# Georgian Railway
# **Annual Report** 2015

Georgian Railway
EST. 1872

Report Date 13 May 2016

# Message from the Chairman

**Chairman of supervisory board**
Konstantine Guntsadze

I am privileged to be tasked with chairing the board of one of Georgia's most strategic companies. Georgian Railway plays a significant role in the country's economic development and in maintaining strong economic relations with partner countries. The Company operates a key segment of the International Transport Corridor Europe-Caucasus-Asia (TRACECA) and the Silk Road, playing an important role in connecting Europe and Asia through the Caucasus region.

We strive to ensure the attractiveness and reliability of the corridor through implementing modernization and containerization projects, which will support demand and ensure cargo diversification so as to keep in line with market developments in the long run. In 2015, Management succeeded in welcoming the first train from China in Tbilisi and I believe that this represents the foundation of future corridor developments and new trade links in the region.

We are very proud of all we have achieved at Georgian Railway in 2015 despite the downturn in the industry as a whole. Management has taken timely and deliberate action to capitalize on growth opportunities through expansion in logistics, which the Company has been focusing on greatly on an annual basis.

We believe that building a sustainable company is something that requires care and hard work. We also understand that the corridor, the geographical environment in which we operate, is vital for us and I would like to thank our partners for all we have achieved together so far.

# Message from the General Director

**CEO**
Mamuka Bakhtadze

I am proud to report a successful close to a very challenging year for the Group in 2015. The Group has managed to increase revenue and improve the EBITDA margin from 49 percent in 2014 to 56 percent in 2015, one of the highest margins in the railroad industry. These results were achieved despite the decreased freight transportation flow through the region. The Group has managed to diversify its customer base and attract new, profitable types of cargo from different countries.

The Management's prudent approach ensured a significant improvement of the Group's liquid funds, which enabled us to repay our matured USD 27.5 million debt in July 2015 and to enhance investments in infrastructure thereby adding more value to the corridor.

*"The success and strong position of the Group would not have been achieved without the commitment of our employees."*

*“Corridor developments create favorable opportunities for the Group to reach new geographical locations and boost profits. “*

Despite the achieved results, we understand the need for further strategic decisions in order to ensure the continuing success of the Group. Corridor developments create favorable opportunities for the Group to reach new geographical locations and boost profits. One such project is the Baku-Tbilisi-Kars line, which is due to become operational by the end of 2016, opening a new and attractive railway link to Turkey.

The Group’s management understands the potential of such development and sees a significant opportunity to attract cargo from another giant economy such as that of China, which is yet another new cargo location for our corridor, especially in light of potential trade between China and Turkey.

Seeing the opportunities available to Georgian Railway proves once again the correct course of its strategy. As the new cargo flows require additional capacity we started in 2010 the Modernization project in order to increase the capacity of our main transportation line throughput to an annual 48 million tons, with further expansion potential of 100 million tons. The Government of Georgia attracted investors to build a deep sea port in Anaklia with a potential capacity of 100 million tons which underlines the growing significance of the corridor and ensures that there are no bottlenecks in the infrastructure chain.

I am extremely pleased by the increasing significance of the Group to the shareholder and the economy of Georgia. The Group is one of the largest employers in the country and provides substantial tax benefits to the Government. Georgian Railway also has a good dividend payout history to its shareholder, the state-owned Partnership Fund.

Expanding the vertical integration of the Company has ensured smooth and reliable services to our customers. For these reasons, we have decided to enter the market of freight forwarding, container handling and terminal operations. In addition, Management intends to further develop the Group as a successful logistics chain.

The success and strong position of the Group would not have been achieved without the commitment of our employees, whose constant passion and devotion have put the Group where it is today, for which I am grateful.

## Supervisory board members

**Konstantine Guntsadze**
Chairman of supervisory board | since 2012
Major field of competence | Jurisprudence

**Oleg Bichiashvili**
Supervisory board member | since 2012
Major field of competence | Logistics

**Guram Gabunia**
Supervisory board member, member of Remuneration and Nomination committees | since 2012
Major field of competence | Audit

**Rezo Tkavadze**
Supervisory board member | since 2015
Major field of competence | Jurisprudence

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

**Michael Gogishvili**
Deputy Chairman of supervisory board , member of Audit Committee | since 2010
Major field of competence | Jurisprudence

**Levan Surguladze**
Chairman of Remuneration and Nomination Committees, member of Audit Committee | since 2011
Major field of competence | Finance

## Management board members

**Mamuka Bakhtadze**
Chief Executive Officer | since 2013

**Irakli Titvinidze**
Chief Financial Officer | since 2013

**Tengiz Todua**
Freight SBU director | since 2015

**David Gelashvili**
Passenger SBU director | since 2013

**Vasil Khorava**
Infrastructure SBU director | since 2015

## Financial and non-financial highlights

*JSC Georgian Railway and Subsidiaries* *Amounts in GEL '000*

| For the year | 2015 | 2014 | 2013 |
|---|---|---|---|
| Revenues | 574,773 | 511,570 | 479,846 |
| EBITDA | 322,787 | 250,030 | 223,304 |
| EBIT | 218,371 | 144,772 | 121,377 |
| Net income | -65,497 | 39,286 | 65,230 |
| Cash provided by operating activities | 299,496 | 280,105 | 218,803 |
| Acquisition of PPE | 156,993 | 86,776 | 148,847 |
| **At year end** | | | |
| Total assets | 3,093,917 | 2,968,381 | 2,885,227 |
| Total liabilities | 1,622,707 | 1,405,630 | 1,316,100 |
| Total equity | 1,471,210 | 1,562,751 | 1,569,127 |
| **Financial Ratios** | | | |
| Revenue growth (%) | 12.4% | 6.6% | 2.1% |
| EBITDA margin (%) | 56.2% | 48.9% | 46.5% |
| Interest coverage ratio | 2.5 | 2.0 | 1.7 |
| Net debt/EBITDA | 2.8 | 2.7 | 3.1 |
| Debt/Equity | 1.1 | 0.9 | 0.8 |
| **Non-financial data (in '000)** | | | |
| Ton-km | 4,222,061 | 4,947,530 | 5,487,360 |
| Number of passengers | 2,397 | 2,725 | 2,982 |
| Average number of employees | 13.0 | 12.9 | 12.8 |

## Credit ratings as at report date

| | First issued | LT | Outlook | ST | Last issued | LT | Outlook | ST |
|---|---|---|---|---|---|---|---|---|
| Standard & Poor's | 2010 | B+ | Stable | B | 2015 | BB- | Stable | B |
| Fitch Ratings | 2010 | B+ | Stable | B | 2015 | BB- | Stable | B |

# Forward-looking statements

This report contains certain forward-looking statements with respect to the business, financial conditions and results of 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 historical fact and generally, but not always, may be identified by the use of words such as “believes”, “expects”, “are expected to”, “anticipates”, “intends”, “estimates”, “should”, “will”, “will continue”, “may”, “is likely to”, “plans” or similar expressions.

The forward-looking statements in this report are based upon various assumptions, many of which in turn are based upon further assumptions, including, without limitation, 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 control. Accordingly, the Group may not achieve or accomplish these expectations, beliefs or projections.

When relying on 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 speak only as at 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 those made in, or suggested by, 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 be indicative of results or developments in subsequent periods.

The facts contained in the 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.

# Table of Contents

# Overview of the Group

1.1

# History of the Company

## 2016

The ISO 9001:2015, a control system of quality, certificate has been given to Passenger transportation SBU

## 2015

The Company appropriated the international certificate of quality of management ISO 9001:2008. Revived Silk Road and first Chinese train in Georgia

## 2013

Entered freight forwarding business

## 2011

Georgian Railway registered as JSC

## 2010

First Eurobond placement on London stock Exchange. Initial credit rating assignment from Fitch ratings and S&P

## 2008

The Company separated its operations into three SBUs, each with separate reporting functions

## 2005

The Company launched the restructuring programme based on the proposals of an independent consultant

## 1998

The Company was established as a limited liability company on 21 December

## 1993

Georgian Railway network was a founding member of TRACECA

## 1992

An independent Georgian Railway was formed

## 1991

The assets of the Transcaucasian Railway Company were allocated to the national railroad companies of Georgia, Armenia and Azerbaijan

## 1883

A connection was made between Tbilisi and Baku

## 1872

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

# 1.2

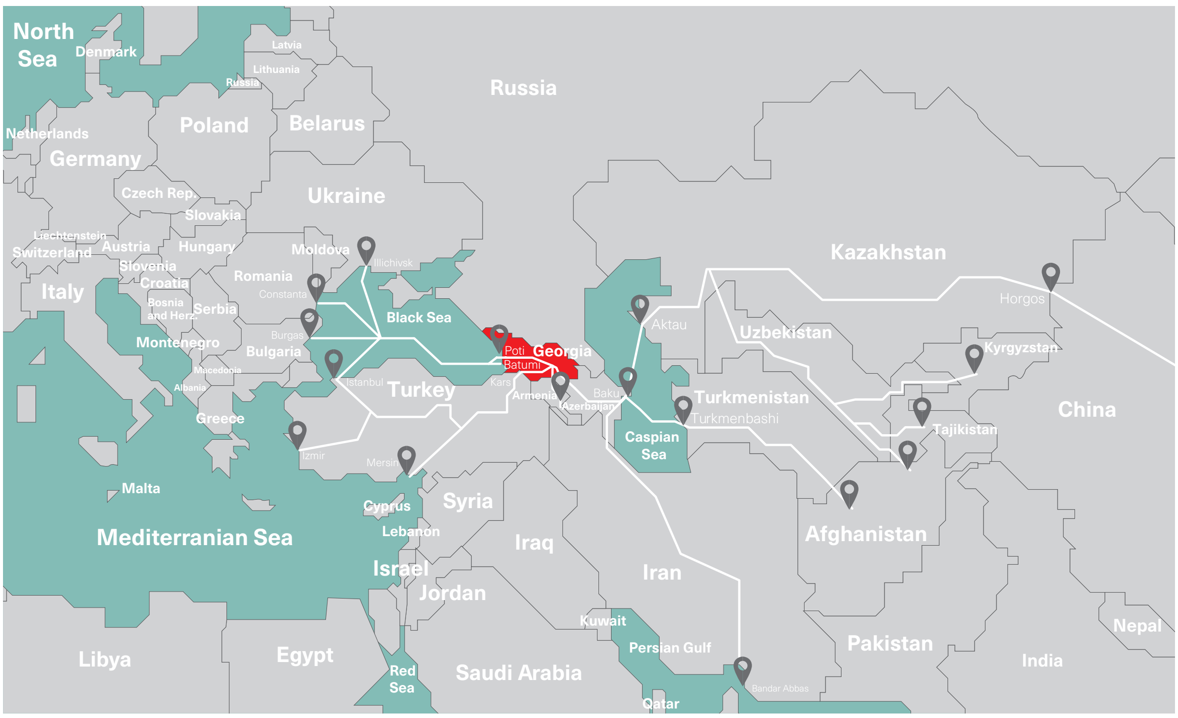
# Business profile

## 1.2.1 Overview

JSC Georgian Railway is Georgia's only railway operator. It principally provides freight services, transshipping a variety of cargo, originating principally in the east from the Caspian Sea and Central Asia to the Black Sea. The Company 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. From 2013, the Company also became engaged in the freight forwarding business through its subsidiaries.

The Company's mainline rail network, together with that of CJSC Azerbaijan Railway forms the Caucasus railway corridor, a key segment of the Transport Corridor Europe-Caucasus-Asia (TRACECA). The Company's mainline rail network is thus a link in the shortest route from the Caspian region and Central Asia to the Black Sea and the Mediterranean Basin. As a key link in the transportation chain between Europe and Central Asia, the Company's management believes that it is uniquely positioned to capitalize on trade between Europe, the Caspian region and Central Asia. Currently, Georgian Railway's network has access to three ports at the Georgian port cities of Batumi, Kulevi and Poti all of which are on the Black Sea. Access to these ports allows easy shipment of transit cargo to the Mediterranean Basin and Europe.

The map below shows key transportation links in the region:



Credit ratings - Georgian Railway is rated by two rating agencies: Fitch Ratings and Standard & Poor's. From the date of this report, the Company has a long-term foreign currency issuer default rating of BB- by Fitch Ratings and a long-term corporate credit rating of BB- by S&P, both of which reflect a stable outlook. The rating is capped by the sovereign rating of Georgia, which currently stands at BB-/Stable.

Shareholder - up until 30 September 2011 the Company 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.

## 1.2.2 Corporate governance

Georgian Railway is not subject to the requirements of any 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. Currently, the Supervisory Board of Georgian Railway consists of seven members, two of whom are independent non-executive directors.

### *Shareholders*

The JSC Partnership Fund is the only shareholder of the Company. Shareholder(s) elect the external auditor, give approval on the appointment and dismissal of the members of the Board of Directors, and make decisions on the establishment and liquidation of subsidiaries of the Company 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 a two-month period after the publication of the Group's audited financial statements.

### *Supervisory Board*

The Supervisory Board of Georgian Railway, which is appointed by 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 shall not make up the majority of the Supervisory Board. The meetings of the Supervisory Board are held at least quarterly.

The Supervisory Board supervises 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 in the Company policy and any other regulative documents, with the help of invited experts or separate members who inspect personally the accounting books and properties, among which the treasury and the securities and the goods of the Company. It also gives approval on starting a new business and stopping or terminating ongoing activities, determines the general principles of the business policy and strategy of the Company, give consent on 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, which are advisory bodies of the Supervisory Board.

Today, the committees are comprised of three members from the Supervisory Board, who 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 reviews, monitors and presents the financial statements and other public announcements of the Company concerning its financial position, as well as the issuer's financial processes to the Supervisory Board, reviews material transactions and contracts entered 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 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 GMS, and recommends candidates to the Audit and Remuneration Committees to the Supervisory Board, in consultation with the chairmen of such committees.

The Remuneration Committee 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, conducts certain functions in relation to any schemes of performance-related remuneration, shares incentive plans, pensions, bonus and other incentive schemes.

## *Board of Directors*

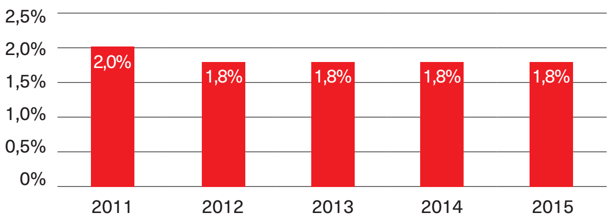
Georgian Railway's Board of Directors consists of five members: CEO, CFO, Freight transportation SBU director, Passenger transportation SBU director and Infrastructure SBU director. The CEO is authorized to supervise the execution of the decisions of the Board of Directors, supervisory board and shareholders, 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 operates and 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 policy, internal regulations and any other regulative documents that shall be approved by the Supervisory Board and ensures their implementation, makes decisions on any other issue that can be assigned to the Board of Directors by the Supervisory Board and/or the general meeting of shareholders.

## 1.2.3 Government support

Significant importance to the economy - the Group's revenue represented about 1.8 percent of the country's total GDP* in 2015. The Group is one of the top 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 in the region, namely Azerbaijan, Armenia, Kazakhstan, Tajikistan, Turkey and Turkmenistan. Furthermore, the Company provides steady dividends to its owner, the Partnership Fund, which is fully owned by the Government of Georgia.

**The Group's revenue as % of Georgia's GDP**




The above-mentioned circumstances ensure that the Government of Georgia has a significant interest in the favourable and sustainable performance of the Group in order to ensure the sustainable development of the country's economy.

Prominent examples of government support to the Group:

- Contribution of approximately 182 hectares of land for the Bypass Project in 2010 and 2011 with a value of approximately GEL 33.1 million;

- Exemption of railroad infrastructure from property taxes;

- Agreement on the restriction on dividends by Eurobond covenants;

- Deduction in dividend receivable by the amount that was spent by the Group to relocate the train station from Makhinjauri to Batumi.



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

## 1.3

# Group Structure

The Company 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 Georgian Railway's SBUs and subsidiaries:

**JSC Georgian Railway**

- Freight Transportation SBU
- Passenger Transportation SBU
- Infrastructure SBU
- Freight Forwarding & Handling Subsidiaries
- Property Management Subsidiary

### 1.3.1 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 the Company'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 the Company's railcars for their own transportation.

Freight transportation SBU is the principal source of the Group's revenue, accounting for 96 percent of the Group's total revenue in 2015. Freight transportation generated 80 percent of the Freight transportation SBU's revenue in 2015.

## Freight transportation volume

| *For the year ended 31 December* | *Million tons* | | | | | *Percent* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** | **2015** | **2014** | **2013** | **2012** | **2011** |
| **Liquid cargoes** | **6.7** | **7.5** | **9.1** | **9.5** | **10.5** | **47.7%** | **45.1%** | **50.0%** | **47.2%** | **52.0%** |
| Oil products | 5.9 | 5.8 | 5.1 | 4.8 | 5.1 | 41.6% | 35.0% | 28.2% | 23.7% | 25.1% |
| Crude oil | 0.9 | 1.7 | 4.0 | 4.7 | 5.4 | 6.1% | 10.1% | 21.8% | 23.5% | 26.8% |
| **Dry cargoes** | **7.4** | **9.2** | **9.1** | **10.6** | **9.7** | **52.3%** | **54.9%** | **50.0%** | **52.8%** | **48.0%** |
| Ores | 1.5 | 1.8 | 2.0 | 2.2 | 1.9 | 10.3% | 10.9% | 10.8% | 10.8% | 9.6% |
| Grain | 0.7 | 0.9 | 1.0 | 1.4 | 1.2 | 5.1% | 5.2% | 5.2% | 7.1% | 6.2% |
| Ferrous metals and scrap | 0.9 | 1.1 | 0.9 | 1.1 | 1.2 | 6.3% | 6.4% | 5.1% | 5.5% | 5.8% |
| Sugar | 0.5 | 0.6 | 0.6 | 0.7 | 0.5 | 3.3% | 3.7% | 3.4% | 3.4% | 2.7% |
| Chemicals and fertilizers | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 3.6% | 3.0% | 2.6% | 2.5% | 2.6% |
| Construction freight | 1.4 | 1.8 | 1.4 | 1.6 | 1.6 | 10.1% | 10.8% | 7.8% | 7.9% | 8.1% |
| Industrial freight | 0.3 | 0.4 | 0.5 | 0.7 | 0.5 | 1.8% | 2.4% | 3.0% | 3.5% | 2.3% |
| Cement | 0.1 | 0.4 | 0.6 | 0.7 | 0.5 | 0.6% | 2.3% | 3.5% | 3.3% | 2.5% |
| Other | 1.6 | 1.7 | 1.6 | 1.7 | 1.7 | 11.2% | 10.2% | 8.7% | 8.6% | 8.3% |
| **Total** | **14.1** | **16.7** | **18.2** | **20.1** | **20.1** | **100%** | **100%** | **100%** | **100%** | **100%** |

Freight transportation SBU transports both liquid and dry cargo. Liquid cargo, which consists of crude oil and oil products, accounted for 48 percent of the Group's total freight transportation volume in 2015.

## Freight transportation volume by destination

| *For the year ended 31 December* | *Million tons* | | | | | *Percent* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** | **2015** | **2014** | **2013** | **2012** | **2011** |
| **Liquid cargoes** | **6.7** | **7.5** | **9.1** | **9.5** | **10.5** | **47.7%** | **45.1%** | **50.0%** | **47.2%** | **52.0%** |
| Transit | 5.4 | 6.3 | 7.9 | 8.2 | 9.2 | 38.0% | 37.7% | 43.5% | 41.1% | 45.5% |
| Export | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.2% | 0.3% | 0.3% | 0.2% | 0.2% |
| Import | 1.0 | 1.0 | 0.9 | 0.9 | 0.9 | 7.3% | 5.7% | 4.9% | 4.4% | 4.4% |
| Local | 0.3 | 0.2 | 0.2 | 0.3 | 0.4 | 2.2% | 1.4% | 1.3% | 1.5% | 1.8% |
| **Dry cargoes** | **7.4** | **9.2** | **9.1** | **10.6** | **9.7** | **52.3%** | **54.9%** | **50.0%** | **52.8%** | **48.0%** |
| Transit | 2.6 | 3.2 | 3.3 | 3.9 | 3.4 | 18.2% | 19.3% | 18.0% | 19.3% | 17.0% |
| Export | 1.1 | 1.6 | 1.7 | 1.7 | 1.5 | 7.6% | 9.5% | 9.2% | 8.3% | 7.7% |
| Import | 1.7 | 2.0 | 1.9 | 2.4 | 2.0 | 11.8% | 12.1% | 10.2% | 11.9% | 10.2% |
| Local | 2.1 | 2.3 | 2.3 | 2.7 | 2.6 | 14.7% | 14.0% | 12.6% | 13.3% | 13.1% |
| **Total** | **14.1** | **16.7** | **18.2** | **20.1** | **20.1** | **100%** | **100%** | **100%** | **100%** | **100%** |



Approximately 56 percent of the Group's freight transportation volume derived from transit shipments through Georgia.

# 1.3.2 Passenger transportation SBU

Passenger transportation is currently a minor segment of the Group's operations as it only accounted for about 3 percent of total revenue in 2015. The primary activity of Passenger transportation SBU is the transportation of passengers within Georgia and on international routes, connecting Georgia with Azerbaijan and Armenia.

As the passenger transportation service is currently a loss making segment (with an incremental loss of about GEL 18 million, not considering head office and infrastructure costs), one of the Group's mediumterm strategic objectives is to transform the Passenger transportation SBU into a profitable unit by increasing the number of passengers and achieving increased revenue per passenger. To achieve this, the Group is taking a series of measures to improve average revenue per passenger. These measures include:

- Introducing higher levels 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 schedules to optimize utilization;
- Better availability of tickets via different sales channels;
- Marketing campaign to attract potential customers, etc.

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

## 1.3.3 Infrastructure SBU

Infrastructure SBU operates, maintains and manages the Group's principal infrastructure assets, including its track, embankments, signaling, land, electric power lines and equipment. Infrastructure SBU is a cost center providing services to Freight and Passenger SBUs. It does not conduct business with third-parties and for the coming year the Management has no intention to change this policy.

The principal aims of the Infrastructure SBU are to ensure safety and to promote the efficient use of the Group's infrastructure assets and to decrease maintenance costs. 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.

## 1.3.4 Subsidiaries

### *Freight forwarding and terminal operators*

In 2009 the Company established 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, Trans Caucasus Terminals LLC also became involved in cargo forwarding through the corridor. In 2015 another subsidiary, GR Transshipment LLC, was established, which has terminal operator VIBRO DIAGNOSTIK under its management and which operates oil terminals in the Port of Batumi.

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

### *Property Management*

Georgian 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 and to ensure the commercialization of these assets.

## 1.4

# Customers

### 1.4.1 Freight transportation SBU's customers

The Freight transportation SBU's clients are highly concentrated as its primary clients are represented by freight forwarders, which serve different geographical locations and cargo owners. Although there are a limited number of direct clients for 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.

The Freight 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 need for strict commitments, the Freight SBU also provides flexibility for its customers.

### 1.4.2 Passenger transportation SBU's customers

The Passenger transportation SBU provides domestic and international transportation services.

As Georgian Railway's rail line is linked to Azerbaijan and Armenia, international transportation is performed in these directions. After the completion of the Baku-Tbilisi-Kars project it will be possible to transport passengers to Turkey and further on to Europe.

Domestic transportation is performed within Georgia and comprises regional and long distance transportation. Some of the domestic routes are loss making. The domestic transportation is mostly active in summer, when the number of passengers travelling to the Black Sea resorts is peaking.

**Number of passengers**



*For the year ended 31 December* *Numbers in millions*

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| International | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Domestic | 2.3 | 2.6 | 2.9 | 3.0 | 3.2 |
| **Total** | **2.4** | **2.7** | **3.0** | **3.1** | **3.3** |

The number of passengers transported by the Passenger transportation SBU decreased during the period under review. The decrease in domestic transportation was caused by Management's decision to reduce passenger trains on the routes generating the lowest revenue and those making a loss. This was one of the measures undertaken by the Group to minimize losses from passenger transportation, and to increase revenue per passenger (See subheading 1.5.2 Passenger transportation tariffs).

The ISO 9001:2015 certificate has been given to the Passenger transportation SBU. It should be noted that Georgian Railway has become the first owner of this latest standard in Georgia, which is believed to make passenger transportation by rail even more reliable and attractive for customers.

Georgian Railway also plans to purchase four new double-decker EMUs from the Swiss company Stadler Bussnang AG. These trains will be equipped with all necessary modern equipment and security systems, which will be in full compliance with European safety standards and will be completely adjusted to the needs of physically disabled persons. Two new trains for tourists and local passengers are expected to run from Tbilisi to the Black Sea from the summer-autumn season of 2016 and it is believed that they will attract additional customers.

## 1.5

# Tariffs

### 1.5.1 Freight transportation 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 a tariff policy independently for all services, including tariffs for freight transportation and related services. The Group is able to change its tariffs at one month's notice to its customers.

The Group 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 U.S. Dollars. Therefore, as its revenue was derived mainly from freight transportation in 2015, the Group received most of its total revenue (about 88 percent) in USD, about 4 percent of total revenue was in Swiss Francs (CHF) and about 8 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 so as to partially hedge foreign exchange risk.

#### Average Revenue per ton-kilometers

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| **In Tetri** | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Oil products | 10.93 | 8.25 | 7.58 | 32.4% | 9.0% |
| Crude oil | 7.97 | 5.63 | 4.77 | 41.6% | 18.0% |
| Dry cargo | 10.35 | 7.89 | 7.20 | 31.1% | 9.6% |

(1) Revenue per ton-kilometers is calculated as freight traffic revenue (not including 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.
(2) Ton-kilometers are computed by multiplying the weight of the freight in tons by the distance in kilometers.



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

### 1.5.2 Passenger transportation tariffs

Similar to freight transportation tariffs, the Group is not subject to government regulations in establishing prices for passenger transportation. In many cases, however, passenger transportation tariffs are not determined by market forces, because affordable passenger transportation services have significant social importance.

The Management's intention is that any increases in tariffs are to be made in line with improvements in 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 the station, through tourist agencies, payboxes located in almost every market in Georgia, or electronic tickets online.

### Average revenue per passenger

*For the year ended 31 December*

| In GEL | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Average revenue per passenger (1) | 6.46 | 6.71 | 6.06 | 5.64 | 4.65 |

(1) Average revenue per passenger is calculated as passenger traffic revenue per passenger.

The decrease in average revenue per passenger in 2015 compared to the previous year was due to an increased share of regional transportation, which is relatively cheap compared to domestic long distance and international transportation. Another factor here was the decrease in international tariffs to and from Azerbaijan. The increase in average revenue per passenger in previous years can be explained by the increased share of higher priced seats sold, as new trains with improved services were added to long distance trips. This is the result of the Group's strategy to focus more on the higher-income segment: purchasing new trains, offering more comfort, new services etc.

## 1.5.3 Cash generation

The Group's customers are required to pay for transportation and station services in advance, with the exception being the fee for demurrage and freight car rental.

The Group's current trade receivable balance is derived mainly from freight car rental revenue.

# 1.6

# Competition

The Group faces competition in freight transportation as well as in passenger transportation.

Freight transportation is the Group's main source of revenue, where it faces competition from pipelines, alternative rail transit routes and road transportation.

Passenger SBU faces competition in passenger transportation services from other forms of domestic transport, such as buses and mini-buses, passenger automobiles and airplanes. In order to compete with these transportation means, the Group tries to keep tariffs low and to improve its services.

## 1.6.1 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) - 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) - 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 - 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).

Transportation of crude oil accounted for 6 percent and 27 percent of the Group's total freight transportation volume in the years ended 31 December 2015 and 2011, respectively. In particular, the decrease in the Group's liquid cargo volumes can be partly explained by the fact that crude oil was redirected to the CPC and the BTC pipelines, especially after the expansion of the CPC pipeline.



### *Strengths*

Low cost for large volumes - 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 in transporting large volumes of crude oil.

## *Weaknesses*

Changing the quality of crude oil - pipelines generally do not carry all grades of crude oil as different grades of oil are mixed in the pipeline with the quality changing accordingly. Therefore, pipelines are best suited for average grade oils, while for high quality and low quality crude oil, pipelines may not be the best method of transportation.

No pipelines for oil products - it should be mentioned that pipelines are competing only 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 the region, they mostly transport oil in high volumes. However, small players have limited access to pipelines, as they may experience difficulties in the minimum quotas required to use the pipelines or the pipelines might be inefficient for small volume transportation. This therefore creates a niche for the railway business in crude oil transportation.

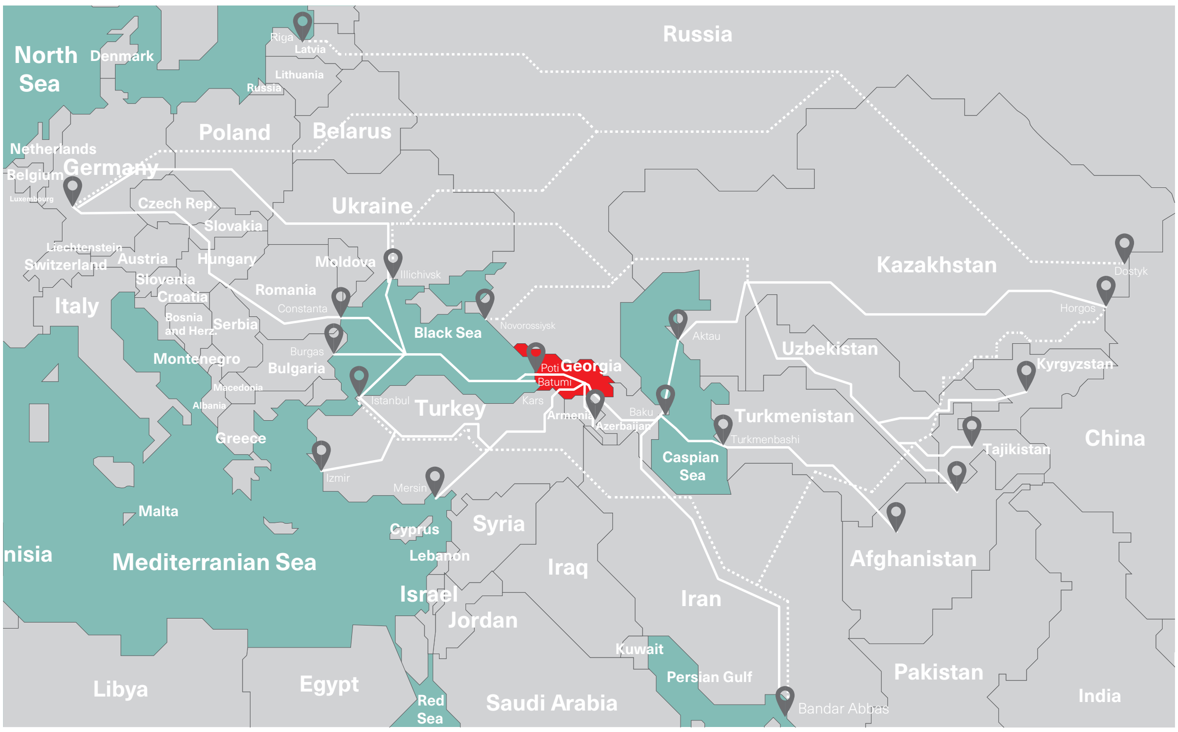
# 1.6.2 Competition from alternative rail transit routes

## *General description*

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

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

- The Central Asian route through Iran.



## Russian routes

### *Strengths*

Capacity – the rail line and ports on these routes have a higher capacity for transportation than the Georgian route.

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

### *Weaknesses*

Reliability – the Russian rail route has a competitive disadvantage compared to Georgian Railway 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*

Implementation of the Modernization project should increase the Group's capacity and its competitiveness against Russian routes. The Modernization should also increase transportation speed, safety and service quality, which will give the Group an opportunity to attract customers that are currently using alternative rail transportation routes. The new deep sea port in Anaklia and the Poti port expansion also play an important role in strengthening the Georgian route's competitive position.

## 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 completion of the Baku-Tbilisi-Kars railway line, the Group expects to attract cargo transportation business, which may currently use the alternative routes offered through Iran.

After lifting sanctions on Iran, the country's high potential in trade is expected to materialize in both liquid and dry cargo forms. Lifting the sanctions is believed to create the potential for transporting trade goods between Iran and Europe through Armenia, Azerbaijan and subsequently Georgia, thereby opening a completely new South-North corridor.

## 1.6.3 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 from road transporters becomes stronger when prices of oil products are low.

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

### *Weaknesses*

Less safety - railway transportation is considered to be safer and more environmentally-friendly than road transportation.

Expensive bulk transportation - in cases of bulk transportation, railway is considered to be cheaper than the alternative road option.

### *Competitive developments*

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

# 1.7

# 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 2015 was GEL 2.5 billion. It owns and operates the following assets:

- Rail network;
- Railcars;
- Containers;
- Locomotives;
- EMUs;
- Stations;
- Administrative buildings;
- Land;
- Tunnels, bridges and other infrastructural assets.

## Rail network

### *General description*

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

The Company owns and operates a 1,308 km railway network, 293 km of which is a double-track line. Meanwhile, about 94 percent of the Company's network is electrified.

Georgian Railway's network is connected to Azerbaijan and Armenian railways. Upon completion of the construction of the Baku-Tbilisi-Kars railway line, the Company's rail network will be connected to Turkish Railway. The Company also has a line connected to Russia through Abkhazia, which is currently not operational.



### *Capacity*

The infrastructure capacity varies within different lines of the Company. The main bottleneck of the infrastructure is the mountainous region 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 capacity of the gorge line segment is 27 million tons of cargo annually. The ongoing works on the Modernization project are aimed to increase the possible throughput capacity of the rail line to 48 million tons annually, with further potential to increase capacity to 100 million tons.

An increase in the capacity of the rail lines contributes to an increase in the capacity of the whole TRACECA corridor, along with other planned or implemented projects such as the development of a deep sea port on the Black Sea shore, the modernization of Azerbaijan Railway network and development of ports on the Caspian Sea in Kazakhstan.

## Rolling Stock

### *General description*

As at 31 December 2015 the Group had 7,006 active freight railcars and 43 active passenger wagons.

### *Capacity*

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

**Share of cargoes transported by railcar owners**

| *For the year ended 31 December* | | | | | *% Change* |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** |
| Group's own railcars | 50.1% | 58.5% | 52.6% | 46.5% | 39.3% |
| Railcars owned by other railways | 16.9% | 16.7% | 26.2% | 36.3% | 43.6% |
| Railcars of private companies | 33.0% | 24.8% | 21.2% | 17.2% | 17.1% |
| **Total** | **100%** | **100%** | **100%** | **100%** | **100%** |

The information above helps to illustrate the Group's dependence on its own wagons. About half of the Group's total freight transportation in 2015 was performed by its own railcars. The decrease in freight transportation by railcars owned by other railways was mainly due to the privatization of the Ukrainian, Russian and Kazakhstani wagon fleets. In 2015, utilization of the Group's own fleet was approximately 62 percent.



## Containers

In 2014 the Group purchased 480 containers to facilitate container transportation within the corridor.

## Locomotives and EMUs

As at 31 December 2015 the Group owned 20 units of EMUs and 33 units of passenger locomotives, and about 168 freight locomotives from which about 105 are electric and 63 are 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 2015 the Group owns and operates 106 freight stations within Georgia. Tbilisi Central is the country's main railway passenger station. The Group's headquarter building is also in the center of Tbilisi.

## Land

The Group mainly owns infrastructure-related land. As the Group has been purchasing additional land for the Tbilisi Bypass and the Modernization projects, the book value of land increased during the period under review and at the end of 2015 it was GEL 545 million.

## Tunnels and bridges

The Group's infrastructure assets consist of about 63 tunnels and 1,459 bridges. It also owns signal equipment and other assets that support the safety of operations.

## 1.8

# Employees

The Group is one of the largest corporate employers in Georgia, with 12,966 employees as of 31 December 2015. The average monthly employee benefits for the year 2015 were about GEL 955.

### Distribution of the Group's employees, by business unit

*For the year ended 31 December* *Percent*

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Freight SBU | 42.7% | 43.2% | 42.8% | 42.5% | 42.7% |
| Infrastructure SBU | 37.6% | 37.8% | 38.2% | 39.9% | 40.1% |
| Passenger SBU | 11.2% | 11.2% | 11.8% | 12.2% | 12.6% |
| Head office | 6.1% | 5.7% | 5.1% | 3.7% | 3.3% |
| Subsidiaries | 2.4% | 2.1% | 2.1% | 1.7% | 1.3% |

Currently, there are two trade unions within the Group. In total, about 63 percent of the Group's employees are members of the trade unions.

1.9

# Social responsibilities

## Environmental

Most of the Company's network is electrified, making it one of the most energy-efficient and environmentally-friendly transportation means available.

## Accessible and comfortable travel for people

One of Georgian Railway's objectives is to provide a high-quality service to its customers. For this reason, during recent years the Group has provided capital repairs for locomotives and railcars, purchased new passenger trains and invested in the reconstruction of stations, bridges and administrative buildings. The tariffs for passenger transportation nevertheless remain low compared to other alternatives, especially in the more sparsely populated regions, where the average income of the population is below the national average. Georgian Railway provides essential passenger transportation services with considerably low tariffs to meet the Government's interest in transportation issues within Georgia, as keeping affordable transportation tariffs are socially important and benefits the regional development of the country. Passenger transportation SBU is currently subsidized by Freight transportation SBU, which is intended to change as requires European Union directives and regulations.

## Employees

The Group is continuously promoting employee efficiency and know-how through staff optimization and ongoing training programs at all levels of its workforce. To achieve this, the Group promotes business education among its mid-level managers and engages lower-level managers in the decision-making process.

The Group also provides a number of social benefits to its employees such as medical insurance, financing certain expensive operations that are not covered by health insurance and financial incentives for occasions such as the birth of a child and a child's first day at school, while also offering other bonuses for certain holidays, events, and honorary occasions.

# 1.10

## Environmental matters

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). As of 31 December 2015, the Group has not experienced any material claims for environmental pollution.

On June 2015 a change was made to Georgia's environmental laws and regulations (Environmental Impact Permit) according to which the Group has to conduct an environmental audit of the railway throughout the country by June 2017. A report on the environmental impact of the Group's two main projects (Modernization and Tbilisi Bypass) has already been prepared.

# 1.11

# Risk factors

## Economic and political conditions

The Company's railway network comprises a key segment of the TRACECA corridor, the shortest route from the Caspian Sea and Central Asia to the Black Sea and the Mediterranean Basin. A significant portion of the Company's freight operations are derived from the transport of goods through Georgia from and to its neighboring countries whose rail networks, together with Georgia's, comprise the TRACECA corridor. As a result, the Group's freight transportation volumes are sensitive to changes in GDP and industrial production of TRACECA countries and their end markets. Therefore, the Group's financial conditions and results of operations are significantly influenced by the overall economic and political conditions affecting both Georgia and neighboring countries as well as the countries to or from which the goods are shipped through the TRACECA.

## Limited number of customers

The Company has well-established ties with a number of large customers for its freight services. The Company has historically earned, and expects to continue to generate a significant share of its revenues from freight forwarders and logistic companies.

A number of factors, such as pricing and market demand for the Group's services, could cause the loss of customer. Some of these factors may be unforeseeable. In addition, the crude oil transported by the Group originates primarily from a limited number of oil fields in Kazakhstan and Azerbaijan. Any disruption in crude oil production from such fields, planned or accidental, decreased demand or other unforeseen factors could decrease the volumes of liquid cargo transported by the Group.

## Ownership



The Company is indirectly owned by the State, which has the power to replace the members of the Supervisory Board and elect new members, to influence the Company's operational and financial decisions.

## Laws and regulations

The Group is subject to various environmental protection and occupational health and safety laws and regulations relating to the protection of the environment and human health and safety in Georgia. The Group cannot guarantee that it will be in compliance with all applicable environmental and health and safety laws and regulations at all times, as they change from time to time. Any failure to comply with these environmental and health and safety requirements could expose the Group to civil liabilities, administrative sanctions and penalty fees.

The uncertainties of the Georgian tax system could have an adverse material effect on the Group's business. Today, there are different opinions among governmental ministries and organizations, including the tax authorities, regarding the interpretation of various provisions creating uncertainties, inconsistencies and areas of conflict. While the Group believes that it is currently in compliance with the tax laws affecting its operations, it is possible that the relevant authorities could take different positions in interpretative issues, which may result in tax adjustments or fines for the Group.

## Ageing of the Group's infrastructure and related assets

A portion 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 to carry out the Group's current and planned railway operations without significant disruptions, 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.

## Self-insurance

To some extent, insurance may be available for the Group; however, the Group understands that such insurance would be prohibitively expensive. Based on statistics of past failures on the railway, the Group believes it would not be cost effective to purchase insurance services for its infrastructure assets. Accordingly, the Group does not have any insurance for its infrastructure and other 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.

Nonetheless, the Group periodically analyzes insurance markets and potential risks and might consider insurance coverage if a cost-benefit analysis shows positive results.

## Strikes, lockouts and labor legislation

Today, about 63 percent of the Group's employees are members of trade unions. Therefore, there can be no guarantee that in the future the Group's business will not be subject to the threat of interruptions through strikes or lockouts, which has been the case in the past. The Group has to date managed to maintain continuous operations without any major delays. Moreover, as the largest employer in Georgia, the Group is subject to certain social responsibilities with respect to its workforce and, therefore, may be unable to make any rapid or significant reductions in the number of its employees, if required. Any such objection to the restructuring of its workforce or to the threat of strikes could have an adverse effect on the Group's business.

## Currency exchange risk

The Group's functional and presentation currency is Georgian Lari. Before 2012, the Group quoted its freight tariffs in Swiss Francs, its outstanding loans and also a portion of its trade payables in U.S. Dollars, while most of its operating expenses and a portion of its liabilities were in Georgian Lari. Therefore, variations in the exchange rate among Swiss Franc, U.S. Dollar and Georgian Lari affected the Group's operating results.

The Group is not using forward exchange contracts, currency swaps or other hedging arrangements with respect to its foreign currency risk. In order to reduce foreign currency risk, in 2012 the Group's management decided to set its tariffs in USD in order to partially hedge its risk to the exposure to the exchange rate accordingly. Currently, its revenue and most of its liabilities are denominated in USD and most of its operating expenses are in GEL. However, there can be no guarantee that this or other strategies will enable the Group to fully offset any negative effects that may arise from the currency fluctuations to which it is exposed.

## 1.12

# Ongoing developments/projects

The Group is focused on achieving its key strategic objectives, which include:

- Increasing freight transportation through diversification and new geographical locations;
- Developing and modernizing infrastructure;
- Achieving effectiveness in the Group's costs and core operations;
- Maintaining competitiveness of the corridor;
- Creating maximum value for the shareholder.

Ongoing developments are well in line with the chosen strategy of the Group's management. The two main projects of the Group are the Railway Modernization and the Tbilisi Bypass projects. Tbilisi Bypass is more of a municipal project aimed to create value for the shareholder rather than the railway itself, while the Railway Modernization project is designed as a profitable project aimed to improve the existing infrastructure and significantly increase the throughput capacity from about annual 27 million tons to 48 million, with the possibility of further expansion to a potential 100 million tons per annum. This improvement in capacity is aimed to meet the potential cargo flows of the corridor.

The long-term projects of the Group include increasing the containerization rate of the corridor, which should greatly simplify operations, as handling and transporting containers is much cheaper and operationally simpler for the Group compared to specific railcar transportation. The management believes that the increasing rate of containerization could greatly improve the Group's operations.

Ongoing projects in the region are also in line with the strategic goals of the Group:

- The Baku-Tbilisi-Kars project carried out by the Georgian government with the help and cooperation of the governments of Azerbaijan and Turkey should open a completely new railway connection through Georgia to Turkey. This creates great potential to capitalize on trade between the East and the West;

- The planned construction of Anaklia Deep Sea Port (with a potential throughput capacity of 100 million tons annually) could bring substantial cargo flow through the corridor, which will require significant transportation capacity along the route;

- One of the current goals of the Group's Management and the participants of the TRACECA corridor is to open a new route for transportation from China and especially its western region. This effort is designed to open a completely new and promising geographical market;

- Multiple infrastructure development projects in the region serve to increase the competitiveness and attractiveness of the corridor.


## 1.12.1 Railway Modernization project

The Modernization project was started by the Group in 2010. The aim of the project is to modernize the infrastructure of the Group and increase the capacity of the main line. The implementation of the project would create several important benefits for the Group:

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

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



The main bottleneck is a mountainous region in the center of Georgia, referred to as the gorge section (40 km). The slope of the mentioned region complicates rail operations causing delays, increased depreciation of the tracks and rolling stock, and 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 believed 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 the current annual 27 million tons to 48 million, with the possibility of further expansion to a potential 100 million per annum.

The Modernization project is financed by the Group's operations and the proceeds from its Eurobond placement in 2010 and 2012. The project is expected to be completed by the end of 2019 and the total remaining payments to be made stand at approximately GEL 407 million.

The parts of the project which were concerned with the modernization of the rail infrastructure along the line and the construction of three tunnels with a total length of 2,095 meters have already been completed. Construction works on the double-track of the railway tunnel connecting Kvishkheti-Zvare, the design length of which is 8,350 meters, are actively being carried out. The beginning of the construction works of tunnels in the village Dzirula (875 m) and in the village Aniula (2,190 m) are also planned for 2016.

## 1.12.2 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's main railroad to the suburban area of Tbilisi.

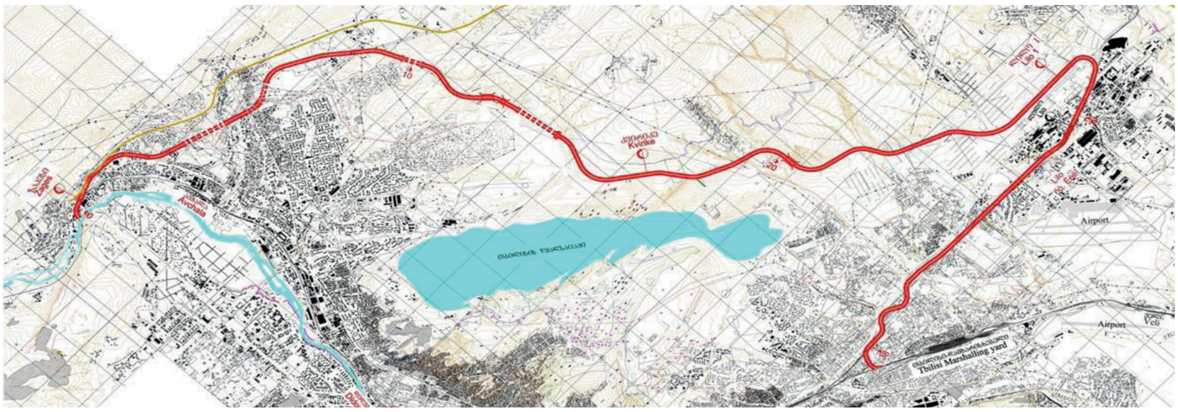
Shareholders' benefits:

- Relocating certain railway infrastructure components from the center of Tbilisi to the northern part of the city will free up land for urban regeneration in Tbilisi center, which is currently used for railroad infrastructure;

- Improving Tbilisi residents' quality of life by reducing noise and environmental pollution;

- Improving public transportation infrastructure and the growing traffic problems in the center of the city.

The following map shows the location of the Tbilisi Bypass project:




Benefits for the Group:

- Environmental - moving dangerous freight outside the city will improve the safety of residents and reduce pollution;

- Dividend moratorium - due to the project, the Company was allowed to not pay dividends to the Government in 2010;

- Proceeds from sale of land - it has been agreed that the land will be transferred to the Government at market price, expected to be higher than its net book value.

In June 2013 the Group announced its decision to redesign the Tbilisi Bypass project. In March 2014, the Government of Georgia decided that the suspension of the construction of the Tbilisi Bypass project will last for 18 months until the final modified project is presented. In 2015 the Group presented the final project with various scenarios including the best option identified by third party consultants to the Government of Georgia for approval. Currently, the Group is in discussion with Tbilisi City Hall and the Government of Georgia about various scenarios to complete the project.

## 1.12.3 Containerization

One of the key strategic objectives of the Group is to achieve greater effectiveness in the Group's costs and core operations, thus the Group is keen to increase containerization rates in the corridor. The container traffic has significant value for freight operators as container transportation services are much cheaper than regular wagons. Current levels of containerization are quite low, which shows that there is significant room for improvement.

### Share of containerized cargo in total cargo flows

*For the year ended 31 December* *Percent*

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Share of containerized cargo in total cargo flows | 5.4% | 5.2% | 4.6% | 4.5% | 3.7% |

The share of containerized cargo in total cargo flows is increasing, as can be seen from the table above.

In order to foster the containerization process the Company founded a subsidiary – Transcontainer LLC (later renamed Trans Caucasus Terminals LLC) in 2009, the main aim of which is to create and develop the necessary container infrastructure along the route. The subsidiary has created container terminals in the port cities on the Black Sea and a container terminal in the capital, Tbilisi. The Group also purchased 480 containers for moving cargo through the Georgian corridor, for which one of the reason was that sea carriers did not allow their containers to be transported to Central Asia. The Management believes that the availability of infrastructure would greatly foster the containerization rates and potentially bring completely new cargo to the corridor.



## 1.12.4 Baku-Tbilisi-Kars

The Baku-Tbilisi-Kars project is designed to connect Azerbaijan and Turkey with a railway link through Georgia. The project foresees the rehabilitation and reconstruction of a 178 km-long railway between Marabda and Akhalkalaki 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 will open 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. However, when the tracks are built, the Group will be granted the exclusive rights to operate the Georgian part of the line.

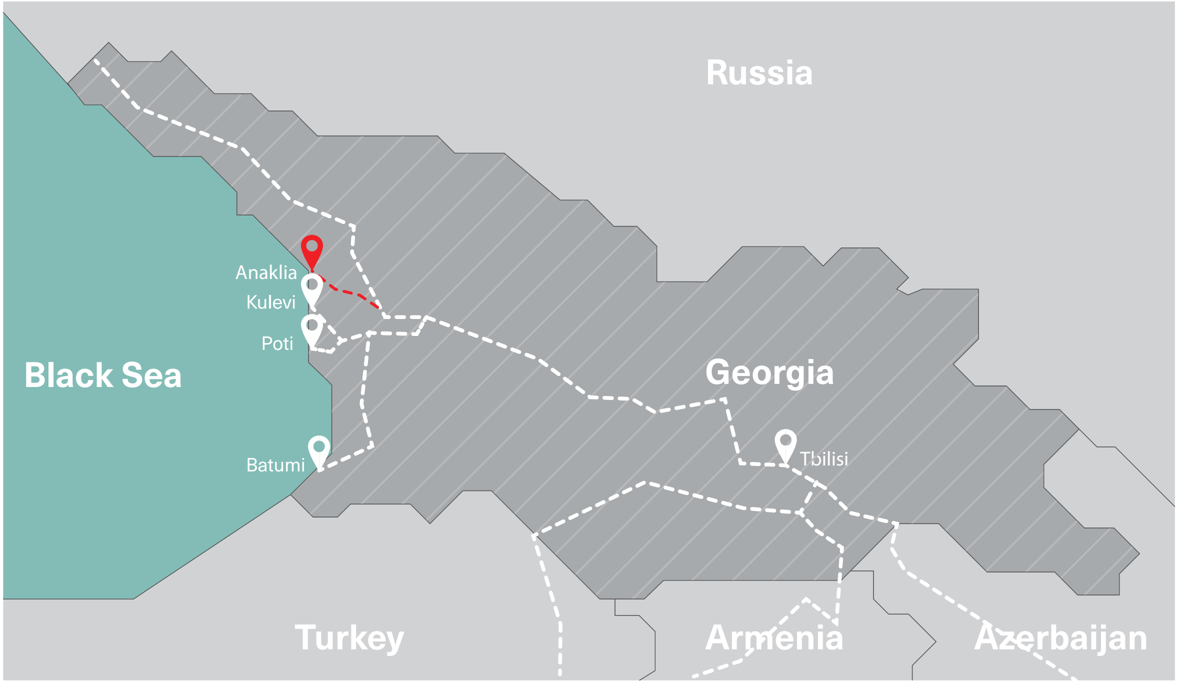
The financing of the project comes from Azerbaijan, who granted a loan to the Georgian government for the construction of the project. Currently, the project is estimated to be completed by the end of 2016. Testing of the Georgian section of the railway in 2015 was performed successfully.

The completion of the project should open a completely new geographical market for rail operations, which would bring significant cargo flow to and from Turkey to the Caucasus and Central Asia. The Group would greatly benefit in the freight transportation sector as well as in the passenger sector where customers would be able to travel to and from Turkey. Opening the Turkey rail connection should also foster the development of other potential markets, especially China.

## 1.12.5 Anaklia, the new deep water Black Sea port

Currently three ports are operating in Georgia: Poti, Batumi and Kulevi. There is also a liquid cargo terminal in Supsa. The depth of existing ports however is not sufficient to accept mid-sized cargo ships or large crude carriers. To eliminate this barrier the Government of Georgia decided to start the construction of a new Georgian port on the Black Sea shore, namely in Anaklia. The port is planned to be oriented on containers and bulk cargo and should be capable of handling large vessels, carrying 6,500 containers and more. The depth at the planned location is sufficient to accept Panamax and VLC vessels and should provide the potential to handle increasing cargo turnover between Europe and Asia.

The new port is planned to be one of the main logistic centers in the South Caucasus and one of the main maritime gateways for Georgia. Because of its strategic location the Government of Georgia has given a great deal of importance to this project. In 2016, at the 9th annual CGLA Forum held in Washington, the project was named the Top Strategic Project of the year.




The Government has selected Anaklia Development Consortium to build and operate the new Anaklia Deep Sea Port. The Anaklia Development Consortium was jointly established by local company TBC Holding and Conti International (a US firm).

Construction of the Anaklia port is expected to start by the end of 2016. It is planned to be conducted through seven phases according to the growth of the cargo turnover of the port. The potential throughput of the port should be expandable to 100 million tons per annum. The initial stage should be completed within three years from the start of construction and it is expected that the port should be able to receive cargo of up to 7 million tons.

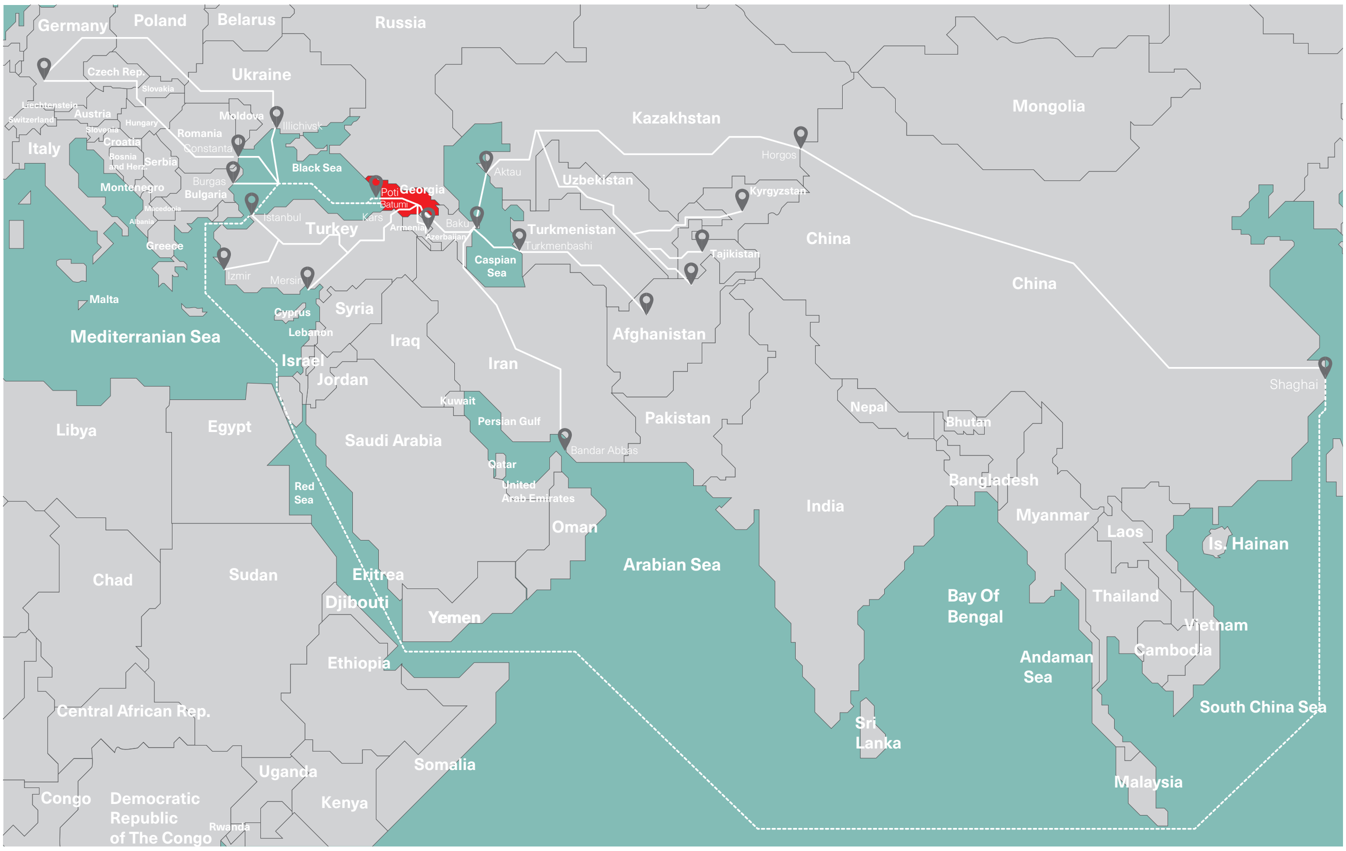
## 1.12.6 Poti port expansion plans

Poti port is currently the largest port in Georgia, handling liquid and dry cargo. The port is strategically located and serves international trade routes in the corridor.

The port has experienced significant growth since its acquisition by APM Terminals and has the potential for further growth. In 2015, Poti port officials announced their plans for the next investment in the port infrastructure and despite the cargo reduction in the Georgian corridor APM Terminals have not refused plans for expansion of the port.

It is expected that the construction will consist of two new deep water berths, which should increase the port's capacity, enabling it to accommodate vessels of 9,000 TEU and to create a throughput capacity of one million TEUs annually.

After the completion of the planned new quay in front of the existing Inland Container Terminal, the port, with a water depth of up to 16 meters, is expected to have an annual cargo throughput capacity of 50 million tons, 2 million TEUs and will be able to handle large vessels.




## 1.12.7 China

A new route from China to Georgia and through Georgia to Turkey, Europe and the countries of the Mediterranean Basin is actively developing. This route provides an alternative to an already existing sea route and creates the possibility to attract cargo of a completely new geography. The project is carried out in close cooperation with Georgian and Kazakhstan Railways and with the support of Xinjiang province (China).

In 2015, the first transit train from Chinese port terminal Lianyungang arrived in Tbilisi. With the arrival of the train, “The Silk Road” was officially opened. Since 2016 within the mentioned project the transportation of an additional several thousand containers is expected.

The new route is 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 nine days.

Kazakhstan, Azerbaijan, Georgia and Turkey are working on agreeing a common throughput rate along the Trans-Caspian route, which would greatly simplify operations for cargo owning companies and increase the competitiveness of the corridor. A protocol on setting preferential tariffs for cargo transportation on the Trans-Caspian international transport route was signed between Azerbaijan, Kazakhstan, Georgia and Ukraine. This agreement is also expected to increase the commercial operation of the route.

In recent years trade among China, Turkey and EU countries has increased significantly and it is expected that this trend will be maintained in the future. The Group sees huge potential in the development of the new route, especially in light of the nearly completed Baku-Tbilisi-Kars rail link.

## 1.12.8 Infrastructure developments in the corridor

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

## Kazakhstan infrastructure improvements

Kazakhstan plans to increase its transit role by aiming to capture a large share of the trade between Europe and China. Currently, the goods from China to Europe are mainly delivered via the sea route. To fulfil its goal Kazakhstan has started to implement a number of infrastructure projects: 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.

### *Construction of new ferry complex at Kuryk port*

In April 2015 the construction of a ferry complex in the port of Kuryk began and is expected to be completed by the end of 2016. The project is considered to be strategically important. The decision to build this new ferry complex was made to increase the transit potential of Kazakhstan and to serve cargo flow to and from China.

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

- Good climate;
- Sufficient depth;
- Prospects for increasing throughput capacity.

The new ferry complex is designed to handle various types of goods such as consumer goods, petroleum products, fertilizers, chemicals and liquefied petroleum gas.

### *Development of Aktau port*

The Port of Aktau is currently considered to be the main seaport of Kazakhstan. Due to the port's importance and the expected increase in traffic, it was decided that the port's capacity be increased. Part of the work was done in 2015 and the project is expected to be completed in late 2016.

### *Opening of new rail line Zhezkazgan-Beyneu*

In 2014 the new rail line Zhezkazgan-Beyneu was launched. This new rail line shortens the 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 Khorgos - Eastern Gate, which is expected to become part of the Free Economic Zone, started in July 2014 and is progressing at full speed. In December 2015 the first stage of this objective was put into operation, allowing the operator of the dry port KTZ Khorgos-Gateway to start operation and investment activities. Currently, the second start-up complex of the dry port is under construction.

The complex is located near the Kazakh-Chinese border. The dry port and other components of the SEZ (special economic zone) will allow Kazakhstan to become a main commercial and transportation hub, significantly improving the cargo logistics of the country with China, and linking together the East and the West.

The Khorgos - Eastern Gate free economic zone together with the Zhezgazgan-Beyneu railway line and the Port of Aktau on the Caspian coast represents a huge logistics and distribution center and assists Kazakhstan's further integration into international trade and transportation.

## Azerbaijan 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 is 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 Alyat and the modernization of its railways.

### *Construction of the new Alyat sea port*

The geographic location of Azerbaijan requires 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 it was decided that the new Baku International Sea Trade Port in Alyat would be built, which is located near Baku. The first test container train arrived at the new Baku International Sea Trade Port complex in 2015.

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 Baku-Tbilisi-Kars railway, which will provide direct access to European railway networks.

### *Modernization of Azerbaijan Railway*

Azerbaijan is actively investing in the development of its railway. The modernization of different railway lines in Azerbaijan is expected to increase the speed of the trains and carry more cargo than it does at present, which is another important step toward increasing the potential of the whole corridor.

## 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. It is believed that the port will play an important role in trade cooperation between European and Asian countries.

## *Viking container train*

Viking train is a joint project between Lithuania, Ukraine, Belarus, Bulgaria and Romania. It connects the Baltic Sea and the Black Sea by railways. The project is considered to be one of the best European project in sector of freight transportations, by the Transport Commission of the European Union.

In 2015 the Group joined the Viking project. And with this participation, Georgia will become the connecting knot of the Viking and a transit corridor of TRACECA.

# Management Discussion and Analysis

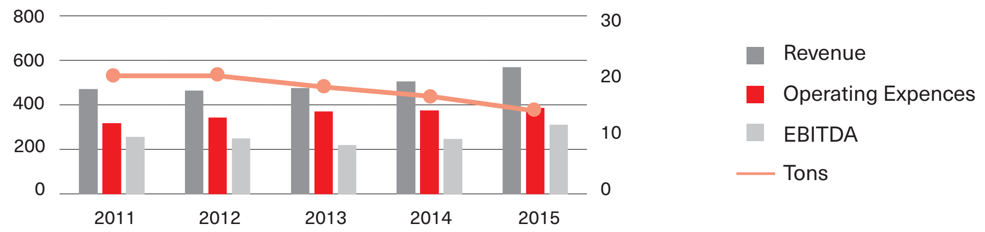
The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and their respective notes.

## 2.1

# Summary

The Group performed well financially in 2015. Despite the decreasing cargo transportation volume, revenue increased as a result of a favorable change in the GEL/USD exchange rate, an increased share of more profitable freights in the freight transportation mix and increased revenue from freight forwarding subsidiaries.

**Amounts in GEL ‘000, Volumes in million**

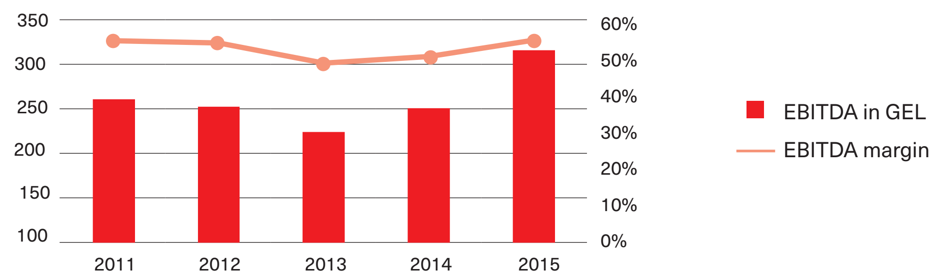



Despite the decrease in transportation volume (not only in Georgia but throughout the region), as a result of timely and effective repositioning the Group has managed to:

- Increase its revenue;
- Maintain its operating expenses at about the same level;
- Increase its EBITDA and EBITDA margin.

In 2015 the Group significantly improved its operating profitability and achieved a 29 percent increase in EBITDA and a 7 percent increase in EBITDA margin compared to 2014. Despite the improved operating results, the Group reported a net loss in the year 2015, due to FX losses on a revaluation of debt caused by USD appreciation against the GEL.

**Amounts in GEL ‘000**




In 2015 the Group managed to maintain about the same cash balance as it had in 2014 despite the fact that it repaid the remaining portion of Eurobonds issued in 2010 (USD 27.5 million), increased cash outflow on investment activities (mostly with regard to the Modernization project) and has provided a short-term loan of USD 16.0 million to another entity.

### Key achievements in 2015:

- Maintained a leading EBITDA margin in the industry;
- Hit a historic maximum in oil products transportation;
- Welcomed the first railway freight train from China.

# 2.2

# Profit & Loss statement

## 2.2.1 The Group's operating revenue

Most of the Group's revenue (about 77 percent in 2015) is derived from freight transportation. Thus the Group's results are particularly sensitive to cargo flows, which mainly comprise of transit shipments accounting for no less than 74 percent of freight transportation revenue during the period under review. In addition, freight transit is mainly derived from trade between Europe and Central Asia.

The main part of the Group's freight traffic (about 38 percent of transportation revenue in 2015) was transported from or to Azerbaijan. Other significant trade partners for the Group in 2015 were Kazakhstan, Russia, Armenia certain European countries. Only about 5 percent of total transportation revenue in 2015 was generated by local transportation.

### Revenue breakdown

| *For the year ended 31 December* | *Amounts in GEL '000* | | | *Percent* | | |
|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **2014** | **2013** |
| Freight transportation | 440,086 | 382,732 | 364,057 | 76.6% | 74.8% | 75.9% |
| Freight handling | 87,950 | 69,049 | 60,529 | 15.3% | 13.5% | 12.6% |
| Freight car rental | 24,261 | 37,811 | 34,308 | 4.2% | 7.4% | 7.1% |
| Passenger traffic | 15,487 | 18,317 | 18,044 | 2.7% | 3.6% | 3.8% |
| Other | 6,988 | 3,661 | 2,908 | 1.2% | 0.7% | 0.6% |
| **Total revenue** | **574,773** | **511,570** | **479,846** | **100.0%** | **100.0%** | **100.0%** |

## Freight transportation

The Group's freight transportation revenue consists of liquid and dry cargoes. The split between liquid and dry cargo revenue in 2015 was about 55 and 45 percent, respectively.

Transportation revenue depends on several factors, which generally influence its performance and these are discussed in some depth below:

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

Transportation volume - measured in tons transported.

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 (such as grain, ore, sugar etc.). These categories themselves are comprised of 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 transportation direction mix.

GEL/USD exchange rate - one important issue in 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 rate* | | | *% Change* | | *Reporting date spot rates* | | |
|---|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** | **31-Dec-15** | **31-Dec-14** | **31-Dec-13** |
| USD | 2.27 | 1.77 | 1.66 | 28.6% | 6.2% | 2.39 | 1.86 | 1.74 |
| CHF | 2.36 | 1.93 | 1.80 | 22.3% | 7.6% | 2.42 | 1.88 | 1.95 |

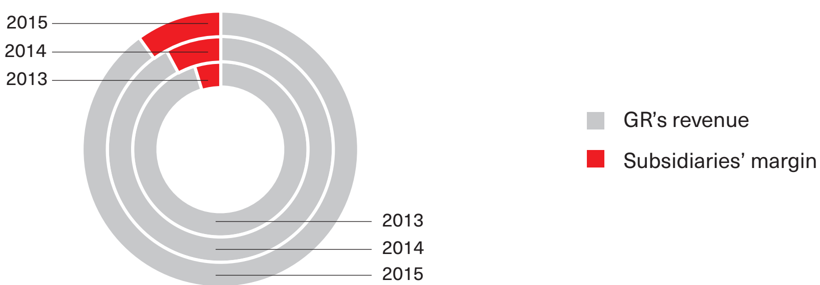
Subsidiaries - another factor to consider when analyzing the Group's revenue is its subsidiaries. In order to expand vertical integration and ensure smooth and reliable service to customers, from 2013 the Group has become engaged in the freight forwarding of oil and oil products through its subsidiaries - Georgia Transit LLC and GR Transit Line LLC.

▸ Georgia Transit LLC - acquired by Georgian Railway in April 2013, Georgia Transit is one of the Group's largest freight forwarding customers. It mainly serves crude oil and oil products transported by Georgian Railway.

▸ GR Transit Line LLC - another freight forwarding company, Georgia Transit Line started operating in April 2014 and mainly serves oil products transported to Armenia and Azerbaijan. Since 2014, the subsidiary grew and added margin to the Group's average revenue per ton-kilometer.

The Management's decision to add the element of logistics to the Group contributed to its revenue growth because the margin of the Georgian Railway's subsidiaries increased during the period under review.

**Subsidiaries' margin in total revenue**




It is also important to understand that while the Group's operations are centered in Georgia, the extent of its operations is more far reaching. In fact, the Group is serving not only Georgia's own rail cargo, but also cargo transported to and from Central Asia, other regions across the Caucasus and Europe.

## Armenia

For this direction, Georgian Railway is the only available rail link. Thus, 100 percent of the rail cargo transported to and from Armenia is served by the Group.

## Azerbaijan

Azerbaijan is a land-locked country and as Georgia is the shortest route to reach the Black Sea, Georgian Railway is the principal transportation service provider for cargo transported between Azerbaijan and the Black Sea Basin.

## Central Asia

As Kazakhstan and other Central Asian countries are all land-locked countries, this makes them dependent on their neighbors for access to the Western market. Georgian Railway is one of the few alternatives for transportation routes that connect these land-locked, but resource-rich countries to the European market.

The alternative rail routes are:

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

## China

The first railway freight transportation from China to Georgia was performed in 2015, which officially opened the "The Silk Road" project. In future the transit train will connect Asia to Europe via Turkey. The new railway connection will facilitate the transportation of cargo from China to Europe and Turkey through Georgia and increase Georgia's importance as a transit country. The new route is cheaper than air and faster and safer than sea transportation, and is anticipated to reduce transit duration five times compared with carriage by sea.

## Revenue and ton-km of cargo transported by type of freight

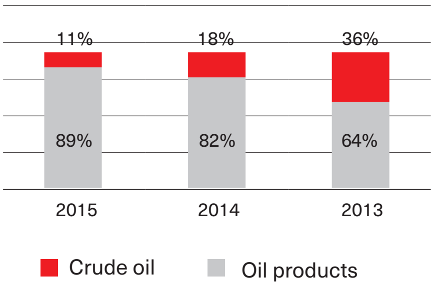
| *For the year ended 31 December* | *Revenue ( in GEL million)* | | | *tkm (in million)* | | | *% Change* Revenue | tkm | Revenue | tkm |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| **Liquid cargoes** | **242** | **201** | **203** | **2,303** | **2,639** | **3,249** | **20.5%** | **-12.7%** | **-1.1%** | **-18.8%** |
| Oil products | 214 | 163 | 129 | 1,963 | 1,980 | 1,706 | 31.2% | -0.9% | 26.5% | 16.1% |
| Crude oil | 27 | 37 | 74 | 341 | 659 | 1,544 | -26.8% | -48.3% | -49.7% | -57.3% |
| **Dry cargoes** | **198** | **182** | **161** | **1,919** | **2,309** | **2,238** | **8.9%** | **-16.9%** | **13.0%** | **3.1%** |
| Ores | 26 | 28 | 31 | 329 | 419 | 495 | -7.3% | -21.6% | -11.4% | -15.3% |
| Grain | 25 | 24 | 24 | 225 | 263 | 276 | 7.4% | -14.5% | 0.1% | -4.5% |
| Ferrous metals and scrap | 32 | 23 | 16 | 248 | 272 | 242 | 41.7% | -8.9% | 39.2% | 12.7% |
| Sugar | 17 | 20 | 17 | 168 | 227 | 222 | -14.8% | -26.1% | 23.6% | 2.2% |
| Chemicals and fertilizers | 12 | 10 | 9 | 159 | 151 | 154 | 19.0% | 5.0% | 5.4% | -2.0% |
| Construction Freight | 11 | 13 | 11 | 213 | 288 | 238 | -15.1% | -26.2% | 20.0% | 21.2% |
| Industrial freight | 5 | 9 | 7 | 54 | 127 | 106 | -41.4% | -57.7% | 29.9% | 20.6% |
| Cement | 2 | 3 | 3 | 23 | 39 | 42 | -44.6% | -41.9% | -7.0% | -7.1% |
| Other | 68 | 53 | 43 | 501 | 521 | 464 | 28.9% | -3.9% | 22.7% | 12.2% |
| **Total** | **440** | **383** | **364** | **4,222** | **4,948** | **5,487** | **15.0%** | **-14.7%** | **5.1%** | **-9.8%** |

## Liquid cargo

One of the key drivers of liquid freight traffic is the production of oil and oil products in the Caspian region, which has large oil reserves and growing levels of production. In 2015 about 84 percent of total oil and oil products were transported from the Caspian region mostly to European countries and Georgia and about 9 percent of total oil and oil products were transported from Europe mostly to Georgia for its own consumption.

Most of the Group's liquid cargo revenue comes from oil products and its share increased during the period under review as a result of an increased flow of oil products and a decrease in crude oil volumes.

**Breakdown of liquid cargo revenue**




## Oil products

### *Main directions of cargo*

Oil products are currently the main component of liquid cargo (87 percent of the transportation volume of liquid cargo in 2015). They are mainly transported by rail as there is practically no competition from pipelines. Oil products mostly originate from large refineries in Azerbaijan and Kazakhstan (38 percent and 30 percent of total oil products transported in 2015, respectively). Another important origin of oil products in 2015 was refineries in Turkmenistan (about 15 percent of total oil products transported in 2015). A relatively small part of the volume (about 10 percent of the transportation volume in 2015) came from Europe (mostly to Georgia) and about 7 percent was transported from Russia (mostly for Georgia and Armenia).

### Detailed information about oil product transportation

*For the year ended 31 December* | | | | *% Change* |

| | 2015 | 2014 | 2013 | 2015 vs 2014 | 2014 vs 2013 |
|---|---|---|---|---|---|
| Revenue in GEL million | 214.45 | 163.44 | 129.20 | 31.2% | 26.5% |
| Ton-km in million | 1,962.72 | 1,980.09 | 1,705.51 | -0.9% | 16.1% |
| Revenue / tkm (in Tetri) | 10.93 | 8.25 | 7.58 | 32.4% | 9.0% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing performance*

Ton-kilometers – ton-kilometers of cargo transported in 2015 shows a decrease by 1 percent compared to 2014, while transportation volume in tons has increased by about 1 percent. This is mainly due to transportation from Turkmenistan and Russia, where the average transportation distance has decreased.

Total ton-kilometers of transported cargo showed an increase in 2014 when compared to the amount in 2013. This difference was mainly caused by the increase in transportation of gas oil from Azerbaijan and heavy fuel oil from Kazakhstan, which was less significant in previous years.

Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometers was mainly caused by the depreciation of GEL against USD and the subsidiaries' margin, which was added to the revenue.

## Crude oil

### *Main directions of cargo*

The crude oil transported by rail through the Caucasus region in 2015 was mostly high grade Azeri-light oil from Azerbaijan (about 51 percent), Turkmenistan (about 29 percent) and Kazakhstan (about 18 percent).

### Detailed information about crude oil transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | 2014 vs 2013 |
| Revenue in GEL million | 27.15 | 37.08 | 73.65 | -26.8% | -49.7% |
| Freight turnover (million tkm) | 340.71 | 658.63 | 1,543.51 | -48.3% | -57.3% |
| Revenue / tkm (in Tetri) | 7.97 | 5.63 | 4.77 | 41.6% | 18.0% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - the decrease in ton-kilometer of cargo transported was mainly due to the reduced levels of transportation from Kazakhstan by 77 percent (0.5 million tons) in the 12-month period ended 31 December 2015 compared to the same period of 2014. This followed a 76 percent drop (2.2 million tons) in 2014 compared to 2013. The transportation volume from Azerbaijan also decreased by 53 percent in 2015 compared to 2014 and by 8 percent in 2014 compared to 2013.

Azerbaijan and Kazakhstan were the main directions for crude oil transportation in 2013 and 2014. From May 2015 the Group started the transportation of crude oil from Turkmenistan, which by the end of the year reached 29 percent of total crude oil transported by the Group in 2015.



Decreased price of crude oil - the decrease in the volume transported can be explained by the fall in the price of crude oil throughout international markets, which led to a decrease in supply. The corridor, through which the Group operates, serves oil producing countries. Transportation volumes of crude oil decreased dramatically in 2014 and continued to decrease in 2015 in line with crude prices.

CPC expansion - another reason for the decrease was the competition from the CPC pipeline. The expansion of the CPC pipeline, tied to the development of the massive Kashagan field in the Caspian Sea, created additional capacity along the CPC pipeline. However, production at Kashagan launched on 11 September 2013 was halted due to technical problems on the production field. The delays opened up a significant amount of spare capacity in the CPC pipeline, causing a redirection of some of the crude oil from Kazakhstan, previously transported by rail.

Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometer in 2015 compared to 2014 can be explained by depreciation of GEL against USD and subsidiary margin that was added to the Group's revenue.

The increase in revenue per ton-kilometer in 2014 compared to 2013 can be explained by Georgia Transit's (subsidiary) margin that was added to the Group's revenue. As the subsidiary started its operation in April 2013, its contribution in 2014 was higher. Another factor that positively contributed to the increase of the revenue per ton-kilometer was depreciation of GEL against USD.

## Dry cargo

Dry cargo contribution to total transportation revenue in 2015 was about 45 percent. The major factors driving transportation of dry cargo are general national economic conditions and economic developments in partnering countries such as Azerbaijan, Armenia, Turkmenistan and Kazakhstan.

The recent developments should open up new geographic markets to the Group, such as Turkey (via the near-completed Baku-Tbilisi-Kars rail line), China (via direct railway connection between Turkey and China via Georgia) and Iran (after the lifting of international sanctions). These three markets provide significant opportunities to capture principally new dry cargo volumes.

## Ore products

### *Main directions of cargo*

The main destination points of ore products transported by the Group are Georgia, Bulgaria and Azerbaijan, with about 40 percent of total transportation volume in 2015 transported within Georgia. Ore products transported by the Group in 2015 mostly comprise of manganese and copper ores and concentrates (about 49 percent) and coal (about 27 percent).

### Detailed information about ores transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 25.83 | 27.86 | 31.46 | -7.3% | -11.4% |
| Ton-km in million | 328.66 | 419.40 | 495.00 | -21.6% | -15.3% |
| Revenue / tkm (in Tetri) | 7.86 | 6.64 | 6.36 | 18.3% | 4.5% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - One of the main reasons for decreased transportation of ores in 2015 was reduced transportation of aluminum oxide by about 55 percent (0.2 million tons), mostly to Tajikistan, reduced transportation of manganese ores and concentrates by about 27 percent (0.1 million ton), mostly within Georgia, and reduced transportation of iron ores and concentrates from Azerbaijan. Transportation of coke and semi-coke of coal and coal from Ukraine also decreased by about 0.1 million tons.

In 2014, the reduced transportation of aluminum oxide, mostly to Tajikistan, by about 36 percent (0.2 million tons) was one of the most influential factors behind the decreased transportation.

Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometer was mainly caused by the depreciation of GEL against USD. The lower increase in revenue per ton-kilometer compared to the increase in average exchange rate can be explained by the reduction in revenue per ton-kilometer in dollar terms, which was mainly caused by changes in the cargo type mix. The transportation of more profitable sub-categories of ore products, such as aluminum oxide and manganese ores and concentrates, decreased while the transportation of less profitable sub-categories such as copper ores and concentrates increased.

## Grain and grain products

### *Main directions of cargo*

Grain and grain products transported by the Group mostly originate from Russia (about 84 percent in 2015). This cargo is mostly imported for consumption in Georgia and Armenia.

### Detailed information about grain and grain products transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 25.34 | 23.58 | 23.55 | 7.4% | 0.1% |
| Ton-km in million | 225.14 | 263.42 | 275.82 | -14.5% | -4.5% |
| Revenue / tkm (in Tetri) | 11.26 | 8.95 | 8.54 | 25.7% | 4.8% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - the decrease in ton-kilometer during the period under review was due to reduced transportation from Kazakhstan since 2013. This can be explained by the agreement on the supply of flour and grain which was reached between Kazakhstan and China in 2013. Consequently, Kazakhstan has redirected its grain supply to China, which has become one of the most profitable markets for Kazakhstan. Transportation turnover has also decreased from Georgia to Armenia.



Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometer in 2015 compared to 2014 was mainly due to the depreciation of GEL against USD. In dollar terms, revenue per ton-kilometer decreased, which was mainly due to the changes in cargo type mix, transportation of relatively more profitable products like durum wheat and corn has decreased, while transportation of less profitable products such as wheat and meslin has increased.

Compared to 2013, revenue per ton-kilometer in dollar terms also decreased in 2014 due to changes in the cargo transportation mix and reduced transportation to Armenia, which is considered to be one of the most profitable directions.

## Ferrous metals and scrap

### *Main directions of cargo*

The main destination points of ferrous metals and scrap transported by the Group are Azerbaijan and Georgia. In 2015, about 38 percent of goods were transported to Azerbaijan and about 29 percent were transported to Georgia.

### Detailed information about ferrous metals and scrap transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 32.41 | 22.87 | 16.43 | 41.7% | 39.2% |
| Ton-km in million | 248.17 | 272.37 | 241.63 | -8.9% | 12.7% |
| Revenue / tkm (in Tetri) | 13.06 | 8.40 | 6.80 | 55.6% | 23.5% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers – the decrease in transportation turnover in 2015 compared to 2014 was mainly caused by the reduction of bars and rods of iron or non-alloy steel and ferro silicomanganese. This reduction was partly replaced by the transportation of relatively more profitable products, pipes for oil and gas pipelines (mainly for Azerbaijan), which started in 2014 and significantly increased in volume in 2015.

The turnover in 2014 was higher than in 2013 mainly due to the increased transportation of pipes for oil and gas pipelines and flat-rolled of iron or non-alloy steel, which partly offset the reduced transportation of rails and scraps.

Revenue/tkm (in Tetri) - revenue per ton-kilometers increased due to the changes in the cargo type mix and transportation direction mix and the depreciation of GEL against USD.

## Sugar

### *Main directions of cargo*

Most of the sugar transported by the Group during the period under review was for consumption in Azerbaijan, Georgia and Armenia.

### Detailed information about sugar transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 17.46 | 20.50 | 16.59 | -14.8% | 23.6% |
| Ton-km in million | 167.53 | 226.57 | 221.68 | -26.1% | 2.2% |
| Revenue / tkm (in Tetri) | 10.42 | 9.05 | 7.48 | 15.2% | 20.9% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - compared to 2014, transportation turnover in 2015 decreased mainly due to the reduced transportation turnover of cane sugar for refining in Azerbaijan. Even though transportation turnover of sugar to the direction of Azerbaijan increased in 2014 compared to 2013, it was partly offset by the reduced transportation turnover of cane sugar other than for refining in Armenia and sugar in solid form (mostly to Georgia and Armenia).

Revenue/tkm (in Tetri) – the increase in revenue per ton-kilometer during the period under review was mainly due to the depreciation of GEL against USD. In dollar terms, the revenue per ton-kilometer in 2015 compared to 2014 decreased while in 2014 compared to 2013 there was an increase. The fluctuations in revenue per ton-kilometer in dollar terms were caused by changes in the product category mix and also by the changes in the transportation direction mix.

## Chemicals and fertilizers

### *Main directions of cargo*

Chemicals and fertilizers were mainly transported from Georgia to Black Sea ports (about 85 percent for 2015). A relatively small portion of the products was transported to Armenia (about 7 percent) and to Georgia (about 7 percent).

### Detailed information about chemicals and fertilizers transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 11.61 | 9.76 | 9.26 | 19.0% | 5.4% |
| Ton-km in million | 158.74 | 151.22 | 154.27 | 5.0% | -2.0% |
| Revenue / tkm (in Tetri) | 7.31 | 6.45 | 6.00 | 13.4% | 7.5% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - changes in ton-kilometer for the period under review were mainly due to the changes in transportation distances. The main product transported by the Group was ammonium nitrate, making up more than 90 percent of the total transportation volume of chemicals and fertilizers for the period under review.



Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometer in 2015 compared to 2014 was mainly due to the depreciation of GEL against USD. However, in dollar terms, revenue per ton-kilometer decreased, which was mainly due to changes in transportation distances and partly due to changes in the product category mix as transportation of relatively more profitable products, mineral or chemical fertilizers, decreased while transportation of a relatively less profitable product, urea, increased in 2015.

The increase in revenue per ton-kilometer in 2014 compared to 2013 was mainly due to the depreciation of GEL against USD and partly due to the minor changes in transportation distances and the product category mix.

## Construction freight

### *Main directions of cargo*

Transportation of construction freight correlates with economic growth in the region and the activities of the construction sector within Georgia and Azerbaijan (90 percent and 6 percent, respectively, of total construction freight transported in 2015).

### Detailed information about construction freight transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | 2014 vs 2013 |
| Revenue in GEL million | 11.18 | 13.17 | 10.97 | -15.1% | 20.0% |
| Ton-km in million | 212.93 | 288.36 | 237.88 | -26.2% | 21.2% |
| Revenue / tkm (in Tetri) | 5.25 | 4.57 | 4.61 | 14.9% | -1.0% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing performance*

Ton-kilometers - decreased turnover in 2015 compared to the previous year was caused by decreased transportation turnover of construction freight in Georgia and other countries in the region.

Higher turnover in 2014 compared to the previous year can be explained by increased turnover in Georgia, mainly due to the increased contribution of construction activities to Georgia's GDP.

Revenue/tkm (in Tetri) - the increase in revenue per ton-kilometer in 2015 compared to 2014 was mainly due to the depreciation of GEL against USD. In dollar terms, revenue per ton-kilometer decreased. However, the reduction was lower than in transportation turnover. This can be explained by decreased transportation to a less profitable direction (Georgia).

Reduction in revenue per ton-kilometer in 2014 compared to the previous year was mostly due to the increased transportation turnover of construction freight to a less profitable direction (Georgia), which was partly offset by the depreciation of GEL against USD.



## Industrial freight

### *Main directions of cargo*

The main directions of the cargo during the period under review were Azerbaijan, Armenia and Georgia.

### Detailed information about industrial freight transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | 2014 vs 2013 |
| Revenue in GEL million | 5.22 | 8.91 | 6.86 | -41.4% | 29.9% |
| Ton-km in million | 53.87 | 127.29 | 105.58 | -57.7% | 20.6% |
| Revenue / tkm (in Tetri) | 9.69 | 7.00 | 6.50 | 38.5% | 7.7% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

## *Factors influencing performance*

Ton-kilometers - compared to 2014, transportation turnover in 2015 decreased due to the reduction in the transportation of cement clinker to the direction of Azerbaijan and the transportation of wood sawn or chipped lengthwise and siliceous sand and quartz to the direction of Armenia.

The increased transportation in 2014 compared to 2013 was partly a result of the increased transportation of cement clinker to Azerbaijan. The demand for this was particularly high until a cement plant opened in Azerbaijan in 2014. After the opening of the plant, the cargo flow decreased significantly. Consumption of cement clinker in Georgia has also reduced as a result of reduced demand for cement.

Revenue/tkm (in Tetri) - revenue per ton-kilometer in 2015 compared to 2014 has increased mostly due to the depreciation of GEL against USD and partly to changes in the cargo category mix transported to Azerbaijan, as transportation of a relatively less profitable product (cement clinker) was replaced by the transportation of relatively more profitable products like natural barium sulphate.

Revenue per ton-kilometer in 2014 compared to 2013 increased mainly due to the depreciation of GEL against USD and the changes in cargo transportation destinations. Previously, industrial freight was mainly transported to and within Georgia, while in 2014 the principal direction was Azerbaijan which carried higher tariffs. Changes in the cargo type mix also contributed to the increase in revenue per ton-kilometer.

# Cement

## *Main directions of cargo*

Currently, there are four main cement plants in Georgia operated by Heidelberg Cement. In 2015, cement transportation turnover was mainly seen within Georgia (about 88 percent of total turnover). However, in 2013 the main destination was Azerbaijan (about 70 percent of total turnover) which started to reduce its share in 2014.

### Detailed information about cement transportation

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue in GEL million | 1.67 | 3.01 | 3.24 | -44.6% | -7.0% |
| Ton-km in million | 22.90 | 39.42 | 42.42 | -41.9% | -7.1% |
| Revenue / tkm (in Tetri) | 7.28 | 7.63 | 7.63 | -4.6% | 0.0% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

## *Factors influencing the performance*

Ton-kilometers - the decrease in transportation turnover in 2015 compared to 2014 was mainly caused by the reduced transportation of hydraulic cements within Georgia and to Azerbaijan direction.

Compared to 2013, turnover in 2014 decreased mainly due to the reduced transportation to Azerbaijan, which can be explained by the opening of cement plants in July 2014 in Azerbaijan.

Revenue/tkm (in Tetri) – the decrease in revenue per ton-kilometer was mainly due to changes in the transportation direction mix, which was even higher in dollar terms but was partly offset by the depreciation of GEL against USD.

## Other product categories

### *Main directions of cargo*

During the period under review the main directions for other product categories were Azerbaijan, Turkey, Armenia, Kazakhstan and Georgia, with decreasing transportation turnover to Azerbaijan, Georgia and Armenia. The main products transported in 2015 were methanol (about 10 percent of total turnover) and not-alloyed aluminum (about 9 percent of total turnover).

**Detailed information about the transportation of other product categories**

| *For the year ended 31 December* | | | | *% Change* | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | 2014 vs 2013 |
| Revenue in GEL million | 67.77 | 52.56 | 42.84 | 28.9% | 22.7% |
| Ton-km in million | 500.68 | 520.76 | 464.06 | -3.9% | 12.2% |
| Revenue / tkm (in Tetri) | 13.54 | 10.09 | 9.23 | 34.1% | 9.3% |
| Average exchange rate GEL/USD | 2.27 | 1.77 | 1.66 | 28.3% | 6.6% |

### *Factors influencing the performance*

Ton-kilometers - compared to 2014, the transportation turnover in 2015 decreased. This was mainly due to the reduced turnover to Azerbaijan, Georgia, Russia and Armenia which was partly offset by increased turnover to Turkey, Black Sea ports and Europe. Transportation turnover of not-alloyed aluminum, sulphur and methanol increased in 2015 offsetting the reduction in natural mineral waters and oil-cake and other solid residues.

Compared to 2013, the transportation turnover to China and Europe increased in 2014, but a decrease was seen in transportation turnover to Turkey and Azerbaijan. In 2014 the Group significantly increased transportation turnover of methanol and this trend continued in 2015 as well. Transportation turnover of cotton also increased in 2014. This increased turnover was more than offset by reduced turnover in not-alloyed aluminum, which returned to its turnover level in 2015.

Revenue/tkm (in Tetri) – the increase in revenue per ton-kilometer during the period under review was mainly due to the depreciation of GEL against USD. However, the increase was also caused by changes in the transportation direction mix and changes in the product category mix.

# Freight handling

### *General description*

Revenue from freight handling is the sum of 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 represents a fee paid by customers for failing to unload a railcar within 24 hours of arrival at its agreed destination;

- Revenue from certain other services, derived from cargo loading/unloading, storage, accelerated service fees and other sources.

## *Currency and tariff setting*

Most of the freight handling revenue, about 91 percent (not taking into account penalties incurred by the contractor) for 2015 was denominated in USD, while the rest was denominated in GEL. The Group sets its tariffs independently.

## *Driver*

The revenue from this source mainly changes in line with transportation volumes in tons. The correlation however is not perfect as there are many factors influencing the revenue.

### Freight handling

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs.Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **vs 2014** | **2014** | **vs 2013** |
| Station services | 54,774 | 49,340 | 40,975 | 11.0% | 5,434 | 20.4% | 8,365 |
| 24-hour service | 21,686 | 5,944 | 13,539 | 264.9% | 15,743 | -56.1% | -7,595 |
| Other | 11,490 | 13,765 | 6,015 | -16.5% | -2,275 | 128.8% | 7,750 |
| **Total freight handling** | **87,950** | **69,049** | **60,529** | **27.4%** | **18,902** | **14.1%** | **8,520** |

## *Factors influencing the performance*

Compared to 2014, revenue from freight handling in 2015 increased due to the increase in revenue from station services and the 24-hour service. However, there was a decrease in other revenues.

24-hour service – a significant increase in revenue from the 24-hour service in 2015 compared to 2014 was mainly due to wagon delays, because after the termination of the contract for wagon rent the railcars remained at the Group's stations, however about GEL 13 million provision was established against revenue from 24-hour services in 2015.

The decrease in revenue from the 24-hour service in 2014 compared to 2013 was mainly due to the level reached in 2013 being abnormally high. The reason for this is that in 2013 Georgian Railway had a contract for the capital repair of its railcars. However, the contractor was not able to carry out its obligations under the contract in a timely manner and thus the railcars stayed at the Group's stations. For each day of delay, Georgian Railway charged the subcontractor its normal fee for railcar delays. In 2014, 24-hour delays returned to their normal level.

Station service - An increase of 11% (GEL 5.4 million) of revenue from station services in 2015 was mainly caused by the appreciation of USD against GEL.

A revenue increase of 20% (GEL 8.4 million) in 2014 compared to 2013 was mainly caused by the optimization of station service tariffs and the commencement of operations of the subsidiary company, Georgia Transit LLC, in the second quarter of 2014.

Other - The 17% (about GEL 2.3 million) decrease in other revenue in 2015 compared to 2014 was mainly due to the reduced margin from Georgian Railway's subsidiary company, Trans Caucasus Terminals.

The increase in other revenue in 2014 compared to 2013 was caused by the fact that revenue from the subsidiary company, Trans Caucasus Terminals, which before 2014 was classified under other income, was transferred to revenue generated from freight handling.

# 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 changes in accordance with the tariff and the number of days the railcars are used by other railways.

### Freight car rental

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 | vs 2014 | 2014 | vs 2013 |
| Freight car rental | 24,261 | 37,811 | 34,308 | -35.8% | -13,550 | 10.2% | 3,503 |

## *Factors influencing the performance*

The decrease in freight car rental revenue in 2015 compared to 2014 can be explained by the reduced transportation volume and at the same time decreased transportation by the Group's own fleet.

The increase in revenue in 2014 compared to the previous year was mainly caused by the increased freight car rental days charged to Turkmenistan Railway. Management believes that the railcar delays were caused by the renewed bottlenecks on the Afghanistan border due to increased security measures.

# Passenger traffic

## *General description*

Passenger transportation comprises of domestic and international transportation 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, in particular the suburban component, typically serve the low income sections of society and accordingly low fares apply to such travel. Georgian rail lines are linked to Azerbaijan and Armenia, and international transportation services are provided to these directions.

## *Currency and tariff setting*

Tariffs for domestic transportation are set independently by the Group and are denominated in GEL. Tariffs are not determined by market forces and are kept relatively low, because the Group's affordable passenger transportation services have social importance. Accordingly, Georgian Railway may be constrained to remove or reduce services on certain passenger routes, even in cases when such routes are not economical.

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

## *Drivers*

Passenger revenue changes are in line with the tariff and number of passengers transported.

### Passenger transportation

| *For the year ended 31 December* | In million | | | *% Change* | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | **2014 vs 2013** |
| Revenue from Passenger SBU in GEL | 15.49 | 18.32 | 18.04 | -15.4% | 1.5% |
| Number of passengers | 2.40 | 2.73 | 2.98 | -12.2% | -8.4% |



## *Factors influencing the performance*

Compared to 2014, the decrease in revenue in 2015 was greater than the decrease in the number of passengers. This was due to an increased share in regional transportation, which is relatively cheap compared to domestic long distance and international transportation. The decrease was also partly driven by the decrease in tariffs in international transportation to and from the direction of Azerbaijan.

Passenger revenue in 2014 increased compared to 2013 while the number of transported passengers decreased. The lack of correlation between the change in passenger numbers and change in revenue was caused by the increased share of higher priced seats being sold. This can be explained by the addition of new trains to the mainline direction with significantly improved service quality, while some trains for regional transportation (with lower tariffs) were discontinued.

# Other revenue

## *General description*

Other revenue is mostly denominated in GEL and comprises items such as revenue from rent of space in Group-owned buildings, sale of scrap and repair services to third parties.

### Other revenue

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs | 2014 | 2014 vs | 2013 |
| Revenue from rent | 4,491 | 2,074 | 1,659 | 116.5% | 2,417 | 25.1% | 416 |
| Revenue from repair | 1,311 | 1,259 | 694 | 4.1% | 52 | 81.5% | 565 |
| Revenue from realization of materials (scrap) | 913 | 186 | 389 | 390.6% | 727 | -52.2% | -203 |
| Other | 273 | 142 | 166 | 92.2% | 131 | -14.5% | -24 |
| **Total other revenue** | **6,988** | **3,661** | **2,908** | **90.9%** | **3,326** | **25.9%** | **754** |

## *Factors influencing the performance*

Other forms of revenue increased during the period under review, which was mainly caused by the increased revenue from rent and revenue from repair. The increase in revenue from rent in 2015 compared to 2014 was mainly due to the increased revenue from land rent.

# 2.2.2 Other income

## *General description*

Other income mostly comprises of items such as penalties accrued on debtors or creditors, revenue from electricity transit, revenue from other communication services and revenue from subsidiary companies, which cannot be included in operating revenue.

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, revenue from electricity transit, revenue from other communication services and some other items) and non-continuing operations (such as provision reversals, fixed assets written off and other items, which are not expected to reoccur in the future).

### Other income

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs | 2014 | 2014 vs | 2013 |
| Continuing operations | 13,293 | 10,390 | 15,547 | 27.9% | 2,903 | -33.2% | -5,157 |
| Non-continuing operations | 17,478 | 1,963 | -96 | NM | 15,515 | NM | 2,059 |
| **Other income** | **30,771** | **12,353** | **15,452** | **149.1%** | **18,418** | **-20.1%** | **-3,099** |

### *Factors influencing the performance*

A significantly high indicator of non-continuing operations in 2015 compared to 2014 and 2013 was largely due to the difference in the market and book value of the assets transferred to the State under the bypass memorandum and other income from the assets realization. Higher continuing operations in 2015 compared to 2014 was mainly caused by the higher fines and penalties on debtors.

The reduced continuing operations in 2014 compared to 2013 can be explained by the fact that before 2014 the revenue from Trans Caucasus Terminals (subsidiary company) was included in continuing operations. In 2014, however, the revenue generated by the subsidiary was transferred to revenue from freight handling. The reduction in continuing operations can also be explained by reduced fines and penalties on creditors.

## 2.2.3 Group's operating expenses

### *General description*

Most of the Group's operating expenses are fixed. The variable expenses that depend on the volume of transportation include: freight car rental, most of the electricity, fuel expenses, some materials and expenses for repairs and maintenance.

### Operating expenses

| *For the year ended 31 December* | *In GEL '000* | | | *Percent* | | |
|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **2014** | **2013** |
| Employee benefits expense | 148,625 | 145,174 | 133,509 | 38.4% | 38.3% | 35.7% |
| Depreciation and amortization expense | 104,416 | 105,258 | 101,927 | 27.0% | 27.8% | 27.3% |
| Electricity | 20,424 | 20,091 | 21,236 | 5.3% | 5.3% | 5.7% |
| Materials | 19,276 | 19,280 | 19,770 | 5.0% | 5.1% | 5.3% |
| Fuel | 5,807 | 7,868 | 8,160 | 1.5% | 2.1% | 2.2% |
| Freight car rental | 7,612 | 9,790 | 11,988 | 2.0% | 2.6% | 3.2% |
| Wagon rent expense | 3,597 | 10,202 | 9,857 | 0.9% | 2.7% | 2.6% |
| Repair and Maintenance | 15,420 | 10,001 | 10,550 | 4.0% | 2.6% | 2.8% |
| Security, other op. expenses | 36,026 | 27,103 | 33,370 | 9.3% | 7.1% | 8.9% |
| Taxes other than income tax | 25,969 | 24,384 | 23,554 | 6.7% | 6.4% | 6.3% |
| **Total** | **387,173** | **379,151** | **373,921** | **100.0%** | **100.0%** | **100.0%** |

In 2015 approximately 65% of the Group's operating expenses consisted of employee benefits, depreciation and amortization expenses.

## Employee benefit expenses

### *General description*

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

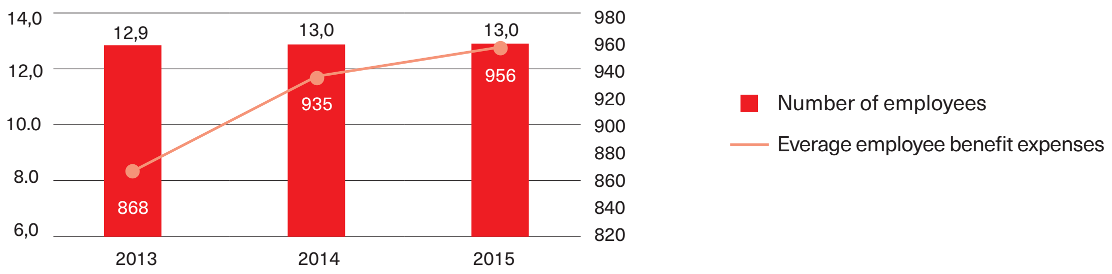
## Employee benefit expenses

| *For the year ended 31 December* | | *In GEL '000* | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **vs 2014** | **2014** | **vs 2013** |
| Salary | 124,591 | 122,428 | 118,035 | 1.8% | 2,163 | 3.7% | 4,393 |
| Bonus-reward | 11,769 | 7,968 | 2,890 | 47.7% | 3,801 | 175.7% | 5,078 |
| Other benefits | 12,264 | 14,778 | 12,584 | -17.0% | -2,513 | 17.4% | 2,194 |
| **Total** | **148,625** | **145,174** | **133,509** | **2.4%** | **3,451** | **8.7%** | **11,665** |

### *Factors influencing changes*

Salary - The Group is one of the largest corporate employers and taxpayers in Georgia. This fact underlies its importance for the Government of Georgia along with other important economic benefits for the country. An increase in salary expenses during the period under review was mainly due to the increase in bonuses and rewards.

**Number of employees ('000) and average employee benefit expenses in GEL '000**




Bonus-reward - the lower bonuses in 2013 compared to 2014 and 2015 were mainly caused by the increase in base salaries at the end of 2012 and in the first quarter of 2013, causing the management to withhold additional monetary incentives to employees at the end of the year.

Other benefits – a decrease in other benefits in 2015 compared to 2014 was mainly due to reduced employee insurance costs. The increase in other benefits in 2014 compared to 2013 was mainly due to the higher bulletin funds, compensation damages paid to employees and business trips outside the country.

# 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 expense is denominated in GEL and thus is not affected by fluctuations in foreign exchange rates.

### Depreciation and amortization expense

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs** | **2014** | **2014 vs** | **2013** |
| Depreciation and amortization expense | 104,416 | 105,258 | 101,927 | -0.8% | -841 | 3.3% | 3,330 |

## *Factors influencing changes*

The decrease in depreciation expenses in 2015 compared to the same period in 2014 was due to the increased useful life of assets caused by capital repairs. The increase in depreciation and amortization expenses in 2014 compared to the same period in 2013 reflected the Group's continuing investment in infrastructure, and also procurement and capital repairs of railcars.

# Electricity expenses

## *General description*

Approximately 94 percent of Georgian Railway's railway network is electrified. Until September 2011, the Company purchased most of its electricity on the open market in Georgia. In the same month, 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.

The changes in electricity expenses will be split into two categories: electricity consumption for traction, which is driven by transportation volume (the Group mostly uses electric locomotives for freight transportation) and utility expenses, which is not related to transportation volume and is normally considered to be fixed.

### Electricity expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs** | **2014** | **2014 vs** | **2013** |
| Electricity consumption for traction | 17,654 | 17,537 | 18,709 | 0.7% | 118 | -6.3% | -1,172 |
| Utility Expenses | 2,770 | 2,554 | 2,527 | 8.4% | 216 | 1.1% | 27 |
| **Total Electricity expenses** | **20,424** | **20,091** | **21,236** | **1.7%** | **333** | **-5.4%** | **-1,145** |



## *Factors influencing changes*

The increase in electricity expenses for traction in 2015 compared to the same period in 2014, while noting a decrease in transportation turnover, was mainly due to increased electricity tariffs. As mentioned above Georgian Railway's agreement on electricity procurement considers tariff review in the case of a change in regulated tariffs. In August 2015 Georgian National Energy and Water Supply Regulatory Commission (GNERC) increased electricity tariffs, which thus resulted in increased tariffs for Georgian Railway.

The decrease in electricity expenses for traction in 2014 compared to the same period in 2013 was in line with the changes in electricity consumption and freight turnover.

### Purchased electricity and weighted average tariff

| | 2015 | | | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|---|
| *For the year ended 31 December* | *GWh* | *Gross ton-km (mln.)* | *Weighted average tariff (GEL)* | *GWh* | *Gross ton-km (mln.)* | *Weighted average tariff (GEL)* | *GWh* | *Gross ton-km (mln.)* | *Weighted average tariff (GEL)* |
| January | 16.6 | 763.5 | 0.088 | 16.5 | 760.7 | 0.092 | 19.5 | 928.2 | 0.089 |
| February | 14.4 | 642.3 | 0.090 | 13.6 | 612.0 | 0.092 | 17.2 | 835.1 | 0.090 |
| March | 16.2 | 763.1 | 0.089 | 16.7 | 806.2 | 0.091 | 18.5 | 907.1 | 0.089 |
| April | 14.5 | 681.6 | 0.088 | 15.6 | 730.7 | 0.090 | 16.9 | 819.7 | 0.087 |
| May | 14.8 | 695.1 | 0.083 | 16.2 | 780.4 | 0.082 | 14.8 | 675.2 | 0.082 |
| June | 14.1 | 654.0 | 0.083 | 15.9 | 759.9 | 0.082 | 15.0 | 709.5 | 0.082 |
| July | 14.8 | 678.7 | 0.083 | 18.4 | 896.6 | 0.086 | 17.7 | 831.1 | 0.086 |
| August | 14.1 | 639.3 | 0.118 | 17.9 | 861.0 | 0.089 | 19.6 | 940.0 | 0.087 |
| September | 14.4 | 638.2 | 0.118 | 16.8 | 789.6 | 0.087 | 17.9 | 823.6 | 0.088 |
| October | 13.8 | 612.8 | 0.117 | 16.5 | 782.5 | 0.088 | 19.6 | 954.0 | 0.089 |
| November | 14.5 | 657.7 | 0.119 | 15.7 | 726.3 | 0.090 | 19.1 | 925.0 | 0.090 |
| December | 15.3 | 661.9 | 0.119 | 19.0 | 914.6 | 0.088 | 17.6 | 759.0 | 0.091 |
| **Total** | **177.5** | **8,088.2** | **0.100** | **198.8** | **9,420.5** | **0.088** | **213.4** | **10,107.5** | **0.088** |

# Fuel expenses

## *General description*

The Group's fuel requirements consist principally of the costs of diesel used by diesel-fueled locomotives at stations, which generate freight handling revenue. It should be noted that the main driver for these operations is dry cargo. Liquid cargo volume also affects expenses, however less so than that of dry cargo because liquid cargo is mainly transported to destinations where the Group's locomotives are not used for station operations and the customer uses its own locomotives, while Georgian Railway locomotives are used for station operations of dry cargo.

Another factor affecting the 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 (usually ports), most local, export and import cargos are served in two stations (origin station and destination station).

Another minor use of fuel is for lubricants to serve the equipment of the Group and for administrative fuel. The Group purchases fuel based on market prices, thus the expenses are tied to the market price of fuel in Georgia and subsequently the prices globally.

### Fuel expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs | 2014 | 2014 vs | 2013 |
| Fuel | 5,807 | 6,919 | 7,054 | -16.1% | -1,112 | -1.9% | -135 |
| Lubricants | 0 | 949 | 1,106 | -100.0% | -949 | -14.2% | -157 |
| **Total** | **5,807** | **7,868** | **8,160** | **-26.2%** | **-2,061** | **-3.6%** | **-292** |

### *Factors influencing changes*

The decrease in fuel expenses during the period under review was mostly caused by the decrease in transportation volume; however, as the consumption of fuel is influenced by a number of factors the relationship is not linear.

The decrease in total fuel expenses in 2015 compared to 2014 was higher than the decrease in transportation volume. This was because from 2015 the lubricants were reclassified from fuel expenses to material expenses. When adjusted for the aforementioned reclassification the change was a 14 percent decrease in 2015 compared to 2014.

## Freight car rental expenses

### *General description*

Freight car rental expenses are derived from the usage of foreign railways' railcars by the Group in its operations, for which it is charged a daily fee. This expense counters the freight car rental revenue and is essentially of the same nature. The expense is based on CHF tariffs and thus is tied to the GEL/CHF exchange rate and the amount of cargo Georgian Railway transports using other railways' railcars.

### Freight car rental expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs | 2014 | 2014 vs | 2013 |
| Freight car rental expenses | 7,612 | 9,790 | 11,988 | -22.2% | -2,178 | -18.3% | -2,198 |



### *Factors influencing changes*

The decreasing trend in freight car rental expenses during the period under review was primarily caused by the decrease of crude oil transportation, as crude oil was usually transported with wagons owned by Azerbaijan Railway.

# Wagon rent expenses

## *General description*

Wagon rent expenses cover the rent paid for 425 tank cars, rented from AS Spacecom since 30 March 2012. The daily rent price is set in USD and thus is affected by the GEL/USD exchange rate. However, the rent itself is fixed and is not affected by the amount of cargo transported by these tank cars.

### Wagon rent expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | | 2014 vs 2013 | |
| Wagon rent expenses | 3,597 | 10,202 | 9,857 | -64.7% | -6,604 | 3.5% | 345 |

## *Factors influencing changes*

Despite the depreciation of GEL against USD, the wagon rent expenses in 2015 decreased by GEL 6.6 million compared to the same period in 2014. This can be explained by the fact that the rent contract for 425 wagons expired in April 2015.

The increase in wagon rent expenses in 2014 compared to the same period in 2013 was mainly due to the increase in the GEL/USD exchange rate.

# Materials, repair and maintenance expenses

## *General description*

The Group uses materials for repairs that are mainly performed by its own employees. Such material usage represents a material expense of the Group. However, for some types of repairs the Group uses outsourcing, in which case the Group does not incur material expenses. This repair outsourcing represents a repair and maintenance expense of the Group.

While repair and maintenance are mainly denominated in GEL, materials expenses to some extent are affected by foreign currency fluctuations as some of the procurements are denominated in USD and not all necessary materials are purchased in Georgia.

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

## Materials, repair and maintenance expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **vs 2014** | **2014** | **vs 2013** |
| Materials | 19,276 | 19,280 | 19,770 | 0.0% | -4 | -2.5% | -490 |
| Repair and maintenance | 15,420 | 10,001 | 10,550 | 54.2% | 5,419 | -5.2% | -550 |
| **Total materials, repair and maintenance expenses** | **34,696** | **29,281** | **30,320** | **18.5%** | **5,415** | **-3.4%** | **-1,040** |

### *Factors influencing changes*

Increased repair and maintenance expenses in 2015 compared to the same period in 2014 were mainly due to the increased repairs of rolling stock and also buildings and other construction facilities. Materials expenses remained at about the same level in 2015 compared to the same period in 2014 but, if adjusted to the above mentioned reclassification of lubricants from fuel expenses to materials expenses, the decrease would be about GEL 1 million.

Materials, repair and maintenance expenses did not show any significant changes in 2014 compared to the same period in 2013.

# Security and other operating expenses

### *General description*

Security expenses mainly comprise the Group's buildings and station protection expenses. The services in this regard are purchased from the state security agency.

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

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* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015** | **vs 2014** | **2014** | **vs 2013** |
| Security | 8,734 | 8,495 | 7,775 | 2.8% | 239 | 9.3% | 720 |
| Other op. expenses | 27,292 | 18,608 | 25,595 | 46.7% | 8,684 | -27.3% | -6,987 |
| **Total security and other op. expenses** | **36,026** | **27,103** | **33,370** | **32.9%** | **8,922** | **-18.8%** | **-6,267** |

### *Factors influencing changes*

The increase in other operating expenses in 2015 compared to the same period in 2014 was mostly due to the increased expenses of the Group's subsidiaries, during the period under review.

The decrease in other operating expenses in 2014 compared to 2013 was mainly due to reduced provisions.

The increase in security expenses was mostly caused by the increased number of the Group's buildings under protection.

## Taxes other than income tax

### *General description*

Land and property taxes represent the amount of tax paid to municipal governments throughout Georgia. The tax amount depends on the value of the assets under taxation and the tax rate set by the local government.

Land taxes are determined by the municipalities where the land is located, while property taxes are calculated at 1 percent of the 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* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Property tax | 13,200 | 12,892 | 12,051 | 2.4% | 307 | 7.0% | 841 |
| Land Tax | 10,982 | 10,225 | 9,207 | 7.4% | 757 | 11.1% | 1,018 |
| Other taxes | 1,787 | 1,267 | 2,296 | 41.1% | 520 | -44.8% | -1,029 |
| **Total** | **25,969** | **24,384** | **23,554** | **6.5%** | **1,585** | **3.5%** | **830** |

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



### *Factors influencing changes*

The increase in property tax during the period under review was mainly due to an increase in the Company's assets, such as Georgian Railway's rolling stock, power and working machinery, and progress in the construction of the Group's projects (mostly Modernization project).

The increase in land tax during the period under review was due to the increase in land owned by the Company and the decision of local governments in several regions in Georgia to increase the taxation coefficient on land taxes.

## 2.2.4 Financial income and cost

### *General description*

The financial income of the Group mainly consists of interest income, which represents the interest accrued on the Group's cash balances.

Financial costs mainly consist of interest expenses and foreign exchange losses (see subheading 2.3.4 Non-current liabilities). Part of the Group's interest expenses is 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 under IFRS.

The main sources of FX gains or losses are the Group's Eurobonds, which are denominated in USD. This is however partly countered by the USD cash balances and receivables in the Group's foreign hard currencies. It must be noted that such FX gains or losses on Eurobonds are not monetary in nature until the bonds mature.

### Financial income and cost

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs** | **2014** | **2014 vs** | **2013** |
| Interest income | 20,932 | 11,666 | 12,334 | 79.4% | 9,266 | -5.4% | 841 |
| Impairment loss on trade receivables | -28,627 | -5,245 | -8,903 | 445.8% | -23,381 | -41.1% | 1,018 |
| Interest expense | -59,891 | -44,891 | -14,251 | 33.4% | -15,000 | 215.0% | -1,029 |
| FX gain/loss | -226,837 | -61,133 | -34,367 | 271.1% | -165,705 | 77.9% | 1,018 |
| **Net financial income/loss** | **-294,423** | **-99,603** | **-45,187** | **195.6%** | **-194,820** | **120.4%** | **-1,029** |

### *Factors influencing changes*

Net financial loss increased during the period under review, which was mainly caused by the depreciation of GEL against both USD and CHF.

Fluctuation of the GEL/USD exchange rate has a significant effect on foreign currency gains/losses. Considering the depreciation of the GEL during the period under review the Group experienced an increase in net foreign currency losses. At the same time, the Group matches the borrowing and revenue generation currencies, thus creating a natural economic hedge.

Accordingly, an increase in liabilities was accompanied by an increase in revenues in GEL. Due to the fact that the annual revenue base is lower than the Eurobond amount (it has remained at USD 500 million since 7 July 2015, as USD 27.5 million was repaid in July of the current year), the net effect in the period when the FX change took place is a loss. However, this will be compensated in subsequent years, as while revenue in GEL terms stays high, liabilities will not increase further (in the event of a stable level of FX). On the other hand, if GEL will appreciate against USD, FX losses will be reversed by FX gains and liabilities in GEL terms will decrease. In 2015 the GEL was the weakest it had been against the USD for ten years.

The table sets forth average annual GEL/USD exchange rates for the previous years:

| | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| GEL/USD | 2.27 | 1.77 | 1.66 | 1.65 | 1.69 | 1.78 | 1.67 | 1.49 | 1.67 | 1.78 | 1.81 |

Due to the significant depreciation of GEL against USD the Group's ratio of net financial indebtedness to EBITDA (which ensures its compliance to the covenant) has deteriorated. In 2015 the ratio was 2.8 while for the same period in 2014 it was 2.7.

It should also be mentioned that, in the short term period, FX loss has practically no monetary effect for the Group, as most of its liabilities (USD 500 million) will mature in 2022. Furthermore, the Group has shown significant EBITDA improvements, which ensures the Group's ability to meet its financial needs at the moment of debt maturity.

Significantly higher interest expenses in 2015 and 2014 compared to the same period in 2013 were mostly caused by the temporary stoppage of the Tbilisi Bypass project (see subheading 1.12.2 Tbilisi Bypass project). Due to the suspension, the interest expenses on the funds spent on the Tbilisi Bypass project were not capitalized in 2015 and 2014. The increased interest expenses can also be explained by the depreciation of GEL against USD as the Group's Eurobonds are denominated in USD.

Another factor that contributed to the net financial loss in 2015 was the impairment loss on trade receivables, which was mainly caused by the impairment of receivables from 24 hour services charged to the contractor company, which provided wagon rent services and failed to relocate wagons from the Group's stations in time after the contract termination. Change was also partly driven by the portion of receivables, which was impaired in previous periods and was revaluated to account for the depreciation of GEL.

Higher interest income in 2015 compared to the same period in 2014 and 2013 can be explained by higher cash balances held by the Group and also the depreciation of GEL against USD.

## 2.2.5 Income tax expenses

In May 2016, the Parliament of Georgia adopted amendments to the Tax Code of Georgia, according to which current profit tax regulations will change to so-called "tax on distributed profits" model, similar to Estonian one. The new tax rules are announced to be effective on 1 January 2017.

### Income tax expenses

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | | 2014 vs 2013 | |
| Income tax expense | -10,555 | 5,883 | 10,960 | -279.4% | -16,438 | -46.3% | -5,077 |

The Group's profit before tax in 2015 was negative, which resulted in income tax loss. According to the current Georgian tax code, income tax losses can be carried forward up to five years and a respective tax asset is created to the extent that it will be utilized against a probable future taxable profit.

The decrease in income tax expenses in 2014 compared to the same period in 2013 was due to the decreased profit before taxes driven by FX losses.

# 2.3

# Balance sheet

## 2.3.1 Non-current assets

### *General description*

Property, plant and equipment - consists mainly of land, construction in progress, railcars, buildings, power and working machinery.

Other non-current assets - consists mainly of prepayments and inventories that were acquired for capital projects.

### Non-current assets

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs 2014 | | 2014 vs 2013 | |
| Property, plant and equipment | 2,483,393 | 2,378,228 | 2,347,187 | 4.4% | 105,165 | 1.3% | 31,040 |
| Other non-current assets | 147,998 | 170,190 | 180,908 | -13.0% | -22,192 | -5.9% | -10,718 |
| Deferred tax Assets | 1,094 | 1,557 | 1,557 | -29.7% | -463 | 0.0% | 0 |
| **Total Non-current assets** | **2,632,485** | **2,549,975** | **2,529,652** | **3.2%** | **82,510** | **0.8%** | **20,323** |

### *Factors influencing changes*

Property, plant and equipment - The increase in total non-current assets in 2015 compared to the same period in 2014 was due to an increase in property, plant and equipment, which was principally caused by increased investments in construction in progress within the framework of Modernization project, and the modernization of the Group's rail track infrastructure.

The increase in 2014 compared to the same period in 2013 was mainly due to the investments in construction in progress. A smaller increase in property plant and equipment in 2014vs2013 compared to 2015vs2014 was mainly due to the slower pace of works for Modernization project.



Other non-current assets - the increase in property, plant and equipment during the period under review was partially offset by the decrease in other non-current assets. Compared to 2014 the decrease in 2015 was mainly caused by a decrease in prepayments (mostly due to the Modernization project) and materials that were acquired for capital projects. The decrease in 2014 compared to the same period of 2013 was mainly caused by the decrease in prepayments mostly due to the completion of some parts of the Modernization project.

## 2.3.2 Current assets

### *General description*

Inventory – the current inventory balance mainly consists of inventories needed by the Group for its running repairs and maintenance activities.

Current tax assets - represents income tax overpayments by the Group to the State.

### Current assets

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Inventories | 34,768 | 34,008 | 43,059 | 2.2% | 760 | -21.0% | -9,051 |
| Loan receivable | 38,341 | 0 | 0 | NM | 38,341 | NM | 0 |
| Current tax assets | 10,993 | 10,924 | 11,689 | 0.6% | 69 | -6.5% | -765 |
| Trade and other receivables | 70,645 | 53,944 | 52,402 | 31.0% | 16,701 | 2.9% | 1,542 |
| Prepayments and other current assets | 11,901 | 18,547 | 39,429 | -35.8% | -6,646 | -53.0% | -20,882 |
| Cash and cash equivalents | 294,784 | 300,983 | 208,996 | -2.1% | -6,199 | 44.0% | 91,987 |
| **Total current assets** | **461,432** | **418,406** | **355,575** | **10.3%** | **43,026** | **17.7%** | **62,831** |

### *Factors influencing changes*

The increase in total current assets in 2015 compared to the same period in 2014 can be explained mainly by loan receivable, specifically a short-term loan that the Group provided to a state controlled entity.

The increase in trade and other receivables in 2015 compared to 2014 can be explained mainly by the depreciation of GEL against foreign currencies and also by the increased amount to be received from foreign railways due to usage of the Group's freight cars and partially due to receivables from other activities such as rent and repair services.

The decrease in prepayments and other current assets during the period under review was mainly due to the reduced tax asset balances (other than income tax).

## 2.3.3 Equity

### Equity

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Share capital | 1,052,605 | 1,052,202 | 1,050,075 | 0.0% | 403 | 0.2% | 2,127 |
| Non-cash owner contribution reserve | 34,214 | 34,214 | 31,673 | 0.0% | 0 | 8.0% | 2,541 |
| Retained earnings | 384,391 | 476,335 | 487,379 | -19.3% | -91,944 | -2.3% | -11,044 |
| **Total equity** | **1,471,210** | **1,562,751** | **1,569,127** | **-5.9%** | **-91,541** | **-0.4%** | **-6,376** |

The decrease in total equity during the period under review was due to the reduced retained earnings, which in 2015 was mainly caused by the net loss that the Group recorded for the year and dividend payments. In 2014 the reduction was mainly caused by dividend payments.

## 2.3.4 Non-current liabilities

### *General description*

Eurobonds – the Group's non-current liabilities mainly consist of non-current borrowings, representing the Group's Eurobonds (valued at USD 500 million), issued in 2012 with semiannual interest payments (at a rate of 7.750 percent) on 11 January and 11 July and maturing in 2022. At the end of 2013, borrowings also included USD 27.5 million which represented the remaining part of the USD 250 million Eurobonds issued in 2010 with semiannual interest payments (at a rate of 9.875 percent) on 22 January and 22 July and maturing on 22 July 2015.

The Eurobonds issued in 2012 were partly used to buy back about 89 percent of Eurobonds issued in 2010, leaving USD 27.5 million that have matured in 2015.

Advances received from the Government - another major item in the non-current liabilities is advances received from the Government. This item represents the nonmonetary prepayment received from the Government of Georgia for the land, which should be freed up upon the completion of the Tbilisi Bypass project. In April 2012, the Company and the Government entered into the 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 Government agrees to pay the equivalent of CHF 138 million in national currency to the Group by reducing the amount of dividends payable to the Government. In 2012, the Company declared dividends out of which GEL 232 million (CHF 138 million) were classified as an advance received from the Government for the sale of the land covered in the Bypass Project Memorandum. The subtraction from retained earnings has already been made, however the project has not been completed yet and the land remains under the ownership of the Group. Thus, the amount is shown in the balance sheet as a liability.

### Non-current liabilities

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2015 vs | 2014 | 2014 vs | 2013 |
| Loans and borrowings | 1,193,301 | 929,373 | 913,194 | 28.4% | 263,928 | 1.8% | 16,179 |
| Advances received from the Government | 221,788 | 229,377 | 231,592 | -3.3% | -7,589 | -1.0% | -2,215 |
| Trade and other payables | 52 | 52 | 52 | 0.0% | 0 | -0.9% | 0 |
| Deferred tax liability | 43,928 | 59,998 | 58,436 | -26.8% | -16,070 | 2.7% | 1,562 |
| **Total non-current liabilities** | **1,459,069** | **1,218,800** | **1,203,274** | **19.7%** | **240,269** | **1.3%** | **15,526** |

### *Factors influencing changes*

The main reason for the increase in total non-current liabilities during the period under review was loans and borrowings. As the Eurobonds of the Group are denominated in USD, the depreciation of GEL against USD caused an increase in loans and borrowings in GEL terms. In 2014, compared to the same period of 2013, this increase was partly offset by the transfer of part of the long-term loans and borrowings (USD 27.5 million) to current loans and borrowings.

The decrease in advances received from the Government during the period under review was due to the transfer of a part of the asset to the State in accordance with the above mentioned agreement. The decrease in deferred tax liability in 2015 compared to the same period of 2014 was caused by the net loss recorded by the Group in 2015.

## 2.3.5 Current liabilities

### *General description*

Current loans and borrowings - current portion of long-term loans and interest payables.

Liabilities to the Government - caused by the fact that in previous periods certain assets were taken out of the Group's capital in order to be transferred to the Government, but were recorded as a liability as the actual transfer was delayed.

### Current liabilities

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Loans and borrowings | 44,855 | 87,330 | 33,747 | -48.6% | -42,475 | 158.8% | 53,583 |
| Trade and other payables | 89,258 | 78,480 | 56,161 | 13.7% | 10,778 | 39.7% | 22,319 |
| Liabilities to the Government | 8,009 | 8,467 | 11,917 | -5.4% | -458 | -29.0% | -3,450 |
| Provisions | 8,325 | 6,447 | 6,154 | 29.1% | 1,878 | 4.8% | 293 |
| Other current liabilities | 13,191 | 6,106 | 4,847 | 116.0% | 7,085 | 26.0% | 1,259 |
| **Total current liabilities** | **163,638** | **186,830** | **112,826** | **-12.4%** | **-23,192** | **65.6%** | **74,004** |

### *Factors influencing changes*

Compared to 2014, the loans and borrowings in 2015 decreased because Eurobonds worth USD 27.5 million were repaid in July 2015 (see subheading 2.3.4 Non-current liabilities). Meanwhile, the increase in loans and borrowings in 2014 compared to the same period of 2013 was caused due to the fact that the remaining portion of the Eurobonds issued in 2010 (USD 27.5 million) having been transfered from long-term loans and borrowings to short-term.

The increase in trade and other payables in 2015 compared to the same period of 2014 was mainly due to increased payables under the Modernization project. The increase in 2014 compared to the same period of 2013 was due to the payables for railcar rent and advance payments received from customers.

The decrease in liabilities to the Government during the period under review was due to the fact that certain assets were transferred to the State.

The increase in other current liabilities in 2015 compared to the same period of 2014 was mainly due to the remaining dividend payments of GEL 2.8 million and bonuses.

# 2.4

# Liquidity and capital resources

By the end of 2015, the Group had quite a significant balance of cash and cash equivalents. These cash resources are held to support existing and future capital expenditures. Capital expenditures mainly entail the Modernization and Tbilisi Bypass projects. Works on the Modernization project developed at a faster pace in 2015 compared to the same period of 2014, while the Tbilisi Bypass project remained suspended.

As at 31 December 2015 and 31 December 2014, the Group had cash and cash equivalents of GEL 294.8 million and GEL 301.0 million, respectively. The Group can also rely on its available credit lines of approximately GEL 44.0 million as at the end of 2015.

The Group mainly relies on its operating activities in order to provide funds for its future cash requirements.

## 2.4.1 Operating activities

### *General description*

Cash receipts from customers - the Group's freight as well as passenger transportation services are based on advance payments. However, payments for services like freight handling, freight car rental and repairs are made after the services are provided.

VAT tax refund from the State - the Group has capital expenditures which include VAT payments to the Government, and provides services for which it has to pay VAT. In the case of a positive VAT surplus, the Group can reclaim the entire VAT surplus from the Government or use it to cover other taxes such as corporate income tax and personal income tax of the employees.

### Operating activities



| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Cash receipts from customers | 564,849 | 526,862 | 475,455 | 7.2% | 37,987 | 10.8% | 51,407 |
| Cash paid to suppliers and employees | -260,232 | -243,832 | -240,401 | 6.7% | -16,400 | 1.4% | -3,431 |
| VAT tax refund from the State | 0 | 0 | 7,500 | 0.0% | 0 | -100.0% | -7,500 |
| Income tax paid | -5,121 | -2,925 | -23,751 | 75.1% | -2,196 | -87.7% | 20,826 |
| **Net cash from operating activities** | **299,496** | **280,105** | **218,803** | **6.9%** | **19,391** | **28.0%** | **61,302** |

## *Factors influencing changes*

The increase in cash receipts from customers during the period under review was due to the higher revenues generated by the Group (see subheading 2.2.1 Group's operating revenues).

The increase in cash paid to suppliers and employees in 2015 compared to the same period in 2014 was mainly due to the higher taxes paid (other than income tax), the higher amount paid for personnel salaries and personal insurance. The increase in 2014 compared to the same period of 2013 was mainly due to the increased payments for personnel salaries.

The significant decline in income tax paid in 2015 and 2014 compared to the same period of 2013 is explained by the usage of an accumulated VAT balance of the Company to cover other taxes including corporate income tax of the Company.

# 2.4.2 Investing activities

## *General description*

Acquisition of property, plant and equipment - includes capital expenditures for the Group's two main projects, Modernization and Tbilisi Bypass, and other investments in infrastructure as well as the purchase of new railcars and repair services.

Interest received - the Group receives interest for cash it holds in banks.

Term deposits - the Group keeps some of its cash on current accounts and some on call deposits, which provide a higher return. 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. In 2012 the Group held term deposits which did not fell under the definition of call deposits. In the future the Group aims to place only call deposits.

### Investing activities

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs 2014** | | **2014 vs 2013** | |
| Property, plant and equipment | -156,993 | -86,776 | -148,661 | 80.9% | -70,217 | -41.6% | 61,885 |
| Interest received | 20,992 | 11,523 | 16,764 | 82.2% | 9,469 | -31.3% | -5,241 |
| Decrease (Increase) in term deposits | 0 | 0 | 95,525 | NM | 0 | -100.0% | -95,525 |
| Lending to other entities | -38,507 | 0 | 0 | NM | -38,507 | NM | 0 |
| Acquisition of subsidiary | 0 | 0 | -48 | NM | 0 | -100.0% | 48 |
| **Net cash used in investing activities** | **-174,508** | **-75,253** | **-36,420** | **131.9%** | **-99,255** | **106.6%** | **-38,833** |

## *Factors influencing changes*

The increase in cash outflow for the acquisition of property, plant and equipment in 2015 compared to the same period of 2014 was mainly due to the increased works on the Modernization project, as well as modernization and construction of other assets of the Group. The decrease in 2014 compared to the same period of 2013 was mainly caused by the deceleration in works on the Modernization project and also the temporary stoppage of the Tbilisi Bypass project.

Higher interest income in 2015 compared to the same period in 2014 and 2013 can be explained by higher cash balances held by the Group and the depreciation of GEL against USD. Even though the Group held more cash during the year 2014 compared to the same period of 2013, the amount of interest it received decreased. This can be explained by the fact that the interest rates offered by Georgian banks on current accounts and term deposits decreased in 2014.

As the Group's funds are placed on call deposits since 2013 and it aims to maintain the unilateral right to withdraw the deposits within a few days without penalties or loss of interest, no further increase/decrease of term deposits are expected.

Cash outflow of GEL 38.5 million (USD 16 million) in 2015 covers a short-term loan that the Group provided to a state controlled entity.

## 2.4.3 Financing activities

### *General description*

Dividends paid - 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 shall be no more than 50 percent of the cumulated consolidated net income of the Group.

Interest paid - the Group pays interest on its Eurobonds, denominated in USD.

### Financing activities

| *For the year ended 31 December* | *In GEL '000* | | | *% Change* | *Abs. Change* | *% Change* | *Abs. Change* |
|---|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2015 vs** | **2014** | **2014 vs** | **2013** |
| Dividends paid | -21,852 | -50,330 | -25,000 | -56.6% | 28,478 | 101.3% | -25,330 |
| Interest paid | -85,731 | -72,826 | -69,764 | 17.7% | -12,905 | 4.4% | -3,062 |
| Repayment of borrowings | -62,514 | 0 | -32 | NM | -62,514 | -100.0% | 32 |
| **Net cash used in financing activities** | **-170,097** | **-123,156** | **-94,796** | **38.1%** | **-46,941** | **29.9%** | **-28,360** |



### *Factors influencing changes*

The Company's dividend payments are linked to its net income and are bound by the covenants on its bond, which limits the amount that can be paid in dividends.

The increase in interest paid during the period under review was due to the depreciation of GEL against USD as the interest accrues on USD denominated debt obligations and is vulnerable to the GEL/USD exchange rate.

In July 2015 the Group repaid GEL 62.5 million (USD 27.5 million), the remaining portion of the Eurobonds issued in 2010.

# Glossary

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

**BTC:** The Baku-Tbilisi-Ceyhan

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

**CJSC:** Closed Joint Stock Company

**CPC:** The Caspian Pipeline Consortium

**EMU:** Electric Multiple Unit

**EU:** European Union

**Foreign Exchange (FX):** The value of the Georgian Lari relative to the U.S. Dollar or any other currency

**GDP:** Gross Domestic Product

**GMS:** General Shareholders meeting

**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

**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- the unit of capacity of a container ship, a container terminal and the statistics of container transit in a port

**The Company:** Georgian Railway JSC

**The Government:** The government of Georgia

**The Group:** Georgian Railway JSC and its subsidiaries

**The State:** Republic of Georgia

**Ton-kilometer:** Unit of measure 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 2015

## Contents

KPMG Georgia LLC
2nd Floor, Besiki Business Centre
4, Besiki Street
0108 Tbilisi, Georgia
Telephone +995 322 93 5713
Fax +995 322 98 2276
Internet www.kpmg.ge

## Independent Auditors' Report

To the Management Board
Georgian Railway JSC

We have audited the accompanying 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 2015, and 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 a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Georgia LLC

KPMG Georgia LLC
13 May 2016

შეზღუდული პასუხისმგებლობის საზოგადოება
LIMITED LIABILITY COMPANY
404437695
KPMG Georgia

| ’000 GEL | Note | 2015 | 2014 |
|---|---|---|---|
| **Assets** | | | |
| Property, plant and equipment | 11 | 2,483,393 | 2,378,228 |
| Deferred tax assets | 10 | 1,094 | 1,557 |
| Other non-current assets | 12 | 147,998 | 170,190 |
| **Non-current assets** | | **2,632,485** | **2,549,975** |
| | | | |
| Inventories | 13 | 34,768 | 34,008 |
| Loan receivable | 27 | 38,341 | - |
| Current tax assets | | 10,993 | 10,924 |
| Trade and other receivables | 14 | 70,645 | 53,944 |
| Prepayments and other current assets | 15 | 11,901 | 18,547 |
| Cash and cash equivalents | 16 | 294,784 | 300,983 |
| **Current assets** | | **461,432** | **418,406** |
| **Total assets** | | **3,093,917** | **2,968,381** |
| | | | |
| **Equity** | 17 | | |
| Share capital | | 1,052,605 | 1,052,202 |
| Non-cash owner contribution reserve | | 34,214 | 34,214 |
| Retained earnings | | 384,391 | 476,335 |
| **Total equity** | | **1,471,210** | **1,562,751** |
| | | | |
| **Liabilities** | | | |
| Loans and borrowings | 19 | 1,193,301 | 929,373 |
| Advance received from the Government | 17(e) | 221,788 | 229,377 |
| Trade and other payables | | 52 | 52 |
| Deferred tax liabilities | 10 | 43,928 | 59,998 |
| **Non-current liabilities** | | **1,459,069** | **1,218,800** |
| | | | |
| Loans and borrowings | 19 | 44,855 | 87,330 |
| Trade and other payables | 20 | 89,258 | 78,480 |
| Liabilities to the Government | 17(c) | 8,009 | 8,467 |
| Provisions | 21 | 8,325 | 6,447 |
| Dividend payable | 17(d) | 2,762 | - |
| Other current liabilities | | 10,429 | 6,106 |
| **Current liabilities** | | **163,638** | **186,830** |
| **Total liabilities** | | **1,622,707** | **1,405,630** |
| **Total equity and liabilities** | | **3,093,917** | **2,968,381** |



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 9 to 40.

| '000 GEL | Note | 2015 | 2014 |
|---|---|---|---|
| Revenue | 6 | 574,773 | 511,570 |
| Other income | 17(e) | 30,771 | 12,353 |
| Employee benefits expense | | (148,625) | (145,174) |
| Depreciation and amortization expense | | (104,416) | (105,258) |
| Electricity and materials used | 7 | (45,507) | (47,239) |
| Other expenses | 8 | (88,625) | (81,480) |
| **Results from operating activities** | | **218,371** | **144,772** |
| Finance income | 9 | 20,932 | 11,666 |
| Finance costs | 9 | (315,355) | (111,269) |
| **Net finance costs** | | **(294,423)** | **(99,603)** |
| **(Loss)/ profit before income tax** | | **(76,052)** | **45,169** |
| Income tax benefit/ (expense) | 10 | 10,555 | (5,883) |
| **(Loss)/ profit and total comprehensive (loss)/ income for the year** | | **(65,497)** | **39,286** |

These consolidated financial statements were approved by the Management Board on 13 May 2016 and were signed on its behalf by:

Mamuka Bakhtadze
General Director

Tamaz 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 9 to 42.

| | Share capital | Non-cash owner contribution reserve | Retained earnings | Total equity |
|---|---|---|---|---|
| Balance at 1 January 2014 | 1,050,075 | 31,673 | 487,379 | 1,569,127 |
| **Total comprehensive income for the year** | | | | |
| Profit for the year | - | - | 39, 286 | 39, 286 |
| **Transactions with owners, recorded directly in equity** | | | | |
| Dividends to equity holders (note 17(d)) | - | - | (50,330) | (50,330) |
| Net non-cash contributions by and distributions to owners (note 17(b)) | 2,127 | 2,541 | - | 4,668 |
| **Total transactions with owners, recorded directly in equity** | **2,127** | **2,541** | **(50,330)** | **(45,662)** |
| **Balance at 31 December 2014** | **1,052,202** | **34,214** | **476,335** | **1,562,751** |
| | | | | |
| Balance at 1 January 2015 | 1,052,202 | 34,214 | 476,335 | 1,562,751 |
| **Total comprehensive loss for the year** | | | | |
| Loss for the year | - | - | (65,497) | (65,497) |
| **Transactions with owners, recorded directly in equity** | | | | |
| Dividends to equity holders (note 17(d)) | - | - | (25,537) | (25,537) |
| Net non-cash contributions by and distributions to owners (note 17 (b)) | 403 | - | (910) | (507) |
| **Total transactions with owners, recorded directly in equity** | **403** | **-** | **(26,447)** | **(26,044)** |
| **Balance at 31 December 2015** | **1,052,605** | **34,214** | **384,391** | **1,471,210** |



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 9 to 40.

| '000 GEL | Note | 2015 | 2014 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash receipts from customers | | 564,849 | 526,862 |
| Cash paid to suppliers and employees | | (260,232) | (243,832) |
| **Cash flows from operations before income taxes paid** | | **304,617** | **283,030** |
| Income tax paid | | (5,121) | (2,925) |
| **Net cash from operating activities** | | **299,496** | **280,105** |
| | | | |
| **Cash flows from investing activities** | | | |
| Acquisition of property, plant and equipment | | (156,993) | (86,776) |
| Interest received | | 20,992 | 11,523 |
| Issuance of the loan | 27 | (38,507) | - |
| **Net cash used in investing activities** | | **(174,508)** | **(75,253)** |
| | | | |
| **Cash flows from financing activities** | | | |
| Repayment of borrowings | | (62,514) | - |
| Interest paid | | (85,731) | (72,826) |
| Dividends paid | 17(d) | (21,852) | (50,330) |
| **Net cash used in financing activities** | | **(170,097)** | **(123,156)** |
| | | | |
| **Net (decrease)/ increase in cash and cash equivalents** | | **(45,109)** | **81,696** |
| Cash and cash equivalents at 1 January | | 300,983 | 208,996 |
| Effect of exchange rate fluctuations on cash and cash equivalents | | 38,910 | 10,291 |
| **Cash and cash equivalents at 31 December** | 16 | **294,784** | **300,983** |



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 9 to 40.

# 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 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.

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. Related party transactions are disclosed in note 27.

# 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 Company'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 29(h)(iii) – useful lives and residual values of property, plant and equipment;
- Note 22(b)(ii) – impairment allowances for trade and other receivables;
- Note 16 – classification of deposits with original maturities of more than three months as cash and cash equivalents;
- Note 17 (e) – fair value of the land plots transferred to the Government of Georgia.

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 (a) – recoverability of construction of Tbilisi Bypass project;
- Note 27(c) (iii) – recoverability of the loan issued to the state controlled entity.

***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 note 22 (a) - financial instruments.

# 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 and luggage.

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** | **2015** | **2014** | **2015** | **2014** | **2015** | **2014** |
| External revenues | 552,298 | 489,592 | 15,487 | 18,317 | 567,785 | 507,909 |
| Depreciation and amortization | (42,411) | (41,859) | (9,144) | (8,135) | (51,555) | (49,994) |
| Reportable segment profit/(loss) before infrastructure costs, net interest cost and income tax | 378,494 | 311,551 | (18,810) | (15,182) | 359,684 | 296,369 |
| Reportable segment assets | 361,759 | 370,972 | 113,206 | 114,629 | 474,965 | 485,601 |
| Capital expenditure and other additions to non-current assets | 36,449 | 41,674 | 3,860 | 1,147 | 40,309 | 42,821 |

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

| '000 GEL | 2015 | 2014 |
|---|---|---|
| **Revenues** | | |
| Total revenue for reportable segments | 567,785 | 507,909 |
| Other revenue | 6,988 | 3,661 |
| Consolidated revenue | **574,773** | **511,570** |
| **Profit or loss** | | |
| Total profit or loss for reportable segments | 359,684 | 296,369 |
| Employee benefits expense – infrastructure and headquarters | (58,539) | (57,743) |
| Depreciation expenses – infrastructure and headquarters | (52,861) | (55,264) |
| Net finance costs | (294,423) | (99,603) |
| Other net unallocated expenses | (29,913) | (38,590) |
| Consolidated (loss)/ profit before income tax | **(76,052)** | **45,169** |
| **Assets** | | |
| Total assets for reportable segments | 474,965 | 485,601 |
| Property, plant and equipment - infrastructure and headquarters | 2,033,350 | 1,917,603 |
| Other unallocated assets, principally cash and non-current assets | 585,602 | 565,177 |
| **Consolidated total assets** | **3,093,917** | **2,968,381** |

### *(iii) Other material items 2015*

| '000 GEL | Reportable segment totals | Infrastructure and headquarters | Consolidated totals |
|---|---|---|---|
| Capital expenditure and other additions to non-current assets | 40,309 | 154,049 | 194,358 |
| Depreciation and amortization | 51,555 | 52,861 | 104,416 |

### *(iv) Other material items 2014*

| '000 GEL | Reportable segment totals | Infrastructure and headquarters | Consolidated totals |
|---|---|---|---|
| Capital expenditure and other additions to non-current assets | 42,821 | 75,874 | 118,695 |
| Depreciation and amortization | 49,994 | 55,264 | 105,258 |

### *(v) Geographical information*

Approximately 90% (2014: 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 2015 one customer of the Group's freight transportation segment represented approximately 22% of the Group's total revenue (GEL 125,727 thousand). In 2014 one customer of the Group's freight transportation segment represented approximately 18% of the Group's total revenue (GEL 92,499 thousand).

## 6. Revenue

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Freight traffic | 528,037 | 451,781 |
| Freight car rental | 24,261 | 37,811 |
| Passenger traffic | 15,487 | 18,317 |
| Other | 6,988 | 3,661 |
| | **574,773** | **511,570** |

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 and luggage 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 and materials used

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Electricity | 20,424 | 20,091 |
| Materials | 19,276 | 19,280 |
| Fuel | 5,807 | 7,868 |
| | **45,507** | **47,239** |

## 8. Other expenses

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Taxes other than income tax | 25,969 | 24,384 |
| Repairs and maintenance | 15,420 | 10,001 |
| Freight car rental | 11,210 | 19,992 |
| Security | 8,734 | 8,495 |
| Write off of non-current assets | - | 3,858 |
| Other | 27,292 | 14,750 |
| | **88,625** | **81,480** |

# 9. Finance income and finance costs

| **'000 GEL** | **2015** | **2014** |
|---|---|---|
| **Recognised in profit or loss** | | |
| Interest income on bank balances | 20,932 | 11,666 |
| **Finance income** | **20,932** | **11,666** |
| | | |
| Impairment loss on trade receivables (note 22 (b)(ii)) | (28,627) | (5,245) |
| Interest expense on financial liabilities | (59,891) | (44,891) |
| Net foreign exchange loss | (226,837) | (61,133) |
| **Finance costs** | **(315,355)** | **(111,269)** |
| **Net finance costs recognised in profit or loss** | **(294,423)** | **(99,603)** |

# 10. Income tax expense

## (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** | **2015** | **2014** |
|---|---|---|
| **Current tax expense** | | |
| Current year | 5,052 | 4,321 |
| | **5,052** | **4,321** |
| **Deferred tax (benefit)/expense** | | |
| Origination and reversal of temporary differences | (15,607) | 1,562 |
| | **(10,555)** | **5,883** |

**Reconciliation of effective tax rate:**

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | **'000 GEL** | **%** | **'000 GEL** | **%** |
| (Loss)/ profit before income tax | (76,052) | 100 | 45,169 | 100 |
| Income tax at applicable tax rate | (11,408) | 15 | 6,775 | 15 |
| Net non-deductible expenses/ (non-taxable income) | 853 | (1) | (892) | (2) |
| | **(10,555)** | **14** | **5,883** | **13** |

### (b) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| **'000 GEL** | **2015** | **2014** | **2015** | **2014** | **2015** | **2014** |
| Property, plant and equipment | - | - | (102,133) | (95,270) | (102,133) | (95,270) |
| Other non-current assets | - | 46 | (297) | - | (297) | 46 |
| Inventories | 10,919 | 10,516 | - | - | 10,919 | 10,516 |
| Trade and other receivables | 21,136 | 15,688 | - | - | 21,136 | 15,688 |
| Prepayments and other current assets | 1,636 | 1,636 | - | - | 1,636 | 1,636 |
| Loans and borrowings | 6,277 | 4,966 | - | - | 6,277 | 4,966 |
| Trade and other payables | 120 | 673 | - | - | 120 | 673 |
| Provisions | 1,249 | 967 | - | - | 1,249 | 967 |
| Other current liabilities | 1,041 | 780 | - | - | 1,041 | 780 |
| Tax loss carry-forwards | 17,218 | 1,557 | - | - | 17,218 | 1,557 |
| **Tax assets/(liabilities)** | **59,596** | **36,829** | **(102,430)** | **(95,270)** | **(42,834)** | **(58,441)** |
| Set off of tax | (58,502) | (35,272) | 58,502 | 35,272 | - | - |
| **Net tax assets/(liabilities)** | **1,094** | **1,557** | **(43,928)** | **(59,998)** | **(42,834)** | **(58,441)** |

## (c) Movement in temporary differences during the year

| ’000 GEL | 1 January 2015 | Recognised in profit or loss | 31 December 2015 |
|---|---|---|---|
| Property, plant and equipment | (95,270) | (6,863) | (102,133) |
| Other non-current assets | 46 | (343) | (297) |
| Inventories | 10,516 | 403 | 10,919 |
| Trade and other receivables | 15,688 | 5,448 | 21,136 |
| Prepayments and other current assets | 1,636 | - | 1,636 |
| Loans and borrowings | 4,966 | 1,311 | 6,277 |
| Trade and other payables | 673 | (553) | 120 |
| Provisions | 967 | 282 | 1,249 |
| Other current liabilities | 780 | 261 | 1,041 |
| Tax loss carry-forwards | 1,557 | 15,661 | 17,218 |
| | **(58,441)** | **15,607** | **(42,834)** |

| ’000 GEL | 1 January 2014 | Recognised in profit or loss | 31 December 2014 |
|---|---|---|---|
| Property, plant and equipment | (94,141) | (1,129) | (95,270) |
| Other non-current assets | 46 | - | 46 |
| Inventories | 12,948 | (2,432) | 10,516 |
| Trade and other receivables | 14,878 | 810 | 15,688 |
| Prepayments and other current assets | 1,637 | (1) | 1,636 |
| Loans and borrowings | 4,611 | 355 | 4,966 |
| Trade and other payables | 28 | 645 | 673 |
| Provisions | 923 | 44 | 967 |
| Other current liabilities | 634 | 146 | 780 |
| Tax loss carry-forwards | 1,557 | - | 1,557 |
| | **(56,879)** | **(1,562)** | **(58,441)** |

## 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 2014 | 541,816 | 131,239 | 845,820 | 853,590 | 585,939 | 2,958,404 |
| Additions | 3,343 | 2,137 | 53 | 23,495 | 114,548 | 143,576 |
| Disposals and write offs | (60) | (749) | (6,629) | (12,194) | (7,036) | (26,668) |
| Transfers | (1,147) | 1,800 | 32,436 | 22,503 | (55,592) | - |
| **Balance at 31 December 2014** | **543,952** | **134,427** | **871,680** | **887,394** | **637,859** | **3,075,312** |
| Balance at 1 January 2015 | 543,952 | 134,427 | 871,680 | 887,394 | 637,859 | 3,075,312 |
| Additions | 401 | 1,792 | - | 23,520 | 186,624 | 212,337 |
| Disposals and write offs | (122) | (6,984) | (14,485) | (36,278) | (47) | (57,916) |
| Transfers | 1,240 | 768 | 46,357 | 27,589 | (75,954) | - |
| **Balance at 31 December 2015** | **545,471** | **130,003** | **903,552** | **902,225** | **748,482** | **3,229,733** |
| ***Depreciation*** | | | | | | |
| Balance at 1 January 2014 | - | 26,869 | 227,904 | 356,444 | - | 611,217 |
| Depreciation for the year | - | 3,827 | 43,405 | 57,655 | - | 104,887 |
| Disposals and write offs | - | (521) | (6,418) | (12,081) | - | (19,020) |
| **Balance at 31 December 2014** | **-** | **30,175** | **264,891** | **402,018** | **-** | **697,084** |
| Balance at 1 January 2015 | - | 30,175 | 264,891 | 402,018 | - | 697,084 |
| Depreciation for the year | - | 4,062 | 40,910 | 59,396 | - | 104,368 |
| Disposals and write offs | - | (5,034) | (14,365) | (35,713) | - | (55,112) |
| **Balance at 31 December 2015** | **-** | **29,203** | **291,436** | **425,701** | **-** | **746,340** |
| ***Carrying amounts*** | | | | | | |
| At 1 January 2014 | 541,816 | 104,370 | 617,916 | 497,146 | 585,939 | 2,347,187 |
| **At 31 December 2014** | **543,952** | **104,252** | **606,789** | **485,376** | **637,859** | **2,378,228** |
| **At 31 December 2015** | **545,471** | **100,800** | **612,116** | **476,524** | **748,482** | **2,483,393** |

(a) During the year ended 31 December 2010 the Group started two large capital projects (included in construction in progress): the Main Line Modernization and the Tbilisi Bypass and started to incur expenditures for the projects in September 2010 and November 2010 respectively. To partly finance the projects the Group issued unsecured bonds in 2010. In 2012, the Group redeemed the bonds issued in 2010 by issuing new bonds for general corporate and liquidity management purposes (see note 19).

All the borrowing costs of the 2010 unsecured bonds allocated to each project on a 59%/41% basis were capitalized upon starting to incur expenditures for the projects. The interest on the bonds issued in 2012 was capitalized to the two projects in proportion to the costs incurred on the projects based on a capitalization rate of 8% (2014: 8%). Capitalised borrowing costs during 2015 related to the Main Line Modernization project amounted to GEL 33,310 thousand (2014: GEL 29,391 thousand).

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 after 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. The modified project will be completed within an additional 18 months. The Group signed the amended construction contract with the main third party construction companies in accordance with the Government decision.

In January 2015, a comparative study for the existing and the bypass line was prepared by a third party consultant. The study analyzed different scenarios and concluded that the best option is maintaining only the current rail system on the existing main line (demolishing supporting railway infrastructure, such as depots and intermediate stations except the main terminal station) and constructing the Tbilisi Bypass line. Following this option the cargo directed from West to the East border will be transmitted via Tbilisi Main Line and the Cargo directed from the East to the West region- via new Tbilisi Bypass.

In 2015 the Group has presented the final project with various scenarios including the best option identified by the third party consultants to the Government of Georgia for approval. As at the date these consolidated financial statements were authorized for issue, the Group is in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. It is believed that the final decision will be agreed by June 2016 and that the execution of any of the possible scenarios will not cause any existing significant constructions to become redundant.

(b) The Government of Georgia contributes certain property, plant and equipment in the form of an increase in share capital. In 2015 and 2014 the share capital has been increased by the fair value of these assets of GEL 402 thousand and GEL 780 thousand respectively (see note 17 (a)).

## 12. Other non-current assets

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Prepayments for non-current assets | 88,341 | 103,338 |
| Construction materials | 56,232 | 65,662 |
| Goodwill | 46 | 46 |
| Other | 3,379 | 1,144 |
| | **147,998** | **170,190** |

## 13. Inventories

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Materials | 30,347 | 29,939 |
| Rails | 2,109 | 3,141 |
| Fuel | 2,086 | 3,110 |
| Other | 4,203 | 2,022 |
| | 38,745 | 38,212 |
| Allowance for inventory obsolescence | (3,977) | (4,204) |
| | **34,768** | **34,008** |
| Reversal of previous write-down of inventories | 227 | 57 |

## 14. Trade and other receivables

| ’000 GEL | 2015 | 2014 |
|---|---|---|
| Trade receivables | 210,519 | 158,138 |
| Impairment allowance on trade receivables | (140,846) | (104,463) |
| | **69,673** | **53,675** |
| Other receivables | 972 | 269 |
| | **70,645** | **53,944** |

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

## 15. Prepayments and other current assets

| '000 GEL | 2015 | 2014 |
|---|---|---|
| Taxes, other than on income | 10,906 | 16,515 |
| Advances paid to suppliers | 995 | 2,032 |
| | **11,901** | **18,547** |

## 16. Cash and cash equivalents

| '000 GEL | 2015 | 2014 |
|---|---|---|
| Current accounts in banks | 142,953 | 88,169 |
| Call deposits | 151,770 | 212,710 |
| Petty cash | 61 | 104 |
| **Cash and cash equivalents in the consolidated statement of financial position and the consolidated statement of cash flows** | **294,784** | **300,983** |

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 any significant penalties or 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 and a sensitivity analysis for financial assets and liabilities are disclosed in note 22.

## 17. Equity and liabilities to the Government

### (a) Share capital

| _Number of shares_ | Ordinary shares | |
|---|---|---|
| | 2015 | 2014 |
| In issue at 1 January | 1,052,202,448 | 1,050,075,578 |
| Issued for property, plant and equipment (see note 11 (b)) | 402,055 | 779,590 |
| Withdrawal of property, plant and equipment | - | (9,520) |
| Issued for inventory | - | 1,356,800 |
| **In issue at 31 December, fully paid** | **1,052,604,503** | **1,052,202,448** |
| **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 owners 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 owners. These liabilities are recorded at the carrying amount of assets to be transferred to the owner.

| **’000 GEL** | **2015** | **2014** |
|---|---|---|
| Liabilities to the Government | **8,009** | **8,467** |

**(d) Dividends**

In 2015, the Company declared and paid dividends of GEL 25,537 thousand (GEL 0.02 per issued share) and GEL 21,852 thousand, respectively (2014: declared and paid dividends of GEL 50,330 thousand in total or GEL 0.05 per issued share). The remaining amount of the dividends payable is gradually reduced by the costs incurred by the Company on the construction of Batumi Station infrastructure as declared by the Government.

**(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 70.1 hectares of land plots with attached constructions which will 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 agrees 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.

In 2015 the Company transferred 3,266 square meter land plots with the carrying value of GEL 85 thousand to the Government within the framework of the Bypass Project Memorandum. The fair value of these land plots was determined by an independent appraiser at GEL 7,588 thousand based on market prices in recent transactions or adjusted ask prices for similar properties. The difference between the fair value and the carrying value of the transferred land plots of GEL 7,503 thousand was recognized as other income in the consolidated statement of profit or loss.

# 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** | **2015** | **2014** |
|---|---|---|
| ***Non-current liabilities*** | | |
| Unsecured bonds | 1,193,301 | 929,373 |
| **Loans and borrowings** | **1,193,301** | **929,373** |
| | | |
| ***Current liabilities*** | | |
| Current portion of unsecured bonds | 44,855 | 87,330 |
| **Loans and borrowings** | **44,855** | **87,330** |

### Terms and debt repayment schedule

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

| | | | | **31 December 2015** | | **31 December 2014** | |
|---|---|---|---|---|---|---|---|
| **'000 GEL** | **Currency** | **Nominal interest rate** | **Year of maturity** | **Face value** | **Carrying amount** | **Face value** | **Carrying amount** |
| Unsecured bonds | USD | 7.8% | 2022 | 1,238,156 | 1,238,156 | 963,253 | 963,253 |
| Unsecured bonds | USD | 9.9% | 2015 | - | - | 53,450 | 53,450 |
| **Total interest-bearing liabilities** | | | | **1,238,156** | **1,238,156** | **1,016,703** | **1,016,703** |

In July 2012 the Group carried out the issuance, placement and registration (listing) on the London Stock Exchange of unsecured bonds of USD 500 million and the early redemption of the unsecured bonds of USD 250 million due in 2015 issued by the Group in July 2010 (the 2010 Notes). As a result of the above transaction, the Group has issued USD 500 million 7.75% Notes due 2022 and redeemed 88.99% of the outstanding 2010 Notes with a face value of USD 222 million.

In July 2015 the Group has fully repaid 2010 Notes.

# 20. Trade and other payables

| **'000 GEL** | **2015** | **2014** |
|---|---|---|
| Trade payables | 73,064 | 57,448 |
| Advances received from customers | 16,194 | 21,032 |
| | **89,258** | **78,480** |

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

# 21. Provisions

| **'000 GEL** | **2015** | **2014** |
|---|---|---|
| Balance as at 1 January | 6,447 | 6,154 |
| Provisions made during the year | 1,878 | 608 |
| Provisions used during the year | - | (315) |
| **Balance as at 31 December** | **8,325** | **6,447** |

The Group recognised a provision for the estimated cash outflow required to settle legal cases against the Group existing as at 31 December 2015 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) Accounting classifications and fair values

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.

The carrying values of 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 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** | **2015** | **2014** |
| Cash and cash equivalents - Georgian banks (not impaired or past due) | 294,723 | 300,879 |
| Loan receivable | 38,341 | - |
| Trade receivables | 69,673 | 53,675 |
| | **402,737** | **354,554** |

#### _Trade and other 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. Approximately 22% (2014: 18%) 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 and other receivables is generally required.

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

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

| | Carrying amount | |
|---|---|---|
| **'000 GEL** | **2015** | **2014** |
| CIS countries | 54,544 | 46,321 |
| Domestic | 15,129 | 7,354 |
| | **69,673** | **53,675** |

The Group's two most significant customers account for GEL 41,143 thousand of the trade receivables carrying amount as at 31 December 2015 (2014: GEL 34,267 thousand).

**Impairment losses**

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

| **'000 GEL** | **Gross 2015** | **Impairment 2015** | **Gross 2014** | **Impairment 2014** |
|---|---|---|---|---|
| Past due 0- 90 days | 9,319 | 8,040 | 5,030 | 2,777 |
| Past due 91-180 days | 18,814 | 9,988 | 3,742 | 837 |
| Past due 181-365 days | 37,636 | 18,355 | 11,535 | 4,470 |
| Past due more than one year | 144,750 | 104,463 | 137,831 | 96,379 |
| | **210,519** | **140,846** | **158,138** | **104,463** |

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

| **'000 GEL** | **2015** | **2014** |
|---|---|---|
| Balance at beginning of the year | 104,463 | 96,379 |
| Increase during the year | 28,627 | 8,084 |
| Net foreign exchange loss | 7,756 | - |
| **Balance at end of the year** | **140,846** | **104,463** |

In 2015 the Group recognized impairment loss of approximately GEL 13 million for the trade receivables from one counterparty that were originated in 2015. The Group believes that, at the origination date, it was probable that the economic benefits would flow to the Group. The corresponding revenue is included in freight traffic revenue for 2015.

Most of the impairment loss at 31 December 2015 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 42,024 thousand (2014: GEL 38,663 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.

***Cash and cash equivalents and term deposits***

To mitigate the credit risk of cash and bank balances, the Group holds the majority of its funds with five 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.

***Loan receivable***

The loan is receivable from a state controlled entity (see note 27 (c) (iii)). Management believes that as at 31 December 2015 the Group is not significantly exposed to credit risk from the loan receivable, as the loan is not overdue and, if required, the Government of Georgia, represented by the Ministry of Energy, will provide support to the extent permitted by the Georgian legislation to the state controlled entity to enable it to repay the loan to the Group.

### *(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.

The Group maintains an unsecured GEL 43,975 thousand unused overdraft facility. Interest on this facility is payable at the rate of 12%-14.5%.

The Group has significant contractual commitments to purchase property, plant and equipment (see note 25) for the Main Line Modernization and Tbilisi Bypass projects expected to be completed by the end of 2019 and 2020, respectively. Management believes that the cash and cash equivalents held by the Group and the future cash flows from operating activities will be sufficient to finance these two projects.

**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.

**2015**

| '000 GEL | Carrying amount | Contractual cash flows | 0-6 months | 6-12 months | 1-2 years | 2-5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| Unsecured bonds | 1,238,156 | 1,847,066 | 46,401 | 46,401 | 92,802 | 278,407 | 1,383,055 |
| Trade payables | 73,116 | 73,116 | 73,064 | - | - | 52 | - |
| Other current liabilities | 10,429 | 10,429 | 10,429 | - | - | - | - |
| | **1,321,701** | **1,930,611** | **129,894** | **46,401** | **92,802** | **278,459** | **1,383,055** |

**2014**

| '000 GEL | Carrying amount | Contractual cash flows | 0-6 months | 6-12 months | 1-2 years | 2-5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| Unsecured bonds | 1,016,703 | 1,565,867 | 38,640 | 89,926 | 72,215 | 216,644 | 1,148,442 |
| Trade payables | 57,500 | 57,500 | 57,448 | - | - | 52 | - |
| Other current liabilities | 6,106 | 6,106 | 6,106 | - | - | - | - |
| | **1,080,309** | **1,629,473** | **102,194** | **89,926** | **72,215** | **216,696** | **1,148,442** |

### *(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 companies 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 | CHF - denominated | USD - denominated | CHF - denominated |
|---|---|---|---|---|
| | 2015 | 2015 | 2014 | 2014 |
| Cash and cash equivalents | 142,233 | 324 | 175,479 | 3,297 |
| Loan receivable | 38,341 | - | - | - |
| Trade receivables | 494 | 54,544 | 1 | 46,319 |
| Unsecured bonds | (1,238,156) | - | (1,016,703) | - |
| Trade and other payables | (5,717) | - | (4,625) | - |
| **Net exposure** | **(1,062,805)** | **54,868** | **(845,848)** | **49,616** |

The following significant exchange rates applied during the year:

| in GEL | Average rate | | Reporting date spot rate | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| USD 1 | 2.27 | 1.77 | 2.39 | 1.86 |
| CHF 1 | 2.36 | 1.93 | 2.42 | 1.88 |

***Sensitivity analysis***

A reasonably possible strengthening (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 |
|---|---|
| **2015** | |
| USD (30% weakening) | (271,015) |
| CHF (30% weakening) | 13,991 |
| **2014** | |
| USD (30% weakening) | (215,691) |
| CHF (30% weakening) | 12,652 |

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:

| | Carrying amount | |
|---|---|---|
| **'000 GEL** | **2015** | **2014** |
| **Fixed rate instruments** | | |
| Financial assets | 190,111 | 212,710 |
| Financial liabilities | (1,238,156) | (1,016,703) |
| | **(1,048,045)** | **(803,933)** |

***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.

# 23. Subsidiaries

| | | | **2015** | **2014** |
|---|---|---|---|---|
| **Subsidiary** | **Country of incorporation** | **Principal activities** | **Ownership/ voting** | **Ownership/ voting** |
| Georgian Railway Property Management LLC | Georgia | Property management and development | 100% | 100% |
| Trans Caucasus Terminals LLC (former Georgian Railway Transcontainer LLC) | Georgia | Container transportation | 100% | 100% |
| Georgian Railway Construction JSC | Georgia | Construction and other projects | 100% | 100% |
| Borjomi Bakuriani Railway LLC | Georgia | Passenger transportation | 100% | 100% |
| Georgia Transit LLC | Georgia | Transportation services | 100% | 100% |
| GR Transit Line LLC | Georgia | Transportation services | 100% | 100% |
| GR Trans Shipment LLC (established in 2015) | Georgia | Transportation services | 100% | - |
| Georgian Transit LLC (established in 2015) | Georgia | Transportation services | 100% | - |

# 24. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

| '000 GEL | 2015 | 2014 |
|---|---|---|
| Less than one year | 4,832 | 3,028 |
| Between one and five years | 5,686 | 5,883 |
| More than five years | 17,754 | 16,103 |
| | **28,272** | **25,014** |

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. Capital commitments

As at 31 December 2015 the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 628,928 thousand (2014: GEL 561,489 thousand) mainly relating to the Main Line Modernization project of GEL 406,595 thousand (2014: GEL 385,660 thousand) and Tbilisi Bypass project of GEL 216,421 thousand (2014: GEL 156,155 thousand).

# 26. 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 four 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, 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.

# 27. Related parties

## (a) Parent and ultimate controlling party

At 31 December 2015 and 2014 the immediate and ultimate parent of the Group is Partnership Fund JSC. The ultimate controlling party of the Group is the Government of Georgia. Partnership Fund JSC produces publicly available consolidated financial statements.

## (b) 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** | **2015** | **2014** |
|---|---|---|
| Salaries and bonuses | **1,132** | **1,138** |

## (c) 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 1,376 thousand for 2015 (2014: GEL 1,864 thousand). The Group also purchases security services from a state agency which amounted to GEL 8,741 thousand for 2015 (2014: GEL 8,437 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) Loan issued to a state controlled entity*

In December 2015 the Group issued loan of USD 16 million to a state controlled entity with the purpose to guarantee the contractual obligations of the counterparty in a form of a restricted bank deposit. The loan together with the accrued interest matures in July 2016, when it is expected that the state controlled entity will receive the financing from the international financial institution to settle the contractual obligations and release the restriction on the funds received from the Group. The loan is not secured and bears a contractual interest rate of 10.5% per annum.

As at 31 December 2015 the loan is not overdue. Management believes, that if required, the Government of Georgia, represented by the Ministry of Energy, will provide support to the extent permitted by the Georgian legislation to the state controlled entity to enable it to repay the loan to the Group.

The Group's exposure to currency risk related to the loan issued to the state controlled entity is disclosed in note 22.

# 28. Basis of measurement

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

# 29. 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;
- interest expense on financial liabilities;
- Impairment loss on trade receivables;
- 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. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised in other comprehensive income or directly in equity.

### *(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.

### *(ii) Deferred tax*

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries, associates and joint arrangements to the extent that the Group is able to control the timing of the reversal of the temporary differences and it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

A deferred tax asset is recognised for unused tax losses, unused tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

### (g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out 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.

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.

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 44 years;
- rail track infrastructure 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 (see note 29(j)(i)).

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.

## 30. New standards and interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2015, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- 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, with early adoption permitted. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 9.

- 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, with early adoption permitted. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 15.

- IFRS 16 replaces the existing lease accounting guidance in 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_. It eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, early adoption is permitted if IFRS 15 Revenue from Contracts with Customers is also adopted. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16.