2017

Annual Report

Georgian Railway
Est. 1872

Georgian Railway

A Message from the Chairman

Chairman of Supervisory Board
Konstantine Guntsadze

I am proud to present the Annual Report for 2017, the sixth year in which I have had the privilege of being tasked with chairing the board of one of Georgia's most strategically important companies. JSC Georgian Railway plays a significant role in the country's economy and in maintaining strong economic relations between Georgia and its partner countries in the Caucasus and the Central Asia region.

In the past two years, the Group has faced some difficulties in terms of its financial results due to downturns in cargo volumes, but it nevertheless maintains reasonable liquidity levels. The Management, along with its highly competent and dedicated team of about 13,000 people, is working hard in many areas to overcome the latest challenges. I believe that the development of infrastructure in the region through projects like the Baku-Tbilisi-Kars railway, Anaklia Deep-Sea Port and Shah Deniz gas field will have positive effects on the transported volumes by the Group and thus improve its operating results in the coming years.

A Message from the General Director

CEO
David Peradze

I have been appointed as the General Director of JSC Georgian Railway in late 2017 and first of all, I want to admit that this is a great pleasure for me to lead one of the most successful companies in Georgia. I would also like to thank my predecessor, Mamuka Bakhtadze, for the taken by him efforts during years at the Company, which has led to transforming Georgian Railway into one of the most successful companies in Georgia.

Positive effect has been achieved in various areas of activities of the group. Specifically in 2013, Georgian Railway entered the freight forwarding business resulting in additional value for the company. In 2015, the Group revived the Silk Road leading to the first Chinese train to arrive in Georgia and the Group also attained an international certificate of quality management (ISO 9001:2008). In 2016 and 2017, Georgian Railway purchased four new passenger trains for its passenger transportation unit from a Swiss manufacturer, increasing the number of customers of the Company and passenger kilometers by 17 percent in 2017, compared to 2016.

2017 has been a very challenging year for the Group. External factors, as mentioned above, resulted certain decrease of cargo volumes, what eventually caused changes to the credit ratings of the Group.

Despite these setbacks, the Group has maintained solid financial figures. Its EBITDA margin and adjusted EBITDA margin are still on significant levels with 49 percent and 42 percent, respectively. The Group has also maintained strong liquidity, with its cash ratio fixed at 1.24 at the end of 2017. We are continuing to invest in infrastructure development through the Modernization Project, which will guarantee more value and efficiency for the Group, TRACECA and the region as a whole.

The Group is one of the main contributors to the Georgian economy. Its revenue contributed 1.1 percent of the country's GDP in 2017. Successful years lie ahead for the country as a whole as the International Monetary Fund expects the GDP of the country to increase stably. I believe Georgian Railway will contribute significantly to the economy of the country. The Government of Georgia has a strong track record of supporting the Company and I believe that this will continue in the coming years.

I look forward to confronting all the challenges of the Company during the following years. Hereby numerous current regional projects promise to enhance rail transportation profile in the medium and long term. The Company aims to develop by improving its efficiency in utilizing its available resources. This would be difficult to achieve without Georgian Railway's competent human capital. I am confident that company's staff is capable to handle every challenge successfully

Supervisory Board Members

Konstantine Guntsadze
Chairman of Supervisory Board | since 2012
Main field of competence | Jurisprudence

Oleg Bichiashvili
Supervisory Board member | since 2012
Main field of competence | Logistics

Guram Gabunia
Supervisory Board member; member of Remuneration and Nomination Committees | since 2012
Main field of competence | Audit/Risk management

Levan Kifiani
Supervisory Board member | since 2016
Main field of competence | Jurisprudence/Management

Clifford Stanley Isaak
Chairman of Audit Committee | since 2011
Main field of competence | Finance

Michael Gogishvili
Deputy Chairman of Supervisory Board; member of Audit Committee | since 2010
Main field of competence | Jurisprudence

Levan Surguladze
Chairman of Remuneration and Nomination Committees; member of Audit Committee | since 2011
Main field of competence | Finance

Management Board Members

David Peradze
Chief Executive Officer | since 2017

Irakli Titvinidze
Chief Financial Officer | since 2013

Guram Guramishvili
Freight SBU Director | since 2017

Eldar Pertsuliani
Passenger SBU Director | since 2017

Vasil Khorava
Infrastructure SBU Director | since 2015

Forward-looking Statements

This report contains certain forward-looking statements with respect to the business, financial conditions and results of the operations of the Group and certain plans, intentions, expectations, assumptions, goals and beliefs of the Group in this regard. These statements include matters that are not factual and generally, but not always, may be identified by the use of words or expressions such as "believes", "expects", "are expected to", "anticipates", "intends", "estimates", "should", "will", "will continue", "may", "is likely to", or "plans" among others.

The forward-looking statements in this report are based upon various assumptions, many of which are based upon further assumptions, including, without limitation, the Management's examination of historical operating trends, data contained in the Group's records and other data available from third parties. Although the Group believes that these assumptions were reasonable when made, they are subject to significant uncertainties and contingencies, which are difficult or impossible to predict and which are beyond the Group's control. Accordingly, the Group may not actually achieve such expectations, beliefs or projections.

When reading forward-looking statements, the reader should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which the Group operates. Such forward-looking statements are valid only on the date on which they are made. Neither the Group nor any of its agents, employees or advisers intend, or have any obligation, to supplement, amend, update or revise any of the forward-looking statements given in this report.

The reader should be aware that forward-looking statements are not guarantees of future performance and that the Group's actual business, financial conditions and results of operations and prospects, as well as the development of the industry in which it operates, may differ significantly from what is stated in the forward-looking statements given in this report. In addition, even if the Group's business, financial conditions and results of operations and prospects, as well as the development of the industry in which it operates, *are* consistent with the forward-looking statements given in this report, those results or developments may not necessarily be indicative of results or developments in subsequent periods.

The facts contained in this report refer to the period under review. The Group does not undertake any obligation to update any fact or forward-looking statement to reflect events or circumstances that may occur after the period under review.

Assumptions

EBITDA is calculated by adding back depreciation and amortization as well as impairment loss to the results from operating activities.
Adjusted EBITDA is adjusted for significant non-cash and one-off items.
Financial result variances at constant currency are obtained by translating the comparable period of the current-year results denominated in Georgian Lari at the average foreign exchange rates of the prior period.

Financial and non-Financial Highlights

For the year (in GEL '000)	2017	2016	2015
Revenues	434,534	439,922	574,773
EBITDA	211,851	281,755	322,787
Adjusted EBITDA	181,425	195,149	307,828
EBIT	102,148	175,488	218,371
Net loss/income	-354,100	65,126	-65,497
Cash provided by operating activities	176,232	187,411	299,496
Acquisition of Property, plant and equipment (PPE)	165,265	200,274	156,993

At year end (in GEL '000)			
Total assets	2,862,237	3,225,683	3,093,917
Total liabilities	1,617,389	1,626,407	1,622,707
Total equity	1,244,848	1,599,276	1,471,210

Financial ratios			
Revenue growth	-1.22%	-23.46%	12.35%
EBITDA margin	48.75%	64.05%	56.16%
Adjusted EBITDA margin	41.75%	44.36%	53.56%
Operating ratio	85.46%	82.71%	67.36%
Dividend payout ratio	0%	0%	0%
Interest coverage ratio	0.99	1.91	2.55
Net debt/EBITDA	4.87	3.48	2.79
Debt/Equity	1.30	1.02	1.10

Statistical data (in ‘000)			
Tons	10,673	11,882	14,143
Ton-km	2,929,793	3,390,880	4,222,061
Number of passengers	2,684	2,463	2,397
Passenger-km	596,727	508,586	467,178
Average number of employees	13	13	13

Key operating measures			
Total freight revenue per ton-km (in Tetri)	13.2	11.7	12.5
Passenger revenue per passenger-km (in Tetri)	3.8	3.5	3.3
Revenue per average number of employees (in GEL '000)	33.91	33.98	44.37
Operating expenses per ton-km (in GEL)	0.13	0.11	0.09
Ton-km per average number of Freight SBU employees in '000	524.44	606.92	758.82
Passenger -km per average number of Passenger SBU employees in '000	461.15	366.42	322.41

Safety indicators			
Accident rate per million ton-km	0.04	0.02	0.02
Injury per '000 number of average employees	0.00	5.72	5.87
Death per '000 number of average employees	0.00	0.54	0.39

Credit Ratings by the End of 2017

	First issued	LT	Outlook	ST	Last issued	LT	Outlook	ST
Standard & Poor's	2010	B+	Stable	B	2017	B+	Negative	B
Fitch Ratings	2010	B+	Stable	B	2017	B+	Stable	B

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Overview of the Group

1. Description of the Company's Business

1.1 History of the Company

2016, 2017 – At the end of 2016 and at the beginning of 2017, the Company purchased four new modern passenger trains from Stadler Bussnang

2016 – ISO 9001:2015 certificate given to Passenger Transportation SBU

2015 – Georgian Railway attains international certificate of quality management (ISO 9001:2008)

2015 – Revival of Silk Road and first Chinese train in Georgia

2013 – Georgian Railway enters freight forwarding business

2011 – Georgian Railway registered as JSC

2010 – First Eurobond placement on London Stock Exchange

2010 – Initial credit rating assignment from Fitch ratings

2008 – Georgian Railway separates its operations into three SBUs

2005 – Georgian Railway launches restructuring program based on the proposals of an independent consultant

1998 – The Company is established as a limited liability company on 21 December

1993 –TRACECA established, with Georgian Railway a founding member

1992 –Georgian Railway independently formed

1991 – The assets of the Transcaucasian Railway Company are divided and allocated to the national railroad companies of Georgia, Armenia and Azerbaijan

1883 – A connection is made between Tbilisi and Baku

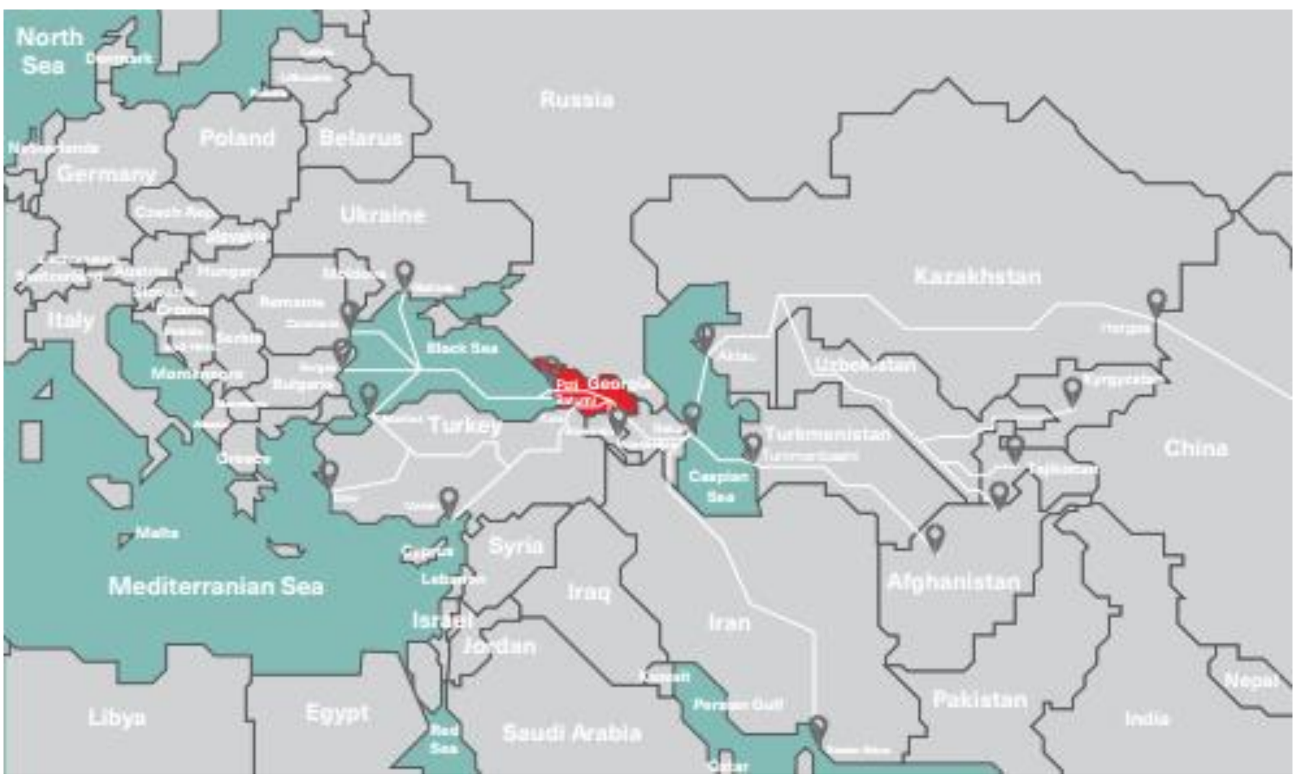
1872 – The Transcaucasian Railway, which ran through Georgia, Armenia and Azerbaijan, commenced operations

1.2 Business Profile

JSC Georgian Railway (hereafter referred to as "GR" or "the Company" and as "the Group" with its subsidiaries) is Georgia's only railway operator. It principally provides freight services, transshipping a variety of cargo and mainly connecting the Caspian Sea and Central Asia to the Black Sea. GR also provides passenger services. It has a vertically integrated business model, and owns and operates the tracks, stations, terminals, other infrastructure and rolling stock that comprise the entire national railway system. Since 2013, GR has also become engaged in the business of freight forwarding through its subsidiaries. GR's mainline rail network, together with that of CJSC Azerbaijan Railways, forms the Caucasus railway corridor, a key segment of the TRACECA.

GR's mainline rail network is thus a key link in the shortest route from the Caspian Sea region and Central Asia to the Black Sea and the Mediterranean Basin. Thus, GR's Management believes that it is uniquely positioned to capitalize on trade between Europe, the Caspian Sea region and Central Asia. Currently, GR's network has access to three Georgian ports, namely Batumi, Kulevi and Poti all of which are located on the Black Sea. Access to these ports enables easy shipment of transit cargo to the Mediterranean Basin and Europe.

The map below shows the key transportation links in the Eurasian region:



Credit ratings - GR is rated by two rating agencies: Fitch Ratings and Standard & Poor's (S&P). In January 2017, Fitch Ratings downgraded Georgian Railway to 'B+' from 'BB-' and assigned it a Stable Outlook. In November 2017, Fitch Ratings affirmed the Group's rating at 'B+' with Stable Outlook. In September 2017, S&P Global Ratings revised its outlook for GR to 'negative' from 'stable.'

Shareholder(s) - Up until 30 September 2011, GR was wholly owned by the Government of Georgia represented by the State Enterprise Management Agency of the Ministry of Economy and

Sustainable Development. Today, the JSC Partnership Fund, a wholly state-owned investment fund, is the sole shareholder of the Company.

1.3 Corporate Governance

GR is not subject to the requirements of national corporate governance rules, as Georgia has not adopted a code of corporate governance. However, the Company has adopted certain corporate governance structures and procedures, including the appointment of independent directors to its Supervisory Board.

GR's governance bodies are: the General Meeting of Shareholders; Supervisory Board; and Board of Directors (Management Board). Information about the composition of the Supervisory Board and the Board of Directors is presented in the table below:

	Supervisory Board and Committee				Board of Directors				
31-Dec-17	Supervisory Board	Audit Committee	Nomination Committee	Remuneration Committee	CEO	CFO	Freight SBU director	Passenger SBU director	Infrastructure SBU director
Konstantine Guntsadze	●								
Michael Gogishvili	●	●	●						
Levan Surguladze	●	●		●					
Clifford Stanley Isaak	●	●							
Levan Kifiani	●								
Oleg Bichiashvili	●								
Guram Gabunia	●		●	●					
David Peradze					●				
Irakli Titvinidze						●			
Eldar Pertsuliani							●		
Guram Guramishvili								●	
Vasil Khorava									●

In November 2017, new CEO, Mr. David Peradze, was appointed by the Supervisory Board, while his predecessor, Mr. Mamuka Bakhtadze was appointed as the new Minister of Finance of Georgia. Before joining GR, Mr. Peradze held the position of the Director of Mtkvari HPP Ltd at Georgian Co-Investment Fund. Before this, in 2004-2007, Mr. Peradze worked in various positions at JSC Georgian Railway.

Shareholders

The JSC Partnership Fund is the only shareholder of GR. The Shareholder elect the external auditor, approve the appointment and dismissal of members of the Board of Directors, and make decisions on the establishment and liquidation of subsidiaries of GR and on any merger, reorganization or liquidation of the Company.

A general meeting of shareholders is called at least once a year by the Supervisory Board within two months of the publication of the Group's audited financial statements.

Supervisory Board

The Supervisory Board of GR is appointed at a general meeting of shareholders, currently consisting of seven members, two of whom are independent non-executive directors. Any member of the Supervisory Board may be a member of the Board of Directors at the same time. However, members of the Board of Directors should not make up the majority of the Supervisory Board. Meetings of the Supervisory Board are held at least quarterly.

The Supervisory Board oversees the activities of the Board of Directors, appoints and dismisses the general director and other directors by agreement with the general meeting of shareholders, approves and makes changes to the Company's policy and any other regulative documents, with the help of invited experts or separate members who personally inspect the accounts and properties. It also grants approval for starting new business directions and terminating ongoing activities, determines the general principles of the business policy and strategy of the Company, gives consent to long-term liabilities and determines the salary and/or additional benefits of the Company's Management.

The Supervisory Board established a Nomination Committee and a Remuneration Committee in 2011 and an Audit Committee in 2010, all of which are advisory bodies.

As at 31 December 2017, the Nomination and Remuneration Committees each comprised two members and the Audit Committee comprised three members from the Supervisory Board. Committee members are selected by the Supervisory Board on the basis of a recommendation of the Nomination Committee and must include at least one independent member.

The Audit Committee conducts the following tasks: reviews, monitors and presents financial statements and other public announcements of the Company concerning its financial position, as well as the Groups's financial processes, to the Supervisory Board; reviews material transactions and contracts entered into between or within the Company, or any subsidiary of the Company, and related parties; conducts certain review functions following the completion of the annual audit; reviews and monitors the Company's risk management and internal control processes, policies and procedures; and selects, monitors and works with the Company's external auditors.

The Nomination Committee conducts the following tasks: reviews the structure and performance of the Supervisory Board and Board of Directors; recommends appropriate candidates for ongoing vacancies to the Supervisory Board and Board of Directors; makes recommendations to the Supervisory Board for appointments or reappointments of independent members of the Supervisory Board; makes recommendations to the Supervisory Board for retiring members of the Supervisory Board to be proposed for re-election at a general meeting of shareholders; and recommends candidates to the Audit and Remuneration Committees to the Supervisory Board, in consultation with the chairmen of such committees.

The Remuneration Committee conducts the following tasks: reviews, considers and agrees proposals and provides recommendations about the Company's framework and policy regarding the remuneration of certain members of the Supervisory Board, Board of Directors and other senior management; approves the terms of any service agreement with any member of the Supervisory Board or Board of Directors, as well as certain terms of employment and employment contracts; prepares remuneration reports; and conducts certain functions in relation to any schemes of performance-related remuneration, share incentive plans, pensions, bonuses and other incentive schemes.

Board of Directors

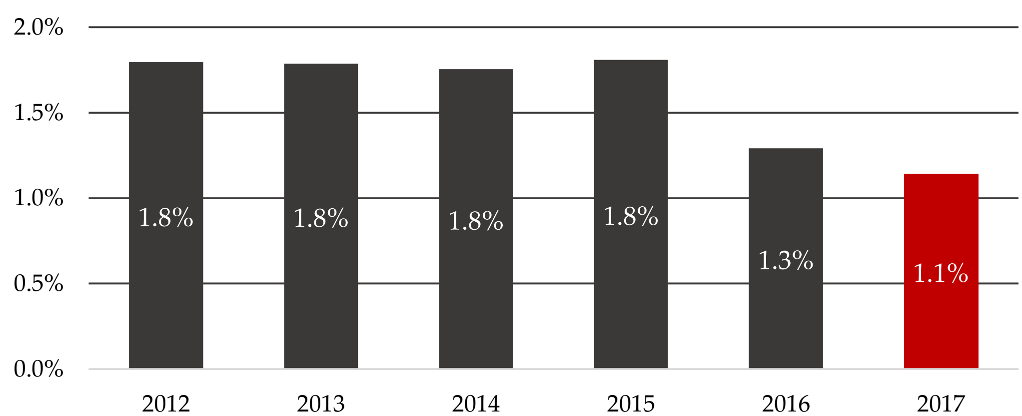
GR's Board of Directors consists of five members: CEO; CFO; Freight Transportation SBU Director; Passenger Transportation SBU Director; and Infrastructure SBU Director. The CEO is authorized to supervise the execution of the decisions of the Board of Directors, Supervisory Board and shareholders, as well as to distribute functions among the members of the Board of Directors and other managers of the Company, for the purpose of issuing orders, instructions and other directions.

The Board of Directors of the Company conducts the following tasks: executes the ongoing activities of the Company; supervises the operations of the subsidiaries of the Company and the performance of the duties assigned to their management; ensures the execution of the decisions of the meeting of shareholders and the Supervisory Board; defines the Company's policy, internal regulations and any other regulative documents that shall be approved by the Supervisory Board and ensures their implementation; and makes decisions on any other issue(s) that can be assigned to the Board of Directors by the Supervisory Board and/or the general meeting of shareholders.

1.4 Government Support

The Group is of significant importance to the country, and its revenue represented about 1.1 percent of the country's total GDP* in 2017. The Group is one of the biggest taxpayers and largest corporate employers in the country. It is also considered to be a strategic partner in national and economic development as it facilitates development in other industrial sectors (locomotive construction, railcar repair, concrete sleeper production, etc.) and plays a critical role in maintaining strong economic relations between Georgia and its partner countries such as Azerbaijan, Armenia, Kazakhstan, Tajikistan, Turkey and Turkmenistan.

The Group's Revenue as a Percentage of Georgia's GDP



**Source: National Statistics Office of Georgia - www.geostat.ge*

Clearly, the Government of Georgia has a significant interest in the favorable and sustainable performance of the Group in order to ensure the sustainable development of the country's economy.

Prominent examples of the Government's support for the Group are as follows:

- The Government provided approximately 182 hectares of land for the Tbilisi Bypass Project in 2010 and 2011, with a value of approximately GEL 33 million, to GR. This land comprised approximately 40 percent of the land required to support the bypass railroad and related assets. Contributions of land and other related assets for GR's projects (mostly for the Modernization Project and Tbilisi Bypass Project) took place from 2012 to 2016 as well, amounting to around GEL 10 million. In the period of 2012-2016, other contributions were also made to share capital. The most significant contribution was in 2012 which mostly comprised infrastructural assets of the access line to Kolkheti Partotskali such as railroads, transmission lines and substations;
- Linear infrastructure such as railroads and transmission lines have been made exempt from property tax in Georgia;
- Payment of Dividends - the Group holds Eurobonds, which imposes restrictions on dividend payments. The covenants of bonds include a constraint according to which, since 2013, cumulated dividend payments must be no more than 50 percent of the cumulated consolidated net income of the Group; and
- In 2015 and 2016, the building of a new passenger station in Batumi was financed by shareholders' dividends.

1.5 Railway Property

The Group owns different types of real estate, machinery, rolling stock and other assets. The net book value of its property, plant and equipment as at 31 December 2017 was GEL 2.4 billion. It owns and operates the following assets:

- Rail network;
- Railcars;
- Containers;
- Locomotives;
- Electric Multiple Units (EMUs);
- Stations;
- Administrative Buildings;
- Land; and
- Tunnels, Bridges and other Infrastructural Assets.

Some of the infrastructure, such as interlocking systems and power substations, and some related assets owned and operated by the Group, such as rolling stock, are relatively old. Although the condition of this infrastructure is sufficient for carrying out the Group's current and planned railway operations without significant disruption, the Group continues to carry out significant maintenance and improvement works on much of its infrastructure. The Group has already made, and intends to continue making, substantial investments to modernize its infrastructure, including the Railway Modernization Project.

Rail network

General description

GR's rail network, together with CJSC Azerbaijan Railways, forms the Caucasus corridor, a key segment of the TRACECA. The Company's rail network is part of the shortest route from the Caspian Sea region and Central Asia to the Black Sea and the Mediterranean Basin.

GR owns and operates a 1,443 km railway network, 295 km of which is double-track line. The Company's network is almost totally electrified.

GR's network is connected to Azerbaijani and Armenian railways.

On 30 October 2017, the Baku-Tbilisi-Kars (BTK) railway line became operational. The BTK rail link directly connects Azerbaijan, Georgia and Turkey.

The Company also has a line connecting with Russia through Abkhazia, which is currently not operational.

Capacity

The infrastructure capacity varies across different lines of the Company. The main bottleneck of the infrastructure is a mountainous region located in the center of Georgia, referred to as the gorge section. Most of the Group's freight is transported through this region, as the gorge section is part of the main line of the network. Currently, the estimated annual capacity of the gorge section is 27 million tons of cargo. The ongoing works on the Modernization Project are designed to increase the possible throughput capacity of the rail line to 48 million tons annually, with potential to increase capacity to 100 million tons.

An increase in the capacity of the rail lines would contribute to an increase in the capacity of the entire TRACECA, along with other planned or implemented projects such as the development of a deep-sea port on the Black Sea shore, the modernization of the Azerbaijani railway network and the development of ports on the Caspian Sea in Kazakhstan.

Rolling Stock

General description

As at 31 December 2017, the Group had 5,363 active freight railcars and 41 active passenger wagons. In addition, in 2014 the Group purchased 480 containers to facilitate container transportation within the corridor.

	31-Dec-17	31-Dec-16	31-Dec-15
Active freight railcars	5,363	6,172	7,493

Capacity

The main component determining the capacity of the rolling stock is the number of railcars available for transportation. Currently, the Group can use railcars from three different sources: the Group's own railcars; railcars owned by other railways; and the railcars of private companies.

Share of cargoes transported by railcar owners

For the year ended 31 December

	2017	2016	2015	2014	2013
Group's own railcars	48%	52%	50%	58%	53%

Railcars owned by other railways	18%	21%	17%	17%	26%
Railcars of private companies	34%	27%	33%	25%	21%

The information presented above helps to illustrate the Group's dependence on its own wagons. Just under half of the Group's total freight transportation in 2017 was performed by its own railcars.

Locomotives and EMUs

As at 31 December 2017, the Group owned 25 units of EMUs, and 180 active locomotives of which 115 were electric and 65 were diesel locomotives. Diesel locomotives are mainly used for shunting operations at stations, while electric locomotives are used to move railcars along the electrified railway network.

Stations and administrative buildings

As at 31 December 2017, the Group owned and operated 92 freight stations within Georgia, while according to the decision of the Management, ten freight stations have been closed since 2016, with the labor force from these stations reassigned to other stations to increase effectiveness. As at 31 December 2017, the Group also owned and operated 51 passenger stations. The Group's headquarter building is located in the center of Tbilisi.

Land

The Group owns land, with a total book value of GEL 538.7 million. After starting the Tbilisi Bypass Project and the Modernization Project the Group has been purchasing additional land for the projects. In 2017, under the Tbilisi Bypass Project Memorandum, the Group transferred a portion of its land, 44,672 square meters of land plots in total, to the Government *(See subheading 5.2 Income from transferred property)*.

Tunnels and bridges

The Group's infrastructure assets comprise 32 railroad tunnels and 1,325 railroad bridges. It also owns signal equipment and other assets related to ensuring the safety of operations.

1.6 Self-insurance

The Group does not have any insurance for its infrastructure assets, business interruption or third-party liability for property or environmental damage arising from accidents on the Group's property or relating to the Group's operations. To some extent, insurance may be available for the Group. However, the Group considers such insurance to be prohibitively expensive. Statistically, there have been very few failures or accidents on the railways in recent years. Therefore, the Group believes it would not be cost-effective to purchase insurance services for its infrastructure assets. Nonetheless, the Group periodically analyzes insurance markets and potential risks, and might consider taking up insurance coverage based on a cost-benefit analysis.

The table below shows the record of failures on its rail lines for 2013-2017 *(see subheading 1.7 Safety)*:

Failures

	2017	2016	2015	2014	2013
Number of failures (1)	0	0	0	1	0
Loss from failures in GEL '000	0	0	0	220	0
Number of accidents (2)	0	0	0	0	1
Loss from accidents in GEL '000	0	0	0	0	684
Number of special defects (3)	0	0	0	0	2
Loss from special defects in GEL '000	0	0	0	0	165

(1) Collisions of passenger or freight trains with other trains or rolling stock or their derailment on railroad or at stations resulting in the death of, or serious injury to, two or more persons or resulting in damage to locomotive and wagons that caused their exclusion from the inventory park.

(2) Collisions of passenger or freight trains with other trains or rolling stock, their derailment on railroad or at stations as well as collision or derailment of rolling stock during the maneuvers or other movements on the Group's own rail lines which resulted in the death of, or serious injury to, no more than one person or resulted in damage to locomotive and wagons that made critical repairs necessary.

(3) Collisions of passenger or freight trains with other trains or rolling stock, their derailment on railroad or at stations as well as collision or derailment of rolling stock during the maneuvers or other movements on the Group's own rail lines, which did not result in death, serious injury or total loss greater than GEL 100,000. Special defects also include: receiving/admission of the train on a busy line; receiving/admission of the train on an unplanned route; and cargo collapse in the course.

1.7 Safety

Accidents

	2017	2016	2015	2014	2013
Number of employees injured due to accidents	0	74	76	82	84
Compensation paid for injured employees in GEL '000	0	558	546	784	376
Number of employees killed due to accidents	0	7	5	6	9
Compensation paid for killed employees in GEL '000	0	117	130	80	58

Train Crashes

	2017	2016	2015	2014	2013
Human	20	32	22	22	24
Automobile	3	12	16	9	16
Animal	105	25	37	26	33
Total	**128**	**69**	**75**	**57**	**73**

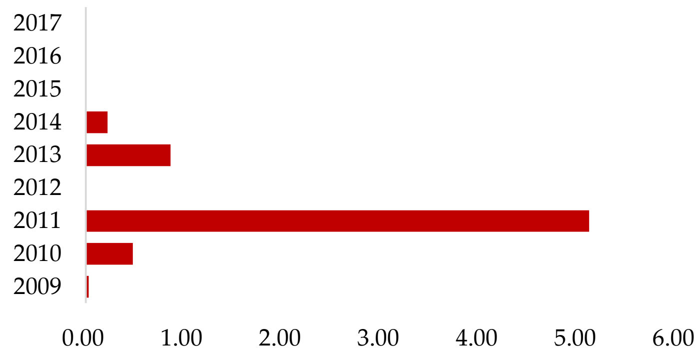
One of the principal priorities of the Company's Infrastructure SBU is safety. Of the many benefits of the Modernization Project, one of its key objectives is to improve GR's operational and social safety. In 2017, special training was held, introducing new methods of increasing safety standards to the contractor. During the period under review, the Company did not incur any significant loss from derailment.

In terms of traffic safety, GR is planning or carrying out the following activities:

- Monthly, quarterly and annual as well as seasonal (spring, autumn) checks according to the plan;
- Random checks; and

- Testing the knowledge level of employees involved in the movement of trains.

Loss from derailment in GEL million



In 2017, the Company purchased two new passenger trains, which are in full compliance with European safety standards.

The employee injury rate in 2017 was reduced to 0 percent from 0.57 percent in 2016 and there was no record of any employee deaths from accidents. GR provides compensation for losses suffered due to accidents, to the affected employees and/or their families.

1.8 Environmental and Social Focus

Environmental focus

Most of GR's network is electrified, making it one of the most energy-efficient and environmentally friendly means of transportation available in Georgia. A filtration system is installed on the railway's facilities in order to reduce the impact of emissions.

The Group is subject to various environmental protection laws and regulations. According to the applicable laws, the construction of railway facilities, as well as the development of railway station infrastructure, is subject to mandatory ecological expertise. Pursuant to the applicable Georgian environmental laws and regulations, the Group is required to remediate any environmental damage caused by its operations through clean-up and rehabilitation works (such as repairing damaged assets or objects). In 2017, GR implemented new document concerning the management of waste accumulated during the operational process.

As of 31 December 2017, the Group has not been the subject of any material claims regarding environmental pollution. In June 2015, changes were made to Georgia's environmental laws and regulations (Environmental Impact Permit) according to which the Group had to conduct an environmental audit of the railway throughout the country by June 2017. The audit was carried out in 2017 and GR developed an ecologic audit document. A report on the environmental impact of the Group's two main projects (Modernization and Tbilisi Bypass) has already been prepared. GR was not penalized for any environmental impact of the (Railway) Modernization Project.in 2017

Social focus

GR, as an indirectly government-owned company, takes into account social interests. One of GR's objectives is to provide accessible and comfortable travel for people. With this in mind, in recent years the Group has provided capital repairs for locomotives and railcars, has purchased new passenger trains (in 2016, two double-decker EMUs were purchased from the Swiss company Stadler Bussnang AG and two more trains were purchased in 2017, which have been completely adjusted to accommodate the needs of physically disabled people) and has invested in the reconstruction of stations, bridges and administrative buildings.

The fares for passenger transportation nevertheless remain low compared to other transport alternatives, especially in the more sparsely populated regions, where the average income of the population is below the national average. Essentially, GR keeps transportation fares relatively low for the benefit of the country's regional development and social interests. Train schedules are adjusted to meet customers' needs, and trains are added when demand is at its highest, for example during the summer time. In 2017, GR took responsibility for the construction of a new passenger railway station near Kutaisi International Airport in order to offer more comfortable travel to people traveling from and to the airport.

1.9 Economic and Political Conditions

GR's railway network is a key segment of the TRACECA, the shortest route from the Caspian Sea and Central Asia to the Black Sea and the Mediterranean Basin. A significant portion of the Group's freight operations (in 2017 about 81 percent of its total transportation revenue) was generated from freight transported from, or directed to, CIS countries. As a result, the Group's freight transportation volumes are sensitive to economic activity in the CIS countries and the Group's financial conditions and operational results are significantly influenced by the overall economic and political conditions affecting Georgia and other countries in the Eurasian region.

Economic growth has been a challenged in recent years for many CIS countries. Low oil prices, a spillover from Russia's recession (the largest economy among CIS countries), reduced import demand from Russia and a number of geopolitical developments/conflicts (e.g., International sanctions on Russia, conflict in eastern Ukraine and the hostile relationship between Azerbaijan and Armenia) have contributed to slower growth in CIS countries. Concerns have also been raised by the depreciation of the Russian Ruble and currencies of other CIS countries in recent years.

In order to reduce its dependence on CIS countries and seize new opportunities, the Group is trying to reach out to new markets. After completing the BTK project and with the subsequent new route from China to Europe, through Georgia and Turkey, GR aims to capitalize on increased trade volumes. About 16% of China's total trade in 2017 was with the European Union. China is also one of the biggest trading partners of Turkey. Indeed, about 12% of Turkish imports were from China in 2017. Moreover, after the lifting of sanctions, Iran will resume international trade and the Group seeks to grasp the opportunity to serve as a transit route for trade between Iran and Europe. The Group also targets the development of a trade route through Iran to India *(See subheading 3.2 China and 3.3 South-West Route)*.

1.10 Competition

GR's Freight Transportation SBU faces competition from alternative providers of transportation. Its Passenger Transportation SBU competes with other forms of transport, such as buses, mini-buses, passenger automobiles and airplanes.

To reduce the risk from competition, the Group is trying to diversify the markets in which it operates, as well as the kinds of goods it transports. In 2017, about 41 percent of total goods transported by the Group were liquid goods and the remainder were dry goods. To reduce risks and increase capacity, in 2010 the Group started the Modernization Project. The project is expected to be completed by the end of 2019 and will increase the capacity of the main transportation line from a current annual capacity of 27 mln tons to 48 mln tons, with further potential to expand to 100 mln tons. In order to increase competitiveness and thus provide a better service to customers, GR entered the freight forwarding business in April 2013.

Competition from oil pipelines

General description

In crude oil transportation, the Group faces direct competition from the following oil pipelines:

- The Caspian Pipeline Consortium (CPC pipeline), which transports crude oil from Tengiz oil field, Kazakhstan (on the coast of the Caspian Sea) to Novorossiysk, Russia (on the coast of the Black Sea);
- The Baku-Tbilisi-Ceyhan (BTC pipeline), which transports crude oil from Baku, Azerbaijan (on the coast of the Caspian Sea) to Ceyhan, Turkey (on the coast of the Mediterranean Sea);
- The Baku-Novorossiysk pipeline, which transports crude oil from Baku, Azerbaijan (on the coast of the Caspian Sea) to Novorossiysk, Russia (on the coast of the Black Sea);
- The Baku-Supsa pipeline - transports crude oil from Baku, Azerbaijan (on the coast of the Caspian Sea) to Supsa, Georgia (on the coast of the Black Sea);

The share of crude oil transported by the Group in terms of total transportation volume dropped to 4 percent in 2017 compared to 32 percent in 2010. The decrease in the Group's liquid cargo volumes can be mainly explained by the fact that some crude oil was redirected to the CPC and BTC pipelines, especially after the expansion of the CPC pipeline.

Strengths

<u>Low cost for large volumes</u> - pipelines often have lower transport and operational costs, particularly for large oil producers that participate in their construction, and are more cost-efficient than rail when transporting large volumes of crude oil.

Weaknesses

<u>Changing the quality of crude oil</u> - pipelines generally do not carry all grades of crude oil as different grades of oil are mixed in the pipeline, and this affects the quality. Therefore, pipelines are best suited for average-grade oil, while for high-quality and low-quality crude oil, pipelines may not be the best mode of transportation.

<u>No pipelines for oil products</u> - it should be mentioned that pipelines are only competing with railways in crude oil transportation, while refined oil products are not subject to competition from pipelines.

Competitive developments

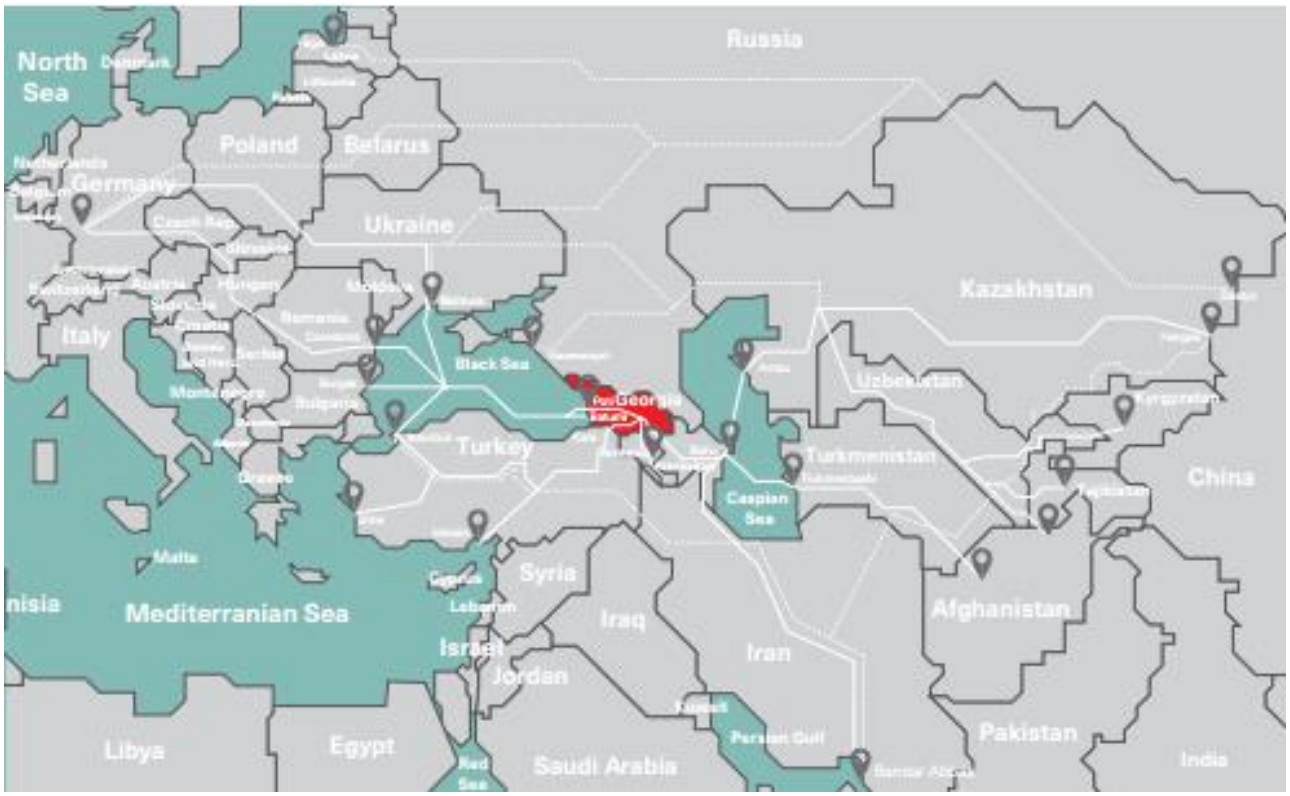
Although oil pipelines are competitors in crude oil transportation in CIS countries, they mostly transport oil in high volumes, which can exclude small players. They have limited access to pipelines, as they may experience difficulties in meeting the minimum quotas required to use the pipelines or the pipelines might be inefficient for small volume transportation. This, therefore, opens up a niche for the railway business in crude oil transportation.

Competition from alternative rail transit routes

General description

There are railway routes, which provide alternatives to the Group's rail network. In particular, these routes include:

- The Russian routes going from Central Asia through Russia to the Baltic Sea and Black Sea basins; and
- The Central Asian route through Iran.



Russian routes

Strengths

<u>Capacity</u> – the rail lines and ports on these routes have a higher capacity for transportation than the Georgian route.

<u>Unimodal transportation</u> - routes in Russia offer unimodal transportation, while cargo transported from Central Asia via Georgia has to use several transport modes to reach its destination.

Weaknesses

<u>Reliability</u> - the Russian rail route has a competitive disadvantage compared to GR as Novorossiysk port is typically frozen in winter and operations are frequently delayed.

Longer distance - Russian routes are significantly longer than the Georgian route, which increases costs, risks and transportation time.

Competitive developments

The implementation of the Modernization Project should increase the Group's capacity and its competitiveness against Russian routes. The Modernization Project should also increase transportation speed, safety and service quality, which will give the Group an opportunity to attract new customers. The new deep-sea port in Anaklia will also play an important role in strengthening the Georgian route's competitiveness.

Iranian route

Strengths

Good location for certain cargo - the Iranian route is located in a strategically strong position to compete for certain cargoes, which flow from China and Central Asia to Turkey and other destinations.

Weaknesses

Political tensions - the railway route running through Iran is less attractive than the Georgian route due to the tense political relations between Iran and the West.

Longer distance - the Iranian route is significantly longer than the Georgian route, which increases costs, risks and transportation time.

Competitive developments

After the lifting of international sanctions on Iran, the country's high potential in trade is expected to be fulfilled in terms of both liquid and dry cargo. The lifting of sanctions is anticipated to unlock potential in terms of transporting goods between Iran and Europe through Armenia, Azerbaijan and subsequently Georgia, thereby opening a completely new South-North corridor.

Competition from road transportation

General description

There is competition from roads within Georgia for the transportation of containerized goods.

Strengths

Cheaper short-distance transportation - in Georgia, which is a relatively small country, short-distance transportation by road is cheaper, especially for containerized cargo. Competition strengthens when international prices on oil products are low, especially considering the low excise on oil products and low taxes on road transport in Georgia.

Flexibility - door-to-door transportation is an inherent advantage of road transportation.

Weaknesses

Safety concerns - railway transportation is considered safer and more environmentally friendly than road transportation.

Expensive bulk transportation - in cases of bulk transportation, railway is considered cheaper than road.

Competitive developments

In order to compete with road transportation, GR has established a subsidiary, GR Logistics and Terminals LLC, to foster the containerization of regional freight. In 2014, the Group also purchased a container fleet, which is another important step towards increasing the overall competitiveness of the corridor. The Management believes that containerization can attract new customers and expand the range of transported cargo.

1.11 Risk Factors

Risk	Description	Impact/Sensitivity	Mitigation/Comment
Economic and political conditions *See subheading 1.9 Economic and political conditions*	Influenced by local and CIS countries' economic and political conditions.	Adverse economic developments in CIS countries and in Georgia, as well as political, social and economic instability negatively impacts on the Company's performance.	• Diversify in terms of geographies and markets.
Competition *See subheadings 1.10 Competitors and 2.1 Freight Transportation SBU*	The Group faces competition from alternative rail transit routes, from road transportation, from oil pipelines and from providers of other methods of transportation.	Strong competition from alternative transit routes and other transportation methods may have a material adverse effect on the Group's business, financial condition and results of operations.	• Diversify the type of products transported; • Work out single tariffs with partner railways; and • Better understand customers' needs.
Limited number of customers *See subheading 2.1 Freight Transportation SBU*	The Group earns a significant portion of its revenue from a relatively small pool of large customers.	A number of factors such as pricing and market demand for the Group's services, could cause the loss of customers.	By entering the freight forwarding business, Georgian Railway tries to: • Deepen its understanding of customers' industries; • Deepen its understanding of business processes; and • Have control over the whole chain of services.
Foreign currency exchange risk *See subheadings 6.4 Non-current liabilities and 5.5 Finance income and cost*	The Group's functional and presentation currency is Georgian Lari. However, most of its revenue is denominated in foreign currency.	Variations in exchange rates can affect the Group's results of operations.	• Take measures to naturally hedge currency exchange risk.

Strikes, lockouts and labor legislation	As at December 2017, about 60 percent of the Group's employees were members of trade unions.	There is some risk that in the future the Group's business will be subject to interruptions caused by strikes or lockouts.	• Try to make work rewarding and improve working environment.

Risk	Description	Impact/Sensitivity	Mitigation/Comment
Qualified personnel *See heading 4 Employees*	Hiring and retention of qualified and key personnel.	The Group would not be able to move forward and could not have become what it is today without both high levels of expertise to make long-term plans, and commitment of its personnel.	• Promote business education: • Make work challenging and rewarding; • Make efforts to improve conditions of work; and • Offer social benefits.
Aging of infrastructure, rolling stock and related assets *See subheadings 1.5 Railway property, 2.2 Passenger Transportation SBU, subheading 2.3 Infrastructure SBU*	The Group's infrastructure and its related assets are aging and may need to be replaced in the future.	Accidents related to the poor condition of the rail infrastructure and its related assets or any failure of the infrastructure to operate properly, could result in interruptions in the Group's business, increase its operating expenses or requiring significant CAPEX.	• Continue to carry out extensive renewal and improvement of rail network, rolling stock and related assets;
Self-insurance *See subheading 1.6 Self-insurance*	The Group does not have full insurance coverage for its property, business interruption or third-party liability.	Until the Group obtains adequate insurance coverage, failures in operational processes or destruction of its property could have a material adverse effect on the Group's operations and financial position.	• Keep operational procedures in place and controls them to minimize the risk; and • Periodically analyzes insurance markets and potential risks.
Laws and regulations	The Group is subject to various environmental protection and health and safety laws.	Failure to comply with environmental and health and safety requirements could cause the Group administrative sanctions, penalty fees and civil liabilities. The uncertainties	• Employ qualified personnel; and • Provide trainings when there are changes in legislation.

Strategy of the Group

Strategy for Sustainable Future

2. Focus on Core Business Activities

GR operates its national railway system through its subsidiaries and three strategic business units: Freight Transportation SBU; Passenger Transportation SBU; and Infrastructure SBU. The following chart presents GR's SBUs and subsidiaries:

JSC Georgian Railway				
Freight Transportation SBU	Passenger Transportation SBU	Infrastructure SBU	Freight Forwarding & Handling Subsidiaries	Property Management Subsidiary

2.1 Freight Transportation SBU

The Group's Freight Transportation SBU generates revenue from three main sources: freight transportation; freight handling; and freight car rental.

Freight transportation services encompass the transportation of cargo along GR's railway network within Georgia. Freight handling services, including railcar marshaling and the delivery of freight to and from customer facilities are provided at the stations that run commercial freight services. Freight car rental revenue is generated by allowing other countries' railways to use GR's railcars for their own transportation.

The Freight Transportation SBU is the principal source of the Group's revenue, accounting for 76 percent of the Group's total revenue in 2017. Freight transportation generated 80 percent of the Freight Transportation SBU's revenue in 2017.

Freight transportation volume

For the year ended 31 December	*Million tons*					*Percent*				
	2017	2016	2015	2014	2013	2017	2016	2015	2014	2013
Liquid cargoes	**4,347**	**5,494**	**6,748**	**7,514**	**9,087**	**40.7%**	**46.2%**	**47.7%**	**45.1%**	**50.0%**
Oil products	3,946	3,686	5,884	5,838	5,131	37.0%	31.0%	41.6%	35.0%	28.2%
Crude oil	401	1,808	864	1,676	3,957	3.8%	15.2%	6.1%	10.1%	21.8%
Dry cargoes	**6,325**	**6,388**	**7,395**	**9,159**	**9,098**	**59.3%**	**53.8%**	**52.3%**	**54.9%**	**50.0%**
Ores	1,424	1,454	1,458	1,820	1,956	13.3%	12.2%	10.3%	10.9%	10.8%
Grain and grain products	302	448	716	861	952	2.8%	3.8%	5.1%	5.2%	5.2%
Ferrous metals and scrap	529	663	892	1,064	931	5.0%	5.6%	6.3%	6.4%	5.1%
Sugar	378	499	464	618	610	3.5%	4.2%	3.3%	3.7%	3.4%
Chemicals and fertilizers	566	429	507	508	481	5.3%	3.6%	3.6%	3.0%	2.6%
Construction freight	1,157	1,065	1,426	1,793	1,410	10.8%	9.0%	10.1%	10.8%	7.8%
Industrial freight	302	271	261	407	546	2.8%	2.3%	1.8%	2.4%	3.0%
Cement	95	62	80	380	637	0.9%	0.5%	0.6%	2.3%	3.5%
Other	1,572	1,496	1,590	1,709	1,574	14.7%	12.6%	11.2%	10.2%	8.7%
Total	**10,673**	**11,882**	**14,143**	**16,673**	**18,185**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

The Freight Transportation SBU transports both liquid and dry cargo. Liquid cargo, which consists of crude oil and oil products, accounted for 41 percent of the Group's total freight transportation volume in 2017.

Freight volumes by transportation mode

For the year ended 31 December	*Million tons*					*Percent*				
	2017	2016	2015	2014	2013	2017	2016	2015	2014	2013
Liquid cargoes	**4.4**	**5.5**	**6.7**	**7.5**	**9.1**	**40.7%**	**46.2%**	**47.7%**	**45.1%**	**50.0%**
Transit	2.8	4.0	5.4	6.3	7.9	26.5%	33.8%	38.0%	37.7%	43.5%
Export	0.1	0.0	0.0	0.0	0.1	0.7%	0.3%	0.2%	0.3%	0.3%
Import	1.2	1.2	1.0	1.0	0.9	11.5%	9.7%	7.3%	5.7%	4.9%
Local	0.2	0.3	0.3	0.2	0.2	2.1%	2.5%	2.2%	1.4%	1.3%
Dry cargoes	**6.3**	**6.4**	**7.4**	**9.2**	**9.1**	**59.3%**	**53.8%**	**52.3%**	**54.9%**	**50.0%**
Transit	2.1	2.2	2.6	3.2	3.3	20.1%	18.3%	18.2%	19.3%	18.0%
Export	1.0	1.0	1.1	1.6	1.7	9.7%	8.8%	7.6%	9.5%	9.2%
Import	1.4	1.5	1.7	2.0	1.9	13.5%	12.6%	11.8%	12.1%	10.2%
Local	1.7	1.7	2.1	2.3	2.3	16.0%	14.2%	14.7%	14.0%	12.6%
Total	**10.7**	**11.9**	**14.1**	**16.7**	**18.2**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Transit shipment represented about 47 percent of the Group's freight transportation volume in 2017.

Customers

The Freight Transportation SBU's primary clients are freight forwarders, which serve different geographical locations and cargo owners. Although there are a limited number of direct clients of the Freight Transportation SBU, each freight forwarder represents a number of indirect clients who are free to switch from one freight forwarder to another, using the same cargo corridor and services provided by the Freight Transportation SBU.

In order to provide a better service to its customers and to increase its competitiveness, GR entered into the freight forwarding business in April 2013. The Group also negotiates with neighboring railways to ensure competitive pricing for the TRACECA.

To better understand customers' needs and business processes the Group entered the freight forwarding business.

The Group provides its customers with flexibility, by not entering into binding long-term contracts.

For liquid cargo, the top five customers accounted for 53 percent of total liquid cargo transported in 2017. In terms of dry cargo, the top five customers accounted for 44 percent of total dry cargo transportation in 2017.

The Freight Transportation SBU does not generally enter into binding long-term contracts with its customers, allowing the Group to maintain operational flexibility and to change its prices in accordance with market conditions. As there is no demand for strict commitments, the Freight Transportation SBU also provides flexibility for its customers.

Tariffs

Independent tariff setting - the Group has a monopoly on rail transportation within Georgia. However, its tariff policy is not subject to government regulation. Currently, the railway business is fully deregulated in Georgia and no changes in this regard are foreseeable. The Group sets its tariff policy independently for all services, including tariffs for freight transportation and related services. The Group is able to change its tariffs with one month's prior notice to its customers.

GR has a written tariff policy specifying the methods and formulas for determining the various tariffs for its services, which is published on its website.

Tariff currency – the Group's freight transportation tariffs are set in US Dollars (USD) except container transportation for domestic directions and import/export from/to Azerbaijan which comprised only 0.1 percent of total transportation revenue in 2017 (This tariff policy was implemented in May 2017, and, before that, this type of transportation was also set in USD). Therefore, as its revenue was derived mainly from freight transportation in 2017, the Group received most of its total revenue (about 81 percent) in USD, about 4 percent of total revenue was in Swiss Francs (CHF) and about 15 percent was in GEL. Before 2012, the Group's freight tariffs were quoted in CHF. However, in 2012, before issuing Eurobonds in USD, the Group switched its tariffs from CHF to USD to partially hedge against foreign exchange risk.

Revenue per ton-kilometer

For the year ended 31 December *In Tetri*

	2017	2016	2015	2014	2013
Oil products	8.8	9.8	8.8	7.0	6.6
Crude oil	5.1	4.0	5.9	4.9	4.4
Dry cargo	9.4	9.9	10.4	7.9	7.2

Revenue per ton-kilometer is calculated as freight traffic revenue (not including revenue from logistical services and any handling charges) divided by ton-kilometers. The Group uses a detailed formula for each individual transportation order that takes into consideration factors including the type and weight of freight as well as the direction and the distance over which the cargo is carried.

GR offers a number of discounts, which can be found in the tariff policy section on its website (www.railway.ge).

2.2 Passenger Transportation SBU

Passenger transportation is currently a minor segment of the Group's operations as it only accounted for about 5 percent of the total revenue in 2017. The primary activity of the Passenger Transportation SBU is the transportation of passengers within Georgia and on international routes, connecting Georgia with Azerbaijan and Armenia.

One of the Group's medium-term strategic objectives is to optimize expenses and increase revenue by increasing the number of passengers and revenue per passenger. The Passenger Transportation SBU is expected to receive subsidies (calculated as expenses less revenue plus reasonable profit) from the Government from 2019 according to EU regulation number 1370/2007. The Group is taking the following measures to increase average revenue per passenger:

- Introducing a higher level of service by investing in new railcars, or improving the existing ones in order to provide improved speed and comfort of transportation;
- Adjusting passenger train timetables to optimize utilization;
- Easing the accessibility of tickets via different sales channels; and
- Launching a marketing campaign to attract potential customers.

In 2017

- *Two additional double-decker EMUs were purchased from the Swiss company Stadler Bussnang AG (first two were purchased in 2016).*

By undertaking these measures, the Group aims to attract customers with higher incomes and other passengers who might otherwise have travelled by car.

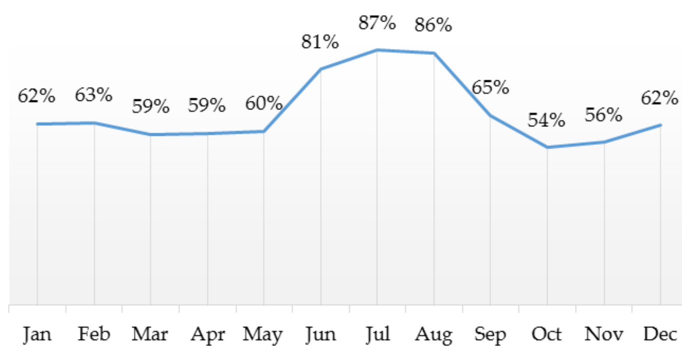
Additionally, regulation EU 1370/2007, effective from 2018, underlines the need for Passenger Transportation SBU subsidies and prohibits cross subsidizing from the Freight Transportation SBU. Accordingly, GR expects to receive government subsidies to support further development of the Passenger Transportation SBU.

Customers

The Passenger Transportation SBU provides domestic and international transportation services.

As GR's rail lines are linked to Azerbaijan and Armenia, international rail transportation is carried out in these directions. After the completion of the BTK project it will be possible to transport passengers to Turkey and onward to Europe.

Passenger occupancy rate on main line in 2017



Domestic transportation is carried out within Georgia and comprises regional and long-distance transportation. Domestic transportation is most active in summer, when the number of passengers traveling to the Black Sea peaks.

Value creation for customers

In July 2016, Georgian Railway purchased two double-decker EMUs from the Swiss company Stadler Bussnang AG. In 2017 the Company purchased two more trains from the same company. These trains are equipped with all necessary modern equipment and security systems, and are in full compliance with European safety standards and have been completely adjusted to the needs of physically disabled persons.

In 2017, GR took responsibility to construct a new passenger rail station near Kutaisi International Airport in order to offer more comfortable travel to people traveling from and to the airport.

The Passenger Transportation SBU adjusts its train schedules to meet customers' needs, so trains are added when the demand is at its highest.

Number of passengers

For the year ended 31 December *Numbers in millions*

	2017	2016	2015	2014	2013
International	0.1	0.1	0.1	0.1	0.1
Domestic	2.6	2.4	2.3	2.6	2.9
Total	**2.7**	**2.5**	**2.4**	**2.7**	**3.0**

In 2017, the Company purchased two more new passenger trains. The increase in passenger transportation (specifically domestic transportation) in 2017 was mainly due to these two new trains being introduced by GR to its customers in 2017.

Tariffs

Similar to the situation for freight transportation tariffs, the Group is not subject to government regulations in setting fares for passenger transportation. In many cases, however, passenger transportation tariffs are not affected by market forces, because having affordable passenger transportation services carries significant social importance.

The Management's intention is that any increases in tariffs are to be made in line with improvements to the Group's services, the provision of new modern trains and inflation. The Group's tariffs are designed to be competitive with those for buses, mini-buses and other passenger transportation services in Georgia.

Passengers can buy tickets directly at stations, or through tourist agencies, pay-boxes and online.

Average revenue per passenger-km

For the year ended 31 December *In Tetri*

	2017	2016	2015	2014	2013
Average revenue per passenger-km	3.8	3.5	3.3	3.3	3.1

Average revenue per passenger-km is calculated as passenger traffic revenue divided by passenger-km.

The increase in average revenue per passenger-km in 2017 was driven by an increased share of number of passengers on the main line in total passengers transported from 45 percent in 2016 to 48 percent in 2017. The increase in average revenue per passenger was also driven by the addition of two new trains in 2017, transporting passengers from Tbilisi to Black Sea destinations. Overall, the increasing trend in average revenue per passenger-km for the period under review can be explained by the increased share of higher priced seats sold, as new trains with improved services were added for long-distance routes. This change is the result of the Group's strategy to focus more on the higher-income segment, purchasing new trains and offering a more comfortable and attractive service.

2.3 Infrastructure SBU

The Infrastructure SBU operates, maintains and manages the Group's principal infrastructure assets, including its track, embankments, signaling, land, electric power lines and other equipment. The Infrastructure SBU is a cost center providing services to the Freight and Passenger Transportation SBUs.

The principal aims of the Infrastructure SBU are to ensure safety, to promote the efficient use of the Group's infrastructure assets and to decrease maintenance costs. The Infrastructure SBU promotes safety by setting speed and loading standards on lines and at stations. It is also in charge of controlling signaling and blocking systems.

GR owns and operates 1,443 km of railway network in total, 295 km of which is double-track line. The Company's rail network is almost fully electrified.

GR's network is connected to Azerbaijani and Armenian railways. In 2017, as the BTK railway line became operational, the Company's rail network is now connected to the Turkish railway as well.

The infrastructure capacity varies across different lines of the Company. Currently, the estimated capacity of the gorge section, which is the main bottleneck on the main line of the network, is 27 million tons of cargo annually.

Projects

Commercial project

The Railway Modernization Project is designed as a profitable project seeking to improve the existing infrastructure, increase safety, reduce operational expenses and significantly increase the throughput capacity from about 27 million tons of cargo per annum to 48 million, with the possibility of further expansion to a potential 100 million tons per annum.

Socio-commercial project

Kutaisi Airport Station Project is planned to serve the passengers traveling from/to Kutaisi International Airport

Railway Modernization Project

The Group launched its Modernization Project in 2010. The aim of the project is to modernize the infrastructure of the Group and to increase the capacity of the main line. The implementation of the project is expected to create the following important benefits for the Group:

- Increase the capacity of the Group's infrastructure;
- Eliminate the need for extensive capital expenditures for the maintenance of existing tracks;
- Increase transportation speed along the line, offering improved services for freight and passenger customers;
- Further increase the safety level of transportation; and
- Reduce operational expenses.

This project can be divided into two main parts. The first part is concentrated on the improvement of the rail lines along the Group's main line, while the second is concerned with debottlenecking the line thereby increasing its capacity.

The main bottleneck is in a mountainous region in the center of Georgia, referred to as the gorge section (40 km long). The topography of the mentioned region complicates rail operations, causing delays, quickening depreciation of the tracks and rolling stock, and increasing the need for additional pulling locomotives. One of the key aims of the project is to decrease the track gradient in the gorge section, which is expected to reduce electricity and fuel expenses. A flatter gradient is expected to reduce wear and tear on wheels and tracks, which would decrease maintenance expenses, decrease the need for extra locomotives in that section and reduce the extra stops needed to cool the brakes on the trains. The project envisages the digging of a direct tunnel in the gorge section, thereby simplifying operations and increasing throughput capacity from 27 million tons of cargo per annum to 48 million tons per annum, with the possibility of further expansion to a potential 100 million per annum with relatively small capital expenditure.

The Modernization Project is financed by the Group's operations and the proceeds from its Eurobond placements in 2010 and 2012. The project is expected to be completed by the end of 2019, for which the total remaining payments to be made stand at approximately GEL 267.3 million.

As at 31 December 2017, about 59% of the total works on the Modernization Project had been completed. During 2017, GEL 91.5 million was spent on the project.

Kutaisi Airport Connection Project

In 2017, GR took responsibility to construct a new passenger rail station near Kutaisi International Airport in order to offer more comfortable travel to people traveling from and to the airport.

The project is considered to be of a socio-commercial nature. It will facilitate travel to/from this airport and is expected to be profitable for the Group because the overall number of passengers is expected to increase after the project's completion.

Tbilisi Bypass Project

The Tbilisi Bypass Project is a municipal project, which started in 2010. The main objective of this project is to relocate the capital city's main railroad to its suburban area.

In June 2013, the Group announced a decision to redesign the Tbilisi Bypass Project. The Group held negotiations with the Government of Georgia and with the main third-party construction companies to agree a plan for the conservation of the project for the period of redesigning. All construction works in progress were substantially completed by the end of October 2013 and further construction was suspended.

In March 2014, the Government of Georgia decided that the suspension of the construction of the Tbilisi Bypass Project would last for 18 months until the final modified project would be presented.

During 2015 and 2016, the Group was in discussions with Tbilisi City Hall and the Government of Georgia about various scenarios for completion of the project. One of the scenarios under discussion included an option envisaging a change to the original bypass location, which would possibly render the existing bypass infrastructure redundant. The alternative scenarios included the determination of the future use of the existing infrastructure, should it become redundant. The options put forward for future use of the infrastructure included a bypass automobile road, light rail/extension of the Tbilisi Metro System, and freight depot. However, as at 31 December 2017, no decision had been made by the Government of Georgia about the redesign of the Tbilisi Bypass Project.

Due to significant uncertainties associated with either the continuation of the existing project or the implementation of any other scenarios envisaging change in the existing use of the project, and also considering the fact that the Management does not expect that the project will generate any future economic benefit to the Group either individually, or in combination with other non-current assets, the carrying value of the project was written-down to its recoverable amount.

As a result of the above an impairment loss of GEL 382,616 thousand was recognized in the Statement of Profit or loss and comprehensive income.

2.4 Subsidiaries

Freight forwarding and terminal operators

In 2009, the Company established GR Logistics and Terminals LLC (formerly Trans Caucasus Terminals LLC) to promote the containerization of the corridor. Its corporate objective is to help strengthen the Group's presence in the container transportation market, primarily by creating the necessary infrastructure, such as container terminals. Recently, GR Logistics and Terminals LLC also became involved in cargo forwarding through the corridor. In 2015, another subsidiary, GR Trans-Shipment LLC, was established, which has terminal operator VIBRO DIAGNOSTIK under its management and which operates oil terminals in Batumi Port.

In recent years, GR has taken important steps to cover logistical services. In 2013, the Company acquired Georgia Transit LLC and established Georgian Transit LLC (later renamed GR Transit LLC) in 2015. These subsidiaries are freight forwarders and serve crude oil and oil products transportation mainly from Azerbaijan, Kazakhstan and Turkmenistan. In 2014, GR established GR Transit Line LLC, another freight forwarder that carries oil products mainly transported in the direction of Azerbaijan and Armenia.

The share of revenue from logistical services in total revenue increased from 12 percent in 2016 to 17 percent in 2017.

Property Management

GR Property Management LLC (formerly Railway Property Management LLC) was established in 2009, and its main objective is to define the best use of railway-related assets such as land, depots and stations, to utilize non-core assets and to ensure the commercialization of these assets.

3. Building a Valuable Supply Chain

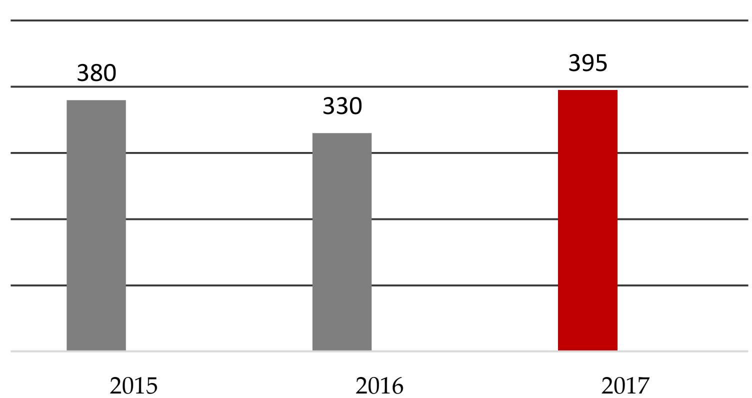
The Group is focused on achieving its key strategic objective, namely building a valuable supply chain, through vertical integration and making suitable connections. The Group forms part of the Caucasus railway corridor, a key segment of the TRACECA. Therefore, the Group's projects are also in line with other planned or implemented projects in Georgia and in the Caspian Sea region, such as the development of a deep-water sea port on the Black Sea shore, the modernization of Azerbaijan's railway network and the development of ports on the Caspian Sea in Kazakhstan. A valuable supply chain cannot be created without other participants' efforts in the corridor.

3.1 Containerization

One of the key strategic objectives of the Group is to achieve greater effectiveness in terms of its costs and core operations, thus the Group is keen to increase containerization rates in the Caucasus railway corridor. Container traffic has significant value for freight operators, as container transportation services are much cheaper than regular wagons.

In 2017, the total Black Sea container market rose by 12.75 percent, compared to 2016. One of the main contributors to this increase was Georgian ports. Loaded container turnover in Georgian ports increased by 17.61 percent. Current levels of containerization are low, so there is a significant room for improvement. Backed by internal estimates, GR's transportation share in containers transported within Georgia in 2017 was about 26 percent.

Total handled containers by sea ports



Share of containerized cargo in total freight volumes transported by the Group

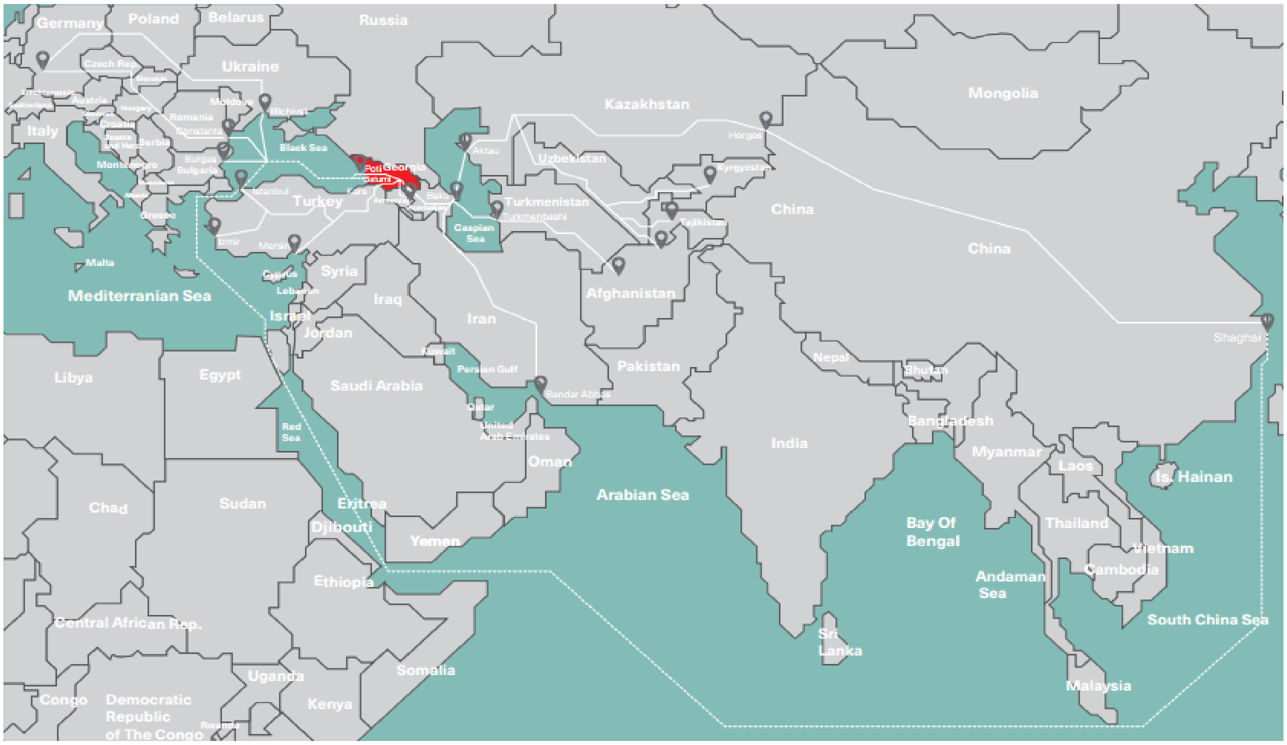
For the year ended 31 December *Percent*

	2017	2016	2015	2014	2013
Share of containerized cargo in total cargo flows	6.7%	5.1%	5.4%	5.2%	4.6%

In order to boost containerization, the Company founded a subsidiary – GR Logistics and Terminals LLC (formerly Transcontainer LLC) - in 2009, the main aim of which was to create and develop the necessary container infrastructure along the Black Sea and Central Asian route. The subsidiary has created container terminals in the port cities on the Black Sea and a container terminal in Tbilisi. In 2014, the Group purchased 480 containers for moving cargo through the Georgian corridor, especially considering that sea carriers' transportation of containers to Central Asia is limited. The Management believes that the availability of sufficient infrastructure would boost containerization rates and potentially bring completely new cargo to the corridor.

3.2 China

A new route from China to Georgia and through Georgia to Turkey, Europe and the countries of the Mediterranean Basin, is under development. This route provides an alternative to the existing sea route and creates the possibility of attracting cargo from new markets.



The new rail route would be more time-efficient than its alternative sea route. Previously, cargo from China was delivered to the Black Sea in 40-45 days, while the new route can transport cargo in only 9-11 days.

Simplifying operations for cargo-owning companies on this route is one of the main priorities of the International Association "Trans-Caspian International Route" (TITR) *(for more details see subheading 3.4 International agreements)*, the efforts of which are believed to increase the competitiveness of the corridor thereby increasing the commercial operations on the route.

In 2015, the first transit train from the Chinese port terminal of Lianyungang arrived in Tbilisi, heralding the official opening of "The Silk Road." In 2017, the number of trains to arrive from China within the mentioned project increased by 125 percent, compared to 2016.

In recent years, China's trade with Turkey and EU countries has increased. Indeed, trade with these countries represented about 16 percent of China's total trade in 2017. This upward trend is expected to continue in the future. Therefore, the Group sees great potential in the development of this route, especially in light of the BTK rail link.

3.3 South-West Route

In 2016, Georgian, Iranian and Azerbaijani railways developed a special tariff policy for goods to be transported from India via Iran, Azerbaijan and Georgia to the Black Sea ports of Georgia, and through which freight would be transported on to Europe. The same tariff policy also extends to cargo being transported from Europe to Iran and back.

Negotiations are underway with large companies interested in freight transportation on this route. In 2017, the Group, together with Azerbaijani railway, successfully negotiated with Iran railway company to simplify procedures on the Azerbaijan-Iran border. This will help to reduce transportation time and cost for freight transportation.

3.4 International Agreements

International agreements play an important role in eliminating trade barriers, reducing tariffs and implementing infrastructure projects. Below are listed several agreements that are believed to help GR in increasing its transit potential and attracting new cargoes.

In 2016, GR signed a memorandum with Azerbaijan Railways and Kazakhstan Railways regarding the establishment of the TITR. The association coordination committee was established in 2017. It has seven founding members: GR; Azerbaijan Railways; Kazakhstan Railways; Batumi Port; Baku Port; Caspian Shipping Company; and Aktau Port. The purpose of the TITR will be to study the corridor and make recommendations to members of the association to attract freight to the Caucasus corridor and reduce administrative barriers related with multiple players being involved in transportation, and to facilitate the processing of cargo and containers in multiple locations. Ukraine was also involved in this project and, in the first quarter of 2016, Georgia, Azerbaijan, Kazakhstan and Ukraine decided to apply new competitive tariffs on cargo transported via the TITR. The single competitive tariff was introduced for the TITR in June 2016.

3.5 Ongoing Projects in the Corridor

The ongoing projects in the corridor are also in line with the strategic goals of the Group:

Anaklia Deep-Sea Port → **Baku-Tbilisi-Kars** → **Other infrastructure projects**

Anaklia Deep-Sea Port

Currently, three ports are operational in Georgia: Poti, Batumi and Kulevi. There is also a liquid cargo terminal in Supsa. The depth of the currently operational ports however is not sufficient to accept mid-sized cargo ships or large crude carriers. To overcome this issue, the Government of Georgia decided to start the construction of a new Georgian port on the Black Sea shore in Anaklia. The port is designed to accommodate containers and bulk cargo and should be capable of handling large vessels, carrying at least 10,000 containers. The depth at the planned location is sufficient to accept Panamax and VLC vessels and should have the potential to handle the increasing cargo

turnover between Europe and Asia.

The new port is expected to become one of the main logistical centers in the South Caucasus and one of the main maritime gateways for Georgia. Due to its strategic location, the Government of Georgia considers the project as a high priority. In 2016, at the 9th annual CGLA Forum held in Washington, the project was named the Top Strategic Project of the Year.

In 2016, the Georgian government and the Anaklia Development Consortium signed an investment agreement on the construction and operation of the deep-sea port in Anaklia. The Anaklia Development Consortium was jointly established by local company TBC Holding and Conti International (based in the USA). The investment area (340 hectares of land area and 225 hectares of sea area) was granted to the Consortium for 52 years. The cost of the construction and development of Anaklia Deep-Sea Port is expected to be about USD2.5 billion.

The construction of Anaklia Deep-Sea Port began at the end of 2017. The port's construction is expected to go through nine phases in line with the growth of cargo turnover. The potential throughput of the port should reach 100 million tons per annum. Once the initial stage has been completed, it is planned that the port will open in 2021 and it is expected that the port should be able to handle up to 7 million tons of cargo per annum. The Government of Georgia has also decided to build an 18 km railway line to connect Anaklia Deep-Sea Port with the existing railway network.

GR expects increased container traffic after the project is finalized.

Baku-Tbilisi-Kars

The BTK project is designed to connect Azerbaijan and Turkey with a railway link through Georgia. The project includes the rehabilitation and reconstruction of a 178 km-long railway line between Marabda and Akhalkalaki (both in Georgia) and the construction of a new railway from Akhalkalaki to the Turkish border, which will connect the Group's operational track to Turkish rail lines. The railway corridor is to be extended to Europe under the Marmaris project (a railway tunnel under the Bosporus), which will create a safe, fast and short route to transport goods from Asia to Europe and vice versa. This would entail the opening of a new rail-only corridor from the Caspian Sea to Europe via Turkey, removing the need for sea transportation.

The project is being implemented by the Georgian government without the financial participation of the Group. The project is being financed by the Government of Azerbaijan, who granted a loan to the Georgian government for its construction. However, when the tracks are built, the Group will be granted exclusive rights to operate the Georgian part of the line.

The project began on 30 October 2017 and has started running a testing regime. Significant volumes from this line are expected from 2019.

The completion of the project should open a completely new geographical market for rail operations with Turkey. The Group will benefit in terms of the freight transportation sector as well as in the passenger sector as customers will be able to travel to and from Turkey (at the beginning it will have a capacity of about 1 million passengers annually). Opening this rail connection should also increase access to other potential markets, especially China.

Batumi Sea Port

In 2017, dredging works were performed at Batumi Sea Port, which will allow the port to maintain sufficient depth for many years and to increase its operational capacities. Dredging works of this significance were last performed here in 1979.

Free trade agreements

In December 2015, talks between China and Georgia regarding a free trade agreement (FTA) were launched and, in October 2016, a free trade memorandum was signed between the two countries, making it the first FTA negotiation of China in Eurasia. According to the agreement, the memorandum will enter into force in 2018.

There are also ongoing negotiations with India and Hong Kong regarding FTAs.

Infrastructure developments in the corridor

A significant number of projects are being carried out in the corridor in order to expand into new geographical locations and to improve the efficiency of the route.

Kazakhstan's infrastructure improvements

Kazakhstan plans to increase its transit role by accommodating a large share of the trade between Europe and China. Currently, goods from China to Europe are mainly delivered by sea.

The construction of a new ferry complex at Kuryk Port, the development of Aktau Sea Port, the opening of a new rail line (Zhezkazgan-Beyneu) and the construction of the dry port of Khorgos - Eastern Gate are all projects that will help Kazakhstan to achieve its transit goals.

<u>Construction of new ferry complex at Kuryk Port</u>
Previously, the only means by which Kazakhstan could transport cargo to other Caspian Sea countries was the port of Aktau. However, in recent years the ferry terminal in Aktau Port has been working to its capacity. Therefore, a decision was made by the Government of Kazakhstan to start the construction of a new ferry complex at Kuryk Port, which is an important part of the TITR. This project is considered strategically important, as it is believed that this new ferry complex will strengthen Kazakhstan's part in the China-Europe transportation corridor and will make it possible to triple the capacity of its ferry transportation.

The construction of a ferry complex has been completed and the port has started operating. The new ferry complex is designed to handle various types of goods such as consumer goods, petroleum products, fertilizers, chemicals and liquefied petroleum gas.

The ferry complex in the port of Kuryk is considered to offer the following advantages:

- Good climate;

- Sufficient depth; and
- Prospects for increasing throughput capacity.

Development of Aktau Port

The port of Aktau is currently considered the main seaport of Kazakhstan. Due to the port's importance and the expected increase in traffic, it was decided by the Government of Kazakhstan to increase the port's capacity. Since 2015, three new dry cargo terminals have been built in Aktau Port. In 2017, works on the northern expansion of Aktau Port started. This development is expected to eventually double the port's cargo capacity from 10 to about 20 million tons per year.

Opening of new Zhezkazgan-Beyneu rail line

In 2014, the new Zhezkazgan-Beyneu rail line was opened. This new rail line shortens the transportation distance from the Caspian Sea to the East by offering a direct route, which reduces travel time significantly. The new line shortens the distance for cargo transported from China to the Caspian Sea by about 1,000 km. The Zhezkazgan-Beyneu line is the shortest rail route from central Kazakhstan to the port of Aktau.

Dry port of Khorgos - Eastern Gate

The construction of a new dry port entitled Khorgos - Eastern Gate, which is expected to become part of the free economic zone (FEZ), started in July 2014. In 2016, BAZIS Construction Company, which is the general contractor for Khorgos - Eastern Gate FEZ's construction, completed the construction project. Some other projects such as a customs clearance center, warehouses for cargo storage and packaging a fire station, and vehicle maintenance have been put into operation along with the dry port. The capacity of the dry port is 4 million tons of cargo per year.

Khorgos - Eastern Gate FEZ is located near the Kazakh-Chinese border. The complex includes a dry port, logistics, industrial zone, access railways and road overpasses, and is located on an area of over 700 hectares. The dry port and other components of the special economic zone (SEZ) will allow Kazakhstan to become a main commercial and transportation hub, significantly improving the cargo logistics of the country with China, and linking it to the East and the West.

The Khorgos - Eastern Gate FEZ together with the Zhezgazgan-Beyneu rail line and the port of Aktau represents a huge logistics and distribution capacity and assists Kazakhstan's further integration into international trade and transportation.

Azerbaijan's infrastructure improvements

Kazakhstan's intention to increase its role as a transit country connecting the East to the West will affect Azerbaijan as well, which represents one of the alternative routes through which goods from Kazakhstan can be transported to Europe. This consequently increases the transportation of cargo via Georgia.

In order to meet the needs of increased trade and traffic, Azerbaijan has started to invest in infrastructure projects such as the construction of the new port of Alyat and the modernization of its railways.

Construction of the new Alyat Port

The geographical location of Azerbaijan means that it would benefit from the development of an effective maritime transportation system via the Caspian Sea. Baku seaport's current location in the city center limits its operations. Therefore, in 2010 the Government of Azerbaijan decided that the new Baku International Sea Trade Port in Alyat would be built, which is located 7 km from Baku. The project is expected to be implemented in three phases. The capacity of the port by the end of the first phase is expected to reach 11.5 million tons per year of general cargo and up to 50,000 TEU per year and by the end of phase three the capacity is expected to increase to 25 million tons of general cargo and up to 1 million TEU. The construction of the ferry terminal was completed in 2014, however the completion of the first stage is planned by 2018. The timeline of phases two and three will depend on cargo volumes.

The construction of the new port should increase the throughput capacity of the route and support the expected increase in cargo transportation between the East and the West. It is expected that the importance of the port will increase after the completion of the BTK railway, which will provide direct access to European railway networks.

Modernization of Azerbaijan's Railway

Azerbaijan is actively investing in the development of its railway network. By the end of 2017, about 79 percent of works had been completed on a project concerning the capital repair of the 600-km Baku-Boyuk-Kesik rail line, which started in October 2015. A new 8.3-km rail line was laid from the station at Astara to the Iranian border and in April 2016 the construction works on a railway bridge across the Astarachay River started on the Azerbaijan-Iran border. Works are also underway to replace the signaling system on roads with a microprocessor system, controlled from a single dispatch center.

Azerbaijan Railways is also renewing its rolling stock. It signed a contract to purchase 50 locomotives from ALSTOM and purchased 10 diesel locomotives from Kazakhstan. Azerbaijan Railways has purchased four electric locomotives.

The modernization of different rail lines in Azerbaijan and the renewal of its rolling stock is expected to increase the speed of trains and its cargo capacity, which are important steps toward increasing the potential of the whole corridor.

Considering this facts GR expects cargo flow will increase from Azerbaijan through Georgia

Other infrastructure projects and developments

Development of Turkmenbashi International Seaport

Turkmenbashi International Seaport, which links Central Asia with the Black Sea region and Europe, is currently under development and is expected to be opened by May 2018. It is believed that the port will play an important role in trade between European and Asian countries.

Iran's infrastructure development

Georgia, Azerbaijan and Iran are planning to start operating a corridor that will carry cargo from the Black Sea to the Persian Gulf. In the summer of 2016, GR signed a memorandum of collaboration with Deutsche Bahn (German railway company), which is to be GR's partner for the new route.

Construction of the 8.3-km railway section between Astara (Azerbaijan) and Astara (Iran) began in the first half of 2016 and opened in 2017. Thereafter, there are plans to connect the line with the

Iranian railway network at Qazvin, works on which are underway. This Azerbaijan-Iran project has potential to become one of the main routes connecting India and Europe.

Viking Container Train

The Viking Container Train is a joint project involving Lithuania, Ukraine, Belarus, Bulgaria and Romania. It connects the Baltic Sea and the Black Sea by rail. The project is considered one of the most impressive European projects in freight transportation, according to the Transport Commission of the European Union.

In 2015, the Group joined the Viking Container Train project whereby Georgia will become the connecting knot between this project and the TRACECA. In May 2016, Azerbaijan Railways also joined the project, which will make the Viking Container Train project even more competitive.

Negotiations are underway to attract customers to transport cargo via this corridor.

Uzbekistan developing its rail transport

The Government of Uzbekistan has decided to develop it rail transport to transport foreign trade goods via the BTK line with an opportunity to reach the ports. This plan includes participation in the creation of the Azerbaijan-Georgia-Turkey-EU countries transit corridor. The first steps in the implementation of these plans are earmarked for the first quarter of 2018.

Bulgaria modernizing its railways

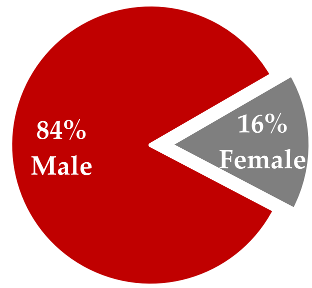
Bulgaria is working to modernize its railways to achieve full participation in the projects of the Silk Road participating countries. The modernization of its railway sections is mainly financed through the EU development program.

4. Employees

The Group is one of the largest corporate employers in Georgia, with approximately 13,000 employees as at 31 December 2017. Due to the physical nature of much of the work, the Group employs more men than women.

The Group continuously promotes employee efficiency and know-how through ongoing training programs at all levels of its workforce. The Group also provides a number of social benefits to its employees and family members such as medical insurance, financing certain expensive operations that are not covered by health insurance. The Company reports a healthy employee turnover rate, which is about 5% (not considering subsidiaries).

Employee distribution



As one of the largest employers in Georgia, Georgian Railway has certain social responsibilities with respect to its workforce. The Group is permanently taking actions to optimize its labor resources.

Employee turnover rate by business unit	31-Dec-17
Head office	10%
Freight Transportation SBU	3%
Infrastructure SBU	6%
Passenger Transportation SBU	10%
Total turnover	**5%**

Distribution of the Group's employees, by business unit

For the year ended 31 December

	2017	2016	2015	2014	2013
Freight SBU	44%	44%	43%	43%	43%
Infrastructure SBU	39%	39%	38%	38%	38%
Passenger SBU	10%	10%	11%	11%	12%
Head office	5%	5%	6%	6%	5%
Subsidiaries	3%	3%	2%	2%	2%

The Group's employees' age categories are shown in the table. The average age of the Group's employees is 48 years. The Group engages its workers in decision-making processes, which makes their work more challenging and gives employees opportunities to develop. At the same time, this process brings new and innovative ideas to an experienced team.

Employee distribution by age	31-Dec-17
<20	0.3%
21-30	7.7%
31-40	19.7%
41-50	23.1%
51-60	31.2%
>60	18.1%

Labor productivity measures

For the year ended 31 December

	2017	2016	2015	2014	2013
Ton-km per average number of Freight SBU employees (millions)	0.5	0.6	0.8	0.9	1.0
Freight revenue per average number of Freight SBU employees (GEL '000)	59.0	64.4	89.2	80.9	80.1
Average number of Infrastructure SBU employees per average expanded length (km) of infrastructure	2.48	2.47	2.45	2.46	2.50
Passenger-km per average number of Passenger SBU employees (millions)	0.5	0.4	0.3	0.4	0.4
Passenger revenue per average number of Passenger SBU employees (GEL '000)	17.7	13.0	10.7	12.3	11.8

As at December 2017, about 60 percent of the Group's employees were members of two trade unions. Therefore, there is some risk that in the future the Group's business will be subject to interruptions through strikes or lockouts, as has been the case in the past.

Education and training

The Group promotes business education among its employees. By financing employees' trainings and education, the Group increases both its human capital and the effectiveness of its workforce. The Group's investment in training and education in 2017 amounted to about GEL 223,000, which was a 6 percent rise compared to 2016.

In 2015, the Railway Transportation College was established and in 2016 it was granted vocational education status for six years. The college will start running classes in 2018.

The founders of the college are:

- Georgian Railway;
- Ministry of Education and Science of Georgia; and
- Georgian Technical University.

The partners of the college are:

- Subsidiary of German railway company - DB Engineering and Consulting; and
- Iowa State University.

The objectives of the Railway Transportation College are to develop a dual vocational education method in the railway sector and to improve the railway labor market.

The college is financed by GR, the Ministry of Education and Science of Georgia and Georgian Technical University, while it was also granted around USD 2.3 million from the Millennium Challenge Account - Georgia. The instructors of the college will undergo trainings in specialized training institutes – DB Training. The college offers free education to students with the relevant vouchers. Therefore, the establishment of the college is also considered to be a social project to some degree as it will be beneficial not only for GR but for any student seeking to gain professional knowledge in this field.

Other benefits

The Company has a bonus system, according to which bonuses are distributed to employees based on their performance evaluation. Before 2017, bonuses were distributed only to leading employees quarterly, which in 2017 was changed to annual distributions and to all employees. Internal research shows that employee satisfaction has increased after these changes.

The Group offers medical insurance to its employees and also finances a number of employees' healthcare expenditure not covered by insurance. In 2017, the amount spent on employees' healthcare expenses totaled about GEL 415,000. The Group also offers other financial incentives for occasions such as the birth of a child and a child's first day at school, and offers other bonuses to employees for certain holidays, events, and special occasions.

Working conditions

The working conditions of employees is another high priority for the Management of GR. In 2016, under the initiative of the Management, the inspectors of labor from the Ministry of Labor Health and Social Affairs of Georgia checked GR's working conditions and the safety of its employees. The process of inspection was carried out in different structures of GR across the country. Following the inspection, a conclusion was prepared and corresponding recommendations were issued. In 2017, the recommendations were taken into consideration and changes were made accordingly.

Management Discussion and Analysis for FY 2017

Financial and non-financial highlights

Revenue
FY 2017
434,534
-1.2% from FY 2016

Results from operating activities
FY 2017
-280,467
-2.59x from FY 2016

EBITDA
FY 2017
211,852
-25% from FY 2016

EBITDA margin
FY 2017
48.8%
-15 points from FY 2016

Adjusted EBITDA
FY 2017
181,427
-7% from FY 2016

Adjusted EBITDA margin
FY 2017
41.8%
-3 points from FY 2016

Net investment in fixed capital
FY 2017
168,463
-14% from FY 2016

Net debt to EBITDA
31 Dec 2017
4.87
3.48 as at 31 Dec 2016

Main developments in 2017

- Purchase of two double-decker passenger trains;
- Additional borrowing of USD 20.3 million to finance new passenger trains procurement;
- Transfer of land plots to the Government under the Tbilisi Bypass Project memorandum;
- Freight volume decreased by 10 percent;
- Long-term corporate rating downgraded to 'B+' from 'BB-' by Fitch Ratings in January 2017, affirmed at 'B+' with Stable Outlook in November 2017; and revised outlook from Stable to Negative by S&P Global. Ratings.

5. Profit or Loss Statement

GEL '000 period ended 30 September	2017	2016	change	Abs. change
Revenue	434,534	439,922	-1.2%	-5,388
Income from transferred property	23,417	80,294	-70.8%	-56,876
Other income	15,560	19,122	-18.6%	-3562
Impairment loss on property, plant and equipment	-382,616	0	N/A	-382,616
Employee benefits expense	-148,302	-146,626	1.1%	-1676
Depreciation and amortization	-109,703	-106,267	3.2%	-3,436
Electricity, consumables and maintenance costs	-41,490	-47,289	-12.3%	5799
Other expenses	-71,868	-63,668	12.9%	-8,200
Result from operating activities	**-280,468**	**175,488**	**-259.8%**	**-455,955**
Net finance income/loss	**-72,984**	**-149,221**	**-51.1%**	**76,237**
Profit before income tax	**-353,452**	**26,267**	**-1445.6%**	**-379,718**
Income tax (expense)/benefit	-648	38,859	-101.7%	-39,507
Profit and total comprehensive income	**-354,100**	**65,126**	**-643.7%**	**-419,225**
EBITDA	211,852	281,755	-24.8%	-69,903
EBITDA margin	48.75%	64.05%	N/A	-15.29%
Adjusted EBITDA	181,427	195,149	-7.0%	-13,722
Adjusted EBITDA margin	41.75%	44.40%	N/A	-2.65%

5.1 Revenue

Most of the Group's revenue (about 60 percent in 2017) is derived from freight transportation. Thus, the Group's results are particularly sensitive to cargo flows, which mainly comprise transit shipments, which accounted for about 63 percent of freight transportation revenue in 2017. The transit transportation volume mainly comes from trade between Europe and Central Asia.

The majority of GR's freight traffic was transported from or to Azerbaijan and Armenia (about 28 percent and 23 percent of transportation revenue in 2017, respectively). Other significant trade partners for the Company in 2017 were Russia, Kazakhstan and Turkmenistan (together generating 38 percent of transportation revenue in 2017). Only about 6 percent of total transportation revenue in 2017 was generated by domestic transportation.

GEL '000	2017	2016	% Change	% Change at constant currency	Abs. Change
Freight transportation*	262,772	292,612	-10.2%	-15.3%	-29,840
Freight handling*	50,189	52,974	-5.3%	-9.9%	-2,785
Logistical service*	73,773	52,582	40.3%	35.4%	21,191
Freight car rental	16,781	13,948	20.3%	13.4%	2833
Passenger traffic	22,843	18,007	26.9%	26.7%	4,836
Other	8,175	9,799	-16.6%	-17.5%	-1,624
Revenue	**434,534**	**439,922**	**-1.2%**	**-6.0%**	**-5,388**
Income from transferred property	**23,417**	**80,294**	**-70.8%**	**NA**	**-56,877**
Other income	**15,560**	**19,122**	**-18.6%**	**NA**	**-3,562**
Freight transportation	**262,772**	**292,612**	**-10.2%**	**-14.3%**	**-29,840**
Liquid cargoes	**115,626**	**135,530**	**-14.7%**	**-19.5%**	**-19,903**
Oil products	107,521	107,140	0.4%	-5.3%	381
Crude oil	8,105	28,389	-71.5%	-73.1%	-20,285
Dry cargoes	**147,146**	**157,082**	**-6.3%**	**-11.6%**	**-9,936**
Ores	25,294	24,820	1.9%	-0.5%	475
Grain	7,998	14,320	-44.1%	-47.3%	-6,322
Ferrous metals and scrap	10,508	20,936	-49.8%	-52.6%	-10,428
Sugar	18,364	18,333	0.2%	-5.5%	31
Chemicals and fertilizers	12,682	9,397	35.0%	27.3%	3,284
Construction freight	5,663	6,275	-9.8%	7.9%	-612
Industrial freight	5,246	3,440	52.5%	46.1%	1,806
Cement	1,182	933	26.7%	70.1%	249
Other	60,209	58,628	2.7%	-3.1%	1,581
Freight turnover (million ton-km)	2,930	3,391	-13.6%	-13.6%	-461
Revenue / ton-km (in Tetri)	8.97	8.63	3.9%	-0.8%	0.34

** For better presentation, we have separated "logistical services" from "freight transportation" and "freight handling". "Logistical services" represents revenue generated by freight forwarding subsidiaries.*

Freight transportation

The Group's freight transportation revenue consists of liquid and dry cargoes. The split between liquid and dry cargo revenue in 2017 was about 44 and 56 percent, respectively.

Transportation revenue depends on multiple factors, which generally influence its performance and some of them are stated below:

Transportation volume - measured by number of tons transported.

Transportation turnover - measured in ton-kilometers, which is the product of tons transported and the distance covered.

Revenue per ton-kilometer - the term refers to the average revenue that the Group receives per ton-kilometer. This parameter varies for different types of cargo and largely depends on the cargo type mix and transportation direction mix.

- Cargo type mix - the Group transports different cargo categories (grain, ore, sugar, etc.). These categories themselves comprise many sub-categories, each of which has different tariffs. Therefore, while the actual tariffs for cargo sub-categories may remain the same, the average revenue per ton-kilometer of a main cargo category may still change due to changes in the sub-category mix.
- Transportation direction mix - tariffs differ according to freight origins and directions according to the Group's tariff policy. Thus, when the tariffs for different cargo sub-categories and the sub-category mix remain the same, the average revenue per ton-kilometer may still change because of the change in the transportation direction mix.

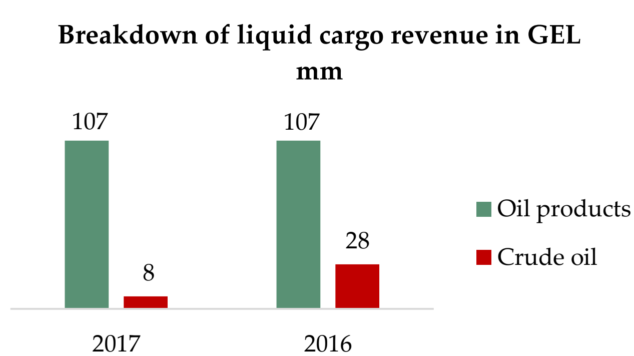
GEL/USD exchange rate - one important issue to bear in mind when analyzing the performance of the Group is the fact that most of its tariffs are denominated in USD. As the Group reports its revenue in GEL, the changes in the GEL/USD exchange rate can have a significant impact on the Group's profitability, as most of its expenses are denominated in Georgian Lari.

	Average exchange rates			*Reporting date spot rates*		
	2017	2016	% Change	2017	2016	Change
GEL/USD	2.51	2.37	6.0%	2.59	2.65	-2.1%
GEL/CHF	2.54	2.40	6.1%	2.60	2.42	2.3%

Liquid cargo

One of the key drivers of liquid freight traffic is the production of oil and oil products in the Caspian Sea region, which has large oil reserves. In 2017, about 68 percent of crude oil and oil products were transported from three Caspian Sea region countries (Kazakhstan, Turkmenistan and Azerbaijan) mostly to European countries and Georgia.

Most of the Group's liquid cargo revenue comes from oil products.

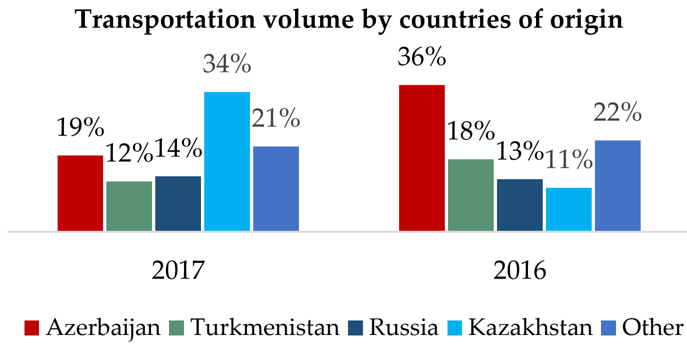


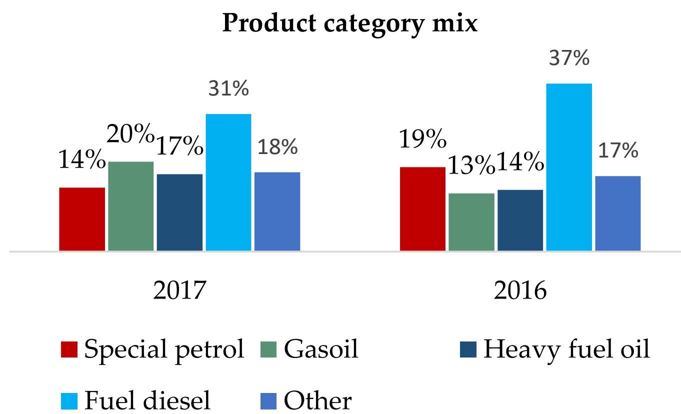
Oil products

Main directions of cargo

Oil products currently make up the majority of liquid cargo (93 percent of the transportation volume of liquid cargo in 2017). They are mainly transported by rail, as there is practically no competition from pipelines.

Oil products transported by the Group during 2017 mainly originated from Azerbaijan, Turkmenistan, Russia and Kazakhstan, with significant changes in the transportation direction mix compared to the same period of 2016. The share of Azerbaijan dropped to 19 percent from 36 percent, while Kazakhstan's share rose to 34 percent from 11 percent in terms of total oil products transported by the Group.





Oil products

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	107.52	107.14	0.4%	-5.3%
Freight volume (million ton)	3.95	3.69	7.1%	7.1%
Freight turnover (million ton-km)	1,221.24	1,087.94	12.3%	12.3%
Revenue / ton-km (in Tetri)	8.80	9.85	-10.6%	-15.7%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – A 12 percent increase in transportation turnover was mainly driven by increase in the transported volume by 7 percent, caused by increased volumes from Kazakhstan and Russia, by 957,000 tons and 62,000 tons, respectively, which was partly offset by decreased volumes from Azerbaijan and Turkmenistan, by 591,000 tons and 168,000 tons, respectively. Another reason for this was the increase in the average transportation distance, mainly driven by an increased share from Kazakhstan (which covers longer distances) and a decreased share from Azerbaijan (which covers shorter distances) in total transportation volume of oil products.

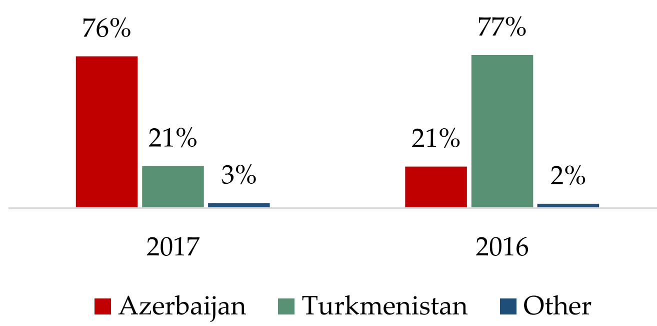
Revenue/ton-km (in Tetri) – the decrease in average revenue per ton-kilometer during 2017, compared to 2016, was mainly due to changes in the product category mix. The share of diesel fuel (which is a relatively more profitable product) has decreased and the share of gasoil (which is a relatively less profitable product) has increased in the total oil products transported by Georgian Railway.

Crude oil

Main directions of cargo

The crude oil transported by Georgian Railway during 2017 mostly originated from Azerbaijan (about 76 percent) and Turkmenistan (about 21 percent). The main final destinations in 2017 were the USA (up to 76 percent from 16 percent in 2016) and Italy (down to 22 percent from 82 percent in 2016).

Transportation volume by country of origin



Crude oil

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	8.10	28.39	-71.5%	-73.1%
Freight volume (million ton)	0.40	1.81	-77.8%	-77.8%
Freight turnover (million ton-km)	157.60	713.65	-77.9%	-77.9%
Revenue / ton-km (in Tetri)	5.14	3.98	29.3%	22.0%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical service) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – the decrease in freight turnover was mainly caused by the sharp fall in crude oil transportation volume from Turkmenistan to Italy during 2017, which dropped by 1.3 million tons, compared to 2016.

Revenue/ton-km (in Tetri) – the increase in revenue per ton-kilometer was mainly caused by changes in the transportation direction mix. The transportation share from Azerbaijan, a relatively more profitable direction, recorded a considerable increase during 2017, compared to the same period of the previous year, while the transportation volume from Turkmenistan, a relatively less profitable direction, has declined significantly.

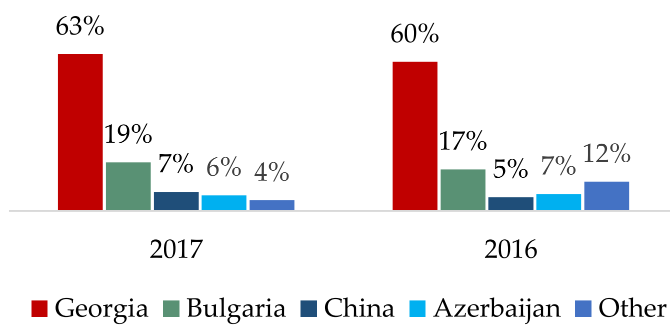
Dry cargo

Dry cargo contributed about 56 percent to total transportation revenue in 2017. The main factors driving the transportation of dry cargo are general national economic conditions and economic developments in Georgia and in partnering countries such as Azerbaijan, Armenia, Turkmenistan, Kazakhstan and other CIS countries.

Ore products

Main directions of cargo

Transportation volume by destination country



The main origin countries for ore products during the period under review were Georgia, Armenia and Russia. No transportation was recorded from Brazil, Gabon and Switzerland during 2017, while the combined share of the transportation volume from these countries for 2016 was 8 percent. The main destination points of ore products transported by the Group are Georgia, Bulgaria, China and Azerbaijan. About 35 percent of the total transportation volume in 2017 was transported within Georgia. Ore products transported by the Group in 2017 mostly comprised copper ores and concentrates (about 27 percent), manganese ores and concentrates (about 23 percent), and coal (about 16 percent).

Ore Products

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	25.29	24.82	1.9%	-0.5%
Freight volume (million ton)	1.42	1.45	-2.1%	-2.1%
Freight turnover (million ton-km)	296.40	310.57	-4.6%	-4.6%
Revenue / ton-km (in Tetri)	8.53	7.99	6.8%	4.2%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*

*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – the decrease in freight transportation turnover was mainly due to the reduction in transported volumes of manganese ores and concentrates and coal, by 70,000 tons and 56,000 tons, respectively, which was partly offset by the increased transportation of bituminous coal and copper ores and concentrates, by 55,000 tons and 41,000 tons, respectively. Another reason for the decreased turnover was a reduction in average transportation distance for ore products directed to Georgia.

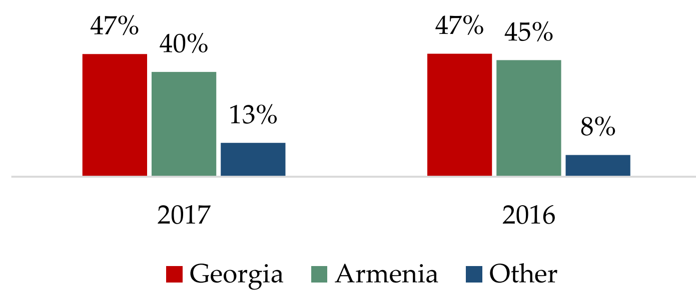
Revenue/ton-km (in Tetri) – the average revenue per ton-kilometer in 2017 increased by 7 percent, compared to 2016. GR signed a contract with an entity according to which an agreement was made on fixed exchange. Had such an agreement not been signed, average revenue per ton-kilometer would have increased by 10 percent.

Grain and grain products

Main directions of cargo

Transportation volume of wheat represents about 81 percent of total grain and grain products transported in 2017. The main country of origin for grain and grain products was Russia (72 percent in 2017). The main destination countries were Georgia and Armenia.

Transportation volume by destination country



Grain and grain products

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	8.00	14.32	-44.1%	-47.3%
Freight volume (million ton)	0.30	0.45	-32.5%	-32.5%
Freight turnover (million ton-km)	75.33	140.64	-46.4%	-46.4%
Revenue / ton-km (in Tetri)	10.62	10.18	4.3%	-1.6%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – the decrease in freight transportation turnover by 46 percent was mainly caused by the decreased transportation of wheat originating from Russia in the direction of Georgia and Armenia, by 59,000 and 93,000 tons, respectively. Another reason was the significant reduction (53 percent) of the average transportation distance for one of the main destination countries, Georgia.

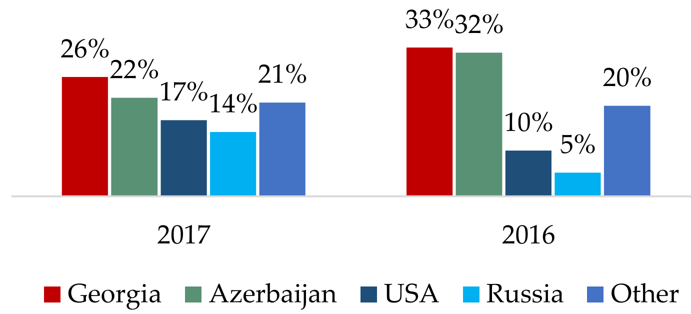
Revenue/ton-km (in Tetri) – the decrease in average revenue per ton-kilometer at constant currency was mainly driven by a reduced share of freight transported to Armenia (a relatively more profitable direction) in total volume transported by the Group.

Ferrous metals and scrap

Main directions of cargo

The main destination countries for ferrous metals and scrap during the period under review were Georgia, Azerbaijan, USA and Russia, together creating 79 percent of the total volume transported in 2017.

Transportation volume by destination country



Ferrous metals and scrap

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	10.51	20.94	-49.8%	-52.6%
Freight volume (million ton)	0.53	0.66	-20.2%	-20.2%
Freight turnover (million ton-km)	123.44	163.10	-24.3%	-24.3%
Revenue / ton-km (in Tetri)	8.51	12.84	-33.7%	-37.4%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

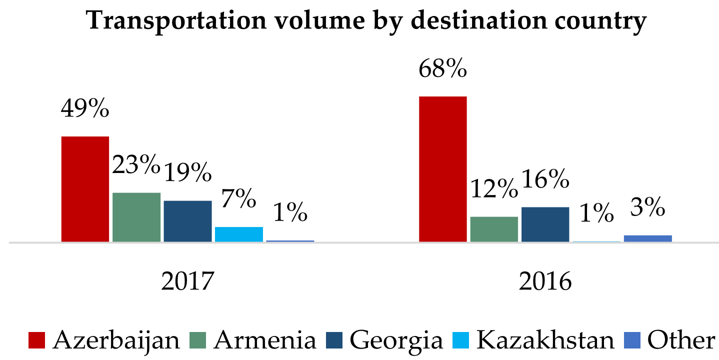
Ton-kilometers – the main factor driving a 24 percent decrease in transportation turnover during 2017, compared to 2016, was a 20 percent decrease in total ferrous metals and scrap transported by the Group caused by the cessation of transportation of pipes for oil and gas pipelines to Azerbaijan. Decreased transportation turnover was also driven by a reduction in average transportation distance, which was on its own caused by a reduced share of freight transported to Azerbaijan (which covers longer distances) from 32 percent to 22 percent of the total volume transported, while the share of freight transported to Russia (which covers shorter distances) increased from 5 to 14 percent.

Revenue/ton-km (in Tetri) – the decrease in the average revenue per ton-kilometer was due to the cessation of the transportation of pipes for oil and gas pipelines to Azerbaijan (14 percent of ferrous metals and scrap transported in 2016), which are relatively more profitable products, because of changes in the product category mix transported in Georgia's direction and also due to the increase in the shares of volumes directed to Russia and USA (which are less profitable directions) in the total volume transported by the Group.

Sugar

Main directions of cargo

Brazil was the main country of origin for transported volumes of sugar in 2017 and 2016, with a share of 93 percent and 91 percent, respectively. The main destination countries for sugar were Azerbaijan, Armenia, Georgia and Kazakhstan (99 percent of the total volume transported by the Group).



Sugar

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	18.36	18.33	0.2%	-5.5%
Freight volume (million ton)	0.38	0.50	-24.2%	-24.2%
Freight turnover (million ton-km)	134.82	183.89	-26.7%	-26.7%
Revenue / ton-km (in Tetri)	13.62	9.97	36.6%	28.9%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

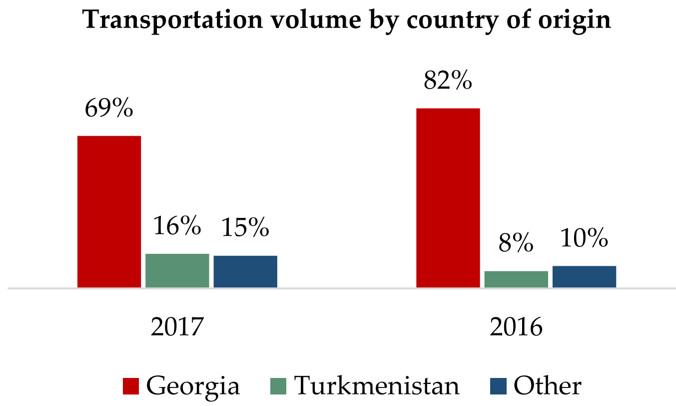
Factors influencing performance

Ton-kilometers – the decrease in transportation turnover in 2017, compared to 2016, was driven by a reduction in the transportation of reed sugar for refining from Brazil to Azerbaijan, by 160,000 tons.

Revenue/ton-km (in Tetri) – a 37 percent increase in the average revenue per ton-kilometer was caused by the contract according to which the entity was obliged to transport a specified volume of sugar and in the case of failure it should have paid the amount of underperformed volumes. The entity failed to perform volumes amount of which was GEL 3.9 million. As a result, only the transportation revenue increased. Without taking into account this issue, the average revenue per ton-kilometer increased by 8 percent.

<u>Chemicals and fertilizers</u>

Main directions of cargo



The main countries of origin for transported volumes of chemicals and fertilizers during the period under review were Georgia and Turkmenistan, together responsible for 85 percent of the total volume transported in 2017. Chemicals and fertilizers were mainly transported to Black Sea ports. A relatively small portion of the products was transported to Georgia and Armenia. In 2017, under the chemicals and fertilizers freight category, the Group mainly transported ammonium nitrate (77 percent).

Chemicals and fertilizers

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	12.68	9.40	35.0%	27.3%
Freight volume (million ton)	0.57	0.43	31.8%	31.8%
Freight turnover (million ton-km)	184.28	132.77	38.8%	38.8%
Revenue / ton-km (in Tetri)	6.88	7.08	-2.8%	-8.3%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

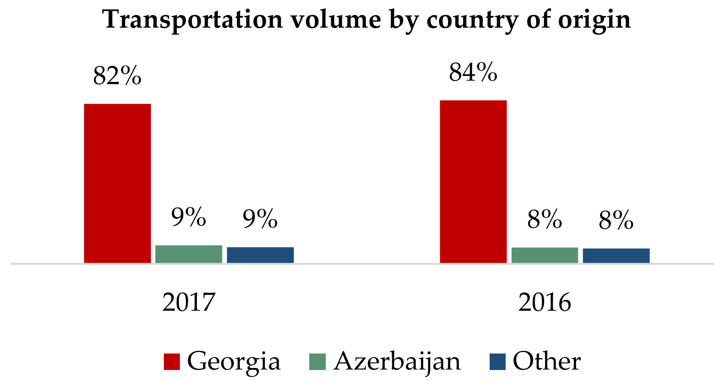
Factors influencing performance

<u>Ton-kilometers</u> - the increase in transportation turnover during 2017, compared to 2016, was mainly due to the increased transportation of ammonium nitrate and urea, by 74,000 tons and 55,000 tons, respectively. Another reason was the increased average transportation distance, as a result of changes in both the product category mix and the transportation direction mix.

<u>Revenue/ton-km (in Tetri)</u> – the decrease in the average revenue per ton-kilometer was mainly due to the reduced average revenue per ton-kilometer for ammonium nitrate in line with changes in the product category mix as the share in the total transported volume of relatively less profitable products, namely urea and ammonium hydrogen phosphate, increased.

Construction freight

Main directions of cargo



The transportation of construction freight correlates with the performance of the construction sector in Georgia. The share of construction freight transported within Georgia was about 81 percent. The second most significant country of origin after Georgia in 2017 and 2016 was Azerbaijan, with 9 percent and 8 percent respectively of the total transported volume of construction freight. The main product under the construction freight category was limestone with 60 percent of the share of the total volume in 2017, compared to 61 percent in 2016.

Construction freight

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	5.66	6.28	-9.8%	7.9%
Freight volume (million ton)	1.16	1.07	8.6%	8.6%
Freight turnover (million ton-km)	159.67	142.03	12.4%	12.4%
Revenue / ton-km (in Tetri)	3.55	4.42	-19.7%	-4.0%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*

*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

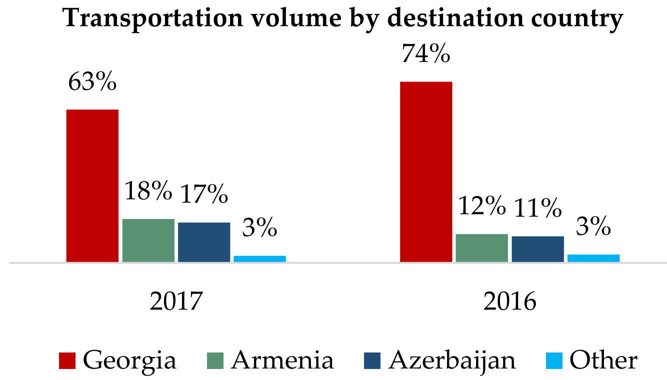
Factors influencing performance

Ton-kilometers – the 9 percent increase in transportation turnover was driven by increased volumes due to increased transportation of limestone (by 43,000 tons) and pebbles, gravel and crushed stone (by 25,000 tons combined) within Georgia combined with an increase in the average transportation distance for two main origin countries, Georgia (by 3 percent) and Azerbaijan (by 19 percent), which was caused by changes in the transportation direction mix.

Revenue/ton-km (in Tetri) - the decrease in the average revenue per ton-kilometer was mainly due to the decreased average revenue per ton-kilometer for Georgia, the main origin country, by 5 percent, caused by changes in the product category mix. Another reason was that GR signed a contract with an entity according to which an agreement was made on a fixed exchange rate. Without such an agreement, the average revenue per ton-kilometer in GEL terms would have increased by 2 percent.

Main directions of cargo

The main country of origin for the total transported volume of industrial freight during 2017 was Azerbaijan, with a 47 percent share. The majority of cargo (97 percent) was directed to Georgia, Armenia and Azerbaijan. In 2017, under the industrial freight category, cement clinker was the most transported product (46 percent).



Industrial freight

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	5.25	3.44	52.5%	46.1%
Freight volume (million ton)	0.30	0.27	11.7%	11.7%
Freight turnover (million ton-km)	52.51	38.67	35.8%	35.8%
Revenue / ton-km (in Tetri)	9.99	8.90	12.3%	7.6%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*

*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

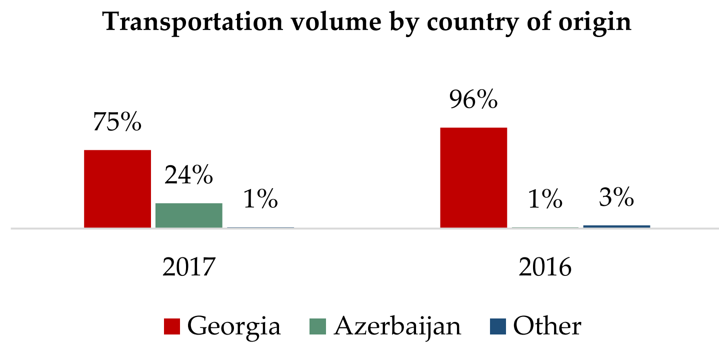
Ton-kilometers – the 36 percent increase in transportation turnover was driven by two factors. First, the increase in volume by 12 percent, caused by increased transportation of barite to Azerbaijan, by 23,000 tons, and an increased transported volume of siliceous sand and quartz to Armenia, by 23,000 tons. Another factor was the increase in the average transportation distance by 22 percent, due to increased shares of volumes directed to Azerbaijan and Armenia (which cover longer distances) and a decreased share to Georgia (which covers shorter distances) in total industrial freight transported during 2017 as well as an increase in the average transportation distance in the direction of Armenia, by 35 percent.

Revenue/ton-km (in Tetri) – the increased shares of barite, siliceous sand and quartz (which are relatively more profitable products) in total industrial freight transported by the Group, combined with increased average revenue per ton-kilometer of cement clinker, by 18 percent, contributed to an increase in the average revenue per ton-kilometer for industrial freight.

Cement

Main directions of cargo

Cement is mainly transported within Georgia, the share of which dropped from 96 percent in 2016 to 75 percent in 2017. This decrease was caused by increased transportation of cement originating from Azerbaijan.



Cement

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	1.18	0.93	26.7%	70.1%
Freight volume (million ton)	0.09	0.06	53.2%	53.2%
Freight turnover (million ton-km)	22.35	17.08	30.9%	30.9%
Revenue / ton-km (in Tetri)	5.29	5.46	-3.2%	30.0%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*

*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – transportation turnover increased by 31 percent, while volume increased by 53 percent (caused by an increase in transportation from Azerbaijan and Georgia of 22,000 tons and 11,000 tons, respectively). This apparent disproportionality was mainly due to the decreased average transportation distance caused by the increased share of Azerbaijan (which covers relatively shorter distances) in the total transported volume of cement in 2017.

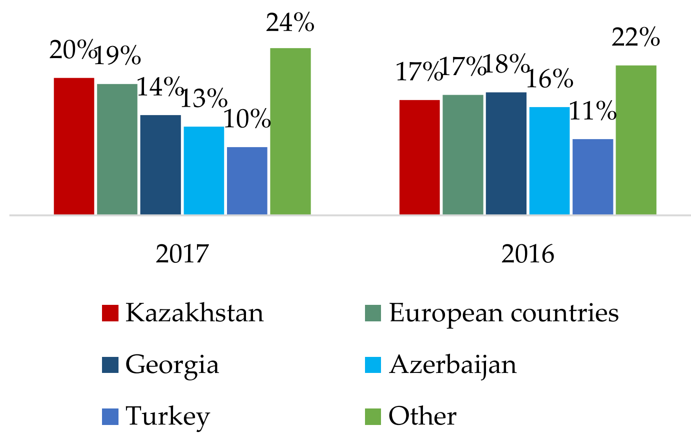
Revenue/ton-km (in Tetri) – the increase in the average revenue per ton-kilometer at constant currency was caused by an increased share of cement originating from Azerbaijan (which is a relatively more profitable direction) in the total transportation volume during 2017, compared to 2016. The reason for a 3 percent decrease in GEL terms was that GR signed a contract with an entity according to which an agreement was made on fixed exchange. Without such an agreement, average revenue per ton-kilometer in GEL terms would have increased by 38 percent.

Other product categories

Main directions of cargo

The main origin countries for other product categories in 2017 were Azerbaijan, Ukraine and Georgia. The cargo was mainly directed to Kazakhstan, European countries, Georgia, Azerbaijan and Turkey. The main products, in this category, transported in 2017 were methanol (about 15 percent of total volume), mineral waters (about 7 percent of total volume) and meat (about 6 percent of total volume).

Transportation volume by destination country



Other products

For the year ended 31 December

	2017	2016	% Change	% Change at constant currency
Revenue (GEL million)	60.21	58.63	2.7%	-3.1%
Freight volume (million ton)	1.57	1.50	5.1%	5.1%
Freight turnover (million ton-km)	502.15	460.66	9.0%	9.0%
Revenue / ton-km (in Tetri)	11.99	12.73	-5.8%	-11.1%

**For better presentation, we have separated "logistical services" from "freight transportation" and ''freight handling''. ''Logistical services'' represents revenue generated by freight forwarding subsidiaries.*
*** Revenue per ton-kilometer represents revenue from freight transportation (excluding revenue from logistical services) divided by ton-kilometers.*

Factors influencing performance

Ton-kilometers – the decreased transportation turnover in 2017, compared to 2016, was mainly due to the increase in the transported volume directed to Kazakhstan, by 63,000 tons, and increased average transportation distance caused by changes in the transportation direction mix.

Revenue/ton-km (in Tetri) – the decrease in average revenue per ton-kilometer was mainly due to changes in the transportation direction mix and the product category mix. The share of the transported volume directed to relatively more profitable directions, namely Georgia and Azerbaijan, in the total transported volume has decreased, while the share being transported to a relatively less profitable direction, namely European countries, has increased. The share of a relatively more profitable product, namely meat, in total transported volume dropped from 8 percent in 2016 to 6 percent in 2017, while the share of a relatively less profitable product, namely methanol, rose from 8 percent in 2016 to 15 percent in 2017.

Freight handling

General description

Revenue from freight handling comprises several components:

- Revenue from station services, derived from railcar marshaling, freight pick-up, delivery at customer facilities and other related services;
- Revenue from 24-hour railcar delays, which is in the form of a fee paid by customers for failing to load or unload a railcar within 24 hours from delivery of a railcar at an agreed destination; and
- Revenue derived from cargo loading/unloading, storage, accelerated service fees and other sources.

Currency and tariff setting

Most of the freight handling revenue, about 86 percent in 2017, was denominated in USD, while the rest was denominated in GEL (10 percent) and CHF (4 percent). The Group sets its tariffs independently.

Drivers

The revenue from this source largely fluctuates in line with transportation volumes in tons. The correlation, however, is not perfect as there are many influential factors.

Freight handling

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Station services	43,048	47,205	-8.8%	-4,157
24-hour services	3,223	4,298	-25.0%	-1,075
Other	3,918	1,471	166.3%	2,447
Total	**50,189**	**52,974**	**-5.3%**	**-2,785**

Factors influencing performance

A 5 percent decrease in revenue from freight handling during the period under review, compared to the same period of the previous year, was mainly driven by a 10 percent decrease in transportation volumes.

Logistical services

General description

Revenue from logistical services is generated by GR's subsidiaries.

Currency and tariff setting

Revenue from logistical services is denominated in two currencies: USD (62 percent) and GEL (38 percent).

Drivers

Revenue from this source fluctuates in line with transportation turnover and volumes in tons.

Logistical services

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Revenue from logistical services	73,773	52,582	40.3%	21,191

Factors influencing performance

A 40 percent increase in revenue from logistical services during 2017, compared to 2016, was driven by GEL 26.4 million (equivalent of USD 10.2 million) revenue from a ship-or-pay agreement, according to which Turkmen client should have reimbursed the contract amount, if it did not transport crude oil through Georgian Railway.

Freight car rental

General description

Freight car rental revenue is derived when the Group's railcars are used by other railways.

Currency and tariff setting

Revenue from freight car rental is denominated in CHF and tariffs are set by the Council for Rail Transport of CIS States (CRT CIS).

Drivers

Freight car rental revenue is determined by tariffs and the number of days the Group's railcars are used by other railway companies

Freight car rental

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Freight car rental	16,781	13,948	20.3%	2,833

Factors influencing performance

The increase in revenue from freight car rental of 20 percent (GEL 2.8 million) in 2017 compared to 2016 was largely attributable to the increased usage of open top-box wagons by Kazakhstan Railways (CHF 410,962 in the fourth quarter of 2017 alone, compared to CHF 503 for the full year of 2016).

Passenger traffic

General description

Passenger transportation comprises domestic and international services. Domestic transportation includes regional and long-distance transportation. Long-distance traffic accounts for the majority of the Group's passenger traffic, while the regional services, particularly suburban services, typically serve the low-income sections of society and fares for such services are low. Georgian rail lines are linked to Azerbaijan and Armenia, and international transportation services are provided to both countries.

In July 2016, the Group acquired two new double-decker trains compliant with European standards from Swiss rolling stock manufacturer Stadler Bussnang, which started to serve passengers going from Tbilisi to the Black Sea in the summer. Two more double-decker trains were procured in 2017.

Currency and tariff setting

Tariffs for domestic transportation are set independently by the Group, in GEL. Tariffs are not determined by market forces and are kept relatively low, because of the social importance of the Group's passenger transportation services being affordable. Accordingly, GR may be restricted in terms of removing or reducing services on certain passenger routes, even in cases when such routes are not economically viable

Tariffs for international transportation are set through negotiations between countries and are denominated in CHF.

Drivers

Revenue from passenger traffic fluctuates in line with the tariffs and number of passengers transported.

Passenger transportation

For the year ended 31 December

	2017	2016	% Change	Abs. change
Revenue in GEL '000	22,843	18,007	26.9%	4,836
Number of passengers '000	2,684	2,463	9.0%	221

Factors influencing performance

Revenue from passenger transportation increased by 27 percent (GEL 4.8 million) in 2017, compared to 2016, while the number of passengers increased by 9 percent. The high increase in revenue was driven by an increase in the share of the number of passengers traveling on the main line, a relatively more profitable route, in the total number of passengers transported(an increase in the number of passengers by 191,000 was caused by the introduction of two more double-decker trains in 2017 in addition to the first two such trains which have been operating since summer 2016). The average occupancy rate of the trains on the main line in 2017 was 67 percent, compared to 65 percent in 2016.

Other revenue

General description

Other revenue is mostly denominated in GEL and comprises items such as revenue from renting out spaces in buildings owned by the Group, sale of scrap and repair services for third parties.

Other revenue

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Revenue from rent	4,434	4,871	-9.0%	-438
Revenue from repair	425	450	-5.6%	-25
Revenue from sale of materials (scrap)	1,456	2,663	-45.3%	-1,206
Other	1,860	1,815	2.5%	46
Total	**8,176**	**9,799**	**-16.6%**	**-1,623**

Factors influencing performance

The decrease in other revenue of GEL 1.6 million during 2017, compared to 2016, was driven by a decrease in revenue from the sale of scrap, by 45 percent.

5.2 Income from Transferred Property

General description

In April 2012, GR and the Government signed the Tbilisi Bypass Project Memorandum according to which the Government aims to purchase from the Group approximately 70 hectares of land plots which will be released as a result of the removal of railway infrastructure from Tbilisi city center. The Company will be reimbursed for the amount of VAT paid for the sale. The Government has agreed to pay the equivalent of CHF 138 million in the national currency to the Group by reducing the amount of dividends payable to the Government. In 2012, the Company declared dividends of which GEL 232 million (CHF 138 million) were classified as an advance received from the Government for the sale of the land for the Tbilisi Bypass Project Memorandum.

Income from transferred property

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Income from transferred property	23,417	80,294	-70.8%	-56,877

Factors influencing performance

In 2016 and 2017, GR transferred 89,166 and 44,672 square-meter land plots with attached constructions, respectively, to the Government in accordance with the Tbilisi Bypass Project Memorandum.

The difference between the fair value and the carrying value of the transferred property (GEL 23,417,000 and GEL 80,294,000, respectively in 2017 and 2016) was recognized as income in the consolidated profit or loss statement.

5.3 Other Income

General description

Other income mostly comprises items such as penalties accrued from debtors or creditors, sale of fixed assets and provision reversals.

In order to better illustrate the operational profitability of the Group, other income is split into two categories: continuing operations (such as penalties on creditors and debtors); and non-continuing operations (such as provision reversals and sale of fixed assets, which are not expected to sustainably reoccur).

Other income

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Continuing operations	7,748	12,165	-36.3%	-4,417
Non-continuing operations	7,812	6,957	12.3%	855
Total	**15,560**	**19,122**	**-18.6%**	**-3,562**

Factors influencing performance

The decrease in continuing operations in 2017, compared to 2016, was mainly due to the GEL 5.3 million decrease in penalties accrued from debtors.

5.4 Operating Expenses

General description

Most of the Group's operating expenses are fixed. Variable expenses that depend on the volume of transportation include: freight car rental; electricity of traction; fuel expenses; and materials, repair and maintenance expenses.

Operating expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Employee benefits expense	148,302	146,626	1.1%	1,676
Depreciation and amortization	109,703	106,267	3.2%	3,436
Impairment loss on property, plant and equipment	382,616	0	N/A	382,616
Electricity	20,869	21,687	-3.8%	-818
Materials	11,564	14,121	-18.1%	-2,557
Repair and maintenance	3,819	7,175	-46.8%	-3,356
Fuel	5,237	4,306	21.6%	931
Freight car rental	4,095	4,407	-7.1%	-312
Logistical services	12,996	14,270	-8.9%	-1,274
Security, other operating expenses	27,736	18,517	49.8%	9,219
Taxes other than income tax	27,043	26,474	2.2%	569
Total	**753,980**	**363,850**	**107.2%**	**390,130**

Total operating expenses in 2017 increased by 107.2 percent (GEL 390.1 million), compared to 2016, which was mainly driven by impairment loss on property, plant and equipment incurred by impairment of the Tbilisi Bypass Project. The increase was also caused by an increase in fixed expenses such as employee benefits expense (by GEL 1.7 million), depreciation and amortization (by GEL 3.4 million), security and other operating expenses (by GEL 9.2 million) and taxes other than income tax (by GEL 0.6 million), partly offset by a decrease in variable expenses as a result of decreased transportation volumes.

Employee benefits expense

General description

The Group's salary expenses are not affected by changes in the transportation volume as employees' salaries are fixed. The salaries are denominated in GEL, thus FX changes do not affect the cost.

Employee benefits expenses

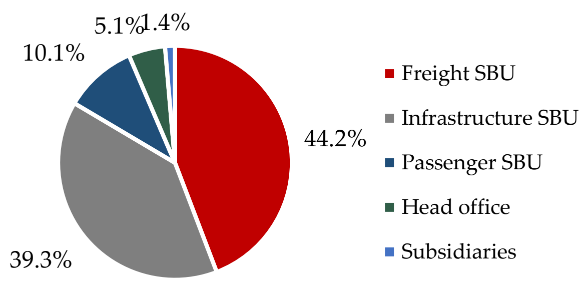
For the year ended 31 December | *In GEL '000*

	2017	2016	% Change	Abs. change
Salary	125,632	125,938	-0.2%	-306
Bonus-reward	6,882	6,188	11.2%	694
Other benefits	15,788	14,500	8.9%	1,285
Total	**148,302**	**146,626**	**1.1%**	**1,674**

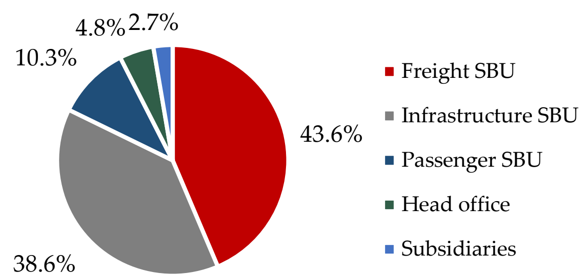
Factors influencing changes

The Group is one of the largest corporate employers and taxpayers in Georgia. This fact underlines its importance for the Government of Georgia along with other important economic and social benefits for the country. Total employee benefits expense increased by GEL 1.7 million in 2017, compared to 2016, mainly driven by an increase in insurance expenses of GEL 1.0 million.

Distribution of staff by business unit as at the end of 2017



Distribution of staff by business unit as at the end of 2017



Depreciation and amortization expenses

General description

The Group's depreciation and amortization expenses are mainly affected by capital additions and property retirements from disposal, sale or abandonment. The expenses are denominated in GEL and thus are not affected by fluctuations in foreign exchange rates.

Depreciation and amortization expenses

For the year ended 31 December | *In GEL '000*

	2017	2016	% Change	Abs. change
Depreciation and amortization	109,703	106,267	3.2%	3,435

Factors influencing changes

An increase in depreciation and amortization expenses in 2017, compared to 2016, was mainly driven by revision of useful lives for certain infrastructure assets, purchase of new passenger trains, as well as an increase of PP&E as a result of the Group's investments in infrastructure.

Electricity expenses

General description

Approximately 97 percent of GR's rail network is electrified. Until September 2011, the Company purchased most of its electricity on the open market in Georgia. In 2011, the Company signed a ten-year contract with the electricity provider, JSC Energo-pro Georgia, securing a fixed price for more than 90% of its electricity needs (subject to certain circumstances in which these tariffs can be increased). The tariffs are denominated in GEL.

Electricity expenses are split into the following two categories: electricity expenses of traction, which are driven by transportation turnover (the Group uses electric locomotives for freight transportation and diesel locomotives for shunting operations); and utility expenses which are not related to transportation volume and are normally considered to be fixed.

Electricity expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Electricity expenses of traction	17,537	18,373	-4.6%	-836
Utility expenses	3,333	3,314	0.6%	19
Total	**20,869**	**21,687**	**-3.8%**	**-818**

Factors influencing changes

The decrease in electricity expenses of traction in 2017 compared to 2016, was caused by decreased turnover, which was partly offset by increased average electricity tariffs.

Purchased electricity and weighted average tariff

For the year ended 31 December

	2017			2016		
	GWH	Gross ton-km (MM)	Weighted av. tariff (GEL)	GWH	Gross ton-km (MM)	Weighted av. tariff (GEL)
January	14.5	620.3	0.121	12.5	491.3	0.119
February	12.6	497.4	0.121	13.5	586.8	0.119
March	12.5	490.7	0.119	12.7	536.2	0.115
April	11.4	416.7	0.118	12.0	498.1	0.116
May	10.9	408.3	0.117	12.0	502.9	0.116
June	11.5	451.7	0.116	12.4	537.8	0.116
July	12.4	459.5	0.116	13.1	562.4	0.116
August	12.3	465.8	0.117	15.5	684.6	0.117
September	12.6	489.3	0.118	13.8	596.4	0.116
October	12.0	463.1	0.119	13.8	593.6	0.117
November	12.5	480.9	0.119	12.4	508.7	0.117
December	12.8	484.9	0.119	13.5	533.4	0.117
Total	**148.1**	**5,728.6**	**0.118**	**157.3**	**6,632.1**	**0.117**

Note: The table above includes only electricity consumed of traction.

Materials, repair and maintenance expenses

General description

The Group consumes materials for repair works performed internally by its own employees. This consumption is presented under "materials expenses." However, some repair works are outsourced and are presented under "repair and maintenance expenses."

The Group's materials, repair and maintenance expenses are all tied to its rolling stock equipment balance, their utilization level and transportation volume. When the transportation volume and transportation by the Group's own rolling stock increases, so too do the expenses for materials, repair and maintenance. However, these expenses can also be affected by increased capital expenditure on the fleet and infrastructure, which reduces operating expenditure on repairs.

Materials, repair and maintenance expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Materials expenses	11,565	14,121	-18.1%	-2,557
Repair and maintenance expenses	3,820	7,175	-46.8%	-3,356
Total	**15,385**	**21,296**	**-27.8%**	**-5,912**

Factors influencing changes

A 28 percent decrease in materials, repair and maintenance expenses during 2017, compared to 2016, was mainly driven by fewer repair works as a result of a downturn in cargo volumes.

Fuel expenses

General description

The Group's fuel consumption principally relates to diesel locomotives fulfilling shunting operations. It should be noted that the main subject for these operations is dry cargo. In everyday business processes, diesel-locomotives are used for railcar marshaling, freight pick-up and delivery at customer facilities.

Another factor affecting fuel expenses is the nature of the cargo (whether it is import, export, local or transit). While transit cargo is mainly served at one of the Group's stations, most local, export and import cargoes are served in their origin and destination stations.

Fuel expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Fuel expenses	5,237	4,306	21.6%	931

Factors influencing changes

Total fuel expenses increased by 22 percent (GEL 0.9 million) in 2017, compared to 2016. This change was mainly caused by an increase in fuel prices.

Freight car rental expenses

General description

Freight car rental expenses comprise short-term rent expenses derived from the usage of other railways' railcars by the Group, for which it is charged a daily fee. This expense counters the freight car rental revenue. The expense is based on CHF tariffs and is thus tied to the GEL/CHF exchange rate and the amount of cargo GR transports using other railways' railcars.

Freight car rental expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Freight car rental expenses	4,095	4,407	-7.1%	-312

Factors influencing changes

Despite the CHF appreciating against the GEL by about 6 percent in 2017 compared to 2016, freight car rental expenses decreased by 7 percent (GEL 0.3 million). This decrease was largely driven by a fall in freight volumes and by reduced usage of Azerbaijani tank cars by GR.

Logistical services

General description

Expenses for logistical services refer to operating expenses relating to transportation and other logistics-related services of GR's subsidiaries operating in freight forwarding and logistics fields.

Logistical services

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Logistical services	12,996	14,270	-8.9%	-1,274

Factors influencing changes

Expenses for logistical services in 2017 decreased by 9 percent (GEL 1.3 million) compared to 2016. The decrease was mainly caused by the reduced expenses of one of GR's subsidiaries that mainly serves crude oil and oil products transported by the Company.

Security and other operating expenses

General description

Security expenses mainly comprise the Group's buildings, depots and station protection expenses.

Other operating expenses mainly consist of items such as communication, legal costs, consulting services, membership fees, rent expenses and advertising expenses.

Security and other operating expenses are mostly denominated in GEL and are mainly fixed.

Security and other operating expenses

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Security	8,918	8,928	-0.1%	-10
Other op. expenses	18,818	9,589	96.3%	9,229
Total	**27,736**	**18,517**	**49.8%**	**9,219**

Factors influencing changes

The 49.8 percent increase in security and other operating expenses in 2017, compared to 2016, was caused by an increase in other operating expenses, specifically an increase in other tax expenses, which occurred by difference of accounting and tax cards by GEL 7.8 million. Security expenses have remained at about the same level.

Taxes other than income tax

General description

Land taxes are determined by the municipalities in which the land is located, while property taxes are calculated at 1 percent of the average book value of the asset. Railway infrastructure assets, such as rail lines, are exempt from property tax.

Taxes other than income tax

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Property tax	14,122	14,086	0.3%	36
Land tax	11,821	11,248	5.1%	572
Other taxes*	1,100	1,141	-3.6%	-41
Total	**27,043**	**26,475**	**2.1%**	**567**

* *Other taxes also include all subsidiaries' taxes (other than income tax).*

Factors influencing changes

The increase in property tax of 0.3 percent during 2017, compared to 2016, was largely driven by the implementation of the Modernization Project, but it was offset by tax reductions on property and land because of impairment loss incurred in 2017. Property tax will be reduced after the Modernization Project is put into operation, as railway-related assets are free from property tax, and assets under the project are taxed under property tax while under construction.

Impairment loss on property, plant and equipment

Impairment loss on property, plant and equipment

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Impairment loss on property plant and equipment	-382,616	0	NA	-382,616

Factors influencing changes

In June 2013, the Group announced a decision to redesign the Tbilisi Bypass Project. The Group held negotiations with the Government of Georgia and with the main third-party construction companies to agree a plan for the conservation of the project for the period of its redesigning. All construction works in progress were substantially completed by the end of October 2013 and further construction was suspended. No borrowing costs have been capitalized since October 2013.

In March 2014, the Government of Georgia decided that the suspension of the construction of the Tbilisi Bypass Project would last 18 months until the final modified project would be presented.

During 2015 and 20165, the Group was in discussions with Tbilisi City Hall and the Government of Georgia about various scenarios of completing the Project. One of the scenarios under discussion included changing the original bypass location, because of which the existing bypass infrastructure may become redundant. The alternative scenarios also included determining the future use of the existing infrastructure, should it become redundant. The options for the future use of the infrastructure included a bypass automobile road, light rail/extension of the Tbilisi Metro System, and freight depot. However, as at 31 December 2017, no decision had yet been made by the Government of Georgia about the redesign of the Tbilisi Bypass Project.

Due to significant uncertainties associated with either the continuation of the existing project or the implementation of any of the other scenarios, and envisaging the change in the existing use of the project, as well as considering the fact that the Management does not expect the project to generate any future economic benefit for the Group either individually or in combination with other non-current assets, the carrying value of the project was written-down to its recoverable amount.

As a result, the carrying amount of the project of GEL 397,305,000 was determined to be higher than its recoverable amount of GEL 14,689,000 and the respective impairment loss of GEL 382,616,000 was recognized in the impairment loss for 2017.

Impairment loss on property, plant and equipment is a non-cash expense and, thus, is not included in the calculation of EBITDA. On the contrary, it reduces the net book value of PP&E, thus property tax (calculated as 1% of average net book value) is reduced. In 2017, a saving of GEL 1.8 million was made in property tax, thereby increasing EBITDA by the same amount. The property tax saving effect will double in 2018.

5.5 Finance Income and Cost

General description

Finance income of the Group mainly consists of interest accrued on the Group's cash balances and foreign exchange gains.

Finance cost mainly consists of interest expenses and foreign exchange losses. Some of the Group's interest expenses are capitalized, as the Group's main debt obligations were issued in order to finance capital projects (Modernization and Tbilisi Bypass). Thus, until the projects are in the construction phase, part of the interest accrued is capitalized in accordance with International Financial Reporting Standards (IFRS).

The main source of FX gain or loss is the Group's Eurobonds, which are denominated in USD. This is, however, partly countered by the Group's USD cash balances and receivables in foreign hard currencies. It must be noted that such FX gain or loss on Eurobonds is not monetary in nature and will not be realized until maturity. The Group's revenues are mostly denominated in hard currencies (81 percent in USD and 4 percent in CHF, based on 2017's revenue). As most of the tariffs are set in USD, the Group's revenue creates a natural economic hedge against foreign exchange fluctuations.

Finance income and cost

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Interest income	17,793	23,882	-25.5%	-6,089
Impairment loss on trade receivables	-39,330	-7,972	393.4%	-31,358
Impairment loss on issued loans	-23,502	0	N/A	-23,502
Interest expenses	-53,433	-52,822	1.2%	-611
FX gain/loss	25,488	-112,309	-122.7%	137,797
Total	**-72,984**	**-149,221**	**-51.1%**	**76,237**

Factors influencing changes

Net financial loss in 2017 decreased by 44 percent (GEL 65.4 million) compared to the previous year. This decrease was mainly caused by an FX gain of GEL 25.5 million in 2017, compared to an FX loss of GEL 112.3 million in 2016.

A drop on interest income of GEL 6.1 million in 2017, compared to 2016, was mainly due to lower average cash balances and lower interest rates. In addition, in 2016, GR received interest income from the loan provided to the state-controlled entity by the end of 2015, which was fully repaid during 2016.

A GEL 31.3 million increase in impairment loss on trade receivables was mainly caused by the provision of GEL 27.1 million made against the VAT receivable from the Government, created as a result of the land plots transfer transaction.

Impairment loss on issued loans of GEL 23.5 million in 2017 represents a provision made against the loan provided to the entity managed by the Group.d

An increase in interest expense during 2017, compared to 2016, was due to additional borrowing of USD 20.3 million to finance the procurement of new passenger trains and the depreciation of GEL against USD by 6 percent.

GEL/USD exchange rate fluctuation has a significant effect on net finance income/cost. Due to GEL's appreciation against USD by 2 percent as at 31 December 2017 compared to 31 December 2016 (GEL/USD exchange rate of 2.59:1 versus 2.65:1), the Group experienced a net foreign exchange gain of GEL 25.5 million, however due to the depreciation of GEL against USD by 10 percent as at 31 December 2016 compared to 31 December 2015 (GEL/USD exchange rate 2.65:1 versus 2.39:1), the Group recorded a net foreign exchange loss of GEL 112.3 million.

5.6 Income Tax Expense/Benefit

General description

In May 2016, the Parliament of Georgia adopted amendments to the Tax Code of Georgia. The new tax code became effective from 1 January 2017. According to the new tax code, previously active profit tax regulation was changed to the so-called "tax on distributed profits" model.

Income tax expense/benefit

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Current tax expense				
Current year	-648	-5,532	-88.3%	4,884
Deferred tax benefit				
Change in recognized temporary differences (due to change in legislation)	0	44,391	-100.0%	-44,391
Total	**-648**	**38,859**	**-101.7%**	**-39,507**

Factors influencing changes

The changes in tax legislation led to the termination of deferred tax accruals. In response, GR reversed deferred tax assets and liabilities in its profit or loss statement, causing a deferred tax benefit of GEL 44.4 million in 2016.

6. Balance Sheet

6.1 Non-current Assets

Non-current assets

As at 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Property, plant and equipment	2,368,380	2,623,594	-9.7%	-255,214
Other non-current assets	123,562	147,565	-16.3%	-24,003
Loans receivable	18,113	35,717	-49.3%	-17,604
Total	**2,510,055**	**2,806,876**	**-10.6%**	**-296,821**

Factors influencing changes

Property, plant and equipment – A GEL 255.2 million decrease in property, plant and equipment in 2017, compared to 2016, was mainly due to the impairment loss of the Tbilisi Bypass Project.

Loans receivable - In 2016, the Group issued long-term loans amounting in total to USD 14.5 million. The loans were issued in USD, at market rates. USD 6 million was provided to its shareholder. In addition, USD 8.5 million was issued in 2016 to the owner of liquid cargo terminals on the Black Sea, which is under the management of the Group. The provision was made against this amount in 2017.

6.2 Current Assets

Current assets

As at 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Inventories	32,807	29,752	10.3%	3,055
Loans receivable	0	3,974	-100.0%	-3,974
Tax assets	2,360	7,129	-66.9%	-4,769
Trade and other receivables	73,614	99,649	-26.1%	-26,035
Prepayments and other current assets	383	350	9.4%	33
Cash and cash equivalents	243,018	277,953	-12.6%	-34,935
Total	**352,182**	**418,807**	**-15.9%**	**-66,625**

Factors influencing changes

Loans receivable - Loans receivable as at the end of 2016 represent the current portion of the loans issued in 2016 and provided to the entity managed by the Group, against which the provision was made in 2017.

Trade and other receivables – Out of the total decrease of GEL 26.0 million, a decrease of GEL 27.1 million in 2017 was driven by provision made against the VAT receivable from the Government, created as a result of the land plots transfer transaction.

6.3 Equity

Equity

As at 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Share capital	1,053,271	1,053,004	0.0%	267
Non-cash owner contribution reserve	98,192	98,312	-0.1%	-120
Retained earnings	93,385	447,960	-79.2%	-354,575
Total	**1,244,848**	**1,599,276**	**-22.2%**	**-354,428**

There was a GEL 354.4 million decrease in total equity in 2017 compared to the previous year. This decrease was mainly due to the impairment loss incurred by impairment of the Tbilisi Bypass Project.

6.4 Non-current Liabilities

Non-current liabilities

As at 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Loans and borrowings	1,374,363	1,361,602	0.9%	12,760
Advances received from the Government	46,594	73,809	-36.9%	-27,215
Total	**1,420,957**	**1,435,411**	**-1.0%**	**-14,454**

Factors influencing changes

Loans and borrowings - In 2016, the Group raised funds through export credit to finance the acquisition of four new passenger trains, two of which were delivered in 2016, and two of which were delivered in 2017; all are currently in operation. The total credit facility was USD 43.7 million. GEL 42.8 million at the end of 2016 and GEL 80.3 million at the end of 2017 were classified as non-current loans and borrowings. The remaining GEL 1,294,069 million of non-current loans and borrowings as at 31 December 2017, represents Eurobonds maturing in 2022.

Eurobonds and Export credit facility

For the year ended 31 December

Type	Date of maturity	Amount (in mln)	Currency	Coupon/percent	Payments
Eurobonds	11-Jul-22	500.0	USD	7.75%	Semi-annually
Export credit facility	10-Nov-26	39.2	USD	LIBOR+1.25%	Semi-annually

Advances received from the Government – These decreased, mainly due to the land plots transfer transaction, mentioned in subheading 1.2 "Income from transferred property."

6.5 Current Liabilities

Current liabilities

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Loans and borrowings	58,809	57,172	2.9%	1,637
Trade and other payables	112,221	109,638	2.4%	2,583
Liabilities to the Government	7,592	8,399	-9.6%	-807
Provisions	7,953	8,547	-6.9%	-594
Other current liabilities	9,857	7,240	36.1%	2,617
Total	**196,432**	**190,996**	**2.8%**	**5,435**

Factors influencing changes

Loans and borrowings – Currently, the Group has two debts, Eurobonds and a secured loan, obtained for the sole purpose of the acquisition of passenger trains. As at 31 December 2017, current loans and borrowings include interest payable of about GEL 47.1 million, and the current portion of long-term borrowing is GEL 11.7 million, which was entered into to finance new passenger trains. A GEL 1.6 million increase in current loans and borrowings was caused by the withdrawal of additional amount of loan in 2017, which was partly offset by appreciation of GEL against USD as at balance sheet dates by 2.1 percent, caused by the revaluation of debt, as the Group's debts are denominated in USD.

Trade and other payables - In 2017, trade and other payables increased by 2 percent (GEL 2.6 million). The main contributor to this increase was the increase in payables for the Modernization Project, which was partly offset by a reduction in payables for new passenger trains acquired.

7. Cash flow statement

By the end of 2017, the Group held GEL 243.0 million of cash and cash equivalents. These cash resources are held to support existing and future capital expenditure. Capital expenditure mainly entails the Modernization Project and the Tbilisi Bypass Project. Works on the Modernization Project continued in 2017, while the Tbilisi Bypass Project remained suspended.

The Group can also rely on its available credit lines of about GEL 158.8 million as at the end of 2017.

The Group mainly relies on its operating activities in order to fund its future cash requirements.

7.1 Operating Activities

Operating activities

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Cash receipts from customers	447,510	456,742	-2.0%	-9,232
Cash paid to suppliers and employees	-268,593	-264,102	-1.7%	-4,491
Income tax paid	-2,685	-5,229	-48.7%	2,544
Net cash from operating activities	**176,232**	**187,411**	**-6.0%**	**-11,179**

Factors influencing changes

Net cash from operating activities decreased by GEL 2.8 million in 2017, compared to 2016. This change was driven by a decrease in cash receipts from customers of GEL 9.2 million, mainly due to the decreased transportation volume.

7.2 Investing Activities

Investing activities

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Acquisition of property, plant and equipment	-165,265	-200,274	100.00%	35,009
Proceeds from sale of property, plant and equipment	5,133	3,350	53.20%	1,783
Interest received	14,805	22,435	-100.00%	-7,630
Issuance of loans	0	-32,563	-100.00%	-32,563
Repayment of issued loans	0	37,838	-100.00%	-37,838
Dividends received	0	1,075	-100.00%	-1,075
Net cash used in investing activities	**-145,327**	**-168,139**	**13.57%**	**22,812**

Factors influencing changes

Cash paid for the acquisition of property, plant and equipment in 2017 decreased by GEL 35.0 million compared to 2016, which was mainly due to decreased capital expenditure on the Modernization Project (GEL 91.5 million in 2017, compared to GEL 108.9 million in 2016). The Modernization Project is scheduled to be finished at the end of 2019. Another large component was cash paid for the procurement of four new passenger trains (two of them in 2016 and another two in 2017) from a Swiss manufacturer (GEL 50.2 million and GEL 42.3 million in 2017 and 2016, respectively).

The decrease in interest received was mainly due to a lower average cash balance held by the Group and lower interest rates during the period under review, compared to the same period of the previous year.

Issuance of loans (GEL 32.6 million) in 2016 comprised USD 6 million provided to the parent company and USD 8.5 million provided to the owner of a liquid cargo terminal on the Black Sea.

Repayment of the issued loans (GEL 37.8 million) mainly comprises the collection of a short-term loan (USD 16 million) that the Group provided to a state-controlled entity at the end of 2015 and the partial collection of the principal due from the loan provided to the owner of a liquid cargo terminal on the Black Sea.

7.3 Financing Activities

Financing activities

For the year ended 31 December *In GEL '000*

	2017	2016	% Change	Abs. change
Interest paid	-103,127	-91,948	12.2%	-11,179
Dividends paid	0	-1,607	-100.0%	-1,607
Repayment of borrowings	-10,996	0	N/A	-10,996
Proceeds from borrowings	50,248	42,349	18.7%	7,899
Net cash used in financing activities	**-63,874**	**-51,206**	**24.7%**	**-12,668**

Factors influencing changes

An increase in interest paid in 2017, compared to 2016, was mainly due to the interest paid on loan for passenger trains and depreciation of GEL against USD as the Group's debts are denominated in USD.

Repayment of borrowings of GEL 11.0 million comprises the amount paid for the current portion of the loan acquired for new passenger trains.

Proceeds from borrowings of GEL 50.2 million comprise the loan for financing the purchase of the new passenger trains.

Appendix

Appendix 1

Breakdown of freight transportation in tons

For the year ended 31 December *In million tons*

	2017	2016	% Change	Abs. change
Liquid cargoes	**4.3**	**5.5**	**-20.9%**	**-1.1**
Oil products	3.9	3.7	7.1%	0.3
Crude oil	0.4	1.8	-77.8%	-1.4
Dry cargoes	**6.3**	**6.4**	**-1.0%**	-0.1
Ores	1.4	1.5	-2.1%	-0.0
Grain	0.3	0.4	-32.5%	-0.1
Ferrous metals and scrap	0.5	0.7	-20.2%	-0.1
Sugar	0.4	0.5	-24.2%	-0.1
Chemicals and fertilizers	0.6	0.4	31.8%	0.1
Construction freight	1.2	1.1	8.6%	0.1
Industrial freight	0.3	0.3	11.7%	0.0
Cement	0.1	0.1	53.2%	0.0
Other	1.6	1.5	5.1%	0.1
Total	**10.7**	**11.9**	**-10.2%**	**-1.2**

Appendix 2

Breakdown of freight transportation in ton-kilometers

For the year ended 31 December

In million ton-kilometers

	2017	2016	% Change	Abs. change
Liquid cargoes	**1,379**	**1,802**	**-23.5%**	**-423**
Oil products	1,221	1,088	12.3%	133
Crude oil	158	714	-77.9%	556
Dry cargoes	**1,551**	**1,589**	**-2.4%**	**-38**
Ores	296	311	-4.6%	-14
Grain	75	141	-46.4%	-65
Ferrous metals and scrap	123	163	-24.3%	-40
Sugar	135	184	-26.7%	-49
Chemicals and fertilizers	184	133	38.8%	52
Construction freight	160	142	12.4%	18
Industrial freight	53	39	35.8%	14
Cement	22	17	30.9%	5
Other	502	461	9.0%	42
Total	**2,930**	**3,391**	**-13.6%**	**-461**

Appendix 3

Calculations of ratio of Net Financial Indebtedness to EBITDA:

'000 GEL	Twelve-month period ended 31-Dec-17	Twelve-month period ended 31-Dec-16
Revenue	434,534	439,922
Income from the transferred property	23,417	80,294
Other income	15,560	19,122
Impairment loss on property, plant and equipment	-382,616	
Employee benefits expenses	-148,300	-146,626
Depreciation and amortization expense	-109,703	-106,267
Electricity, consumables and maintenance costs	-41,490	-47,289
Other expenses	-71,869	-63,668
Results from operating activities	**-280,467**	**175,488**
Finance income	43,281	23,882
Finance costs	-116,265	-173,103
Net finance costs	**-72,984**	**-149,221**
Profit/(loss) before income tax	**-353,451**	**26,267**
Income tax (expense)/ benefit	-648	38,859
Profit/(loss)and total comprehensive income/(loss) for the year	**-354,099**	**65,126**
Results from operating activities	**-280,467**	**175,488**
Depreciation add-back	109,703	106,267
Impairment loss on property, plant and equipment add-back	382.616	0
EBITDA	**211,852**	**281,755**
Net Financial Indebtedness:		
Financial Indebtedness	1,433,172	1,418,774
less:		
Available Credit Facilities	158,833	161,400
Cash	243,018	277,953
Net Financial Indebtedness:	**1,031,321**	**979,422**
Net Financial Indebtedness/EBITDA	**4.87**	**3.48**

Glossary

Average revenue per passenger-kilometer: Unit of measurement calculated as passenger traffic revenue per passenger-kilometer

BTC: Baku-Tbilisi-Ceyhan

BTK: Baku-Tbilisi-Kars

Cargo type mix: The Group's transportation is divided into different cargo categories (such as grain, ore, sugar, etc.). These categories also comprise many sub-categories.

CEO: Chief Executive Officer

CFO: Chief Financial Officer

CIS: Commonwealth of Independent States

CJSC: Closed Joint Stock Company

CPC: The Caspian Pipeline Consortium

EBIT: Earnings before interest and tax

EBITDA: Earnings before interest, taxes, depreciation, and amortization

EMU: Electric Multiple Unit

EU: European Union

FEZ: Free Economic Zone

FX: Foreign Exchange. The value of the Georgian Lari relative to the US Dollar or any other currency.

GDP: Gross Domestic Product

GEL: Georgian Lari

GMS: General Meeting of Shareholders

GR: Georgian Railway

JSC GRC: Georgian Railway Construction

LLC IFRS: International Financial Reporting Standards

JSC: Joint-stock Company

LLC: Limited Liability Company

NM: Not Meaningful

OPEC: The Organization of the Petroleum Exporting Countries. OPEC comprises 13 member countries: Iran, Iraq, Kuwait, Saudi Arabia, Venezuela, Qatar, Libya, the United Arab Emirates, Algeria, Nigeria, Ecuador, Gabon and Angola.

OTB: Open Top Box railcars

PPE: Property, plant and equipment

Revenue per ton-kilometer: The term refers to the average revenue that the Group receives per ton-kilometer, calculated by dividing the freight revenue for a commodity by the ton-kilometer of the given period.

SBU: Strategic Business Unit

SEZ: Special Economic Zone

TEU: Twenty-Foot Equivalent Unit

Tetri: Minor unit of Georgian national currency

The Company: Georgian Railway

TITR: Trans-Caspian International Transport Route

The Government: The Government of Georgia

The Group: Georgian Railway and its subsidiaries

The State: Republic of Georgia

Ton-kilometer: Unit of measurement representing the movement over a distance of one kilometer of one ton of contents (also referred as tkm or ton-km)

TRACECA: Transport Corridor Europe Caucasus Asia Transportation direction mix: The Group performs transportation to different countries (Kazakhstan, Armenia, Georgia, Azerbaijan etc.) which form the Group's direction mix.

Consolidated Financial Statements

Georgian Railway JSC

Consolidated Financial Statements for 2017

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Independent Auditors' Report

To the Shareholder of Georgian Railway JSC

Opinion

We have audited the consolidated financial statements of Georgian Railway JSC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of Tbilisi Bypass Project	
The key audit matter	**How the matter was addressed in our audit**
As described in note 11 (b) to the consolidated financial statements, Tbilisi Bypass Project (the Project) has been suspended since October 2013. Due to significant uncertainties associated with the continuation of the Project, the Group has determined that there is an indication of impairment and assessed the recoverable amount of the Project. The Project related construction in progress to date amounted to GEL 397 million and its impairment is therefore a Key Audit Matter.	We have performed the following audit procedures to address the key audit matter: - Obtained a schedule of work performed on the Tbilisi Bypass Project to date and evaluated the existence and completeness of that population, including the assessment of the physical obsolescence of those assets through carrying out a physical inspection of sections of the Project; - Assessed the existence of necessary plans, envisaging the construction under various scenarios, through the inquiries with the Group Management including requesting a copy of the latest feasibility study that was in progress as of the date the prior year consolidated financial statements were authorized for issue to assess the findings of that study; - Analysed alternative scenarios for the continuation of the Project; - Confirmed with management that there was no credible alternative to discontinuation of the Project; - Challenged management's assessment that the Group would not generate any benefit from either the continuing use or sale of the Project assets, except for the sellable land plots under the Project; - Involved our own valuation specialists to challenge the key assumptions and judgements used in the determination of the recoverable amount of the Project; - In particular, we evaluated the valuation technique applied by the management to estimate the fair value of Land plots located under the Project; and - Evaluated the adequacy of the disclosures made in Note 11 (b) of the consolidated financial statements by reference to the requirements of IAS 36 – Impairment of Assets and IAS 1 – Presentation of financial statements.

Impairment of Property, Plant and Equipment (except for Tbilisi Bypass Project)	
The key audit matter	**How the matter was addressed in our audit**
As described in note 1 (b) and note 11 (c) to the consolidated financial statements, the Group experienced a continuing decline in the cargo volumes and revenues compared to the prior years. Consequently, the Group determined that there is an indication of an impairment and conducted an impairment test of the Group's property, plant and equipment.	We have performed the following audit procedures to address the key audit matter: - Performed inquiries of management to obtain an understanding of the process for the impairment analysis; - Evaluated the design and implementation of the processes and internal controls of the Group, surrounding the preparation of the impairment model, to assess the reliability and accuracy of the Group's forecasting and budgeting process; - Involved our own valuation specialists to challenge the key assumptions and judgements underpinning the impairment-testing model, such as inflation rate,

The impairment of property, plant and equipment is a Key Audit Matter due to the level of judgement involved in our evaluation of Management's impairment analysis and increased inherent estimation uncertainties involved in the forecasting and discounting future cash flows related to the impairment model assessment.	discount rate, period of cash flow projections (to 2037), annual maintenance capital expenditure, payments for the finalisation of the Main Line Modernization project and liquid and dry cargo growth rates; - We compared the current year's actual results with the figures for the same period included in the impairment model prepared as at 31 December 2016, to assess management's ability to accurately budget the expected results; - We obtained the Group's budget for the year ending 31 December 2018 and assessed whether expected cash flows in that budget are comparable with those included in the prior year and current year's impairment model; - We obtained and evaluated the Market Study and Traffic Forecast feasibility study confirming the increased cargo flow, resulting from the completion of Anaklia Deep Sea Port; - We have obtained and evaluated Protocol of meeting between Georgian and Azerbaijan railways supporting the expected increase in cargo flow, resulting from the cooperation of those railways. - We evaluated the sensitivity of the impairment model outcomes by considering the downside scenarios against reasonably plausible changes to the key assumptions; and - We evaluated the adequacy of the disclosures made in Note 1 (b) and Note 11 (c) of the consolidated financial statements by reference to the requirements of IAS 36 –Impairment of Assets and IAS 1 – Presentation of financial statements.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report but does not include the consolidated financial statements and our auditors' report thereon.

The Annual Report is expected to be made available to us after the date of this auditors' report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is

Andrew Coxshall:

A Coxshall

KPMG Georgia LLC
3 July 2018

’000 GEL	Note	2017	2016
Assets			
Property, plant and equipment	11	2,368,380	2,623,594
Loans receivable	12	18,113	35,717
Other non-current assets	13	123,562	147,565
Non-current assets		**2,510,055**	**2,806,876**
Inventories	14	32,807	29,752
Loans receivable	12	-	3,974
Tax assets		2,360	7,129
Prepayments and other current assets		383	350
Trade and other receivables	15	73,614	99,649
Cash and cash equivalents	16	243,018	277,953
Current assets		**352,182**	**418,807**
Total assets		**2,862,237**	**3,225,683**
Equity			
Share capital	17 (a)	1,053,271	1,053,004
Non-cash owner contribution reserve	17 (b)	98,192	98,312
Retained earnings		93,385	447,960
Total equity		**1,244,848**	**1,599,276**
Liabilities			
Loans and borrowings	19	1,374,363	1,361,602
Advance received from the Government	17 (e)	46,594	73,809
Non-current liabilities		**1,420,957**	**1,435,411**
Loans and borrowings	19	58,809	57,172
Trade and other payables	20	112,221	109,638
Liabilities to the Government	17 (c)	7,592	8,399
Provisions	21	7,953	8,547
Other current liabilities		9,857	7,240
Current liabilities		**196,432**	**190,996**
Total liabilities		**1,617,389**	**1,626,407**
Total equity and liabilities		**2,862,237**	**3,225,683**

The 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 12 to 47.

'000 GEL	**Share capital**	**Non-cash owner contribution reserve**	**Retained Earnings**	**Total equity**
Balance at 1 January 2016	1,052,605	34,214	384,391	1,471,210
Profit and total comprehensive income for the year	-	-	65,126	65,126
Transactions with owner, recorded directly in equity				
Increase in share capital (note 17 (a))	399	122	-	521
Non-cash contribution from owner	-	1,631	-	1,631
Reversal of deferred tax asset (note 10 (b))	-	-	(1,557)	(1,557)
Transfer of the property to the Government (note 17 (e))	-	62,345	-	62,345
Total transactions with owner, recorded directly in equity	**399**	**64,098**	**(1,557)**	**62,940**
Balance at 31 December 2016	**1,053,004**	**98,312**	**447,960**	**1,599,276**
Balance at 1 January 2017	1,053,004	98,312	447,960	1,599,276
Loss and total comprehensive loss for the year	-	-	(354,100)	(354,100)
Transactions with owner, recorded directly in equity				
Increase in share capital (note17 (a))	267	-	-	267
Non-cash distribution to owner	-	(120)	(475)	(595)
Total transactions with owner, recorded directly in equity	**267**	**(120)**	**(475)**	**(328)**
Balance at 31 December 2017	**1,053,271**	**98,192**	**93,385**	**1,244,848**

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 12 to 47.

'000 GEL	**Note**	**2017**	**2016**
Revenue	6	434,534	439,922
Income from the transferred property	17 (e)	23,417	80,294
Other income		15,560	19,122
Impairment loss on property, plant and equipment	11 (b) (c)	(382,616)	-
Employee benefits expense		(148,302)	(146,626)
Depreciation and amortization expense		(109,703)	(106,267)
Electricity, consumables and maintenance costs	7	(41,490)	(47,289)
Other expenses	8	(71,868)	(63,668)
Results from operating activities		**(280,468)**	**175,488**
Finance income	9	43,281	23,882
Finance costs	9	(116,265)	(173,103)
Net finance costs		**(72,984)**	**(149,221)**
(Loss) / profit before income tax		**(353,452)**	**26,267**
Income tax (expense) / benefit	10	(648)	38,859
(Loss) / profit and total comprehensive (loss) / income for the year		**(354,100)**	**65,126**

These consolidated financial statements were approved by the Management Board on 03 July 2018 and were signed on its behalf by:

David Peradze
General Director

Tamazi Jgerenaia
Chief Accountant

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 47.

’000 GEL	**Note**	**2017**	**2016**
Cash flows from operating activities			
Cash receipts from customers		447,510	456,742
Cash paid to suppliers and employees		(268,593)	(264,102)
Cash flows from operations before income taxes paid		**178,917**	**192,640**
Income tax paid		(2,685)	(5,229)
Net cash from operating activities		**176,232**	**187,411**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(165,265)	(200,274)
Proceeds from sale of property, plant and equipment		5,133	3,350
Interest received		14,805	22,435
Dividends received		-	1,075
Issuance of loans		-	(32,563)
Repayment of issued loans		-	37,838
Net cash used in investing activities		**(145,327)**	**(168,139)**
Cash flows from financing activities			
Proceeds from borrowings	19 (b)	50,248	42,349
Repayment of borrowings	19 (b)	(10,996)	-
Interest paid	19 (b)	(103,126)	(91,948)
Dividends paid		-	(1,607)
Net cash used in financing activities		**(63,874)**	**(51,206)**
Net decrease in cash and cash equivalents		**(32,969)**	**(31,934)**
Cash and cash equivalents at 1 January		277,953	294,784
Effect of exchange rate fluctuations on cash and cash equivalents		(1,966)	15,103
Cash and cash equivalents at 31 December	16	**243,018**	**277,953**

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 12 to 47.

1. Reporting entity

(a) 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, 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 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.

(b) Organisation and operations

Georgian Railway JSC (the "Company") and its subsidiaries (the "Group") comprise Georgian joint stock and limited liability companies as defined in the Civil Code of Georgia. The Company was established as a state-owned enterprise in December 1998 by the Decree of the President of Georgia # 929 as an entity engaged in the provision of railway transportation services in Georgia. The Company's registration number is 03/4-965.

The Company's registered office is 15 Queen Tamar Avenue, Tbilisi 0112, Georgia.

The Group's principal activity is the operation of a nationwide railway system providing freight and passenger transportation services, freight forwarding services, maintenance and development of railway infrastructure and construction of railway lines within Georgia.

Most of the Group's revenue is derived from the freight transportation and freight forwarding services. Accordingly, the Group's results are particularly sensitive to the cargo flows through Georgia. Due to continued pressure from a challenging market environment, the Group's transportation volumes have been declining for the last 5 years from 5,899 million metric-ton per kilometer of cargo in 2012 to 3,073 million metric-ton per kilometer of cargo in 2017).
As a result, management identified indicators that the recoverable amount of the Group's cash-generating unit might be lower than its carrying value (see note 11 (c)).

However, management expect volumes in 2018 to be relatively stable before increasing significantly (21%) in 2019 as a result of signing a co-operation agreement with CJSC Azerbaijan Railways. Management also expect an increase in volumes from 2023 as a result of the Anaklia Deep Sea Port becoming operational.

The Company is wholly owned by Partnership Fund JSC, a wholly state-owned company. The ultimate controlling party of the Group is the Government of Georgia. Partnership Fund JSC produces publicly available consolidated financial statements.

Related party transactions are disclosed in note 26.

2. Basis of accounting

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

3. 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.

4. Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRSs requires management to make 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.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

- Note 11 (b) – impairment of Tbilisi Bypass Project;
- Note 11 (c) – impairment of property, plant and equipment (excluding Tbilisi Bypass Project);
- Note 12 (a) – impairment loss for loans receivable;
- Note 15 – impairment allowances for trade and other receivables;
- Note 17 (e) – fair value of the land plots transferred to the Government of Georgia.
- Note 28 (h) (iii) – useful lives and residual values of property, plant and equipment;

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Note 11 (c) – sensitivity of impairment of property, plant and equipment (excluding Tbilisi Bypass Project);

Measurement of fair values

Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- *Level 1*: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- *Level 2*: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- *Level 3*: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

Further information about the assumptions made in measuring fair values is included in the following notes:

- Note 17 (e) – fair value of the land plots transferred to the Government of Georgia.
- Note 22 (a) – fair value of financial assets and liabilities;

5. Operating segments

The Group has two 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 because they require different technology and marketing strategies. For each of the strategic business units, the Group's Management Board reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the Group's reportable segments:

- *Freight transportation* – includes transportation of goods and commodities and related services.
- *Passenger transportation* – includes transportation of passengers.

There are no inter-segment charges.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, which are the cost of maintaining the rail network used by both reportable segments, central overheads, interest and income tax, as included in the internal management reports that are reviewed by the Group's Management Board. 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 Group's Management Board does not monitor segment liabilities.

(i) Information about reportable segments

	Freight transportation		Passenger transportation		Total	
'000 GEL	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
External revenues	403,515	412,116	22,843	18,007	426,358	430,123
Depreciation and amortization	(41,939)	(41,638)	(9,245)	(9,345)	(51,184)	(50,983)
Reportable segment profit/(loss) before infrastructure costs, net impairment, interest cost and income tax	244,690	249,699	(10,104)	(16,946)	234,586	232,753
Reportable segment assets	314,442	369,903	204,211	163,350	518,653	533,253
Capital expenditure and other additions to non-current assets	5,098	20,504	60,881	55,998	65,979	76,502

(ii) Reconciliations of reportable segment revenues, profit or loss, assets and other material items

'000 GEL	**2017**	**2016**
Revenues		
Total revenue for reportable segments	426,358	430,123
Other revenue	8,176	9,799
Consolidated revenue	**434,534**	**439,922**

’000 GEL	**2017**	**2016**
Profit or loss		
Total profit or loss for reportable segments	234,586	232,753
Employee benefits expense – infrastructure and headquarters	(60,190)	(58,266)
Depreciation expenses – infrastructure and headquarters	(58,519)	(55,284)
Impairment – Infrastructure and headquarters	(382,616)	-
Net finance costs	(72,984)	(149,221)
Other net unallocated (expenses)/income	(13,729)	56,285
Consolidated (loss)/profit before income tax	**(353,452)**	**26,267**
Assets		
Total assets for reportable segments	518,653	533,253
Property, plant and equipment - infrastructure and headquarters	1,878,568	2,128,459
Other unallocated assets, principally cash and non-current assets	465,016	563,971
Consolidated total assets	**2,862,237**	**3,225,683**

(iii) Other material items 2017

’000 GEL	**Reportable segment totals**	**Infrastructure and headquarters**	**Consolidated totals**
Capital expenditure and other additions to non-current assets	65,979	153,214	219,193
Depreciation and amortization	51,184	58,519	109,703

(iv) Other material items 2016

’000 GEL	**Reportable segment totals**	**Infrastructure and headquarters**	**Consolidated totals**
Capital expenditure and other additions to non-current assets	76,502	178,859	255,361
Depreciation and amortization	50,983	55,284	106,267

(v) Geographical information

Approximately 90% of the Group’s revenue is generated in Georgia with the remainder generated in CIS countries. The non-current assets of the Group are located in Georgia.

(vi) Major customer

In 2017, one customer of the Group’s freight transportation segment represented approximately 8% of the Group’s total revenue (2016: 13%).

6. Revenue

’000 GEL	**2017**	**2016**
Freight traffic	312,960	345,586
Logistic services *	73,774	52,582
Passenger traffic	22,844	18,007
Freight car rental	16,780	13,948
Other	8,176	9,799
	434,534	**439,922**

* On 28 September 2017, GR Transit LLC concluded a Ship-or-Pay Agreement (SoP) with foreign company, according to which foreign company had to transport at least 1,200,000 metric tons of crude oil and oil and gas condensate (Cargo) until the end of 2017 using the Group railway infrastructure. Included in the logistics services during 2017 is the revenue recognised in the above regards, amounting to GEL 26,440 thousand.

Notwithstanding the above, no Cargo was transported during 2017, however, foreign company should still pay for the service, regardless of the Cargo transportation, as stipulated by the SoP (see note 15).

Railroad transportation in Georgia is a natural monopoly, however, the prices are not subject to government regulation. According to clause 64 of the Railway Code of Georgia, which came into force on 1 July 2005, the Government of Georgia allowed the Group to set the prices for all services provided, including freight transportation, freight transportation-related additional services and passenger transportation.

Tariffs for freight transportation are based on the International Rail Transit Tariff. The Group is a co-signatory of the Tariff Agreement together with CIS countries, Latvia, Lithuania and Estonia. The parties to the Agreement hold annual conferences to determine the tariff policy for the following year: each party declares tariffs denominated in Swiss Francs (CHF) for railway transportation and states the general rules that apply to and modify tariffs. The agreed tariffs indicate the maximum level of tariffs applicable.

7. Electricity, consumables and maintenance costs

’000 GEL	**2017**	**2016**
Electricity	20,868	21,687
Materials	11,565	14,121
Repair and maintenance	3,820	7,175
Fuel	5,237	4,306
	41,490	**47,289**

8. Other expenses

’000 GEL	**2017**	**2016**
Property and Land tax	27,043	26,474
Logistic services	12,996	14,270
Security	8,918	8,928
Other Tax	7,752	-
Freight car rental	4,095	4,407
Other *	11,064	9,589
	71,868	**63,668**

* Included in the other above are the fees paid to the audit firms of about GEL 220 thousand, for the provision of audit and other professional services.

9. Finance income and finance costs

’000 GEL	**2017**	**2016**
Recognised in profit or loss		
Interest income	17,793	23,882
Net foreign exchange gain	25,488	-
Finance income	**43,281**	**23,882**
Impairment loss on trade receivables (note 22 (b) (ii); note 15)	(39,330)	(7,972)
Impairment loss on loan receivables (note 12 (a))	(23,502)	-
Interest expense	(53,433)	(52,822)
Net foreign exchange loss	-	(112,309)
Finance costs	**(116,265)**	**(173,103)**
Net finance costs recognised in profit or loss	**(72,984)**	**(149,221)**

10. Income tax benefit

(a) Amounts recognized in profit or loss

The Group's applicable income tax rate is the income tax rate of 15% for Georgian companies.

'000 GEL	**2017**	**2016**
Current tax expense		
Current year	648	5,532
	648	**5,532**
Deferred tax benefit		
Change in recognised temporary differences (due to change in the legislation) *	-	(44,391)
	648	**(38,859)**

* Reversal of previously recognized deferred tax assets and liabilities is attributable to changes in Georgian tax legislation. On 13 May 2016 the Parliament of Georgia passed a bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly transfers 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 of 31 December 2016, the Group has recognized the full in 2016 effect of the change by derecognizing previously recognized deferred tax assets and liabilities through either the current period consolidated statement of profit or loss or through the retained earnings, depending on where the deferred tax was initially recognized. The deferred tax assets and liabilities initially recognized in equity as part of the Group's transition to IFRSs was reversed through the consolidated statement of profit or loss.

Reconciliation of effective tax rate:

	2017		2016	
	’000 GEL	**%**	**’000 GEL**	**%**
Dividends declared / Profit before income tax	-	100	26,267	100
Income tax at applicable tax rate	-	-	3,940	15
Income tax on other non-deductible expenses	648	-	-	-
Change in recognised temporary differences (due to change in the legislation)	-	-	(42,799)	(163)
	648	**-**	**(38,859)**	**(148)**

(b) Movement in temporary differences during 2016

’000 GEL	1 January 2016	Recognised in profit or loss	Recognised directly in equity	31 December 2016
Property, plant and equipment	(102,133)	103,690	(1,557)	-
Other non-current assets	(297)	297	-	-
Inventories	10,919	(10,919)	-	-
Trade and other receivables	21,136	(21,136)	-	-
Prepayments and other current assets	1,636	(1,636)	-	-
Loans and borrowings	6,277	(6,277)	-	-
Trade and other payables	120	(120)	-	-
Provisions	1,249	(1,249)	-	-
Other current liabilities	1,041	(1,041)	-	-
Tax loss carry-forwards	17,218	(17,218)	-	-
	(42,834)	**44,391**	**(1,557)**	**-**

11. Property, plant and equipment

'000 GEL	Land	Buildings and constructions	Rail track infrastructure	Transport, machinery, equipment and other	Construction in progress	Total
Cost or deemed cost						
Balance at 1 January 2016	545,471	130,003	903,552	902,225	748,482	3,229,733
Additions	206	681	700	70,640	182,052	254,279
Disposals and write offs	(3,917)	(1,041)	(12,423)	(10,646)	(1,372)	(29,399)
Transfers	102	198	48,437	5,845	(54,582)	-
Balance at 31 December 2016	**541,862**	**129,841**	**940,266**	**968,064**	**874,580**	**3,454,613**
Balance at 1 January 2017	541,862	129,841	940,266	968,064	874,580	3,454,613
Additions	319	61	255	65,710	181,133	247,478
Disposals and write offs	(3,622)	(3,468)	(25,853)	(5,251)	-	(38,194)
Transfers	125	3,626	41,470	2,828	(51,306)	(3,257)
Balance at 31 December 2017	**538,684**	**130,060**	**956,138**	**1,031,351**	**1,004,407**	**3,660,640**
Depreciation and impairment loss						
Balance at 1 January 2016	-	29,203	291,436	425,701	-	746,340
Depreciation for the year	-	4,210	44,025	57,853	-	106,088
Disposals and write offs	-	-	(12,167)	(9,242)	-	(21,409)
Balance at 31 December 2016	**-**	**33,413**	**323,294**	**474,312**	**-**	**831,019**
Balance at 1 January 2017	-	33,413	323,294	474,312	-	831,019
Depreciation for the year	-	3,934	47,976	57,563	-	109,473
Disposals and write offs	-	(1,326)	(25,316)	(4,206)	-	(30,848)
Impairment loss	32,101	-	-	-	350,515	382,616
Balance at 31 December 2017	**32,101**	**36,021**	**345,954**	**527,669**	**350,515**	**1,292,260**
Carrying amounts						
At 1 January 2016	545,471	100,800	612,116	476,524	748,482	2,483,393
At 31 December 2016	**541,862**	**96,428**	**616,972**	**493,752**	**874,580**	**2,623,594**
At 31 December 2017	**506,583**	**94,039**	**610,184**	**503,682**	**653,892**	**2,368,380**

(a) Construction in progress

By the end of 2010, the Group started two large capital projects:

- The Main Line Modernisation; and
- Tbilisi Bypass Project.

The Group commenced the initiation of the above projects in September 2010 and November 2010, respectively. The Group issued unsecured bonds in 2010 to partly finance the projects above. During 2012, the Group redeemed the bonds issued in 2010 by issuing new bonds for general corporate and liquidity management purposes (see note 19).

The borrowing costs of 2010 unsecured bonds were allocated to each of the project on a 59%/41% basis and were capitalized upon commencement of the above projects. The interest on the bonds issued in

2012 was capitalized on the above two projects in proportion to the costs incurred on those projects based on a capitalization rate of 8% (2016: 8%). Capitalised borrowing costs of GEL 50,687 thousand during 2017 relates to the Main Line Modernization project (2016: GEL 42,536 thousand).

(b) Impairment of Tbilisi Bypass Project (the Project)

In June 2013, the Group announced a decision to redesign the Tbilisi Bypass Project. The Group held negotiations with the Government of Georgia and with the main third party construction companies to agree a plan for the conservation of the Project for the period of redesigning. All construction works in progress were substantially completed by the end of October 2013 and further construction was suspended. No borrowing costs are capitalised since October 2013.

In March 2014, the Government of Georgia decided that the suspension of the construction of Tbilisi Bypass project will last for 18 months until the final modified project is presented.

During 2016 and 2015, the Group was in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. One of the scenarios under discussion included an option envisaging a change of the original bypass location, because of which the existing bypass infrastructure may become redundant. The alternative scenarios also included the determination of the future use of the existing infrastructure, should it become redundant. The options of future use of the infrastructure were bypass automobile road, light rail/extension of the Tbilisi Metro System, freight depot, etc., however, as at 31 December 2017 and the date these consolidated financial statements were authorized for issue, no decision was made by the Government of Georgia about the redesign of the Tbilisi Bypass Project.

Due to significant uncertainties associated with either the continuation of the existing Project or implementation of any other scenarios, envisaging the change in the existing use of the Project, and also considering the fact that Management does not expect that the Project will generate any future economic benefit to the Group either individually, or in combination with other non-current assets, the carrying value of the Project was written-down to its recoverable amount.

Selling price less cost to sell:

The carrying value of Tbilisi Bypass Project included the cost of land (Land located under the Project) and the costs incurred for the construction of the tunnels, bridges and other land related works (Specific Assets).

Due to the nature of these Specific Assets and the fact that the Group would not generate any benefit from either their continuing use or from their sale, or the cost to sell those assets would be higher than their selling price, the recoverable amount of those assets were deemed to be nil.

The selling price the Lands located under the Project was determined based on market prices in the recent transactions or announced asking prices of the similar assets. The significant unobservable inputs related to the differences in the characteristics of the land plots, such as, location and physical conditions, for which the Group applied 0% to 10% adjustments to observed asking or transactions prices.

As a result, the carrying amount of the Project of GEL 397,305 thousand was determined to be higher than its recoverable amount of GEL 14,689 thousand and the respective impairment loss of GEL 382,616 thousand was recognized in the impairment loss during 2017, which is included in the construction in progress heading above.

(c) Impairment of property, plant and equipment (excluding Tbilisi Bypass Project)

The impairment testing was carried out by the Group due to the significant decline in the volumes transported (from 5,899 million metric-ton per kilometer of cargo in 2012 to 3,073 million metric-ton per kilometer of cargo in 2017) and revenue (from USD 212,413 thousand in 2012 to USD 106,454 thousand in 2017). Revenue from freight transportation services represents about 65% of the total revenue generated for the past two years, which was considered as the indicator of the impairment.

The recoverable amount of the CGU was based on its value in use, determined by discounting future cash flows to be generated from the continuing use of the CGU. Based on the analysis, it was concluded that no impairment was required.

The following main key assumptions are used in the estimation of the recoverable amount:

- Cash flows are projected based on actual operating results and cash flows for a period up to 2037, with the further calculation of the terminal value. Due to the significant impact that the construction of Anaklia Port is expected to have on volumes in the future, the Group has determined that it is justified to use cash flow projections for a period of 20 years since the Group believe that the 20 year period will allow cash flows to stabilize after the Anaklia Port is constructed. The projections are prepared in nominal terms;

- Volumes are projected based on the actually transported quantities during 2017, adjusted for the Georgian GDP growth rate of 4.6% up to 2022. No volume growth is projected from 2023. Tariffs to be applied to the quantities above are projected based on the budgeted tariff per metric-ton per kilometer for 2018, adjusted for the changes in the US CPI forecast. The forecast resulted in an increase of 2.25% during the first two projected years and 1.7% increase during the remaining projected period;

- Cash flows include annual maintenance capital expenditure and payments for the finalization of the Main Line Modernization project. Projected cash flows include USD 95 million associated with the Modernization project above. The finalization of the above project is expected to decrease the projected electricity and material costs by 10% during 2019 and 2020;

- A pre-tax discount rate of 11.9% is applied in determining the recoverable amount of the CGU. The discount rate reflects the required rate of return for the cash flows on the invested capital of similar companies denominated in USD. The long-term growth rate for the terminal period approximates to the long-term inflation forecast for USD, which is 1.9%.

Additional assumptions included in the estimation of the recoverable amount, which has the most significant effect on the determination of recoverable amount of the CGU is summarized below:

- Management expects that the completion of the Anaklia Deep Sea Port construction will result in increased cargo flows through Georgia. Accordingly, the projected cash flows include an increase in the container traffic of 9.2% from 2023, 5.7% from 2028 and 4.5% from 2033;

- The Group is in active discussions with CJSC Azerbaijan Railway based on which, management expects that the additional cargo will flow through Georgia, in the form of dry cargo and oil products. The projected cash flows include an increase in the specific dry cargo and oil products of 1,920 million tonnes per annum, starting from 2019. This represents an increase of 25% over the projected 2018 figures for dry cargo and oil products.

The key assumptions used to determine the value in use to which the calculation is most sensitive include:

- Volume growth from CJSC Azerbaijan Railway – The exclusion of these volumes from the projected cash flows would have resulted in an impairment loss of about GEL 353 million;

- Discount rate – An increase of 1% point in the discount rate used would have resulted in an impairment loss of approximately GEL 187 million.
- Volume growth due to Anaklia Deep Sea Port – The exclusion of these volumes from the projected cash flows would have resulted in an impairment loss of about GEL 73 million;
- Terminal growth rate – a decrease of 1% in the terminal growth rate would not have resulted in any impairment, however such a change would have reduced the recoverable amount by GEL 43 million;

(d) Capital contributions

The Government of Georgia contributes certain property, plant and equipment in the form of an increase in share capital. In 2017 and 2016 the share capital has been increased by the fair value of these assets of GEL 267 thousand and GEL 521 thousand respectively (see note 17 (a)).

(e) Security

At 31 December 2017, property with a carrying amount of GEL 108,365 thousand (2016: GEL 52,330 thousand) is pledged in respect of the secured loan (see note 19).

(f) Capital commitment

As at 31 December 2017, the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 488,135 thousand (2016: GEL 612,862 thousand) mainly relating to the Main Line Modernization project of GEL 267,305 thousand (2016: GEL 335,250 thousand) and Tbilisi Bypass project of GEL 216,375 thousand (2016: GEL 211,476 thousand).

Management does not expect that the cessation of the construction agreement with the counterparty, responsible for the Tbilisi Bypass project completion, will result in the payment of the above amount.

12. Loans receivable

This note provides information about the contractual terms of the Group’s interest-bearing loans receivable, which are measured at amortised cost. For more information about the Group’s exposure to interest rate, foreign currency and credit risk, see note 22.

’000 GEL	**2017**	**2016**
Non-current assets		
Entity managed by the Group*	-	18,901
Parent company	18,113	16,816
	18,113	**35,717**
Current assets		
Entity managed by the Group*	-	3,974
	-	**3,974**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				31 December 2017		31 December 2016	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Entity managed by the Group	USD	10.00%	2023	-	-	22,875	22,875
Parent company	USD	9.75%	2021	18,113	18,113	16,816	16,816
Total interest-bearing assets				**18,113**	**18,113**	**39,691**	**39,691**

As at 31 December 2017, Management identified an indicator that the loan receivable from the Entity managed by the Group may be impaired. Compared to initial payment schedule principal and interest payments of GEL 4,762 thousand are past due as at 31 December 2017 and as it is not generating the sufficient cash flows as was initially expected. As a result, the Group recognized an impairment loss for the carrying value of the loan receivable as at 31 December 2017, amounting to GEL 23,502 thousand which was recognised in finance costs during 2017.

13. Other non-current assets

'000 GEL	**2017**	**2016**
Prepayments for non-current assets	79,071	100,976
Construction materials	36,108	43,457
Intangible assets	8,337	3,086
Other	46	46
	123,562	**147,565**

14. Inventories

'000 GEL	**2017**	**2016**
Materials	29,563	26,727
Fuel	2,380	2,105
Rails	1,174	1,499
Other	2,948	2,857
	36,065	**33,188**
Allowance for inventory obsolescence	(3,258)	(3,436)
	32,807	**29,752**
Reversal of previous write-down of inventories	178	540

15. Trade and other receivables

'000 GEL	2017	2016
Trade receivables *	237,464	227,117
Impairment allowance on trade receivables *	(164,058)	(151,372)
	73,406	**75,745**
Receivable from the Government **	27,149	23,690
Impairment allowance on receivable from the Government **	(27,149)	-
	-	**23,690**
Other receivables	208	214
	73,614	**99,649**

* Trade receivables as at 31 December 2017 include the receivable from Foreign Company (see note 6), amounting to GEL 21,256 thousand. As at 31 December 2017 and the date these consolidated financial statements were authorised for issue, the receivable above was fully overdue.

During the first two month after the reporting date, the counterparty made additional payments of GEL 6,040 thousand. The Group and foreign company has agreed on updated payment terms on the outstanding amount above. The first payment was due on 31 May 2018. On 2 June 2018, the counterparty provided the first payment of USD 200 thousand. Based on all of the above, the Group expects to recover the receivable by the end of 2018 and thus, did not make any provision for the outstanding balance as at 31 December 2017.

** Receivable from the Government of Georgia (hereinafter the Government or the GoG) was recognized as a result of the transfer of the property to the GoG, as according to the Bypass Project Memorandum of Understanding (MoU), the Government will reimburse the Group for the value added tax payable incurred on such transfers (see note 17 (e)).

Based on discussions with the GoG and due to uncertainties associated with the reimbursement of the above receivable, the Group recognized an impairment loss on the receivable from the Government, which was recognised in finance cost during 2017.

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 22.

16. Cash and cash equivalents

'000 GEL	2017	2016
Current accounts in banks	79,073	222,047
Call deposits	163,866	55,837
Petty cash	79	69
Cash and cash equivalents in the consolidated statement of financial position and the consolidated statement of cash flows	**243,018**	**277,953**

Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the deposits within a few days of providing notification without incurring penalties or significant loss of interest. Consequently, these term deposits have been classified in accordance with their nature which is that of a call deposit.

The Group's exposure to interest rate risk is disclosed in note 22.

17. Equity and liabilities to the Government

(a) Share capital

Number of shares	Ordinary shares	
	2017	**2016**
In issue at 1 January	1,053,003,675	1,052,604,503
Issued for property, plant and equipment (see note 11 (d))	267,330	399,172
In issue at 31 December, fully paid	**1,053,271,005**	**1,053,003,675**
Authorised shares - par value	**1**	**1**

All ordinary shares rank equally with regard to the Company's residual assets.

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) Non-cash owner contribution reserve

The difference between the nominal amount of registered share capital for non-cash assets contributed by the owner and the fair value of the contributed assets is recognised in the non-cash owner contribution reserve.

(c) Liabilities to the Government

Liabilities to the Government represent liabilities in the form of property, plant and equipment which are withdrawn as a reduction in share capital but not yet transferred formally to the Government. These liabilities are recorded at the carrying amount of assets to be transferred to the owner.

'000 GEL	**2017**	**2016**
Liabilities to the Government	**7,592**	**8,399**

(d) Dividends

In 2017 and 2016, no dividends were declared.

(e) Advance received from the Government

In April 2012, the Company and the Government entered into the Bypass Project Memorandum. According to the Bypass Project Memorandum the Government is interested and aims to purchase from the Group approximately 701,281 square meters of land plots with attached constructions which would be freed up as a result of the removal of railway infrastructure from Tbilisi city center and construction of a new bypass railway route for the purposes of further development of the land plots. The Government agreed to pay to the Group CHF 138 million equivalents in national currency through the reduction in the amount of dividends payable to the Government.

In 2012, the Company declared dividends of GEL 231,592 thousand (CHF 138 million). Subsequently, the Company agreed with the Government that the declared dividend amount would represent a consideration due from the Government for the future sale of the land plots in accordance with the Bypass Project Memorandum. As a result, the dividend payable was classified as an advance received from the Government for the sale of land.

(i) Transfer of the property to the Government

During 2017 and 2016, the Company transferred 55,787 and 89,166 square meters of land plots with attached constructions, respectively, to the Government within the framework of the Bypass Project Memorandum. The fair value of these land plots with attached constructions was determined by an independent appraiser based on announced asking prices of similar properties in the similar location and physical condition. The fair value estimate is categorized into Level 3 of the fair value hierarchy, because of significant unobservable adjustments used in the valuation methods. The significant unobservable inputs related to the differences in the characteristics of the properties, such as size, location, access to the property and discount achieved through negotiation, for which the appraiser applied 0% to 15% adjustments to observed asking prices.

The difference between the fair value and the carrying value of the transferred property was recognized as income in the consolidated statement of profit or loss. The difference between the cost of the transferred property, as agreed between the Group and the Government and used for the reduction of advances received from the Government, and the fair value of the transferred property was recognized directly in equity as a non-cash owner contribution reserve.

’000 GEL	**2017**	**2016**
Cost of the transferred property, as agreed between the Group and the Government	27,215	147,979
Less: fair value of the transferred property	(27,215)	(85,634)
Recognized in non-cash owner contribution reserve	**-**	**62,345**
Fair value of the transferred property	27,215	85,634
Less: carrying value of the transferred property	(3,798)	(5,340)
Recognized as income from the transferred property	**23,417**	**80,294**

18. Capital management

The Group has no formal policy for capital management but management seeks to maintain a sufficient capital base for meeting the Group’s operational and strategic needs, and to maintain confidence of market participants. This is achieved with efficient cash management, constant monitoring of the Group’s revenues and profit, and long-term investment plans mainly financed by the Group’s operating cash flows and unsecured bonds. With these measures the Group aims for steady profits growth.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

19. 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. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 22.

'000 GEL	2017	2016
Non-current liabilities		
Secured loan	80,294	42,788
Unsecured bonds	1,294,069	1,318,814
Loans and borrowings	**1,374,363**	**1,361,602**
Current liabilities		
Secured loan	11,708	6,959
Current portion of unsecured bonds	47,101	50,213
Loans and borrowings	**58,809**	**57,172**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans and borrowings were as follows:

				31 December 2017		**31 December 2016**	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Unsecured bonds	USD	7.8%	2022	1,341,170	1,341,170	1,369,027	1,369,027
Secured loan	USD	Libor +1.25%	2026	92,002	92,002	49,747	49,747
Total interest-bearing liabilities				**1,433,172**	**1,433,172**	**1,418,774**	**1,418,774**

In July 2012, the Group carried out the issuance, placement and registration (listing) of unsecured bonds of USD 500 million on the London Stock Exchange with an interest rate of 7.75% due in 2022.

Part of the above bonds were used for an early redemption of the unsecured bonds of USD 250 million issued by the Group in 2010.

The secured loan was obtained for the sole purpose of the acquisition of passenger trains. The secured loan is collateralized by the underlying passenger trains, with the carrying amount of GEL 108,365 thousand as at 31 December 2017 (31 December 2016: GEL 52,330 thousand) (see note 11 (e)).

(b) Changes in liabilities arising from financing activities

’000 GEL	Loans and borrowings
Balance at 1 January 2017	**1,418,774**
Proceeds from borrowings	50,248
Repayment of borrowings	(10,996)
Interest paid	(103,126)
Total change from financing cash flows	**(63,874)**
The effect of changes in foreign exchange rates	**(24,750)**
Other changes	
Interest expense recognised in finance cost during 2017	53,267
Interest expense capitalised as borrowing costs (note 11 (a))	49,755
Total liability-related other changes	**103,022**
Balance at 31 December 2017	**1,433,172**

20. Trade and other payables

’000 GEL	2017	2016
Payables for non-current assets	77,805	73,576
Trade payables	16,771	17,676
Advances received from customers	17,645	18,386
	112,221	**109,638**

The Group’s exposure to currency and liquidity risk related to trade and other payables is disclosed in note 22.

21. Provisions

’000 GEL	2017	2016
Balance as at 1 January	8,547	8,325
Net provisions made during the year	(594)	222
Balance at 31 December	**7,953**	**8,547**

The Group recognised a provision for the estimated cash outflow required to settle legal cases against the Group existing as at 31 December 2017 as well as to settle the legal obligations towards the employees injured during the performance of their duties.

22. Fair values and risk management

(a) Fair value of financial assets and liabilities

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realizable in an immediate sale of the assets or transfer of liabilities.

The Group has determined fair values of financial assets and liabilities using valuation techniques. The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The valuation technique used is the discounted cash flow model. Fair value of all financial assets and liabilities is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

Management's estimate of the fair value of the unsecured bonds yielded a range of values from a fair value approximately equal to the carrying amount to a fair value approximately 10% higher than the carrying amount.

The carrying values of other financial assets and liabilities of the Group are a reasonable approximation of their fair values.

(b) Financial risk management

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk.

(i) Risk management framework

The Management Board has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(ii) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers, loans receivable and cash and cash equivalents.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was as follows:

	Carrying amount	
’000 GEL	**2017**	**2016**
Cash and cash equivalents	242,939	277,884
Trade and other receivables	73,406	75,745
Loans receivable	18,113	39,691
Receivable from the Government (see note 15)	-	23,690
Balance at 31 December	**334,458**	**417,010**

Cash and cash equivalents

The Group usually holds funds with banks with good credit ratings. As at 31 December 2017, approximately 90% (31 December 2016: 48%) of the bank balances are held with the largest Georgian banks with short-term default rating of B, rated by Fitch Ratings.

The Group does not expect any counterparty to fail to meet its obligations.

Trade receivables

The Group’s exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the factors that may influence the credit risk of the Group’s customer base, including the default risk of the industry and country, in which customers operate, particularly in the currently deteriorating economic circumstances. During 2017, about 8% (2016: 13%) of the Group’s revenue is attributable to sales transactions with a single customer.

Credit risk is managed by requesting prepayments from freight and passenger transportation customers. Accordingly the Group’s trade receivables mainly consist of receivables from foreign railway companies. Credit risk related to receivables from foreign railway companies is managed through the monthly monitoring of receivable balances and requiring immediate repayment of a debt when the balance approaches specific limits set for each individual counterparty.

More than 90% of the Group’s foreign railway customers have been transacting with the Group for several years, and losses have occurred infrequently. In monitoring customer credit risk, customers are grouped according to their credit characteristics, including aging profile, maturity and existence of previous financial difficulties.

No collateral in respect of trade receivables is generally required.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade receivables.

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

	Carrying amount	
’000 GEL	**2017**	**2016**
CIS countries	67,929	57,152
Domestic	5,477	18,593
	73,406	**75,745**

The Group's two most significant customers account for GEL 40,681 thousand of the trade receivables carrying amount as at 31 December 2017 (31 December 2016: GEL 55,880 thousand).

Impairment losses

The ageing of trade receivables at the reporting date was as follows:

'000 GEL	**Gross 2017**	**Impairment 2017**	**Gross 2016**	**Impairment 2016**
Past due 0- 90 days	21,808	-	18,697	5,434
Past due 91-180 days	4,520	1,270	4,251	1,294
Past due 181-365 days	1,606	680	8,920	3,547
Past due more than one year	209,530	162,108	195,249	141,097
	237,464	**164,058**	**227,117**	**151,372**

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

'000 GEL	**2017**	**2016**
Balance at beginning of the year	**151,372**	**140,846**
Increase during the year	12,134	7,972
Write off during the year	-	(1,333)
Net foreign exchange loss	552	3,887
Balance at end of the year	**164,058**	**151,372**

Most of the remaining impairment loss at 31 December 2017 relates to several customers that have indicated that they are not expecting to be able to pay their outstanding balances either because of economic circumstances or as a result of bankruptcy. The Group believes that the unimpaired amounts that are past due are still collectible, based on historic payment behaviour and analyses on the underlying customers' credit ratings, when available.

In addition, receivables of GEL 10,335 thousand (2016: GEL 42,024 thousand) relate to freight car rental customers with which the Group incurs freight car rental expense and related payables. These receivables and payables are periodically net settled.

The allowance account in respect of trade receivables is used to record impairment losses until all possible opportunities for recovery have been exhausted; at that point the amounts are written off against the financial asset directly.

Based on historic default rates, the Group believes that, apart from the above, no impairment allowance is necessary in respect of trade receivables.

Loans receivable

As at 31 December 2017, the Group has issued loans to the parent company. The loan is not secured.

Management believes that the Group is not exposed to a significant amount of credit risk relating to the parent company loan, as the loan is neither past due nor impaired as at 31 December 2017 and there are no indications that the parent company will fail to meet its obligations, when it falls due.

As at 31 December 2016 Group had issued loan to the Entity managed by the Group amounting to GEL 22,875. As at 31 December 2017 per management assessment the loan was impaired. As a result, the Group recognized an impairment loss for the carrying value of the loan receivable as at 31 December 2017, amounting to GEL 23,502, which was recognised in finance costs during 2017.

(iii) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of three months, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters.

As at 31 December 2017, the Group maintains a committed credit line of GEL 158,835 thousand (31 December 2016: GEL 161,400 thousand).

Exposure to liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements. It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

2017

’000 GEL	**Carrying amount**	**Contractual cash flows**	**0-6 months**	**6-12 months**	**1-2 years**	**2-5 years**	**Over 5 years**
Secured loan	92,002	115,581	7,109	7,044	13,820	39,507	48,101
Unsecured bonds	1,341,170	1,798,338	50,223	50,223	100,446	1,597,446	-
Trade payables	94,576	94,576	94,576	-	-	-	-
Other current liabilities	9,857	9,857	9,857	-	-	-	-
	1,537,605	**2,018,345**	**161,729**	**57,296**	**114,592**	**1,639,885**	**44,843**

2016

’000 GEL	**Carrying amount**	**Contractual cash flows**	**0-6 months**	**6-12 months**	**1-2 years**	**2-5 years**	**Over 5 years**
Secured loan	49,747	75,725	4,422	3,954	7,795	22,921	36,633
Unsecured bonds	1,369,027	1,938,781	51,282	51,282	102,564	307,691	1,425,962
Trade payables	91,246	91,246	91,246	-	-	-	-
Other current liabilities	7,240	7,240	7,240	-	-	-	-
	1,517,260	**2,112,992**	**154,190**	**55,236**	**110,359**	**330,612**	**1,462,595**

(iv) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Currency risk

The Group is exposed to currency risk to the extent that there is a mismatch between currencies in which sales, purchases and borrowings are denominated and the respective functional currencies of Group entities. The functional currencies of Group entities are the Georgian Lari (GEL). The currencies in which these transactions are primarily denominated and settled are U.S. Dollars (USD) and Swiss Francs (CHF).

Borrowings and related interest are denominated in currencies that match the cash flows generated by the underlying operations of the Group. This provides an economic hedge without a need to enter into derivatives contracts.

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows:

’000 GEL	USD - denominated 2017	CHF – denominated 2017	USD - denominated 2016	CHF - denominated 2016
Cash and cash equivalents	167,859	1,891	182,617	499
Loan receivable	18,113	-	39,691	-
Trade receivables	39,433	28,505	234	57,152
Secured loan	(92,002)	-	(49,747)	-
Unsecured bonds	(1,341,170)	-	(1,369,027)	-
Trade and other payables	(8,748)	-	(10,591)	-
Net exposure	**(1,216,515)**	**30,396**	**(1,206,823)**	**57,651**

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2017	2016	2017	2016
USD 1	2.51	2.37	2.59	2.65
CHF 1	2.55	2.40	2.66	2.60

Sensitivity analysis

A reasonably possible weakening of the GEL, as indicated below, against all other currencies at 31 December would have affected the measurement of financial instruments denominated in a foreign currency and profit or loss by the amounts shown below. The analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases.

'000 GEL	**Profit or loss**
2017	
USD (10% weakening)	(121,652)
CHF (10% weakening)	3,040
2016	
USD (10% weakening)	(120,682)
CHF (10% weakening)	5,765

A strengthening of the GEL against the above currencies at 31 December would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

(v) Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

Exposure to interest rate risk

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was as follows:

'000 GEL	**Carrying amount**	
Fixed rate instruments	**2017**	**2016**
Financial assets	181,980	95,527
Financial liabilities	(1,341,170)	(1,369,027)
	(1,159,190)	**(1,273,500)**
Variable rate instruments		
Financial liabilities	(92,002)	(49,747)
	(92,002)	**(49,747)**

Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed-rate financial instruments as fair value through profit or loss or as available-for-sale. Therefore, a change in interest rates at the reporting date would not have an effect in profit or loss or in equity.

Cash flow sensitivity analysis for variable rate instruments

A reasonably possible change of 100 basis points in interest rates as at 31 December 2017 would have affected profit or loss by GEL 920 thousand (31 December 2016: GEL 497 thousand). This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

23. Subsidiaries

Subsidiary	Country of incorporation	Principal activities	2017 Ownership/ voting	2016 Ownership/ voting
GR Property Management LLC	Georgia	Property management and development	100%	100%
GR Logistics and Terminals LLC	Georgia	Container transportation and terminal services	100%	100%
Georgian Railway Construction JSC	Georgia	Construction and other projects	100%	100%
Borjomi-Bakuriani Railway LLC	Georgia	Transportation services	100%	100%
Georgia Transit LLC	Georgia	Transportation services	100%	100%
GR Transit Line LLC	Georgia	Transportation services	100%	100%
GR Trans Shipment LLC	Georgia	Transportation services	100%	100%
GR Transit LLC	Georgia	Transportation services	100%	100%

24. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

’000 GEL	**2017**	**2016**
Less than one year	4,378	4,499
Between one and five years	5,660	6,663
More than five years	18,250	19,288
	28,288	**30,450**

Operating leases relate to rent of other buildings, containers, locomotives and fittings owned by the Group with lease terms of mainly between 10 to 50 years. Lessees do not have an option to purchase the property at the end of the lease term.

25. Contingencies

(a) Insurance

The insurance industry in 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 property, 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) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. 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 three 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.

(c) Litigation

In the ordinary course of business, the Group is subject to legal actions, litigations and complaints. Management believes that the ultimate liability not already provided for, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

26. Related parties

(a) Transactions with key management personnel

(i) Key management remuneration

Key management received the following remuneration during the year, which is included in employee benefits expenses:

'000 GEL	**2017**	**2016**
Salaries and bonuses	**1,086**	**1,093**

(b) Other related party transactions

(i) Transactions with the Government

The Group transacts in its daily operations with a number of entities that are either controlled, jointly controlled or under significant influence of the Government of Georgia. The Group has opted to apply the exemption in IAS 24 *Related Party Disclosures* that allows the presentation of reduced related party disclosures regarding transactions with government-related entities.

The Group's other related party transactions are disclosed below.

(ii) Revenue, purchases and expenses

The Group purchases electricity from a state-owned operator which amounted to GEL 662 thousand for 2017 (2016: GEL 1,376 thousand). The Group also purchases security services from a state agency which amounted to GEL 8,956 thousand for 2017 (2016: GEL 8,968 thousand). The Group usually does not have significant balances for these purchases.

Management estimates that the aggregate amounts of other income and expenses and the related balances with other Government-related entities are not significant.

(iii) Loans issued

’000 GEL	**Transaction value for the year ended 31 December**		**Outstanding balance as at 31 December**	
	2017	**2016**	**2017**	**2016**
Loans issued:				
Parent company	-	12,884	18,113	16,816

During 2017, interest income of GEL 1,598 thousand (2016: GEL 851 thousand) was recognised in profit and loss in respect of related party loans.

(iv) Income from the transferred property

During 2017, the Group recogised income from the sale of transferred property of GEL 23,417 thousand (2016: GEL 80,294) within the framework of Bypass Project Memorandum. The movement in the advance received from the Government is summarized in note 17 (e) (i).

The receivable from the Government within the scope of the Bypass Project memorandum as at 31 December 2017 amounted to GEL 27,149 thousand (31 December 2016: GEL 23,690 thousand). The receivable as at 31 December 2017 was fully provisioned (see note 15).

(v) Credit line

As at 31 December 2017, the Group has unused credit line of USD 7 million from the parent company (2016: USD 7 million). The credit line bears interest rate of 10% per annum and matures in June, 2018.

27. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that property, plant and equipment, which was revalued to determine deemed cost as part of the adoption of IFRSs.

28. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

(a) Basis of consolidation

(i) Business combination

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group.
The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; plus
- The recognised amount of any non-controlling interests in the acquiree; plus
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquire; less
- The net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss. The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated.

(b) Revenue

(i) Transportation activities

Revenue from freight and passenger transportation is measured at the fair value of the consideration received or receivable. Freight and passenger transportation revenue is recognized in profit or loss according to the percentage of completed service method based on transit time of freight and passengers moving from the original location to the final destination.

Revenue from services rendered in stations is recognised in profit or loss when the service is rendered.

(ii) Commissions

When the Group acts in the capacity of an agent rather than as the principal in a transaction, the revenue recognised is the net amount of commission made by the Group.

(iii) Rental income

Rental income from investment property or other assets rented is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

(c) Other expense

(i) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(ii) Social expenditure

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in profit or loss as incurred.

(d) Finance income and costs

The Group's finance income and finance costs include:

- interest income on bank deposits and loans receivable;
- interest expense on financial liabilities;
- impairment loss on trade receivables;
- impairment loss on loans receivable;
- the foreign currency gain or loss on financial assets and financial liabilities.

Interest income or expense is recognised using the effective interest method.

Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

(e) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising in retranslation are recognised in profit or loss.

(f) Income tax

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

(i) Current tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from dividends.

On 13 May 2016 the Parliament of Georgia passed 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 entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective at a later date.

The new system of corporate income taxation does not imply exemption from Corporate Income Tax (CIT), rather CIT taxation is shifted from the moment of earning the profits to the moment of their distribution; i.e. the main tax object is distributed earnings. The Tax Code of Georgia defines Distributed Earnings (DE) to mean profit distributed to shareholder as a dividend. However some other transactions are also considered as DE, for example non-arm's length cross-border transactions with related parties and/or with persons exempted from tax are also considered as DE for CIT purposes.

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid. The amount of tax payable on a dividend distribution is calculated as 15/85 of the amount of the net distribution.

Set off the tax payable on dividends declared and paid is available for the corporate income tax paid on the undistributed earnings in the years 2008-2016, if those earnings are distributed in 2017 or further years.

The Tax Code of Georgia provides for charging corporate income tax on certain transactions not related to the entity's economic activities, free of charge supplies and representative expenses over the allowed limit. The Group considers the taxation of such transaction as outside of the scope of IAS 12 *Income Taxes* and accounts for the tax on such items as taxes other than on income.

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the weighted average cost principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(h) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 1 January 2007, the date of transition to IFRS, was determined by reference to its fair value at that date.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalised borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Any gain or loss on disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and is recognised net within other income/other expenses in profit or loss.

(ii) Subsequent costs

The cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced component is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

Maintenance and repair expenses are recognised as follows:

- Rolling stock:
  - current maintenance expenses during the useful life of equipment (repair work and replacement of unusable and missing parts) are recognised as operating expenses in profit or loss as incurred;
  - expenses under multi-year major overhaul programmes are capitalised as a separate overhaul component and depreciated separately from the main asset;
  - overhauls performed near the end of the useful life of an asset, together with refurbishment, are capitalised when they extend the useful life of the underlying asset.

- Fixed installations:
  - current maintenance and repair expenses (technical inspections, maintenance contracts, etc.) are recognised as operating expenses in profit or loss as incurred;
  - labour, materials and other costs (associated with the installation of rails, sleepers and ballast) under multi-year major building or infrastructure maintenance programmes are capitalised through the partial or total replacement of each component concerned;
  - costs associated with infrastructure improvements are capitalized to the extent that they increase the functionality (traffic working speed) of the asset.

(iii) Depreciation

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its residual value. Residual values for rails, wagons and locomotives are assessed based on the estimated market price of scrap metal and the estimated weight of rails, wagons and locomotives less deinstallation costs.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Land is not depreciated. Major scheduled capital repairs for wagons and locomotives, estimated at 20% of the cost, are considered as major components and depreciated separately for an average useful life of 7 to 15 years based on the expected timing of the capital repairs.

The estimated average useful lives of significant items of property, plant and equipment for the current and comparative periods are as follows:

- buildings and constructions 30-44 years;
- rail track infrastructure 17-23 years;
- transport, machinery, equipment and other 12 years.

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(i) Financial instruments

The Group classifies non-derivative financial assets into the following categories: loans and receivables and cash and cash equivalents.

The Group classifies non-derivative financial liabilities into the other financial liabilities category.

(i) Non-derivative financial assets and financial liabilities – recognition and derecognition

The Group initially recognises receivables and deposits on the date that they are originated. All other financial assets are recognised initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group currently has a legally enforceable right to set off if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the Group and all counterparties.

Loans and receivables

Loans and receivables are a category of financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables category comprise loans given, trade and other receivables and cash and cash equivalents.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and highly liquid investments with maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value. Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the deposits within a few days of providing notification without incurring significant penalties or loss of interest.

(ii) Non-derivative financial liabilities-measurement

The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

Other financial liabilities comprise loans and borrowings, trade payables and other current liabilities.

(iii) Share capital

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

Increase of share capital

Share capital increase is affected through the issuance of new shares. When share capital is increased, any difference between the registered amount of share capital and the fair value of the assets contributed is recognized as a separate component of equity as a fair value adjustment reserve for non-cash owner contributions.

Reduction of share capital

Share capital reductions and non-cash distributions are recognized at the carrying amount of the assets distributed. Non-cash distributions of the Company are out of scope of IFRIC 17 *Distributions of Non-cash Assets to Owners* since the ultimate controlling party controls the assets before and after the distribution.

(j) Impairment

(i) Non-derivative financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include:

- default or delinquency by a debtor;
- restructuring of an amount due to the Group on terms that the Group would not consider otherwise;
- indications that a debtor will enter bankruptcy;
- adverse changes in the payment status of borrowers in the Group;
- economic conditions that correlate with defaults; or
- observable data indicating that there is measurable decrease in expected cash flows from a group of financial assets.

The Group considers evidence of impairment for loans and receivables at both a specific asset and collective level. All individually significant loans and receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and receivables that are not individually significant are collectively assessed for impairment by grouping together loans and receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management’s judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the asset’s original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset or its related cash-generating unit (CGU) exceeds its estimated recoverable amount.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated to reduce the carrying amounts of assets in the CGU on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(k) Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(l) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(m) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. All operating segments' operating results are reviewed regularly by the Management Board to make decisions about resources to be allocated to the segment and assess its performance.

Segment results that are reported to the Management Board include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly railway infrastructure, corporate assets (primarily the Group's headquarters), head office expenses, financial income and expenses, tax expenses and tax assets and liabilities. Items related to infrastructure are not allocated as the Group has not implemented systems for such allocations. The Group's Management Board does not monitor segment liabilities.

Segment capital expenditure is the total cost incurred during the year to acquire property, plant and equipment, and intangible assets.

29. New standards and interpretations not yet adopted

(a) Estimated impact of the adoption of IFRS 9 and IFRS 15

The Group is required to adopt IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* from 1 January 2018. The Group has assessed and determined the initial application of IFRS 9 and IFRS 15 will not have an impact in excess of GEL 15,000 thousand on its consolidated financial statements. The estimated impact of the adoption of these standards on the Group's equity as at 1 January 2018 is based on preliminary assessments undertaken to date.

(b) IFRS 9 Financial Instruments

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018.

(c) IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. The core principle of the new standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018.

(d) IFRS 16 *Leases*

IFRS 16 replaces existing leases guidance including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 Operating Leases—Incentives and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

The Group is assessing the potential impact on its financial statements resulting from the application of IFRS 16. The actual impact of applying IFRS 16 on the consolidated financial statements in the period of initial application will depend on future economic conditions, including the Group's borrowing rate at 1 January 2019, the composition of the Group's lease portfolio at that date, the Group's latest assessment of whether it will exercise any lease renewal options and the extent to which the Group chooses to use practical expedients and recognition exemptions.