Georgian Oil & Gas Corporation

Georgian Oil and Gas Corporation JSC

Unaudited Interim Consolidated Condensed Financial Statements for the six months ended 30 June 2013

Contents

Condensed Consolidated Interim Statement of Financial Position	3
Condensed Consolidated Interim Statement of Comprehensive Income	4
Condensed Consolidated Interim Statement of Changes in Equity	5
Consolidated Statement of Cash Flows	6
Notes to the Condensed Consolidated Interim Financial Statements	7

GEL'000	Note	30 June 2013 Unaudited	31 December 2012 Audited
Assets			
Property, plant and equipment	11	273, 125	282, 650
Intangible assets		135	165
Finance lease receivable	12	47, 337	45, 882
Loans given to the shareholder	13	88, 904	85, 322
Other non-current assets		117	107
Term Deposits		67, 378	105, 426
Non-current assets		**476, 995**	**519, 552**
Loans given to state controlled entity	13	51, 266	48, 714
Inventories		579	535
Current tax assets		4,029	6, 621
Taxes other than on income		304	990
Prepayments for current assets and expenses		17, 093	19, 972
Trade and other receivables		62, 480	86, 400
Term Deposits		-	52, 854
Cash and cash equivalents		276, 666	142, 672
Current assets		**412,416**	**358, 758**
Total assets		**889, 412**	**878, 310**
Equity			
Share capital	14	509, 298	509, 298
Additional paid in capital		71, 718	71, 718
Fair value adjustment reserve for non-cash owner contributions		(282, 181)	(282, 181)
Retained earnings		150, 779	99, 924
Total Equity		**449, 613**	**398, 759**
Loans and borrowings	15	406, 021	406, 183
Deferred tax liability		9,566	9, 566
Non-current liabilities		**415,587**	**415, 749**
Loans and borrowings	15	4, 917	5, 090
Trade and other payables		3, 502	24, 822
Dividend payable		14,500	32, 000
Value added tax payable		1, 292	1, 890
Current liabilities		**24,212**	**63, 802**
Total liabilities		**439,799**	**479, 551**
Total equity and liabilities		**889,412**	**878, 310**

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 18.

		Six month ended	
		June 2013	**June 2012**
'000 GEL	**Note**	**Unaudited**	**Unaudited**
Revenue	6	177, 979	144, 931
Cost of gas		(104, 107)	(74, 609)
Depreciation and amortization		(9, 390)	(10, 588)
Personnel costs		(3, 411)	(4, 316)
Taxes, other than on income		(3, 102)	(2, 743)
Other expenses	7	(3, 276)	(5, 997)
Other income	8	6, 769	4, 600
Results from operating activities		**61, 461**	**51, 278**
Finance income	9	20, 497	7, 843
Finance costs	9	(14, 284)	(4, 064)
Net finance income/(costs)		**6, 213**	**3, 779**
Profit before income tax		**67, 674**	**55, 057**
Income tax expense	10	(8, 459)	(6, 896)
Net profit		**59, 215**	**48, 160**

These condensed consolidated interim financial statements were approved by management on 7 August 2013 and were signed on its behalf by:

David Tvalabeishvili
General Director

Irakli Chkhaidze
Financial Director

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 18.

’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 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	-	-	-	(20,000)	(20,000)
Increase in share capital	1,063	-	-	-	1,063
Balance at 31 December 2012	**479,835**	**(282,181)**	**71,718**	**118,320**	**387,693**
Balance at 1 January 2013	**509,298**	**(282,181)**	**71,718**	**99,924**	**398,759**
Total comprehensive income for the year					
Dividends to equity holders (see note 14)	-	-	-	(8,359)	(8,359)
Profit for the year	-	-	-	59, 215	59, 215
Balance at 30 June 2013	**509,298**	**(282,181)**	**71,718**	**150,779**	**449,613**

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 18.

	Six months ended June 2013	Six months ended June 2012
Cash flows from operating activities		
Cash receipts from customers	230, 689	125, 980
Cash paid to suppliers and employees	(146, 830)	(86, 601)
Cash flows from operations before income taxes and interest paid	**83, 859**	**39, 380**
Income tax paid	(2, 645)	(3, 601)
Net interest paid	2, 339	565
Cash flows from operating activities	**83, 553**	**36, 344**
Cash flows from investing activities		
Decrease in term deposits*	90,904	-
Acquisition of property, plant and equipment	(13, 593)	(5, 898)
Acquisition of non-current assets held for distribution	-	(6, 643)
Investing in other companies	-	(266)
Cash flows used in investing activities	**77,311**	**(12, 807)**
Cash flows from financing activities		
Proceeds from borrowings	-	398, 692
Repayment of borrowings	-	(8, 260)
Dividends paid	(25, 859)	(11, 200)
Net cash from/(used in) financing activities	**(25, 859)**	**379, 231**
Effect of exchange rate fluctuations on cash and cash equivalents	(1, 011)	5,561
Net increase/(decrease) in cash and cash equivalents	**135, 005**	**408,328**
Cash and cash equivalents at the beginning of the period	142, 672	35,079
Cash and cash equivalents at 30 June	**276, 666**	**443,407**

* in May 2013, part of Eurobond proceeds (GEL 90,904 thousand) 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 18.

Note		Page
1.	Background	8
2.	Basis of preperation	9
3.	Significant accounting policies	9
4.	Operating segments	10
5.	Seasonality of operations	12
6.	Revenue	12
7.	Other expenses	13
8.	Other income	13
9.	Finance income and finance cost	13
10.	Income tax expense	14
11.	Property, plant and equipment	14
12.	Finance lease receivable	14
13.	Loans given	15
14.	Equity	15
15.	Loans and borrowings	16
16.	Financial instruments and risk management	16
17.	Contingencies	17
18.	Related party transactions	17

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 18.

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 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 2012.

(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 2012.

(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 2012.

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 2013**	**30 June 2012**	**30 June 2013**	**30 June 2012**	**30 June 2013**	**30 June 2012**	**30 June 2013**	**30 June 2012**	**30 June 2013**	**30 June 2012**
External revenues	133,871	117,062	20,664	19,704	17,778	2,877	5,667	5,288	**177, 979**	**144, 931**
Cost of gas	(104,107)	(74,609)	-	-	-	-	-	-	**(104, 107)**	**(74, 609)**
Reportable segment profit before unallocated costs, net finance cost and income tax	**29, 764**	**42, 452**	**20, 664**	**19, 704**	**17, 778**	**2, 877**	**5, 667**	**5, 288**	**73, 872**	**70, 322**

* 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 2013**	**30 June 2012**
Revenues		
Total revenue for reportable segments	**177, 979**	**144, 931**
Profit or loss		
Total profit or loss for reportable segments	73,873	70,322
Unallocated personnel expenses	(3, 411)	(4,316)
Unallocated depreciation and amortization expenses	(9, 390)	(10,588)
Net finance income/(costs)	6, 213	3,779
Other net unallocated (costs)/income	389	(4,139)
Consolidated profit from continuing operations before income tax	**67, 673**	**55,057**

(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 2013, one customer of the Group’s gas supply segment represented approximately 75% of the Group’s total revenue (GEL 177, 979 thousand). 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).

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 2013**	**June 2012**
Sales of gas	133,871	117,062
Rent of gas pipelines	20,664	19,704
Income from crude oil	17,778	2,877
Oil transportation fee	5,667	5,288
Total revenues	**177,979**	**144,931**

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 2013	6 months ended June 2012
Banking, consulting and other professional services	(466)	(3,739)
Representative and business trip expenses	(235)	(249)
Transportation, materials and repair and maintenance	(214)	(220)
Office and related equipment maintenance	(137)	(169)
Communication expenses	(41)	(60)
Other	(2,184)	(1,559)
	(3,276)	**(5,997)**

8. Other income

'000 GEL	6 months ended June 2013	6 months ended June 2012
Customer penalties for late payment	5,294	3,749
Oil processing	695	450
Other	780	401
	6,769	**4,600**

9. Finance income and finance costs

’000 GEL	6 months ended June 2013	6 months ended June 2012
Recognised in profit or loss		
Interest income on bank deposits	12,434	6,469
Interest accrued on given loans	6,607	-
Unwinding of discount on finance lease receivable	1,455	1,374
Finance income	**20,497**	**7,843**
Interest expense on bonds payable	(14,274)	(3,625)
Net foreign exchange loss	(9)	(263)
Interest expense on bank loans	-	(176)
Finance costs	**(14,284)**	**(4,064)**
Net finance costs recognised in profit or loss	**6,214**	**3,779**

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 2013 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	CIP	Total
Opening net book amount as at 1 January 2013	182,080	30,031	12,353	1,657	2,188	54,341	282,650
Additions	45,553	963	-	23	256	245	47,039
Disposals	(1,580)	(830)	-	(26)	(285)	(44,467)	(47,188)
Depreciation	(7,741)	(326)	(802)	(158)	(349)	-	(9,376)
Closing net book amount as at 30 June 2013	**218,311**	**29,838**	**11,551**	**1,495**	**1,809**	**10,120**	**273,125**

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	**2013**	**2012**
Balance at the beginning of the year/date of title transfer	45,882	43,074
Unwinding of discount on finance lease receivable	1,455	2,808
Balance at the end of the period	**47,337**	**45,882**

Contingent rents related to oil transportation recognized in the consolidated statement of comprehensive income during six months of 2013 amounted to GEL 5,667 thousand (6 months of 2012 GEL 5,288 thousand).

13. Loans given

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 Thermo Electric Power Station.

Loans given to state controlled entity bear a contractual rate of interest of 11% per annum and are repayable on maturity in 2013. The National Agency of State Property of the Ministry of Economy and Sustainable Development of Georgia has confirmed its intent to provide support to the extent permitted by the Georgian legislation, if required, to the state controlled entity to enable it to repay these loans.

14. Equity

(a) Share capital

	2012
Balance at 1 January 2013	**509,298**
Balance at 30 June 2013	**509,298**

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

During 6 months of 2013, dividends of GEL 8,359 thousand relating to the year 2012 were declared in addition to GEL 20,000 thousand declared and reported in the audited year 2012 financial statements.

During 6 months of 2013, dividends of GEL 25,859 thousand were paid to the Shareholder out of which GEL 10,000 thousand related to the dividends declared for the year 2010 and the remaining amount of GEL 15,859 thousand is related to the dividends declared for the year 2012.

In 2012 dividends of GEL 40,000 thousand were declared and GEL 47,000 thousand paid.
In 2012, non-cash assets with a carrying amount of GEL 36,779 thousand were transferred 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.

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 2012.

17. 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.

18. 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 2012, 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	**2013**	**2012**
Salaries and bonuses	**262**	**454**

(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	**2013**	**2012**
State controlled entities:		
Rent of pipelines	20,664	19,704
	20,664	**19,704**

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	**2013**	**2012**	**2013**	**2012**
State controlled entities:				
Purchase of Gas	15,643	26,218	5,220	785
	15,643	**26,218**	**5,220**	**785**

(iii) Loans given

'000 GEL	**Interest expense 6 months of**		**Outstanding balance 30 June**	**31 December**
	2013	**2012**	**2013**	**2012**
Shareholder	**2,350**		**88,904**	**85,322**
State controlled entity	**1,650**		**51,266**	**48,714**
	4,000		**140,170**	**134,036**