Georgian Oil and Gas Corporation JSC

Unaudited Interim Consolidated Condensed Financial Statements for the six months ended 30 June 2014

Contents

’000 GEL	Note	30 June 2014	31 December 2013
		Uuaudited	Audited
Assets			
Property, plant and equipment	11	267,343	269,576
Prepayments for non-current assets	18	270,056	199,832
Intangible assets		143	114
Finance lease receivable	12	50,414	48,864
Loans given	13	141,746	89,136
Term deposits	14	37,258	40,083
Non-current assets		**766,960**	**647,605**
Loans given	13	3,466	47,055
Non-current assets held for distribution		-	1,141
Inventories		1,104	657
Current tax assets		-	1,081
Value added tax recoverable		33,369	-
Taxes other than on income		-	732
Prepayments for current assets and expenses		26,199	20,058
Trade and other receivables		92,677	63,530
Term deposits	14	-	78,493
Cash and cash equivalents		184,922	194,541
Current assets		**341,737**	**407,288**
Total assets		**1,108,697**	**1,054,893**
Equity			
Share capital	15	511,144	509,550
Additional paid in capital		71,718	71,718
Fair value adjustment reserve for non-cash owner contributions		(282,181)	(282,181)
Retained earnings		227,668	186,393
Equity attributable to owners of the Company		**485,480**	**485,480**
Non-controlling interests		84,901	83,443
Total equity		**613,250**	**568,923**
Liabilities			
Loans and borrowings	16	433,766	425,699
Deferred tax liabilities		16,486	16,486
Non-current liabilities		**450,252**	**442,185**
Loans and borrowings	16	6,292	6,126
Trade and other payables		30,092	30,656
Current tax liabilities		7,125	-
Value added tax payable		-	5,317
Provisions		1,686	1,686
Current liabilities		**45,195**	**43,785**
Total liabilities		**495,447**	**485,970**
Total equity and liabilities		**1,108,697**	**1,054,893**

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 19.

		Six month ended	
		June 2014	June 2013
'000 GEL	**Note**	**Unaudited**	**Unaudited**
Revenue	6	180, 840	177, 979
Cost of gas		(109, 754)	(104, 107)
Depreciation and amortization		(8, 170)	(9, 390)
Personnel costs		(4, 337)	(3, 411)
Taxes, other than on income		(2, 936)	(3, 102)
Other expenses	7	(4, 094)	(3, 276)
Other income	8	6, 930	6, 769
Results from operating activities		**58, 478**	**61, 461**
Finance income	9	18, 567	20, 497
Finance costs	9	(15, 255)	(14, 284)
Net finance income/(costs)		**3, 312**	**6, 213**
Profit before income tax		**61, 791**	**67, 674**
Income tax expense	10	(9, 584)	(8, 459)
Net profit		**52, 207**	**59, 215**

These condensed consolidated interim financial statements were approved by management on 1 August 2014 and were signed on its behalf by:

David Tvalabeishvili
General Director

Georgian Oil and Gas Corporation JSC
206237491

David Vardiashvili
Financial Director

	Attributable to equity holders of the Company						
’000 GEL	**Share capital**	**Fair value adjustment reserve for non-cash owner contributions**	**APIC**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total equity**
Balance at 1 January 2013	**509,298**	**(282,181)**	**71,718**	**99,924**	**398,759**	**-**	**398,759**
Total comprehensive income							
Profit and total comprehensive income for 6 months of 2013	-	-	-	59,215	59,215	-	59,215
Balance at 30 June 2013	**509,298**	**(282,181)**	**71,718**	**159,138**	**457,972**	**-**	**457,972**
Balance at 1 January 2014	**509,550**	**(282,181)**	**71,718**	**186,393**	**485,480**	**83,443**	**568,923**
Profit and total comprehensive income for 6 months of 2014				52,207	52,207		52,207
Contributions by and distributions to owners							
Distributions of non-cash assets	-	-	-	(1,141)	(1,141)	-	(1,141)
Increase in share capital	1,594	-	-	-	1,594	-	1,594
Increase in non-controlling interest in subsidiary	-	-	-	-	-	1,458	1,458
Transfer of subsidiary (see note 18)	-	-	-	(9,791)	(9,791)	-	(9,791)
Balance at 30 June 2014	**511,144**	**(282,181)**	**71,718**	**227,688**	**528,348**	**84,901**	**613,250**

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 19.

	Six months ended June 2014	Six months ended June 2013
Cash flows from operating activities		
Cash receipts from customers	193, 829	230, 689
Cash paid to suppliers and employees	(167, 827)	(146, 830)
Cash flows from operations before income taxes and interest paid	**26, 002**	**83, 859**
Income tax paid	(1, 600)	(2, 645)
Net interest paid	(4, 260)	2, 339
Cash flows from operating activities	**20, 142**	**83, 553**
Cash flows from investing activities		
Decrease in term deposits*	83,106	90,904
Acquisition of property, plant and equipment	(7, 536)	(13, 593)
Acquisition of non-current assets held for distribution	-	-
Investing in other companies	(100,542)	-
Cash flows used in investing activities	**(24,972)**	**77,311**
Cash flows from financing activities		
Proceeds from borrowings	29,875	-
Repayment of borrowings	(29,787)	-
Cash distributed on the transfer of subsidiary	(9,791)	
Dividends paid	-	(25, 859)
Net cash from/(used in) financing activities	**(9, 703)**	**(25, 859)**
Effect of exchange rate fluctuations on cash and cash equivalents	4,913	(1, 011)
Net increase/(decrease) in cash and cash equivalents	**(14, 533)**	**135, 005**
Cash and cash equivalents at the beginning of the period	194, 541	142, 672
Cash and cash equivalents at 30 June	**184, 922**	**276, 666**

* Part of Eurobond proceeds (GEL 83,106 thousand for the six month ended period of 30 June 2014 and GEL 90,904 thousand for the six month ended period of 30 June 2013) placed in local banks classified as term deposits were renegotiated and the terms of the deposit were amended substantially resulting in reclassification to the cash and cash equivalents.

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 19.

1. Background

(a) Organisation and operations

Georgian Oil and Gas Corporation JSC (the "Company") and its subsidiaries (the "Group") comprise Georgian Joint Stock and Limited Liability Companies as defined in the "Law of Georgia on Entrepreneurs". 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 importation and sale of gas, the rental of gas pipelines, oil and gas exploration and extraction in the territory of Georgia.

Since December 2006, the Company has been granted the status of "National Oil Company" on behalf of the State of Georgia, receives and disposes of the State's share of extracted oil and gas produced by contractors in the territory of 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 2013.

(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 2013.

(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 2013.

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.
- *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

	Gas supply		Pipeline rental		Upstream activities*		Oil transportation		Total	
	Six months ended		Six months ended		Six months ended		Six months ended		Six months ended	
’000 GEL	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**
External revenues	135,187	133,871	24,951	20,664	14,169	17,778	6,533	5,667	**180, 840**	**177, 979**
Cost of gas	(109,754)	(104,107)	-	-	-	-	-	-	**(109, 754)**	**(104, 107)**
Reportable segment profit before unallocated costs, net finance cost and income tax	**25, 433**	**29, 764**	**24, 951**	**20, 664**	**14, 169**	**17, 778**	**6, 533**	**5, 667**	**71, 086**	**73, 872**

* 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 2014**	**30 June 2013**
Revenues		
Total revenue for reportable segments	**180, 840**	**177, 979**
Profit or loss		
Total profit or loss for reportable segments	71,086	73,873
Unallocated personnel expenses	(4, 337)	(3, 411)
Unallocated depreciation and amortization expenses	(8,170)	(9, 390)
Net finance income/(costs)	3, 312	6, 213
Other net unallocated (costs)/income	(100)	389
Consolidated profit from continuing operations before income tax	**61, 791**	**67, 673**

(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 2014, one customer of the Group's gas supply segment represented approximately 75% of the Group's total revenue (GEL 180, 840 thousand). During the 6 months of 2013, one customer of the Group's gas supply segment represented approximately 75% of the Group's total revenue (GEL 177, 979 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 2014**	**June 2013**
Sales of gas	135,187	133,871
Rent of gas pipelines	24,951	20,664
Income from crude oil	14,169	17,778
Oil transportation fee	6,533	5,667
Total revenues	**180,840**	**177,979**

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 2014**	**6 months ended June 2013**
Banking, consulting and other professional services	(2,155)	(466)
Office and related equipment maintenance	(192)	(137)
Representative and business trip expenses	(140)	(235)
Transportation, materials and repair and maintenance	(132)	(214)
Communication expenses	(29)	(41)
Other	(1,446)	(2,184)
	(4,094)	**(3,276)**

8. Other income

'000 GEL	**6 months ended June 2014**	**6 months ended June 2013**
Customer penalties for late payment	6,157	5,294
Oil processing	429	695
Other	344	780
	6,930	**6,769**

9. Finance income and finance costs

'000 GEL	6 months ended June 2014	6 months ended June 2013
Recognised in profit or loss		
Interest income on bank deposits	9,635	12,434
Interest accrued on given loans	6,436	6,607
Unwinding of discount on finance lease receivable	1,550	1,455
Net foreign exchange gain	946	-
Finance income	**18,567**	**20,497**
Interest expense on bonds payable	(15,255)	(14,274)
Net foreign exchange loss	-	(9)
Finance costs	**(15,255)**	**(14,284)**
Net finance costs recognised in profit or loss	**3,312**	**6,214**

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 2014 was 15.5 percent (six month period ended 30 June 2013: 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	CIP	Total
Opening net book amount as at 1 January 2014	210,687	30,554	10,750	1,939	1,895	13,751	269,576
Additions	-	2,638	30	289	33	3,103	6,093
Disposals	-	-	-	-	(178)	-	(178)
Depreciation	(6,727)	(306)	(804)	(158)	(153)	-	(8,148)
Closing net book amount as at 30 June 2014	**203,960**	**32,886**	**9,976**	**2,069**	**1,598**	**16,854**	**267,343**

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	**2014**	**2013**
Balance at the beginning of the year/date of title transfer	48,864	45,882
Unwinding of discount on finance lease receivable	1,550	2,982
Balance at the end of the period	**50,414**	**48,864**

Contingent rents related to oil transportation recognized in the consolidated statement of comprehensive income during six months of 2014 amounted to GEL 6,533 thousand (6 months of 2013 GEL 5,667 thousand).

13. Loans given

	30 June	**31 December**
'000 GEL	**2014**	**2013**
Non-current		
Loan given to the shareholder	94,964	89,136
Loans given to state controlled entity	46,782	-
Current		
Current portion of loans given to state controlled entity	3,466	47,055
	145,212	**136,191**

Loan given to the shareholder bears a contractual rate of interest of 9% per annum and is repayable in equal semi-annual instalments from 2015 to 2019. The loan was given for the purpose of construction of Gardabani Combined Cycle Power Plant (CCPP).

Loans given to state controlled entity bears a contractual rate of interest of 11% per annum and was overdue for over 2 months at 31 December 2013. In April 2014, the Group signed a restructuring agreement with the borrower. The contractual rate of interest was changed to 9.5% and a repayment schedule was agreed with payments scheduled from 2014 to 2017. 100% shares of a wholly owned subsidiary of the borrower with an estimated fair value approximating the carrying value of the loan were pledged to secure the loan given to state controlled entity. In addition management believes that the National Agency of State Property of the Ministry of Economy and Sustainable Development of Georgia will provide further support to the extent permitted by the Georgian legislation, if required, to the state controlled entity to enable it to repay these loans.

14. Term deposits

Terms and conditions of the term deposits are as follows:

				30 June 2014		**31 December 2013**	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Non-current term deposit	USD	7.125%	2017	37,258	37,258	40,083	40,083
				37,258	37,258	**40,083**	**40,083**
Current term deposits	USD	8%	2014	-	-	78,493	78,493
				-	-	**78,493**	**78,493**

The Group's non-current term deposits include GEL 17,691 thousand (2013: 17,363 thousand) which have been pledged as collateral for a loan obtained by a state controlled entity. The Ministry of Agriculture has confirmed its intent to provide support to the state controlled entity to enable it to repay the loan. The loan obtained by the state controlled entity was not overdue at 30 June 2014.

15. Equity

Share capital

Number of shares unless otherwise stated	**Ordinary shares**	
	30 June 2014	**31 December 2013**
Par value	GEL 20	GEL 20
On issue at 1 January	25,477,476	25,464,900
Issue of shares in exchange for non-cash assets	79,744	12,576
Acquisition of own shares in exchange for non-cash assets	-	-
On issue at the reporting date	25,557,220	25,477,476

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.

16. Loans and borrowings

In May 2012 the Group issued bonds with a face value of USD 250 million maturing in May 2017.

17. 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 2013.

18. Significant subsidiary

In April 2014, the Group transferred its wholly owned subsidiary, JSC Namakhvani HPP, to the National Agency of State Property. The net assets of the subsidiary at the date of transfer amounted to GEL 9,791 thousand.

19. 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.

20. Related party transactions

(a) Control relationships

The Company was wholly owned by the state of Georgia represented by the Ministry of Economic Development of Geogia as at 31 December 2010. In November 2011, 24% and in august 2013, the remaining 76% interest in Georgian Oil and Gas Corporation JSC was transferred to JSC Partnership Fund, a wholly state owned entity. The ultimate controlling party of the Group is the Government of Georgia.

(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	**2014**	**2013**
Salaries and bonuses	**296**	**262**

(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	
'000 GEL	**2014**	**2013**
State controlled entities:		
Rent of pipelines	24,951	20,664
	24,951	**20,664**

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	**2014**	**2013**	**2014**	**2013**
State controlled entities:				
Purchase of Gas	18,614	15,643	4,933	608
	18,614	**15,643**	**4,933**	**608**

(iii) Loans given

'000 GEL	Interest accrued 6 months of		Outstanding balance 30 June	31 December
	2014	**2013**	**2014**	**2013**
Shareholder	**4,136**	**2,350**	**94,964**	**89,136**
State controlled entity	**2,300**	**1,650**	**50,248**	**47,055**
	6,436	**4,000**	**145,212**	**136,191**

21. Subsequent events

In July 2014, Government of Georgia contributed Kutaisi-Abasha 47 km and Abasha-Senaki 29 km natural gas pipelines as non-cash asset in the form of an increase in share capital. The fair value of the assets including remaining inventory at the date of contribution amounted to GEL 61,519 thousand.

In July 2014, dividends of GEL 33 million were declared by the Company.