Corporation JSC and Teleti Oil Company JSC.

In 2006 and 2007, respectively, Georgian International Oil Corporation JSC and Georgian Gas International Corporation JSC ceased legal existence and the assets and liabilities were transferred to the Company. In November 2007 the shares in Teleti Oil Company JSC were taken over by the Government of Georgia. Related party transactions are detailed in note 26.

The Company's registered office is 21 Kakheti Highway, Tbilisi 0190, Georgia.

The Group's principal activities are the import and sale of gas, the rental of oil and gas pipelines and oil and gas exploration and extraction in Georgia. Before the transfer of the subsidiary (see note 7), the Group's principal activities also included operation of gas transitory pipelines in Georgia and transit of gas to the Republic of Armenia.

The Company has also been granted the status of "National Oil Company" in December 2006 by Presidential decree number 736 and it acts on behalf of the State of Georgia, receives and disposes of the State's share of extracted oil and gas produced by contractors in Georgia in accordance with the "Law of Georgia on Oil and Gas" and production sharing agreements signed between the State and the contractors. The Group has not recognized an intangible asset for this right as the Group does not control the right.

(b) 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 legal, tax and regulatory frameworks continue development, The consolidated financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34 Interim Financial Reporting. These 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 2011.

(b) Basis of measurement

The consolidated condensed financial statements are prepared on the historical cost basis.

(c) Functional and presentation currency

The national currency of Georgia is the Georgian Lari (“GEL”), which is the Group’s functional currency and the currency in which these consolidated financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand, except when otherwise indicated.

(d) 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 condensed consolidated interim 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 2011.

(e) Oil and gas reserves

There are a number of uncertainties in estimating quantities of oil and gas reserves, including many factors beyond the control of the Group. Oil and gas reserve estimates are based upon engineering evaluations of assay values derived from samplings of oil wells and other openings. Additionally, declines in the market price of oil and gas may render certain reserves containing relatively lower volumes uneconomic to continue in production. Further, availability of operating and environmental permits, changes in operating and capital costs, and other factors could materially affect the Group’s oil and gas reserve estimates. The Group uses the above estimates in evaluating the impairment of property, plant and equipment and extraction licenses and rights.

3. Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at the year ended 31 December 2011.

4. Operating segments

The Group has four 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. For each of the strategic business units, the Company's General Director reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the Group's reportable segments:

- *Gas Supply*. Includes purchase and sale of gas.
- *Pipeline rental*. Includes rental income earned by the Company from the lease of gas pipelines to Georgian Gas Transportation Company LLC. As a consequence of the transfer of Georgian Gas Transportation Company LLC to the shareholder in August 2011 (see note 7), the rental income is presented as external revenue.
- *Upstream activities*. Includes sale of oil from production sharing arrangements.
- *Oil transportation*. Includes transportation of oil through the territory of Georgia.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, central overheads, interest and income tax, as included in the internal management reports that are reviewed by the Company's General Director. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. The Company's General Director does not monitor segment assets or liabilities.

(i) Information about reportable segments

'000 GEL	Gas supply		Pipeline rental		Upstream activities*		Oil transportation		Total	
	Six months ended		Six months ended		Six months ended		Six months ended		Six months ended	
	30 June 2012	30 June 2011	30 June 2012	30 June 2011	30 June 2012	30 June 2011	30 June 2012	30 June 2011	30 June 2012	30 June 2011
External revenues	117,062	100,245	19,704	12,096	2,877	2,973	5,288	5,984	**144,931**	**121,297**
Cost of gas	(74,609)	(62,221)	-	-	-	-	-	-	**(74,609)**	**(62,221)**
Reportable segment profit before unallocated costs, net finance cost and income tax	**42,452**	**38,023**	**19,704**	**12,096**	**2,877**	**2,973**	**5,288**	**5,984**	**70,322**	**59,076**

* Product sharing arrangements are considered as joint operations and the revenue from oil sales is recognised only when it is sold to third parties

	Six months ended	
'000 GEL	**30 June 2012**	**30 June 2011**
Revenues		
Total revenue for reportable segments	**144,931**	**121,297**
Profit or loss		
Total profit or loss for reportable segments	70,322	59,076
Unallocated personnel expenses	(4,316)	(3,810)
Unallocated depreciation and amortization expenses	(10,588)	(10,088)
Net finance income/(costs)	3,779	6,064
Other net unallocated (costs)/income	(4,139)	(3,819)
Consolidated profit from continuing operations before income tax	**55,057**	**47,423**

(ii) Geographical information

All of the Group's revenue is from its non-current assets located in Georgia.

(iii) Major customer

During the 6 months of 2012, one customer of the Group's gas supply segment represented approximately 80% of the Group's total revenue (GEL 144,931 thousand). During the 6 months of 2011, one customer of the Group's gas supply segment represented approximately 81% of the Group's total revenue (GEL 121,297 thousand).

5. Seasonality of operations

Gas supply and pipeline rental revenues follow a seasonal pattern with an annual base-load of gas and a large heating peak occurring during the winter season. Natural gas obtained from suppliers is utilized to meet the peak heating season requirements. The Group's other revenues remain relatively stable during the year.

6. Revenue

	Six months ended	
'000 GEL	**June 2012**	**June 2011**
Sales of gas	117,062	100,245
Rent of gas pipelines	19,704	12,096
Income from crude oil	2,877	2,973
Oil transportation fee	5,288	5,984
Total revenues	**144,931**	**121,297**

The Company rents its gas pipeline to Georgian Gas Transportation Company LLC (former subsidiary). The contract is valid until 1 January 2020. The lease payments are contingent on the volume of gas transported through the leased gas pipeline.

7. Other expenses

'000 GEL	6 months ended June 2012	6 months ended June 2011
Banking, consulting and other professional services	(3,739)	(535)
Representative and business trip expenses	(249)	(277)
Office and related equipment maintenance	(169)	(193)
Transportation, materials and repair and maintenance	(220)	(172)
Communication expenses	(60)	(78)
Other	(1,559)	(2,217)
	(5,997)	**(3,472)**

8. Other income

'000 GEL	6 months ended June 2012	6 months ended June 2011
Customer penalties for late payment	3,749	1,533
Oil processing	450	626
Other	401	242
	4,600	**2,400**

9. Finance income and finance costs

’000 GEL	6 months ended June 2012	6 months ended June 2011
Recognised in profit or loss		
Interest income on bank deposits	6,469	4,366
Unwinding of discount on finance lease receivable	1,374	1,283
Reversal of impairment on trade and other receivables	0	926
Finance income	**7,843**	**6,575**
Interest expense on bonds payable	(3,625)	-
Net foreign exchange loss	(263)	-
Interest expense on bank loans	(176)	(368)
Interest expense on loans from the Government of Georgia	-	(144)
Finance costs	**(4,064)**	**(511)**
Net finance costs recognised in profit or loss	**3,779**	**6,064**

10. Income tax expense

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 periods. The Group's consolidated effective tax rate for the six month period ended 30 June 2012 was 12.5 percent (six month period ended 30 June 2011: 12.5 percent). The statutory tax rate is 15 percent.

11. Property, plant and equipment

In thousand GEL	Gas and oil pipes	Land and Buildings	Oil wells	Plant and equipment	Other	Construction in progress and construction materials	Total
Opening net book amount as at 1 January 2012	170,435	26,844	13,956	1,009	2,243	57,119	271,606
Additions	102	1,489	-	-	717	6,657	8,965
Disposals	(74)	-	-	-	(193)	-	(268)
Depreciation	(8,327)	(384)	(1,437)	(219)	(221)	-	(10,588)
Closing net book amount as at 30 June 2012	**162,135**	**27,949**	**12,519**	**790**	**2,546**	**63,776**	**269,716**

During 6 months of 2012, the Government of Georgia contributed certain property, plant and equipment in the form of an increase in share capital. The share capital has been increased by the nominal amount of these assets of GEL 1,063 thousand, which equals the fair value of these assets, which are included in total additions of GEL 8,965 thousand.

12. Finance lease receivable

In 1996 the Government of Georgia entered into a 30 year arrangement with a consortium of oil companies that undertook major rehabilitation of existing pipeline from the border with Azerbaijan to the Georgian Black Sea coast and construction of Supsa oil terminal.. The arrangement granted the oil companies the right to transport oil across Georgia through that pipeline. The pipeline infrastructure on Georgian territory, being the property of the Government of Georgia and ownership of this infrastructure was transferred to the Company in June-July 2010 through a contribution to its charter capital with a nominal value of GEL 269,299 thousand. In exchange for the oil companies use of the pipeline, the Group receives a transit fee for each barrel of oil transported through the pipeline. Management has determined that the initial arrangement contained a finance lease at inception.

The Group has recognized a lease receivable of GEL 39,229 thousand at the date that title was transferred to the business. The lease receivable is the present value of the net investment in the lease comprising the present value of the assets' unguaranteed residual value at the end of the lease term. The difference of GEL 230,070 thousand between the nominal amount and the present value of the net investment in the lease has been recognized in equity as fair value adjustment for non-cash owner contributions.

	30 June	31 December
'000 GEL	**2012**	**2011**
Balance at the beginning of the year/date of title transfer	43,074	40,445
Unwinding of discount on finance lease receivable	1,374	2,629
Balance at the end of the period	**44,448**	**43,074**

Contingent rents related to oil transportation recognized in the consolidated statement of comprehensive income during 6 months of 2012 amounted to GEL 5,288 thousand (6 mmonths of 2011 GEL 5,984 thousand).

13. Non-current assets held for distribution

Non-current assets held for distribution as at 30 June 2012 represent construction of electric lines and substations. Management has a firm intention to distribute these assets to the shareholder in the third quarter of 2012.

14. Equity

(a) Share capital

	2012
Balance at 1 January 2012	**478,772**
Increase in share capital	1,063
Balance at 30 June 2012	**479,835**

Ordinary shares

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company.

(b) Dividends

In March 2012 dividens of GEL 20,000 thousand were declared.

In 2011, upon request of the shareholder, the Company agreed to pay GEL 4,200 thousand to a State-owned fund out of which GEL 2,200 thousand was paid during six months of 2012.

During 6 months of 2012, dividends of GEL 9,000 thousand were paid to the Shareholder.

15. Loans and borrowings

In May 2012 the Group issued bonds with a face value of USD 250 million maturing in May 2017. The proceeds are to be used to fund the construction of the first phase of the Namakhvani HPPs.

16. 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 2011.

17. Capital commitments

As at 30 June 2012 the Group entered into contracts for construction and purchase of pipes for GEL 11,784 thousand (30 June 2011: GEL 11,591 thousand).

18. Contingencies

(a) Insurance

The insurance industry in the 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) Litigation

The Group is defending a claim brought in a court in Israel in 2010 by counterparty seeking to appoint an arbitrator and commence arbitration proceedings in Israel in respect of the alleged non-performance by the Company of a contract allegedly entered into in 2003 and allegedly amended in 2004 by the Company's predecessor. In 2010, the Group hired legal advisors to represent the Group in the dispute. The Group disputes the validity of the claim. As of the date of this Condensed Consolidated Interim Financial Statements, the parties have only exchanged procedural motions and no claim for damages has yet been served on the Company. Based on its understanding of the claim, management assesses the likelihood that the Group may be liable for an amount up to USD 5 million under the alleged contract as possible. Management assesses the probability that the Group will also be required to pay accrued interest as well as other damages and lost profits in respect of the claim as remote. Management considers the claim to be without merit and intends to contest the claim vigorously."

(c) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after six years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(d) Environmental matters

The enforcement of environmental regulation in Georgia is evolving and the enforcement posture of government authorities is continually being reconsidered. The Company periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

19. Related party transactions

(a) Control relationships

As at 30 June 2012, the ultimate controlling party is the Ministry of Economic Development of Georgia which holds 76% of the issued shares. The Partnership Fund holds 24% of the issued shares of the Company. The Company does not have a parent company.

(b) Transactions with key management personnel

(i) Key management remuneration

Key management received the following remuneration during the year, which is included in personnel costs:

	6 months of	
’000 GEL	**2012**	**2011**
Salaries and bonuses	**454**	**343**

(c) Other related party transactions

The Group’s other related party transactions are disclosed below. The transactions with Georgian Gas Transportation Company are presented from the date it was transferred to the Government of Georgia.

(i) Revenue

	Transaction value for the year ended 30 June		**Outstanding balance as at 30 June**	**31 December**
’000 GEL	**2012**	**2011**	**2012**	**2011**
State controlled entities:				
Rent of pipelines	19,704	12,096	-	-
	19,704	**12,096**	**-**	**-**

All outstanding balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured.

(ii) Expenses

	Transaction value for the year ended 30 June		**Outstanding balance as at**	
			30 June	**31 December**
’000 GEL	**2012**	**2011**	**2012**	**2011**
State controlled entities:				
Purchase of Gas	26,218	-	10,199	1,402
	26,218	**-**	**10,199**	**1,402**

(iii) Loans

’000 GEL	**Interest expense**		**Outstanding balance**	
	6 months of		**30 June**	**31 December**
	2012	**2011**	**2012**	**2011**
State controlled entities:				
Loans received	**117**	**300**	**1,162**	**2,604**

20. Significant subsidiaries

In January 2012 a new subsidiary, JSC Namakhvan HPP Cascade, was created with charter capital of GEL 20,000 thousand. The subsidiary will be used to commence construction of Namakhvani Hydro Power Plant.

21. Events subsequent to the reporting date

In July 2012, Government of Georgia contributed Senaki-Poti 30 km natural gas pipeline as non-cash asset in the form of an increase in share capital. The fare value of the asset at the date of contribution amounted to GEL 28,517 thousand.

On 6 August 2012, as per decree #232 by Government of Georgia, 76% of the issued shares held by Ministry of Economic Development of Georgia was transferred to the Partnership Fund, a wholly state owned entity.