

The State Administration of Railways
Transport of Ukraine ("Ukrzaliznytsia")

Unaudited interim condensed combined
financial statements

As at 30 June 2015

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REPORT ON REVIEW OF INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS

To the Management of the State Administration of Railways Transport of Ukraine

Introduction

We have reviewed the accompanying interim condensed combined financial statements of the State Administration of Railways Transport of Ukraine ("Ukrzaliznytsia") and other combined entities listed in Note 1 (collectively referred to as "the Group"), which comprise the interim combined statement of financial position as at 30 June 2015, the interim combined statement of comprehensive income, the interim combined statement of changes in equity and the interim combined statement of cash flow for the six-month period then ended and explanatory notes. Management is responsible for the preparation and presentation of these interim condensed combined financial statements in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting* ("IAS 34"). Our responsibility is to express a conclusion on these interim condensed combined financial statements based on our review.

Scope of review

Except as explained in Basis for Qualified Conclusion paragraph (ii), we conducted our review in accordance with the International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim condensed combined financial statements 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.

Basis for qualified conclusion

- (i) As disclosed in Notes 1 and 2 to the accompanying interim condensed combined financial statements, as at 30 June 2015, the Group effectively did not have control over the operations of Crimean Direction of Prydniprovskaya Railway. Therefore, the inclusion of Crimean Direction in the interim condensed combined financial statements as at 30 June 2015 constitutes a departure from International Financial Reporting Standards. The carrying value of the Group's assets and liabilities located in the Autonomous Republic of Crimea or otherwise associated with the Crimean Direction included in the interim condensed combined financial statements was UAH 1,108,565 thousand (1.5% of Group's total assets) and UAH 165,088 thousand, respectively.
- (ii) As disclosed in Note 2 to the accompanying interim condensed combined financial statements, certain structural units of Donetsk Railway, a Group entity, including its head office, are located on the territory temporarily not controlled by Ukrainian authorities. We were unable to complete our review of the financial information of Donetsk Railway as at 30 June 2015 and for the six-month period then ended as disclosed in Note 2, as we had no access to relevant underlying accounting records. Had we been able to complete our review of the financial information of Donetsk Railway, matters might have come to our attention indicating that adjustments might be necessary to the interim condensed combined financial statements.

(continued on the next page)

Qualified Conclusion

Based on our review, with the exception of the matter described in the Basis for Qualified Conclusion paragraph (i) and except for the adjustments to the interim condensed combined financial statements that we might have become aware of had it not been for the situation described in the Basis for Qualified Conclusion paragraph (ii), nothing has come to our attention that causes us to believe that the accompanying interim condensed combined financial statements are not prepared, in all material respects, in accordance with IAS 34.

Emphasis of Matter

Without qualifying our conclusion, we draw attention to Note 2 in the interim condensed combined financial statements which indicates that the Group incurred a net loss of UAH 4,707,186 thousand for the six-month period ended 30 June 2015 and, as of that date, the Group's current liabilities exceeded its current assets by UAH 36,794,001 thousand. We further draw attention to Note 8 in the interim condensed combined financial statements which indicates that the Group breached certain undertakings under its loan arrangements as at 30 June 2015 and as at the date of approval of the interim condensed combined financial statements, the Group has not completed its negotiations with the lenders on reaching a mutually acceptable restructuring agreement with respect to its borrowing facilities. These conditions, along with other matters as set forth in Note 2, indicate the existence of a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern.

Ernst & Young Audit Services LLC

25 September 2015

INTERIM COMBINED STATEMENT OF FINANCIAL POSITION

as at 30 June 2015

(in thousands of Ukrainian Hryvnia)

	Notes	30 June 2015 (unaudited)	31 December 2014 (audited)
Assets			
Non-current assets			
Property, plant and equipment	6	60,768,595	62,352,975
Financial assets		111,924	186,986
Taxes receivable, other than income tax		727,460	544,369
Deferred tax asset		3,945,462	4,024,519
		<u>65,553,441</u>	<u>67,108,849</u>
Current assets			
Inventories		3,043,708	3,012,930
Trade and other receivables		640,030	699,686
Prepayments		207,625	232,663
Prepaid income tax		480,301	309,235
Taxes receivable, other than income tax		122,532	271,375
Short-term deposits		10,535	-
Cash and cash equivalents		3,606,069	2,038,008
		<u>8,110,800</u>	<u>6,563,897</u>
Total assets		<u>73,664,241</u>	<u>73,672,746</u>
Equity and liabilities			
Equity			
Contributed capital	7	18,640,130	18,640,130
Retained earnings		4,332,853	9,129,169
		<u>22,972,983</u>	<u>27,769,299</u>
Non-current liabilities			
Interest-bearing loans and borrowings	8	2,403,337	5,729,683
Finance lease liability	9	1,396,714	1,801,722
Defined benefit liability		1,971,068	1,912,649
Deferred tax liability		15,338	15,337
		<u>5,786,457</u>	<u>9,459,391</u>
Current liabilities			
Interest-bearing loans and borrowings	8	35,925,790	25,358,013
Finance lease liability	9	1,391,131	1,612,718
Trade and other payables		4,613,827	6,134,291
Advances from customers		1,753,754	2,380,542
Income tax payable		-	77,037
Taxes payable, other than income tax		632,047	444,790
Provisions	11	588,252	436,665
		<u>44,904,801</u>	<u>36,444,056</u>
Total liabilities		<u>50,691,258</u>	<u>45,903,447</u>
Total equity and liabilities		<u>73,664,241</u>	<u>73,672,746</u>

Signed and authorised for release on behalf of The State Administration of Railways Transport of Ukraine ("Ukrzaliznytsia") on 25 September 2015 by:

Acting Deputy General Director



Igor B. Breus

Head of Central Finance and Economic Department



Tamara S. Ryabchun

INTERIM COMBINED STATEMENT OF COMPREHENSIVE INCOME

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia)

	Notes	For the six months 2015 (unaudited)	For the six months 2014 (unaudited)
Revenues			
Cargo revenues		23,827,858	18,898,401
Passenger revenues		2,738,780	2,345,354
Other revenues		2,355,427	2,194,861
Total revenues		<u>28,922,065</u>	<u>23,438,616</u>
Operating expenses			
Staff costs		(10,444,843)	(11,883,217)
Depreciation		(2,423,729)	(2,868,233)
Electricity		(2,961,083)	(2,528,989)
Fuel		(3,113,159)	(2,100,277)
Maintenance		(1,890,748)	(1,971,571)
Taxes, other than income tax		(653,868)	(419,682)
Change in provisions	11	(158,204)	(324,023)
Social expenses		(209,641)	(252,061)
Other income		435,711	338,914
Other expenses		(846,277)	(216,281)
Total operating expenses		<u>(22,265,841)</u>	<u>(22,225,420)</u>
Operating profit		6,656,224	1,213,196
Finance income		226,344	31,370
Finance costs		(2,627,723)	(1,765,942)
Foreign exchange (loss)/gain, net		(8,738,032)	(7,245,026)
(Loss)/profit before income tax		<u>(4,483,187)</u>	<u>(7,766,402)</u>
Income tax expense	10	<u>(223,999)</u>	<u>(409,828)</u>
(Loss)/profit for the period		<u>(4,707,186)</u>	<u>(8,176,230)</u>
Other comprehensive income for the period, net of tax		-	-
Total comprehensive (loss)/income for the period, net of tax		<u>(4,707,186)</u>	<u>(8,176,230)</u>

INTERIM COMBINED STATEMENT OF CHANGES IN EQUITY

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia)

	Notes	Contributed capital	Retained earnings	Total equity
1 January 2015 (audited)		18,640,130	9,129,169	27,769,299
Loss for the period		-	(4,707,186)	(4,707,186)
Total comprehensive loss		-	(4,707,186)	(4,707,186)
Dividends accrued	14	-	(89,130)	(89,130)
At 30 June 2015 (unaudited)		18,640,130	4,332,853	22,972,983

for the six months ended 30 June 2014

	Notes	Contributed capital	Retained earnings	Total equity
1 January 2014 (audited)		18,640,806	24,572,762	43,213,568
Loss for the period		-	(8,176,230)	(8,176,230)
Total comprehensive loss		-	(8,176,230)	(8,176,230)
Change in Group composition	7	(676)	(262)	(938)
Dividends accrued	14	-	(49,670)	(49,670)
At 30 June 2014 (unaudited)		18,640,130	16,346,600	34,986,730

INTERIM COMBINED STATEMENT OF CASH FLOW

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia)

	Notes	For the six months 2015 (unaudited)	For the six months 2014 (unaudited)
Cash flows from operating activities			
(Loss)/profit before income tax		(4,483,187)	(7,766,402)
<i>Adjustments to reconcile profit before income tax to net cash provided by operations</i>			
Depreciation		2,423,729	2,868,233
Finance costs, net		2,401,379	1,734,572
Loss/(income) on disposal of property, plant and equipment		195,826	93,429
Movements in defined benefit liability and provisions		61,790	180,123
Allowance for estimated irrecoverable amounts		9,225	(7,026)
Unrealised foreign exchange gain		8,675,425	7,310,547
Operating profit before working capital changes		9,284,187	4,413,476
<i>Changes in working capital</i>			
Trade and other receivables		144,789	(305,215)
Prepayments		18,703	(16,775)
Inventories		(22,979)	1,151,720
Taxes receivable and prepaid		(34,248)	226,662
Trade and other payables		(1,592,841)	(1,484,254)
Advances from customers		(626,788)	(575,697)
Taxes payable, other than income tax		187,257	166,200
Cash generated from operating activity		7,358,080	3,576,117
Income tax paid		(392,959)	(428,449)
Interest paid		(1,904,016)	(1,349,217)
Dividends paid	14	(87,750)	(93,664)
Net cash flows from operating activities		4,973,355	1,704,787
Cash flows from investing activities			
Acquisition of property, plant and equipment		(1,153,994)	(1,760,770)
Proceeds from disposal of property, plant and equipment		16,049	52,893
Net cash movement on deposit accounts		(10,535)	457
Interest received		16,413	8,752
Net cash flows used in investing activities		(1,132,067)	(1,698,668)
Cash flows from financing activities			
Proceeds from interest-bearing loans		507,033	5,660,663
Repayment of interest-bearing loans		(1,665,615)	(4,986,862)
Proceeds from domestic bonds		-	643,383
Repayment of domestic bonds		(100,000)	(217,500)
Repayment of finance lease obligations		(1,194,497)	(433,657)
Net cash flows from financing activities		(2,453,079)	666,027
Net increase in cash and cash equivalents		1,388,209	672,146
Net foreign exchange difference		179,852	10,075
Cash and cash equivalents at 1 January		2,038,008	643,559
Cash and cash equivalents at 30 June		3,606,069	1,325,780

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

1. Description of business and the Group's structure

Formation and operations of the Group

The State Administration of Railways Transport of Ukraine (hereinafter referred to as "Ukrzaliznytsia") was established in December 1991 pursuant to the Decree of the Cabinet of Ministers of Ukraine No. 356 as a managing body for state-owned entities engaged in provision of railways transportation services and support of railway infrastructure in Ukraine. Ukrzaliznytsia operates under the Regulation on the State Administration of Railways Transport of Ukraine approved by the Decree of the Cabinet of Ministers of Ukraine dated 29 February 1996 No. 262.

The registered address of Ukrzaliznytsia is 5, Tverska St., Kyiv 03680, Ukraine.

Combined entities

These interim condensed combined financial statements include interim combined statements of financial position and related interim combined statements of comprehensive income, cash flows and changes in equity of entities (hereinafter referred to as the "Combined Entities"), which, according to the Orders of the Ministry of Infrastructure of Ukraine (before 9 December 2010 Ministry of Transport and Communications of Ukraine) and the Decree of the Cabinet of Ministers of Ukraine, were managed by Ukrzaliznytsia during the six months ended 30 June 2015 and the year ended 31 December 2014 which together form the Ukrzaliznytsia Group (hereinafter collectively referred to as the "Group").

The significant Group's entities as at 30 June 2015 are presented below:

Managing entity

1	State Administration of Railways Transportation of Ukraine (Ukrzaliznytsia)	State Enterprise
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Railways

2	Donetsk Railway	State Enterprise
3	Lviv Railway	State Regional Specialised Association
4	Odesa Railway	State Enterprise
5	Prydniprovskaya Railway	State Enterprise
6	South-Western Railway	State Regional Specialised Association
7	Southern Railway	State Enterprise

Auxiliary services

8	Ukrspetsvagon	State Enterprise
9	Ukrainian State Center for Railways Refrigerator Transportation Ukrreftrans	State Enterprise
10	Ukrainian State Center for Transportation Service "Lisky"	State Enterprise
11	Darnytsky Carriage Repair Plant	State Enterprise
12	Main Information Processing Center of Ukrzaliznytsia	State Enterprise
13	Central Communications Station	State Enterprise
14	Ukrainian State Clearing Center for International Transportation	State Enterprise
15	Ukrzaliznychpostach	State Enterprise
16	Ukrainian Center for Railroad Mechanisation	State Enterprise
17	Rava-Rusky Sleeper Plant	State Enterprise
18	Ukrainian Transport Logistics Center	State Enterprise
19	Ukrainian Railway High-Speed Company	State Enterprise
20	Vinnysiatransprylad	State Enterprise
21	Strytsky Carriage Repair Plant	State Enterprise
22	Starokonstantynovsky Concrete Sleeper Plant	State Enterprise
23	Administration for Industrial Enterprises	State Enterprise

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

1. Description of business and the Group's structure (continued)

During the six month 2015 there were no changes in the structure of the Group.

As further disclosed in Note 2, starting from April 2014 the Group effectively temporary lost control over the operations of Crimean Direction of Prydniprovskaya Railway and over social infrastructure assets of other Railways located in the Autonomous Republic of Crimea. However, following the requirements of the Law of Ukraine *On Ensuring Citizens' Rights and Freedoms and Legal Regime on the Temporary Occupied Territory of Ukraine*, the Group still accounts for assets and liabilities located in the Autonomous Republic of Crimea at the carrying values as of 31 March 2014.

In March 2012 a Law of Ukraine No. 4442-VI *On Peculiarities of the Formation of a Public Joint Stock Company for Railway Transportation* was enacted. The Law sets broad principles for the reorganisation of the Group into a single joint stock company with 100% shares to be owned by the State of Ukraine. The Group is in the process of the legal reorganisation which is intended to be completed by 31 December 2015.

Pricing policy

Cargo and passenger transportation in Ukraine is a natural monopoly and is subject to the following tariffs regulations:

Tariffs for domestic cargo transportation – approved by the Ministry of Infrastructure of Ukraine as agreed with the Ministry of Economic Development and Trade of Ukraine and the Ministry of Finance of Ukraine. The tariffs are denominated in Ukrainian Hryvnia and are subject to inflation adjustments in line with a change in consumer prices. There were adjustments to the tariff rates during six months ended 30 June 2015 and in the second half of 2014.

Tariffs for domestic transportation of passengers and baggage – approved by the Ministry of Infrastructure of Ukraine as agreed with the Ministry of Economic Development and Trade of Ukraine. The tariffs are denominated in Ukrainian Hryvnia. During six months ended 30 June 2015 there were no changes to the tariff rate. There were increases in tariffs in the second half of 2014.

Tariffs for international cargo transportation – regulated by special Tariff Policy annually approved by the Ministry of Infrastructure of Ukraine based on intergovernmental agreements. Tariffs are denominated in Swiss Francs.

Tariffs for international transportation of passengers and baggage – approved by the Ministry of Infrastructure of Ukraine, denominated in Swiss Francs for the countries of the Commonwealth of Independent States, Latvia, Lithuania, Estonia and in Euro for transportation in other countries.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

2. Operating environment, risks and economic conditions in Ukraine

The Group conducts its operations in Ukraine. The Ukrainian economy while deemed to be of market status continues to display certain characteristics consistent with that of an economy in transition. These characteristics include, but are not limited to, low levels of liquidity in the capital markets, high inflation, and significant imbalances in the public finance and foreign trade.

In 2014, Ukrainian political and economic situation deteriorated significantly. The political and social unrest combined with regional tensions has led to the temporary occupation of the Autonomous Republic of Crimea from Ukraine by the Russian Federation, full-fledged armed confrontations with separatists in certain parts of the Donetsk and Lugansk regions and, ultimately, to the significant deterioration of the political and economic relations of Ukraine with the Russian Federation. These factors have contributed to the decline of key economic indices, increase of the state budget deficit, depletion of the NBU's foreign currency reserves and, as a result, further downgrading of the Ukrainian sovereign debt credit ratings.

From 1 January 2015 and up to the date of the issuance of these interim condensed combined financial statements, the Ukrainian Hryvnia (the "UAH") depreciated against major foreign currencies by approximately 33% calculated based on the National Bank of Ukraine (the "NBU") exchange rate of UAH to US Dollar. The NBU imposed certain restrictions on purchase of foreign currencies, cross border settlements (including payment of dividends), and also mandated obligatory partial conversion of foreign currency proceeds into UAH.

The known and estimable effects of the above events on the financial position and performance of the Group in the reporting period have been taken into account in preparing the interim condensed combined financial statements. Specific effects of the secession of the Autonomous Republic of Crimea and the ongoing armed confrontations in certain parts of Donetsk and Lugansk regions are disclosed below in this note.

The Crimean authorities declared Crimean Direction of Prydniprovskaya Railway a separate State Company "Crimean Railways". Crimean Direction contributed 0.7% to the Group's revenues during the year ended 31 December 2014. Besides, social infrastructure assets of other Railways are located in the Autonomous Republic of Crimea. As at 30 June 2015, the carrying value of the Group's assets and liabilities located in or otherwise associated with the Autonomous Republic of Crimea (including customers, borrowers, etc.) was UAH 1,108,565 thousand (1.5% of total assets) and 165,051 thousand, respectively.

In the second half of 2014 as a result of the armed confrontations the Ukrainian authorities lost control over certain territory of Donetsk and Lugansk regions where Donetsk Railway operates, including Donetsk, where the head office of Donetsk Railway is located. In total, Donetsk Railway contributed 6% to the Group's revenues during the six months ended 30 June 2015. As at that date the carrying value of the Group's assets located in or otherwise associated with the Donetsk Railway (including customers, borrowers, etc.) was UAH 10,638,640 thousand (14% of total assets). Management was not able to assess the consequences of armed confrontation on the assets, liabilities and related profit or loss of Donetsk railway.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

2. Operating environment, risks and economic conditions in Ukraine (continued)

The summarised financial information of Donetsk Railway included into the interim condensed combined financial statements of the Group as at and for the six months ended 30 June 2015 is presented below:

Statement of financial position

	<i>For the six months 2015 (unaudited)</i>
Assets	
Non-current assets	
Property, plant and equipment	8,391,350
Financial assets	19,415
Deferred tax asset	570,074
	<u>8,980,839</u>
Current assets	
Inventories	463,670
Trade and other receivables	56,620
Trade and other receivables from Group entities	866,961
Prepayments	52,423
Prepaid income tax	82,635
Taxes receivable, other than income tax	15,604
Cash and cash equivalents	119,888
	<u>1,657,801</u>
Total assets	<u>10,638,640</u>
Equity and liabilities	
Equity	
Contributed capital	2,887,853
Retained earnings	(2,213,879)
	<u>673,974</u>
Non-current liabilities	
Interest-bearing loans and borrowings	994,383
Finance lease liability	205,076
Employee benefit liability	335,025
	<u>1,534,484</u>
Current liabilities	
Interest-bearing loans and borrowings	6,823,971
Finance lease liability	497,828
Trade and other payables	411,357
Trade and other payables to Group entities	424,935
Advances from customers	63,516
Taxes payable, other than income tax	208,575
	<u>8,430,182</u>
Total liabilities	<u>9,964,666</u>
Total equity and liabilities	<u>10,638,640</u>

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

2. Operating environment, risks and economic conditions in Ukraine (continued)

Statement of comprehensive income

	<i>For the six months 2015 (unaudited)</i>
Revenues	
Cargo revenues	1,479,885
Passenger revenues	45,816
Other revenues	121,339
Revenue from Group entities	70,937
Total revenues	<u>1,717,977</u>
Operating expenses	
Staff costs	(1,169,626)
Depreciation	(249,375)
Maintenance	(79,627)
Electricity	(245,835)
Fuel	(352,233)
Taxes, other than income tax	(37,684)
Social expenses	(35,931)
Other income	25,632
Other expenses	(293,529)
Total operating expenses	<u>(2,438,208)</u>
Operating profit	(720,231)
Finance income	35,966
Finance costs	(476,142)
Foreign exchange gain/(loss), net	(1,712,816)
Loss before income tax	<u>(2,873,223)</u>
Income tax benefit	(1,935)
Loss for the six months	<u>(2,875,158)</u>
Total comprehensive loss for the six months, net of tax	<u>(2,875,158)</u>

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

2. Operating environment, risks and economic conditions in Ukraine (continued)

Statement of cash flow

	<i>For the six months 2015 (unaudited)</i>
Cash flows from operating activities	
Loss before income tax	(2,873,223)
<i>Adjustments to reconcile profit before income tax to net cash provided by operations</i>	
Depreciation	249,375
Finance costs, net	440,176
Loss on disposal of property, plant and equipment	162
Unrealised foreign exchange loss, net	1,718,665
Operating profit before working capital changes	(464,845)
<i>Changes in working capital</i>	
Trade and other receivables	627,268
Prepayments	2,028
Inventories	(17,308)
Taxes receivable and prepaid	13,489
Trade and other payables	142,329
Advances from customers	(22,062)
Taxes payable, other than income tax	94,987
Cash generated from operating activity	375,886
Income tax paid	(3,589)
Interest paid	(227,176)
Dividends paid	-
Net cash flows from operating activities	145,121
Cash flows from investing activities	
Acquisition of property, plant and equipment	(3,404)
Proceeds from disposal of property, plant and equipment	823
Interest received	1,120
Net cash flows used in investing activities	(1,461)
Cash flows from financing activities	
Proceeds from Interest-bearing loans	-
Repayment of Interest-bearing loans	(56,422)
Proceeds from domestic bonds	-
Repayment of domestic bonds	-
Repayment of finance lease obligations	-
Net cash flows used in financing activities	(56,422)
Net increase in cash and cash equivalents	87,238
Cash and cash equivalents at 1 January	32,650
Cash and cash equivalents at 30 June	119,888

Despite the armed confrontations managements was able to assure railway operations involving uncontrolled territories. Management supports the official position of the Ukrainian authorities that the uncontrolled territories will be reintegrated to Ukraine.

The Government has committed to direct its policy towards the association with the European Union, to implement a set of reforms aiming at the removal of the existing imbalances in the economy, public finance and public governance, and the improvement of the investment climate. Stabilisation of the Ukrainian economy in the foreseeable future depends on the success of the actions undertaken by the Government and securing continued financial support of Ukraine by international donors and international financial institutions.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

2. Operating environment, risks and economic conditions in Ukraine (continued)

Management is monitoring the developments in the current environment and taking actions, where appropriate, to minimize any negative effects to the extent possible. Further adverse developments in the political, macroeconomic and/or international trade conditions may further adversely affect the Group's financial position and performance in a manner not currently determinable.

Going Concern

The Group's operations were significantly impacted by the deterioration of the operating environment. The Group's net loss for the six months ended 30 June 2015 amounted to UAH 4,707,186 thousand. As at 30 June 2015, the Group's current liabilities exceeded its current assets by UAH 36,794,001 thousand (31 December 2014: UAH 29,880,159 thousand). As at 30 June 2015 the Group did not comply with certain undertakings under its long-term loan agreements and failed to remediate the breaches before the reporting date. Such default have triggered a cross default of under certain other borrowings. Therefore, the lenders became entitled to request accelerated repayment of interest-bearing borrowings with carrying value of UAH 30,162,015 thousand as at 30 June 2015. The non-current portion of borrowings under these agreements of UAH 19,083,990 thousand as at 30 June 2015 was reported in these interim condensed combined financial statements within current liabilities.

In April 2015 the Government of Ukraine included the debt related to the Eurobonds issue (Note 8) to the list of external debt subject to restructuring with the support of the Government in relation to the arrangements with the International Monetary Fund (Note 8). In May 2015 the Group reported suspension of principal debt repayment to Ukrainian internal lenders and initiated debt restructuring negotiations. In the meantime the Group intends to timely service and repay the debt to foreign creditors. As at the date of the authorisation of the financial statements certain agreements were reached as for the restructuring of a major part of the internal debt.

The Group's management believes that: (i) negotiations with both internal and external lenders will be successfully completed in the nearest future, as the lenders are not interested in accelerating repayment of debts and due to the support of the Government; (ii) negative impact of the operating environment will decrease in 2015 due to certain stabilization of the political and economic situation, (iii) the Group is able to generate additional cash flows from its operating activities to finance net working capital deficit through cost reduction measures, and (iv) the Group may release additional cash flows by capping capital expenditures in case needed, without short-term negative effects on operations.

The success of the management plan to achieve further profitable operations with sufficient cash flows and the actual outcome of the restructuring of the remaining debt are not virtually certain. These conditions represent a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern. The Group may be unable to realize its assets and discharge its liabilities in the normal course of business.

3. Basis of preparation

These interim condensed combined financial statements for the six months ended 30 June 2015 have been prepared in accordance with IAS 34 *Interim Financial Reporting*.

The interim condensed combined financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as at 31 December 2014, prepared in accordance with International Financial Reporting Standards ("IFRS").

These interim condensed combined financial statements are presented in UAH thousands and all values are rounded off to the nearest thousand except where otherwise indicated.

Functional and presentation currencies

Functional and presentation currency of each of the Group's entities is Ukrainian Hryvnia.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

4. Changes in accounting policy

The accounting policies adopted in the preparation of the interim condensed combined financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2014, except for the adoption of new standards and interpretations effective as of 1 January 2015. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments apply for the first time in 2015, they do not have a material impact on the annual combined financial statements of the Group or the interim condensed combined financial statements of the Group. The nature and the impact of each new standard or amendment is described below.

Amendments to IAS 19 Defined Benefit Plans: Employee Contributions

IAS 19 requires an entity to consider contributions from employees or third parties when accounting for defined benefit plans. Where the contributions are linked to service, they should be attributed to periods of service as a negative benefit. These amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. This amendment is effective for annual periods beginning on or after 1 July 2014. This amendment is not relevant to the Group, since none of the entities within the Group has defined benefit plans with contributions from employees or third parties.

Annual Improvements 2010-2012 Cycle

These improvements are effective from 1 July 2014 and the Group has applied these amendments for the first time in these interim condensed combined financial statements. They include:

IFRS 2 Share-based Payment

This improvement is applied prospectively and clarifies various issues relating to the definitions of performance and service conditions which are vesting conditions. This amendment is not relevant for the Group as it does not undertake share-based payment transactions.

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IFRS 9 (or IAS 39, as applicable). The Group did not record any business combination during the current interim period.

IFRS 8 Operating Segments

The amendments are applied retrospectively and clarify that:

- An entity must disclose the judgements made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are "similar".
- The reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.

The Group has not applied the aggregation criteria in IFRS 8.12. Segment assets and segment liabilities are not reported for the purpose of decision making.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

4. Changes in accounting policy (continued)

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data by either adjusting the gross carrying amount of the asset to market value or by determining the market value of the carrying value and adjusting the gross carrying amount proportionately so that the resulting carrying amount equals the market value. In addition, the accumulated depreciation or amortisation is the difference between the gross and carrying amounts of the asset. The Group did not record any revaluation adjustments during the current interim period.

IAS 24 Related Party Disclosures

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services. This amendment is not relevant for the Group as it does not receive any management services from other entities.

Annual Improvements 2011-2013 Cycle

These improvements are effective from 1 July 2014 and the Group has applied these amendments for the first time in these interim condensed consolidated financial statements. They include:

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies for the scope exceptions within IFRS 3 that:

- Joint arrangements, not just joint ventures, are outside the scope of IFRS 3.
- This scope exception applies only to the accounting in the financial statements of the joint arrangement itself.

The Group is not a joint arrangement, and thus this amendment is not relevant for the Group and combined entities.

IFRS 13 Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable). The Group does not apply the portfolio exception in IFRS 13.

IAS 40 Investment Property

The description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (i.e., property, plant and equipment). The amendment is applied prospectively and clarifies that IFRS 3, and not the description of ancillary services in IAS 40, is used to determine if the transaction is the purchase of an asset or a business combination. The Group did not record any business combination during the current interim period.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

5. Segment reporting

For management purposes, the Group is organized into business units based on their services, and has five reportable operating segments:

- *Cargo segment* includes cargo transportation services provided by the Group.
- *Long-distance passenger segment* comprises all cross-regional passenger transportation services provided by the Group.
- *Suburban passenger segment* includes intraregional rail passenger transportation services.
- *Auxiliary operations segment* includes repair and maintenance of rolling stock, energy re-sale, construction and other services provided by the Group entities.
- *All other segments* include activities of the Group entities which provide services related to cargo, suburban passenger transportation, construction, reconstruction and modernisation of railways and railway transport infrastructure, repair and maintenance of different railway-related equipment and other companies within the Group. None of these operations are of sufficient size to be reported separately. None of these operations can be aggregated with reportable operating segments described above due to dissimilar economical characteristics.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated on the basis of segment operating profit or loss determined based on management accounts that differ from IFRS interim condensed combined financial statements for the reason that the management accounts are based on Ukrainian GAAP figures. The operating segments results do not include the effects of some adjustments that may be considered necessary to reconcile the management accounts to IFRS interim condensed combined financial statements.

Substantially all of the Group's operating assets are located and most of the services are provided in Ukraine.

Segment revenue is revenue that is directly attributable to a segment, whether from sales to external customers or from transactions with other segments. Segment revenue does not include:

- interest income;
- foreign exchange gains;
- gain on disposal, change in fair value and recoverable amounts of financial assets;
- gain on disposal of property, plant and equipment;
- other income.

Segment expenses are expenses resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to sales to external customers and expenses relating to transactions with other segments. Segment expense does not include:

- interest expense;
- foreign exchange losses;
- loss on disposal, change in fair value and recoverable amounts of financial assets;
- loss on disposal of property, plant and equipment;
- loss on impairment of property, plant and equipment;
- bank charges;
- income tax expense;
- bad debt expense;
- social expenses;
- other expenses;
- maintenance.

Segment result is measured as segment revenue less segment expense.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

5. Segment reporting (continued)

For the six months 2015 (unaudited)	Cargo	Long- distance passenger	Suburban passenger	Auxiliary activity	All other segments	Unallocated	Eliminations (A)	Adjustments (B)	Total
Sales to third parties	24,011,534	2,469,069	265,738	2,872,428	189,899	-	-	(886,603)	28,922,065
Inter-segment sales	-	-	-	772,833	296,036	-	(1,068,869)	-	-
Total revenue	<u>24,011,534</u>	<u>2,469,069</u>	<u>265,738</u>	<u>3,645,261</u>	<u>485,935</u>	<u>-</u>	<u>(1,068,869)</u>	<u>(886,603)</u>	<u>28,922,065</u>
Wages, salaries and related contributions	(5,497,086)	(1,735,754)	(890,458)	(1,523,846)	(230,825)	(570,765)	-	3,891	(10,444,843)
Depreciation	(1,870,357)	(613,268)	(303,655)	(601,349)	(46,639)	(36,767)	-	1,048,306	(2,423,729)
Electricity	(2,057,252)	(482,984)	(291,152)	(123,445)	(13,922)	(15,681)	-	23,353	(2,961,083)
Fuel	(2,047,287)	(398,938)	(272,617)	(377,680)	(23,254)	(3,147)	-	9,764	(3,113,159)
Segment result	<u>12,539,552</u>	<u>(761,875)</u>	<u>(1,492,144)</u>	<u>1,018,941</u>	<u>171,295</u>	<u>(626,360)</u>	<u>(1,068,869)</u>	<u>198,711</u>	<u>9,979,251</u>
For the six months 2014 (unaudited)	Cargo	Long- distance passenger	Suburban passenger	Auxiliary activity	All other segments	Unallocated	Eliminations (A)	Adjustments (B)	Total
Sales to third parties	18,651,422	2,079,136	208,163	2,816,617	209,611	-	-	(526,333)	23,438,616
Inter-segment sales	-	-	-	573,349	319,136	-	(892,485)	-	-
Total revenue	<u>18,651,422</u>	<u>2,079,136</u>	<u>208,163</u>	<u>3,389,966</u>	<u>528,747</u>	<u>-</u>	<u>(892,485)</u>	<u>(526,333)</u>	<u>23,438,616</u>
Wages, salaries and related contributions	(5,832,094)	(2,024,673)	(901,836)	(1,689,082)	(260,547)	(663,989)	-	(510,996)	(11,883,217)
Depreciation	(1,779,846)	(699,627)	(304,195)	(647,870)	(51,147)	(36,424)	-	650,876	(2,868,233)
Electricity	(1,746,119)	(436,522)	(227,128)	(89,808)	(15,810)	(13,602)	-	-	(2,528,989)
Fuel	(1,352,849)	(243,467)	(199,857)	(272,620)	(25,201)	(6,283)	-	-	(2,100,277)
Segment result	<u>7,940,514</u>	<u>(1,325,153)</u>	<u>(1,424,853)</u>	<u>690,586</u>	<u>176,042</u>	<u>(720,298)</u>	<u>(892,485)</u>	<u>(386,453)</u>	<u>4,057,900</u>

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS
(continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

5. Segment reporting (continued)

(A) Inter-segment revenue are eliminated on consolidation.

(B) The operating results of each operating segment does not include the following adjustments representing differences between management accounts and interim condensed combined financial statements prepared in accordance with IAS 34 for the six months ended 30 June 2015 and 2014:

	<i>For the six months 2015 (unaudited)</i>	<i>For the six months 2014 (unaudited)</i>
Recognition of revenue in appropriate period	(244,610)	(190,014)
Settlements with foreign railways	(641,993)	(336,319)
	<u>(886,603)</u>	<u>(526,333)</u>
Correction of bonuses and unused vacation expenses accrual	(85,905)	(654,896)
Defined benefits obligation expenses	89,798	143,900
Adjustment to depreciation expenses as the result of revaluation to deemed cost in IFRS accounting	1,048,303	650,876
Recognition of expenses in appropriate period	33,118	-
	<u>1,085,314</u>	<u>139,880</u>
Total adjustments to segment result	<u>198,711</u>	<u>(386,453)</u>

Reconciliation of profit

	<i>For the six months 2015 (unaudited)</i>	<i>For the six months 2014 (unaudited)</i>
Segment results	11,475,769	6,057,136
Total adjustments due to differences in accounting policies adopted for management accounts and IFRS	198,711	(386,453)
Total unallocated amounts	(626,360)	(720,298)
Inter-segment sales (elimination)	(1,068,869)	(892,485)
Items not included in segment expenses		
Maintenance	(1,890,748)	(1,971,571)
Taxes, other than income tax	(653,868)	(419,682)
Change in provisions	(158,204)	(324,023)
Social expenses	(209,641)	(252,061)
Other income	435,711	338,914
Other expenses	(846,277)	(216,281)
Finance income	226,344	31,370
Finance costs	(2,627,723)	(1,765,942)
Foreign exchange gain/(loss), net	(8,738,032)	(7,245,026)
Group profit before tax	<u>(4,483,187)</u>	<u>(7,766,402)</u>

6. Property, plant and equipment

Acquisitions and disposals

During the six months ended 30 June 2015, the Group acquired assets with a cost of UAH 1,233,006 thousand (six months ended 30 June 2014: UAH 1,965,365 thousand).

Assets with a net book value of UAH 377,762 thousand were disposed of by the Group during the six months ended 30 June 2015 (six months ended 30 June 2014: UAH 146,322 thousand).

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

6. Property, plant and equipment (continued)

During the six months ended 30 June 2015, the Group did not acquire assets under finance lease agreements (Note 9). During the six months ended 30 June 2014 new electric trains of UAH 333,330 thousand were acquired under finance lease agreements.

Capitalised depreciation charge

The Group capitalised UAH 15,895 thousand of depreciation charge for the six months ended 30 June 2015 into construction in progress (the six months ended 30 June 2014: UAH 8,264 thousand).

Fully depreciated assets

The cost of fully depreciated property, plant and equipment which remain in use as at 30 June 2015 amounted to UAH 23,379,559 thousand (31 December 2014: UAH 22,241,981 thousand).

7. Equity

Contributed capital

The contributed capital of the Group combines the statutory capital of the following entities adjusted for effect of hyperinflation under IAS 29 *Financial Reporting in Hyperinflationary Economies*:

	30 June 2015 (unaudited)	31 December 2014 (audited)
Lviv Railway	3,319,711	3,319,711
South-Western Railway	3,164,276	3,164,276
Southern Railway	2,956,000	2,956,000
Prydniprovskaya Railway	2,890,591	2,890,591
Donetsk Railway	2,887,853	2,887,853
Odesa Railway	2,562,567	2,562,567
Ukrspetsvagon	360,000	360,000
Ukrainian State Center for Railways Refrigerator Transportation Ukrreftrans	205,518	205,518
Ukrainian State Center for Transportation Service Lisky	144,166	144,166
Darnytsky Carriage Repair Plant	28,069	28,069
Main Information Processing Center of Ukrzaliznytsia	8,506	8,506
Other entities	112,873	112,873
	<u>18,640,130</u>	<u>18,640,130</u>

Changes in the Group composition

During six months ended 30 June 2015 there were no changes in Group structure. One entity engaged in cattering supply on Prydniprovskaya Railway was disposed during the six months ended 30 June 2014, the contributed capital and the retained earnings of the entity comprised UAH 676 thousand and UAH 262 thousand, respectively.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS
(continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

8. Interest-bearing loans and borrowings

As at 30 June 2015 and 31 December 2014 interest-bearing loans and borrowings consisted of the following:

	30 June 2015 (unaudited)	31 December 2014 (audited)
Interest-bearing bank loans	23,476,909	18,790,848
Eurobonds issued	10,615,156	7,966,369
Bonds issued in domestic markets	3,918,297	4,036,818
Other borrowings	318,765	293,661
	<u>38,329,127</u>	<u>31,087,696</u>

On 16 May 2013 the Group issued USD 500,000 thousand (UAH equivalent at the date of issue: 3,996,500 thousand), 9.5% notes maturing in 2018 (the "Eurobonds") on the Irish Stock Exchange.

Domestic bonds are issued and placed in Ukraine. They are denominated in UAH, bear interest of 18%-23.5% and mature in 2015-2017.

As at 30 June 2015 and 31 December 2014, interest rates and currency split for borrowings were as follows:

	Interest rate	30 June 2015 (unaudited)	31 December 2014 (audited)
USD			
floating rate	LIBOR 6 month +1%-6%	4,985,649	4,490,537
fixed rate	9.5%-12%	26,259,598	19,537,131
		<u>31,245,247</u>	<u>24,027,668</u>
EUR			
floating rate	EURIBOR 6m + 6.55%	871,786	766,831
		<u>871,786</u>	<u>766,831</u>
UAH			
fixed rate	17.9%-23.5%	6,212,094	6,293,197
		<u>6,212,094</u>	<u>6,293,197</u>
Total interest-bearing loans and borrowings		38,329,127	31,087,696
Less: current portion		<u>(35,975,790)</u>	<u>(25,358,013)</u>
Interest-bearing loans and borrowings, non-current		<u>2,403,337</u>	<u>5,729,683</u>

Some of the loan agreements provide for financial and non-financial covenants, which impose restrictions on certain transactions and financial ratios, including restrictions of the amount of outstanding debt and profitability of the Group.

As at 31 December 2014 as well as at 30 June 2015 the Group was not in compliance with certain undertakings under its long-term loan agreements and failed to remediate the breaches before the reporting date. Such default have triggered a cross default of under certain other borrowings. Therefore, the lenders became entitled to request accelerated repayment of interest-bearing borrowings with carrying value of UAH 30,162,015 thousand as at 30 June 2015 (31 December 2014: UAH 18,234,800 thousand). Pursuant to the requirements of IAS 1 Presentation of Financial Statements the non-current portion of the Group's borrowings under the above mentioned agreements of UAH 19,083,990 thousand as at 30 June 2015 (31 December 2014: UAH 14,426,435 thousand), were reported in these interim condensed combined financial statements within current liabilities. Subsequent to the reporting date the Group reported the lenders of the occurrence of a technical default on certain debt obligations and initiated restructuring negotiations with external and internal lenders. The Group reached certain agreements as for the restructuring of the internal debt and as at the date of the authorisation of the financial statements the restructuring negotiations with internal lenders were at the completion stage.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

8. Interest-bearing loans and borrowings (continued)

As at 30 June 2015 undrawn loan facilities available to the Group were of UAH 1,448,908 thousand (31 December 2014: UAH 2,521,718 thousand). Following the breaches of undertakings as at 30 June 2015 the access to certain undrawn loan facilities was restricted. Assuming there was no breach, undrawn loan facilities available to the Group would comprise UAH 5,005,076 thousand as at 30 June 2015.

As at 30 June 2015 and 31 December 2014 interest-bearing loans and borrowings were secured as follows:

	30 June 2015 (unaudited)	31 December 2014 (audited)
Type of collateral		
Property and equipment	264,157	268,819
Inventories	111,251	111,251
Future proceeds from revenue	26,446,401	26,012,970

9. Finance lease liability

The Group leases freight and passenger railway cars, locomotives, electric trains and equipment. The majority of lease payments are pegged to USD; the average lease term is 7 years. As at 30 June 2015 the interest rates implicit in the lease were within the range of 11.0%-21.1827% per annum.

During the six months ended 30 June 2015, the Group did not acquire assets under finance lease agreement. During the six months ended 30 June 2014 new electric trains of UAH 333,330 thousand were acquired under finance lease agreement.

In February 2015 a substantial modification of the terms of two existing finance lease agreements occurred. The Group accounted the modification as an extinguishment of the original and recognised new finance lease liability. The difference between the carrying amount of the extinguished finance lease liability and the liabilities assumed in the amount of UAH 110,189 thousand was recognised as finance income in the interim combined statement of comprehensive income.

Principal repayments under finance lease to Ukrainian lessors (unlike foreign lessors) is subject to 20% VAT levied at the payment date. Finance charge is not VAT taxable.

The following are the minimum lease payments and present value of finance lease liability under finance lease agreements:

	Minimum lease payments		Present value of finance lease liability	
	30 June 2015 (unaudited)	31 December 2014 (audited)	30 June 2015 (unaudited)	31 December 2014 (audited)
Amounts payable under finance leases				
within one year	1,687,779	1,909,500	1,391,131	1,612,717
in the second to fifth years inclusive	1,665,883	2,218,416	1,354,347	1,720,840
after five years	44,409	111,026	42,367	80,883
	3,398,071	4,238,942	2,787,845	3,414,440
Less: future finance charges	(610,226)	(824,502)	-	-
	2,787,845	3,414,440	2,787,845	3,414,440
Current	1,391,131	1,612,718	1,391,131	1,612,718
Non-current	1,396,714	1,801,722	1,396,714	1,801,722

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

10. Income tax

The components of income tax expense were as follows:

	<i>For the six months 2015 (unaudited)</i>	<i>For the six months 2014 (unaudited)</i>
Current income tax charge	144,856	369,479
Deferred income tax expenses	79,143	40,349
Income tax expense	<u>223,999</u>	<u>409,828</u>

During the six months ended 30 June 2015, the statutory income tax rate in Ukraine was 18% (during the six months ended 30 June 2014: 18%).

11. Provisions

As at 31 December 2014 the Group recognized provision for litigation in the amount of UAH 430,048 thousand (denominated in foreign currency) in respect of breach of the construction agreement with a supplier. As at 30 June 2015 the amount increased to UAH 588,252 thousand due to devaluation of Ukrainian Hryvnia.

12. Contingencies and commitments

Tax matters

Ukrainian legislation and regulations regarding taxation and other operational matters, including currency exchange control and custom regulations, continue to evolve. Legislation and regulations are not always clearly written and are subject to varying interpretations by local, regional and national authorities, and other Governmental bodies. Instances of inconsistent interpretations are not unusual. Management believes that its interpretation of the relevant legislation is appropriate and that the Group has complied with all regulations, and paid or accrued all taxes and withholdings that are applicable.

However, where the risk of outflow of resources is probable, the Group has accrued tax liabilities based on management's best estimate.

The uncertainty of inconsistent enforcement and application of Ukrainian tax laws creates a risk of substantial additional tax liabilities and penalties being claimed by the tax authorities. Such claims, if sustained, could have a material effect on the Group's financial position, results of operations and cash flows. Management believes that there are strong arguments to successfully defend any such challenge and does not believe that the risk is any more significant than those of similar enterprises in Ukraine. When it is not considered probable that a material claim will arise, no provision has been established in these interim condensed combined financial statements.

In the course of its commercial activities the Group has a necessity to reallocate taxable income among the Group companies. Such reallocation involves a significant degree of management's judgment. In spite of the fact that relevant government authorities had not historically challenged the management judgment in these matters, it is possible that the authorities may attempt to revise their previous approach to such transactions, equally as to any other aspects of application of tax legislation not challenged in the past, and assess additional income and other taxes and penalties against the Group, although this risk significantly diminishes with passage of time. It is not practical to determine the amount of any potential claims or the likelihood of any unfavourable outcome.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS
(continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

12. Contingencies and commitments (continued)

Litigations

In the normal course of business, the Group is subject to various routine litigation and arbitration related matters. As at 30 June 2015 the Group was involved in litigations with tax authorities with respect to additional accrual of tax liabilities in total amount of UAH 315,181 thousand, including additional charges and penalties (31 December 2014: UAH 322,346 thousand). In addition, the Group's exposure to various third parties' claims is UAH 232,054 thousand (31 December 2014: UAH 255,708 thousand).

Management believes that the Group's position in the litigations stated above has sustainable legal merits, and therefore the ultimate resolution of these litigations will not have adverse effect on the Group's financial position or the results of its future operations, accordingly, no corresponding accrual was provided in these interim condensed combined financial statements. Probable obligations are accrued for in these interim condensed combined financial statements (Note 11).

Capital commitments

As at 30 June 2015 the Group's outstanding commitment in respect of purchase of property and equipment amounted to UAH 2,014,554 thousand (31 December 2014: UAH 1,971,931 thousand).

13. Fair value of financial instruments

Set out below is the comparison by category of carrying amounts and fair values of all of the Group's financial instruments, that are carried in the interim condensed combined statements of financial position:

	<i>Carrying amount</i>		<i>Fair value</i>	
	<i>30 June 2015 (unaudited)</i>	<i>31 December 2014 (audited)</i>	<i>30 June 2015 (unaudited)</i>	<i>31 December 2014 (audited)</i>
Financial assets				
Trade and other receivables	640,030	699,686	640,030	699,686
Other financial assets	111,924	114,352	111,924	114,352
Long-term trade receivable	-	72,634	-	72,634
Short-term deposits	10,535	-	10,535	-
Cash and cash equivalents	3,606,069	2,038,008	3,606,069	2,038,008
Financial liabilities				
Interest-bearing loans and borrowings	38,329,127	31,087,696	34,439,936	28,347,910
Finance lease liability	2,787,845	3,414,440	2,787,845	3,414,440
Trade and other payables	4,613,827	6,134,291	4,613,827	6,134,291

In assessing the fair value of financial instruments, the Group uses a variety of methods and makes assumptions based on market conditions existing at the end of the reporting period. Quoted market prices or dealer quotes for the specific or similar instruments or the discounted value of future cash flows are used for financial assets. The face values of financial assets and liabilities with a maturity of less than one year, less any estimated credit adjustments, are assumed to be their fair values. The fair value of interest bearing loans and borrowings is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

14. Related party disclosure

The outstanding balances and transaction with entities under common control of the State comprised:

	30 June 2015 (unaudited)	31 December 2014 (audited)
Prepayments for property, plant and equipment	57	-
Long-term receivable	2,173	72,634
Trade and other receivables	50,915	266,647
Prepayments, other than dividends	13,680	9,314
Cash and cash equivalents	1,034,986	916,499
Trade and other payables, other than dividends	18,246	106,208
Advances received	3,637	499,020
Interest-bearing loans	805,828	772,877
	For the six months 2015 (unaudited)	For the six months 2014 (unaudited)
Cargo revenues	49,126	146,353
Maintenance services purchased	611,098	632,172
Finance income	3,105	21,716
Finance costs	68,990	39,466
Other expenses	62,543	29,746

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made at regular prices, broadly similar to those with other non-related customers and suppliers. Outstanding balances at the reporting date are unsecured, interest-free and settlements occur in cash. There have been no guarantees provided or received for any related party receivables or payables. During the six months ended 30 June 2015 the Group has recorded impairment of long-term and current portion of long-term receivable due from Vugillya Ukrainy. Loss on impairment of UAH 234,850 thousand was included to other expenses in interim combined statement of comprehensive income.

Guarantees issued by the State of Ukraine

The Group's interest bearing loans with carrying value of UAH 4,960,178 thousand (31 December 2014: UAH 3,990,847 thousand) were guaranteed by the State of Ukraine.

Compensation of key management personnel

Key management personnel consist of 19 members of the Board of Ukrzaliznytsia. During the six months ended 30 June 2015, total compensation to key management personnel amounted to UAH 1,215 thousand (six months ended 30 June 2014: UAH 947 thousand). Compensation includes salaries and salary related taxes.

Dividends to the State

As at 30 June 2015 dividends prepaid to the State in the amount of UAH 15 thousand were included in prepayments (31 December 2014: UAH 15 thousand). Included in trade and other payables are dividends payable to the State of UAH 63,807 thousand as at 30 June 2015 (31 December 2014: UAH 62,427 thousand).

NOTES TO THE INTERIM CONDENSED COMBINED FINANCIAL STATEMENTS (continued)

for the six months ended 30 June 2015

(in thousands of Ukrainian Hryvnia, unless otherwise indicated)

14. Related party (continued)

Dividends accrued for the six months ended 30 June 2015 amounted to UAH 89,130 thousand (six months ended 30 June 2014: UAH 49,670 thousand).

Government subsidies

The Group receives subsidies from the State for carriage of certain categories of preferential passengers. During the six months ended 30 June 2015 such subsidies of UAH 88,000 thousand (six months ended 30 June 2014: UAH 60,800 thousand) were included into passenger revenue.