Silknet JSC

Condensed Consolidated Interim Financial Statements for the six months ended 30 June 2017

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Independent Auditors' Report on Review of Condensed Consolidated Interim Financial Statements

To the Shareholder of JSC Silknet

Introduction

We have reviewed the accompanying condensed consolidated interim statement of financial position of JSC Silknet (the "Company") and its subsidiaries (the "Group") as at 30 June 2017, and the related condensed consolidated interim statements of profit or loss and other comprehensive income, changes in equity and cash flows for the six months then ended, and notes to the condensed consolidated interim financial information (the "condensed consolidated interim financial information"). Management is responsible for the preparation and presentation of these condensed consolidated interim financial information in accordance with IAS 34 *Interim Financial Reporting.* Our responsibility is to express a conclusion on these condensed consolidated interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of condensed consolidated interim 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.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated interim financial information as at 30 June 2017 and for the six month period then ended is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Andrew Coxshall
KPMG Georgia LLC
12 October 2017

’000 GEL	Note	30 June 2017	31 December 2016
ASSETS			
Non-current assets			
Property and equipment	8	195,503	187,746
Intangible assets		18,531	16,483
Other non-current assets		14,470	10,827
Loans due from related parties		1,111	804
Total non-current assets		**229,615**	**215,860**
Current assets			
Inventories		7,561	8,226
Trade and other receivables		19,064	19,400
Restricted deposit		-	2,664
Cash and cash equivalents		7,777	1,280
Total current assets		**34,402**	**31,570**
TOTAL ASSETS		**264,017**	**247,430**
EQUITY AND LIABILITIES			
Equity			
Share capital		68,172	68,172
Retained earnings		33,875	28,188
Equity attributable to owner of the Company		**102,047**	**96,360**
Non-controlling interest		381	165
TOTAL EQUITY		**102,428**	**96,525**
LIABILITIES			
Non-current liabilities			
Loans and borrowings	10	67,499	65,732
Trade and other payables		38,392	28,765
Total non-current liabilities		**105,891**	**94,497**
Current liabilities			
Loans and borrowings	10	8,135	16,370
Trade and other payables		46,840	38,914
Current tax liabilities		723	1,124
Total current liabilities		**55,698**	**56,408**
TOTAL LIABILITIES		**161,589**	**150,905**
TOTAL LIABILITIES AND EQUITY		**264,017**	**247,430**

The condensed consolidated interim statement of financial position is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 9 to 15.

'000 GEL	Note	2017	2016
Revenue	5	85,661	79,956
Purchased services	6	(15,384)	(18,370)
Salaries and benefits		(16,166)	(14,428)
Depreciation and amortisation		(18,776)	(18,159)
Other operating expenses		(14,352)	(14,520)
Other income		921	155
Profit from operating activities		**21,904**	**14,634**
Interest income		228	158
Interest expense		(5,095)	(5,075)
Net foreign exchange gain		1,869	2,249
Profit before income tax		**18,906**	**11,966**
Income tax (expense)/ benefit	7	(1,300)	13,532
Profit and total comprehensive income for the period		**17,606**	**25,498**
Profit and total comprehensive income attributable to:			
Owner of the Company		17,390	25,487
Non-controlling interest		216	11
		17,606	**25,498**

These condensed consolidated interim financial statements were approved by management on 12 October 2017 and were signed on its behalf by:

David Mamulaishvili
General Director

Baia Pshavlishvili
Finance Director

The condensed consolidated interim statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 9 to 15.

	Attributable to owner of the Company				
’000 GEL	**Share capital**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Balance as at 1 January 2016	68,172	4,052	72,224	(58)	72,166
Total comprehensive income for the period					
Profit for the period	-	25,487	25,487	11	25,498
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 9)	-	(6,868)	(6,868)	-	(6,868)
Balance as at 30 June 2016	**68,172**	**22,671**	**90,843**	**(47)**	**90,796**
Balance as at 1 January 2017	68,172	28,188	96,360	165	96,525
Total comprehensive income for the period					
Profit for the period	**-**	17,390	17,390	216	17,606
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 9)	-	(11,703)	(11,703)	-	(11,703)
Balance as at 30 June 2017	**68,172**	**33,875**	**102,047**	**381**	**102,428**

The condensed consolidated interim statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 9 to 15.

’000 GEL	Note	2017	2016
Cash flows from operating activities			
Cash received from subscribers		87,016	82,118
Cash received from other telecom operators and for IRU contracts		15,692	11,581
Salaries and benefits paid to and on behalf of employees		(13,542)	(14,125)
Interconnection fees and expenses paid		(3,046)	(6,739)
Purchase of inventory		(2,187)	(854)
Taxes paid		(13,473)	(10,833)
Network repair costs paid		(4,827)	(5,478)
Other operating expenses paid		(13,014)	(15,060)
Net cash from operating activities		**52,619**	**40,610**
Cash flows from investing activities			
Acquisition of property and equipment		(28,228)	(13,292)
Acquisition of intangible assets		(4,837)	(4,469)
Proceeds from disposals of property and equipment		1,379	455
Acquisition of subsidiaries, net of cash acquired		(511)	-
Proceeds from term deposit		2,444	-
Issue of loans		(351)	(391)
Repayment of issued loans		-	27
Net cash used in investing activities		**(30,104)**	**(17,670)**
Cash flows from financing activities			
Proceeds from borrowings*		2,500	15,887
Repayment of borrowings*		(8,587)	(24,535)
Interest paid*		(4,683)	(4,831)
Dividends paid**		(5,070)	(4,205)
Net cash used in financing activities		**(15,840)**	**(17,684)**
Effect of exchange rate changes on cash and cash equivalents		(178)	(1,109)
Net increase in cash and cash equivalents		**6,497**	**4,147**
Cash and equivalents at the beginning of period		1,280	5,487
Cash and cash equivalents at the end of period		**7,777**	**9,634**

The condensed consolidated interim statement of cash flows is to be read in conjunction with the notes to, and forming part of, the condensed consolidated interim financial statements set out on pages 9 to 15.

* In the six months ended 30 June 2017 and 2016, movement on loans and borrowings was as follows:

'000 GEL	**2017**	**2016**
Balance at the beginning of the period	82,102	98,553
Proceeds from borrowings	2,500	15,887
Repayment of borrowings	(8,587)	(24,535)
Interest paid	(4,683)	(4,831)
Interest expense	4,645	5,104
Net foreign exchange gain	(343)	(2,375)
Balance at the end of the period	**75,634**	**87,803**

** In the six months ended 30 June 2017 and 2016, movement on dividends payable (included in trade and other payables) was as follows:

'000 GEL	**2017**	**2016**
Balance at the beginning of the period	123	1,068
Dividends declared (note 9)	11,703	6,868
Dividends paid	(5,070)	(4,205)
Set off of dividends payable with loan issued to the parent company	-	(1,530)
Balance at the end of the period	**6,756**	**2,201**

1. Reporting entity

(a) Georgian business environment

The Group's operations are 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, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The condensed consolidated interim financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

(b) Organisation and operations

These condensed consolidated interim financial statements include the financial statements of Silknet JSC (the Company) and its subsidiaries (together referred to as the Group and individually as the Group entities). The Company and its subsidiaries are limited liability companies as defined under the Law of Georgia on Entrepreneurs and are incorporated and domiciled in Georgia.

The Company's legal address is 95 Tsinamdzgvrishvili street, Tbilisi, 0112 Georgia.

The principal activity of the Group is provision of telecommunication services to corporate and individual customers in Georgia, including local and international telephone services, internet and internet television (IPTV) services and leasing the underground communication facilities. The Group directs its activities as one operating segment.

In September 2016 the Company's Long-Term Issuer Default Rating was affirmed by the Fitch Rating agency as 'B+' with a Stable Outlook.

The Company is wholly-owned by Rhinestream Holdings Limited, an entity incorporated in Malta, and is ultimately controlled by an individual, Giorgi Ramishvili.

2. Basis of accounting

Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting*, and should be read in conjunction with the Group's last annual consolidated financial statements as at and for the year ended 31 December 2016 ("last annual consolidated financial statements").

These condensed consolidated interim financial statements do not include all of the information required for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the last annual consolidated financial statements.

3. Use of estimates and judgments

In preparing these condensed consolidated interim financial statements, management has made judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the last annual consolidated financial statements.

4. Significant accounting policies

The accounting policies applied by the Group were consistent with those applied in the last annual consolidated financial statements.

5. Revenues

'000 GEL	2017	2016
Internet service	44,338	39,359
Internet television	15,474	13,815
Fixed telephone service	13,233	14,898
Interconnect service	5,686	4,356
Facility rental service	3,977	5,438
Wireless telephone ("CDMA*") service	1,700	2,065
Other	1,253	25
Total revenues	**85,661**	**79,956**

The business is not subject to any seasonality and remains constant throughout the year.

6. Purchased services

'000 GEL	2017	2016
IPTV content cost	4,468	4,033
Interconnection fees	3,074	1,806
Internet service cost	1,816	1,782
Utility expenses	1,608	1,594
Software maintenance service	1,502	1,823
Internet clear channel costs	1,455	4,842
Advertising expenses	870	1,670
Professional fees	512	724
Other	79	96
Total purchased services	**15,384**	**18,370**

In the six months ended 30 June 2017, internet clear channel costs were decreased following the negotiation of the contract with more favourable terms with the major supplier.

* Code Division Multiple Access technology supporting the Group's wireless telephone services.

7. Taxation

In the six months ended 30 June 2016, income tax expense mainly represents reversal of previously recognized deferred tax liabilities of GEL 15,698 thousand following the changes in the Georgian tax legislation. On 13 May 2016 the Parliament of Georgia passed with its third and final reading the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law is effective for tax periods starting after 1 January 2017. Considering that the change in the Georgian Tax Code was enacted before the reporting date, the Group has recognized the full effect of the change in 2016 by derecognizing previously recognized deferred tax liabilities through the condensed consolidated interim statement of profit or loss as an income tax benefit.

In the six months ended 30 June 2017, income tax expense mainly represents tax accrued on the declared dividends (see note 9) using tax rate of 8%, which is the applicable effective tax rate for the Group for the six months ended 30 June 2017 and is calculated according to the updated Georgian Tax Code.

8. Property and equipment

’000 GEL	Land	Buildings and facilities	Machinery and equipment	Vehicles	Furniture and fixture	Construction in progress	Total
Cost at 1 January 2016	21,509	107,582	144,165	3,957	12,429	48	289,690
Accumulated depreciation	-	(28,177)	(69,404)	(3,827)	(9,015)	-	(110,423)
Carrying amount at 1 January 2016	**21,509**	**79,405**	**74,761**	**130**	**3,414**	**48**	**179,267**
Additions	-	-	7,601	-	550	6,631	14,782
Disposals	(73)	(62)	(1,831)	(48)	(162)	-	(2,176)
Transfers and others	-	755	4,103	421	186	(6,228)	(763)
Disposals of depreciation	-	19	1,408	48	92	-	1,567
Depreciation charge	-	(1,074)	(11,758)	(117)	(916)	-	(13,865)
Carrying amount at 30 June 2016	**21,436**	**79,043**	**74,284**	**434**	**3,164**	**451**	**178,812**
Cost at 30 June 2016	21,436	108,275	154,038	4,327	13,003	451	301,530
Accumulated depreciation	-	(29,232)	(79,754)	(3,893)	(9,839)	-	(122,718)
Carrying amount at 30 June 2016	**21,436**	**79,043**	**74,284**	**434**	**3,164**	**451**	**178,812**
Cost at 1 January 2017	21,198	109,281	169,450	4,450	13,122	611	318,112
Accumulated depreciation	-	(30,070)	(86,848)	(3,831)	(9,617)	-	(130,366)
Carrying amount at 1 January 2017	**21,198**	**79,211**	**82,602**	**619**	**3,505**	**611**	**187,746**
Additions	15	83	11,270	123	137	11,806	23,434
Disposals	(82)	(855)	(5,517)	(11)	(78)	-	(6,542)
Transfers and others	-	320	5,614	-	-	(5,934)	-
Disposals of depreciation	-	270	4,810	11	68	-	5,158
Depreciation charge	-	(1,142)	(12,353)	(188)	(610)	-	(14,293)
Carrying amount at 30 June 2017	**21,131**	**77,887**	**86,426**	**554**	**3,022**	**6,483**	**195,503**
Cost at 30 June 2017	21,131	108,829	180,817	4,562	13,181	6,483	335,003
Accumulated depreciation	-	(30,942)	(94,391)	(4,008)	(10,159)	-	(139,500)
Carrying amount at 30 June 2017	**21,131**	**77,887**	**86,426**	**554**	**3,022**	**6,483**	**195,503**

(a) Security

All of the Group’s property and equipment is pledged under the secured bank loans.

(b) Acquisition of fixed assets

In the six months ended 30 June 2017, the Group acquired property and equipment of GEL 23,434 thousand (2016: GEL 14,782 thousand) and intangible assets of GEL 6,544 thousand (2016: GEL 3,106 thousand).

(c) CDMA technology

In 2016 the Group made a decision to abandon the CDMA technology due to the significant decline in the customer base of this particular technology. As a result, the remaining useful lives of the assets supporting the CDMA technology were reduced so that these assets would be fully depreciated by July 2017, when the Group expected to leave the CDMA business line.

In the six months ended 30 June 2017, the Group made a decision to remain in the CDMA business segment until July 2018 as the technology is expected to generate positive cash flows until that date.

(d) Construction in progress

Construction in progress as at 30 June 2017 mainly represents construction of the infrastructure for the fiber-optic cables, that will be either used by the Group or leased out to the counterparties under the IRU (“Indefeasible Right of Use”) agreements.

9. Equity

Dividends

In the six months ended 30 June 2017 and 2016, the Group declared dividends of GEL 11,703 thousand (GEL 0.2 per share) and GEL 6,868 thousand (GEL 0.1 per share), respectively.

10. Loans and borrowings

This note provides information about the contractual terms of the Group’s interest-bearing loans and borrowings, which are measured at amortised cost.

’000 GEL	30 June 2017	31 December 2016
Secured bank loans – non-current	67,499	65,732
Secured bank loans – current	8,135	16,370
	75,634	**82,102**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				30 June 2017	
’000 GEL	Currency	Nominal interest rate	Year of maturity	Face Value	Carrying amount
Secured bank loans	USD	10.5%	2024	2,176	2,176
Secured bank loans	GEL	12%	2024	73,458	73,458
Total loans and borrowings				**75,634**	**75,634**

’000 GEL	Currency	Nominal interest rate	Year of maturity	31 December 2016 Face Value	Carrying amount
Secured bank loans	USD	5-6%	2017	1,589	1,589
Secured bank loans	USD	10.5%	2021	2,534	2,534
Secured bank loans	GEL	12%	2021	77,979	77,979
Total loans and borrowings				**82,102**	**82,102**

The secured bank loans are payable to JSC Bank of Georgia. In January 2017, the maturity of the loans was prolonged to 2024. The bank loans are secured by the Company’s share capital, inventories and property and equipment.

In July 2017, loans payable to JSC Bank of Georgia were refinanced by the secured credit received from JSC TBC Bank. The net refinancing fee of GEL 1,044 thousand was paid to JSC Bank of Georgia. Loans payable to JSC TBC Bank mature in 2024 and bear interest rate of 12% till 2019 and a variable interest rate of 5.5% + the refinancing rate (monetary policy rate determined by the National Bank of Georgia) after 2019.

In August 2017, part of the secured bank loans were early repaid from the proceeds of the bonds issue by the Group (see note 12).

11. Fair values and financial risk management

The Group has determined fair values of financial assets and liabilities using valuation techniques disclosed in the last annual consolidated financial statements. Management believes that the fair value of the Group’s financial assets and liabilities approximates their carrying amounts.

The Group’s financial risk management objectives and policies are consistent with those disclosed in the last annual consolidated financial statements.

(a) Credit related commitments

The Group has guaranteed the indebtedness of the parent company in the amount of GEL 35,000 thousand. The guarantee amount represents the maximum accounting loss that would be recognized at the reporting dates if counterparty failed completely to perform as contracted. Therefore, the total outstanding contractual commitment does not necessarily represent future cash requirements, as the commitment may expire or terminate without being funded. As at the reporting dates, no event of default under the guarantee agreement occurred and management believes that the probability of its parent company failing to meet its contractual obligations under the respective agreement was remote. Therefore, no provision was recognized for the arrangement.

(b) Liquidity risk

As at 30 June 2017, the Group’s liquidity position is consistent with the one disclosed in the last annual consolidated financial statements. Subsequent to the reporting date, the Group has improved its liquidity position by refinancing part of the secured bank loans with unsecured long-term bonds, with repayment of the principal amount at the maturity date (see notes 10 and 12).

12. Events subsequent to the reporting date

Subsequent to the reporting date, the Group has listed unsecured bonds of GEL 34,000 thousand on the Georgian Stock Exchange. The unsecured bonds bear a variable interest rate of 3.5% + the refinancing rate and mature after 5 years. The proceeds from the bond issuance were used to repay the secured bank loans (see notes 10 and 11).

In September 2017, the Company’s Long-Term Issuer Default Rating was reassessed by the Fitch Rating agency and was reconfirmed as 'B+' with a Stable Outlook.