

2016 Annual Report



Georgian Railway



A message from the Chairman



Chairman of Supervisory Board

Konstantine Guntsadze

It is my pleasure to present the Annual Report for 2016, the fifth year in which I have had the honor of being Chairman of such a great organization. JSC Georgian Railway plays a significant role in the country's economy and in maintaining strong economic relations between Georgia and its partner countries in Caucasus and Central Asian region, and I am thus fully aware of the great responsibilities that come with this post. Currently, the Group is experiencing some difficulties due to a downturn in transportation volumes, but we are continuing to work hard in many areas to overcome these difficulties and strengthen our position. The Group represents an important part of the Transport Corridor Europe-Caucasus-Asia (TRACECA) and we are striving to strengthen its international cooperation in this regard.

Overcoming the latest challenges was possible by the excellent team spirit and high level of competence among the Group's workers. I believe that we will keep adding value to our customers, shareholders and the TRACECA as a whole.

A handwritten signature in blue ink, appearing to read 'K. Guntsadze', written in a cursive style.

A message from the General Director



CEO

Mamuka Bakhtadze

2016 marks 25 years since Georgian Railway was independently formed. I am proud that we have built a strong railroad during this period, which helped us to adequately overcome the difficulties faced by the Group in 2016.

This was a challenging year for the Group, affected by unfavorable external factors causing a downturn in transportation volumes, not only in Georgia but throughout the CIS countries. The reduced volume of transportation has brought damaging consequences for the Group, including a fall in its rating with S&P Global Ratings and having its foreign and local currency senior unsecured rating placed on Rating Watch Negative by Fitch Ratings.

Despite this downturn in transportation volume, the Group managed to maintain solid Adjusted EBITDA margin in the industry (44 percent), strong liquidity and has continued to invest in infrastructure development to ensure safety, quality and to increase capacity. In so doing, we have added more value to the TRACECA.

There is no question that 2016 was a pivotal year for passenger transportation. Focusing on customers and their travel needs, in the summer of 2016 the Group introduced two new passenger trains produced by Swiss rolling stock manufacturer Stadler. This enabled us to increase both passenger numbers and revenue. Meanwhile, in April 2016 the passenger transportation branch of the organization was awarded the ISO 9001:2015 certificate, a reflection of its quality.

Looking ahead, our business philosophy will not change and we will continue to work to contribute to the growth and development of the Group and to provide our customers with the best service. We will continue to move forward with many different projects and initiatives aimed to improve our service. Our goal is to deliver quality and punctuality, as we understand that if our customers win, we win as well.

What we are today and what we want to be in the future could not be achieved without professionalism, long-term planning and commitment to our human capital. Our employees are the strength of our business, something for which I would like to thank them sincerely.



Supervisory Board members

Konstantine Guntsadze

Chairman of Supervisory Board | since 2012

Main field of competence | Jurisprudence

Oleg Bichiashvili

Supervisory Board member | since 2012

Main field of competence | Logistics

Guram Gabunia

Supervisory Board member; member of Remuneration and Nomination Committees | since 2012

Main field of competence | Audit/Risk management

Levan Kifiani

Supervisory Board member | since 2016

Main field of competence | Jurisprudence/Management

Clifford Stanley Isaak

Chairman of Audit Committee | since 2011

Main field of competence | Finance

Michael Gogishvili

Deputy Chairman of Supervisory Board; member of Audit Committee | since 2010

Main field of competence | Jurisprudence

Levan Surguladze

Chairman of Remuneration and Nomination Committees; member of Audit Committee | since 2011

Main field of competence | Finance

Management board members

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

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 factual and generally, but not always, may be identified by the use of words or expressions such as “believes”, “expects”, “are expected to”, “anticipates”, “intends”, “estimates”, “should”, “will”, “will continue”, “may”, “is likely to”, or “plans” among others.

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

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

The reader should be aware that forward-looking statements are not guarantees of future performance and that the Group’s actual business, financial conditions and results of operations and prospects, as well as the development of the industry in which it operates, may differ significantly from 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 this report refer to the period under review. The Group does not undertake any obligation to update any fact or forward-looking statement to reflect events or circumstances that may occur after the period under review.

Assumptions

EBITDA is calculated by adding back depreciation and amortization to the results from operating activities.

Adjusted EBITDA is adjusted for significant non-cash and one off items.

Financial result variances at constant currency are obtained by translating the comparable period of the current year results denominated in Georgian Lari at the average foreign exchange rates of the prior period.

Financial and non-financial highlights

For the year (in GEL '000)	2016	2015	2014
Revenues	439,922	574,773	511,570
EBITDA	281,755	322,787	250,030
Adjusted EBITDA	195,149	307,828	251,925
EBIT	175,488	218,371	144,772
Net income	65,126	-65,497	39,286
Cash provided by operating activities	187,411	299,496	280,105
Acquisition of PPE	200,274	156,993	86,776

At year end (in GEL '000)			
Total assets	3,225,683	3,093,917	2,968,381
Total liabilities	1,626,407	1,622,707	1,405,630
Total equity	1,599,276	1,471,210	1,562,751

Financial ratios			
Revenue growth	-23.46%	12.35%	6.61%
EBITDA margin	64.05%	56.16%	48.88%
Adjusted EBITDA margin	44.36%	53.56%	49.25%
Operating ratio	82.71%	67.36%	74.12%
Dividend payout ratio	0%	0%	65%
Interest coverage ratio	1.91	2.55	1.99
Net debt/EBITDA	3.48	2.79	2.70
Debt/Equity	1.02	1.10	0.90

Statistical data (in '000)			
Tons	11,882	14,143	16,673
Ton-km	3,390,880	4,222,061	4,947,530
Number of passengers	2,463	2,397	2,725
Passenger-km	508,586	467,178	549,918
Average number of employees	13	13	13

Key operating measures			
Total freight revenue per ton-km (in GEL)	0.12	0.13	0.10
Passenger revenue per passenger-km (in GEL)	0.04	0.03	0.03
Revenue per average number of employees (in GEL '000)	33.98	44.37	39.54
Operating expenses per ton-km (in GEL)	0.11	0.09	0.08
Ton-km per average number of Freight SBU employees in '000	606.92	758.82	889.28
Passenger -km per average number of Passenger SBU employees in '000	366.42	322.41	369.57

Safety indicators			
Accident rate per million ton-km	0.02	0.02	0.01
Injury per '000 number of average employees	5.72	5.87	6.34
Death per '000 number of average employees	0.54	0.39	0.46

Credit ratings by the end of 2016

	First issued	LT	Outlook	ST	Last issued	LT	Outlook	ST
Standard & Poor's	2010	B+	Stable	B	2016	B+	Stable	B
Fitch Ratings	2010	B+	Stable	B	2016	BB-	Watch Negative	B

Table of Contents

Overview of the Group

1. Description of the Company's business	10
1.1 History of the Company	10
1.2 Business profile	11
1.3 Corporate governance	12
1.4 Government support	14
1.5 Railway property	15
1.6 Self-insurance	17
1.7 Safety	18
1.8 Environmental and social factors	19
1.9 Economic and political conditions	19
1.10 Competition	20
1.11 Risk factors	24

Strategy of the Group

2. Focus on core business activities	27
2.1 Freight Transportation SBU	27
2.2 Passenger Transportation SBU	29
2.3 Infrastructure SBU	32
2.4 Subsidiaries	35

3. Building valuable supply chain	37
3.1 Containerization	37
3.2 China	38
3.3 Persian Gulf – Black Sea project	39
3.4 International agreements	39
3.5 Ongoing projects in the region	39

4. Employees	46
---------------------	-----------

Management discussion and analyses

5. Profit or loss statement	50
5.1 Revenue	50
5.2 Income from transferred property	64
5.3 Other Income	65
5.4 Operating expenses	66
5.5 Finance income and cost	72
5.6 Income tax benefit	73

6. Balance sheet	74
6.1 Non-current assets	74
6.2 Current assets	74
6.3 Equity	75
6.4 Non-current liabilities	75
6.5 Current liabilities	76

7. Cash flow statement	77
7.1 Operating activities	77
7.2 Investing activities	77
7.3 Financing activities	78

Appendix	79
-----------------	-----------

Glossary	81
-----------------	-----------

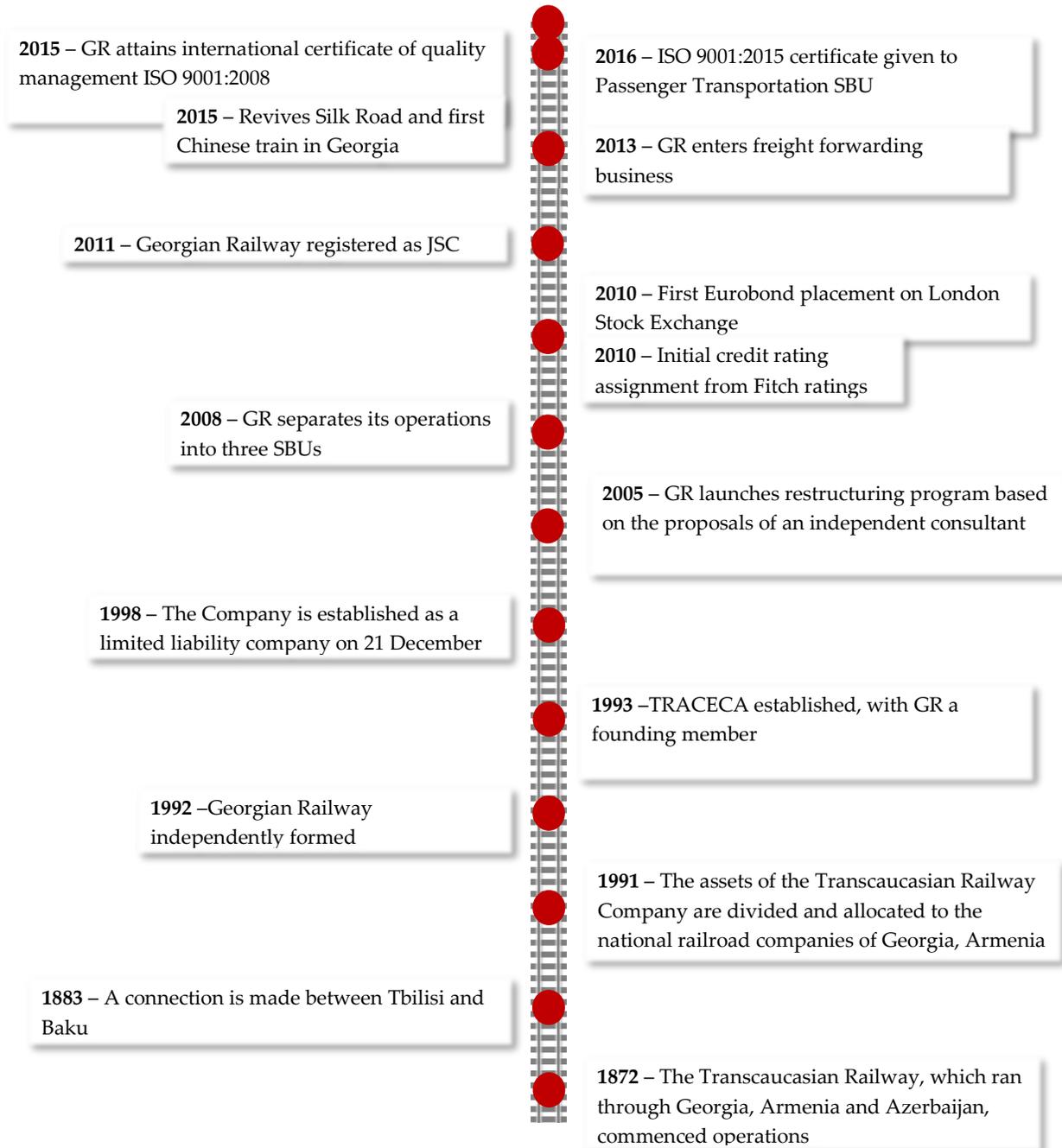
Consolidated financial statements

Overview of the Group



1. Description of the Company's business

1.1 History of the Company

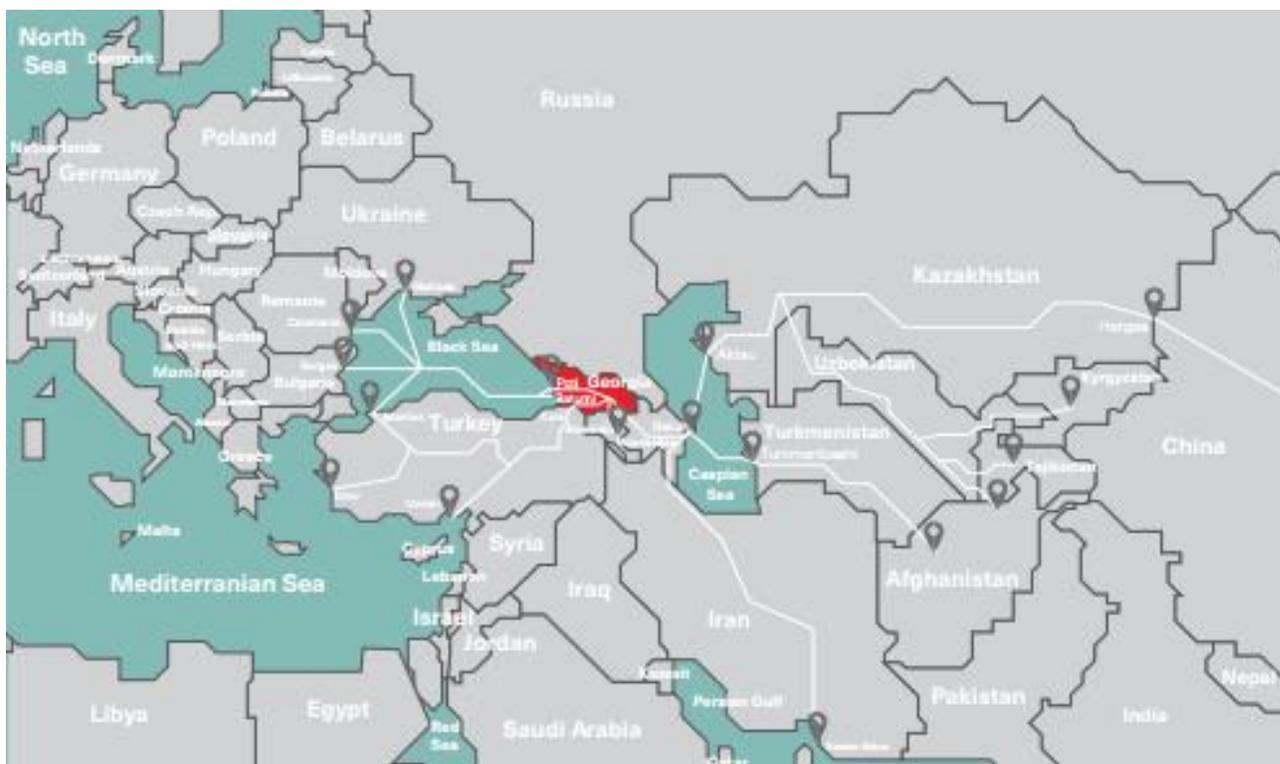


1.2 Business profile

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

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

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



Credit ratings - GR is rated by two rating agencies: Fitch Ratings and Standard & Poor’s (S&P). By the end of 2016, Fitch Downgraded Georgian Railway to 'B+'; off Rating Watch Negative (RWN); Outlook Stable. S&P Global Ratings lowered GR’s long-term corporate rating to 'B+' from 'BB-' with a stable outlook for 2016. Its short-term rating was affirmed at 'B'.

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

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

1.3 Corporate governance

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

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

31-Dec-16	Supervisory Board and Committee				Board of Directors				
	Supervisory Board	Audit Committee	Nomination Committee	Remuneration Committee	CEO	CFO	Freight SBU director	Passenger SBU director	Infrastructure SBU director
Konstantine Guntsadze	■								
Michael Gogishvili	■	■	■						
Levan Surguladze	■	■		■					
Clifford Stanley Isaak	■	■							
Levan Kifiani	■								
Oleg Bichiashvili	■								
Guram Gabunia	■		■	■					
Mamuka Bakhtadze					■				
Irakli Titvinidze						■			
Tengiz Todua							■		
David Gelashvili								■	
Vasil Khorava									■

Shareholders

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

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

Supervisory Board

The Supervisory Board of GR is appointed 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 should not make up the majority of the Supervisory Board. Meetings of the Supervisory Board are held at least quarterly.

The Supervisory Board oversees the activities of the Board of Directors, appoints and dismisses the general director and other directors by agreement with the general meeting of shareholders, approves and makes changes to the Company policy and any other regulative documents, with the

help of invited experts or separate members who personally inspect the accounts and properties. It also grants approval for starting a new business and terminating ongoing activities, determines the general principles of the business policy and strategy of the Company, gives consent to long-term liabilities and determines the salary and/or additional benefits of the Company's Management.

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

As at 31 December 2016, the Nomination and Remuneration Committees each comprised two members and the Audit Committee comprised three members from the Supervisory Board. Committee members are selected by the Supervisory Board on the basis of a recommendation of the Nomination Committee and must include at least one independent member.

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

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

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

Board of Directors

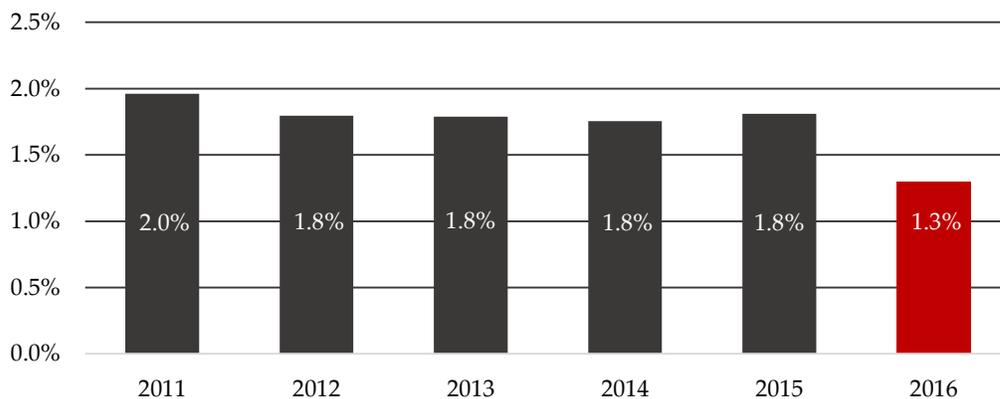
GR's Board of Directors consists of five members: CEO; CFO; Freight Transportation SBU director; Passenger Transportation SBU director; and Infrastructure SBU director. The CEO is authorized to supervise the execution of the decisions of the Board of Directors, Supervisory Board and shareholders, as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

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

1.4 Government support

The Group has significant importance to the country, and its revenue represented about 1.3 percent of the country's total GDP* in 2016. 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 such as Azerbaijan, Armenia, Kazakhstan, Tajikistan, Turkey and Turkmenistan. Furthermore, GR provides dividends to its owner, the Partnership Fund, which is fully owned by the Government of Georgia.

The Group's revenue as a percentage of Georgia's GDP



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

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

Prominent examples of Government support for the Group:

- The Government provided approximately 182 hectares of land for the Tbilisi Bypass Project in 2010 and 2011, with a value of approximately GEL 33 million, to GR. This land comprised approximately 40 percent of the land required to support the bypass railroad and related assets. Contributions of land and other related assets for GR's projects (mostly for Modernization Project and Tbilisi Bypass Project) took place from 2012 to 2016 as well, amounting to around GEL 10 million. In the period of 2012-2016, other contributions were also made to share capital. The most significant contribution was in 2012 which mostly comprised infrastructural assets of the access line to Kolkheti Partotskali such as railroads, transmission lines and substations;

- Linear infrastructure such as railroads and transmission lines are exempt from property tax in Georgia;
- 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.;
- In 2015 and 2016, passenger station in Batumi was financed from shareholders dividends.

1.5 Railway property

The Group owns different types of real estate, machinery, rolling stock and other assets. The net book value of its property, plant and equipment as at 31 December 2016 was GEL 2.6 billion. It owns and operates the following assets:

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

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

Rail network

General description

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

GR owns and operates a 1,443 km railway network, 296 km of which is double-track line. The Company's network is almost totally electrified.

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

Capacity

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

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

Rolling Stock

General description

As at 31 December 2016, the Group had 6,172 active freight railcars and 41 active passenger wagons. In addition, in 2014 the Group purchased 480 containers to facilitate container transportation within the corridor.

A breakdown of freight railcars is given below:

Active freight railcars	31-Dec-16
Box Car	815
Platform Car	1,023
Open Top Box Car	1,301
Tank Car	1,358
Cement Hopper	181
Grain Hopper	1,300
Refrigerator Car	94
Other	100
Total	6,172

Capacity

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

Share of cargoes transported by railcar owners

For the year ended 31 December

	2016	2015	2014	2013	2012
Group's own railcars	52%	50%	58%	53%	46%
Railcars owned by other railways	21%	17%	17%	26%	36%
Railcars of private companies	27%	33%	25%	21%	17%

The information presented above helps to illustrate the Group's dependence on its own wagons. About half of the Group's total freight transportation in 2016 was performed by its own railcars.

Locomotives and EMUs

As at 31 December 2016, the Group owned 22 units of EMUs, four units of passenger locomotives, and 173 freight locomotives of which 108 were electric and 65 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 2016, the Group owned and operated 102 freight stations within Georgia, while four freight stations had been closed since 2015. As at 31 December 2016, the Group also owned and operated 55 passenger stations. The Group's headquarter building is located in the center of Tbilisi.

Land

The Group owns land, with a total book value of GEL 541.8 million. After starting the Tbilisi Bypass Project and the Modernization Project the Group has been purchasing additional land for the projects. In 2016, under the Tbilisi Bypass Project Memorandum, the Group transferred a portion of its land, 89,166 square meters of land plots in total, to the Government (*See subheadings 2.3 Infrastructure SBU and 5.2 Income from transferred property*).

Tunnels and bridges

The Group's infrastructure assets comprise 32 railroad tunnels and 1,325 railroad bridges. It also owns signal equipment and other assets related to ensuring the safety of operations. The Group revised the classification of certain tunnels and bridges during 2016 resulting in a decrease of their number from those disclosed in 2015 Annual Report.

1.6 Self-insurance

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

The table below shows a record of failures and accidents on the rail line for 2012-2016 (*see subheading 1.7 Safety*):

Failures and accidents

	2016	2015	2014	2013	2012
Number of failures (1)	0	0	1	0	0
Loss from failures in GEL '000	0	0	220	0	0
Number of accidents (2)	0	0	0	1	0
Loss from accidents in GEL '000	0	0	0	684	0
Number of special defects (3)	0	0	0	2	0
Loss from special defects in GEL '000	0	0	0	165	0

- (1) Collisions of passenger or freight trains with other trains or rolling stock or their derailment on railroad or stations resulting in the death or serious injury to two or more persons or resulting in the damage to locomotive and wagons that caused their exclusion from the inventory park.
- (2) Collisions of passenger or freight trains with other trains or rolling stock, their derailment on railroad or stations as well as collision or derailment of rolling stock during the maneuvers or other movements on the Group's own rail line which resulted in the death or serious injury to no more than one person or resulted in damage to locomotive and wagons that created necessity for capital repair.
- (3) Collisions of passenger or freight trains with other trains or rolling stock, their derailment on railroad or stations as well as collision or derailment of rolling stock during the maneuvers or other movements on the Group's own rail line, which did not result in death, serious injury or total loss greater than GEL 100,000. Special defects also include: receiving/admission of the train on a busy line; receiving/admission of the train on the unplanned route; cargo collapse in the course.

1.7 Safety

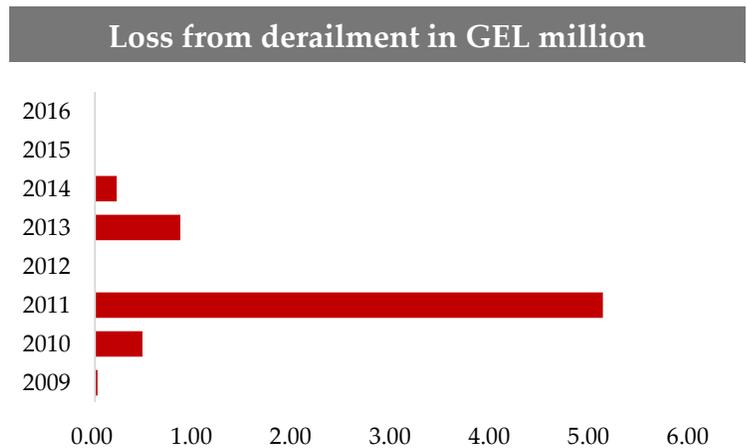
One of the principal priorities of the Company's Infrastructure SBU is to ensure safety. As well as the many benefits of the Modernization Project and Tbilisi Bypass Project is also an objective to improve GR's operational and social safety. During the period under review, the Company has not incurred any significant loss from derailment.

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

- Monthly, quarterly and annual as well as seasonal (spring, autumn) checks according to the plan;
- Random checks;
- Testing the knowledge level of employees involved in the movement of trains.

In 2016, the Company purchased two new passenger trains, which are in full compliance with European safety standards and two more passenger trains are planned to be purchased in 2017.

The employee injury rate in 2016 was about 0.57 percent and the employee death rate from accidents was about 0.05 percent. GR provides compensation for losses suffered due to accidents, to the employees and/or their families.



1.8 Environmental and social focus

Environmental focus

Most of GR's network is electrified, making it one of the most energy-efficient and environmentally friendly transportation means available in Georgia. Filtration system is installed on railway's facilities in order to reduce the impact of emissions and when starting the Tbilisi Bypass Project the main aim was to relocate the capital's main railroad to the suburban area of Tbilisi, thus reducing potential pollution in the city.

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 2016, the Group has not been the subject of any material claims for environmental pollution. In June 2015, changes were 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.

Social focus

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

The fares 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. Essentially, GR keeps transportation fares relatively low for the benefit of the country's regional development and social interest.

Train schedules are adjusted to meet customers' needs, and trains are added when demand is highest, for example during the summer time. GR also plans to offer its customers comfortable travel to Georgia's second largest airport in Kutaisi by directly connecting the railway with the airport. The main line of the Group's railway network will go through this new station.

1.9 Economic and political conditions

GR's railway network is a key segment of the TRACECA, the shortest route from the Caspian Sea and Central Asia to the Black Sea and the Mediterranean Basin. A significant portion of the Group's

freight operations (in 2016 about 85 percent of its total transportation revenue) was generated from freight transported from, or directed to, CIS countries. As a result, the Group's freight transportation volumes are sensitive to economic activity in the CIS countries and the Group's financial conditions and operational results are significantly influenced by the overall economic and political conditions affecting Georgia and other countries in the Eurasian region.

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

In order to reduce its dependence on CIS countries and capture new opportunities, the Group is trying to reach out to new markets. After completing the Baku-Tbilisi-Kars (BTK) project and with the subsequent new route from China to Europe, through Georgia and Turkey, GR aims to capitalize on increased trade volumes through new BTK project and subsequent new route from China and Europe and China and Turkey. About 15% of China's total trade in 2016 was with the European Union. China is also one of the biggest trading partners of Turkey. Indeed, about 13% of Turkish imports were from China in 2016. Moreover, after the lifting of sanctions, Iran will return to world trade and the Group seeks to grasp the opportunity to serve as a transit route for trade between Iran and Europe. The Group also targets the development of a trade route through Iran to India (*See subheading 3.2 China and 3.3 Persian Gulf-Black Sea project*).

1.10 Competition

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

To reduce the risk of competition, the Group tries to diversify the markets in which it operates, as well as the kinds of goods it transports. In 2016, about 46 percent of total goods transported by the Group were liquid goods and the remainder were dry goods. To reduce risks and increase capacity, in 2010 the Group started the Modernization Project. The project is expected to be completed by the end of 2019 and will increase the capacity of the main transportation line from current annual capacity of 27 mln tons to 48 mln tons, with further potential to expand to 100 mln tons. In order to increase competitiveness and thus to provide better service to customers, GR entered the freight forwarding business in April 2013.

Competition from oil pipelines

General description

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

- The Caspian Pipeline Consortium (CPC pipeline) - 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).

The share of crude oil transported by the Group in terms of total transportation volume dropped to 15 percent in 2016 compared to 32 percent in 2010. The decrease in the Group's liquid cargo volumes can be partly explained by the fact that some crude oil was redirected to the CPC and BTC pipelines, especially after the expansion of the CPC pipeline.

Strengths

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

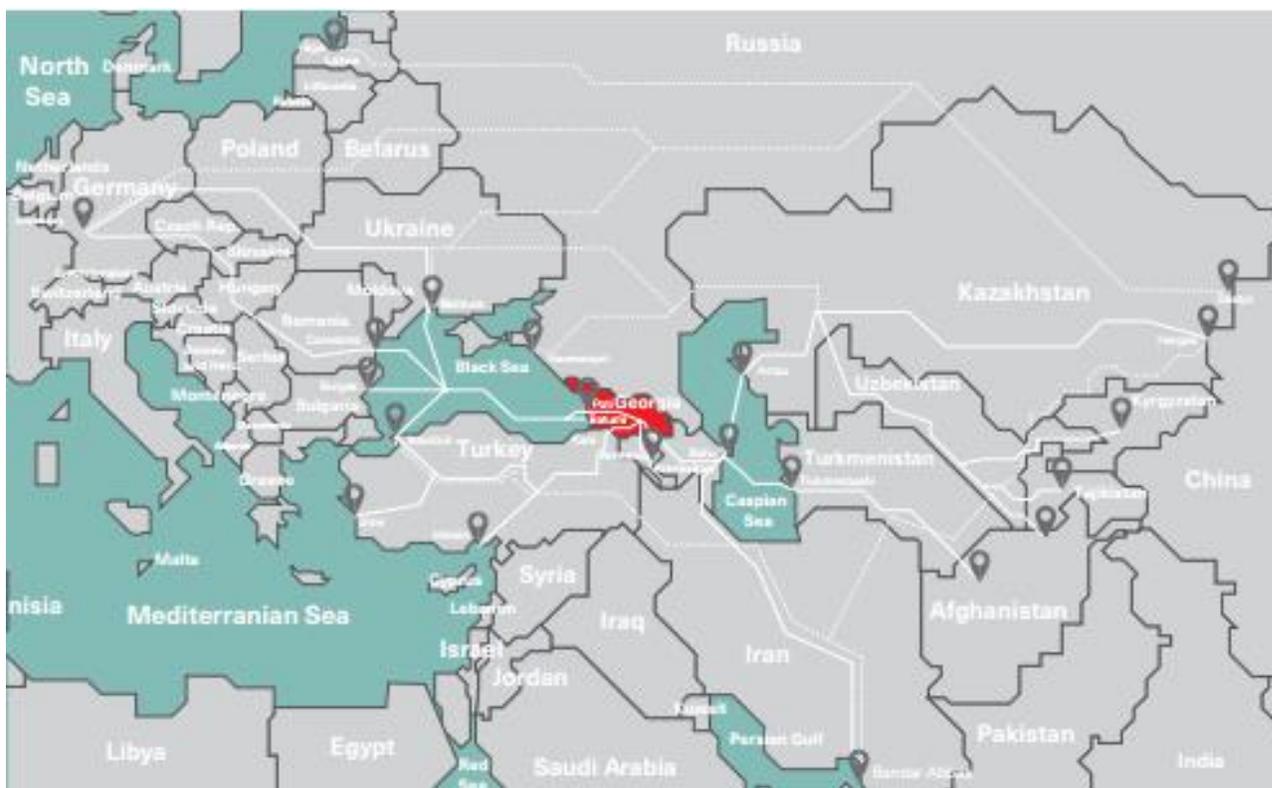
Competition from alternative rail transit routes

General description

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

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

- 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 use several transport modes to reach its destination.

Weaknesses

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

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

Competitive developments

Implementation of the Modernization Project should increase the Group's capacity and its competitiveness against Russian routes. The Modernization Project should also increase transportation speed, safety and service quality, which will give the Group an opportunity to attract new customers. The new deep-sea port in Anaklia also plays 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 currently using the alternative routes offered through Iran.

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

Competition from road transportation

General description

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

Strengths

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

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

Weaknesses

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

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

Competitive developments

In order to compete with road transportation, GR has established a subsidiary GR Logistics and Terminals LLC to foster the containerization of regional freight. In 2014, the Group also purchased a container fleet, which is another important step towards increasing the overall competitiveness of

the corridor. The Management believes that containerization can attract new customers and expand the range of transported cargo.

1.11 Risk factors

Risk	Description	Impact/Sensitivity	Mitigation/Comment
<p>Economic and political conditions</p> <p><i>See subheading 1.9 Economic and political conditions</i></p>	<p>Influenced by local and CIS countries' economic and political conditions.</p>	<p>Adverse economic developments in CIS countries and in Georgia, as well as political, social and economic instability has negative impact on the Company's performance.</p>	<ul style="list-style-type: none"> • Diversify among geographies and markets.
<p>Competition</p> <p><i>See subheadings 1.10 Competitors and 2.1 Freight Transportation SBU</i></p>	<p>The Group faces competition from alternative rail transit routes, from road transportation, from oil pipelines and from providers of other methods of transportation.</p>	<p>Strong competition from alternative transit routes and other transportation methods may have a material adverse effect on the Group's business, financial condition and results of operations.</p>	<ul style="list-style-type: none"> • Diversify the type of products transported; • Work out single tariffs with partner railways; • Better understand customers' needs.
<p>Limited number of customers</p> <p><i>See subheading 2.1 Freight Transportation SBU</i></p>	<p>The Group earns a significant portion of its revenues from a relatively small pool of large customers.</p>	<p>A number of factors such as pricing and market demand for the Group's services, could cause the loss of customers.</p>	<p>By entering the freight forwarding business Georgian Railway tries to:</p> <ul style="list-style-type: none"> • Have deeper understanding of customers' industries; • Have deeper understanding of business processes; • Have control on the whole chain of services.
<p>Foreign currency exchange risk</p> <p><i>See subheadings 6.4 Non-current liabilities and 5.5 Finance income and cost</i></p>	<p>The Group's functional and presentation currency is Georgian Lari. However, most of its revenues are denominated in foreign currency.</p>	<p>Variations in exchange rates can affect the Group's results of operations.</p>	<ul style="list-style-type: none"> • Take measures to naturally hedge currency exchange risk.
<p>Strikes, lockouts and labor legislation</p>	<p>As at December 2016 about 60 percent of the Group's employees were members of trade unions.</p>	<p>There is some risk that in the future the Group's business will be subject to interruptions through strikes or lockouts.</p>	<ul style="list-style-type: none"> • Try to make work rewarding and improve working environment.

Risk	Description	Impact/Sensitivity	Mitigation/Comment
<p>Qualified personnel</p> <p><i>See heading 4 Employees</i></p>	<p>Hiring and retention of qualified and key personnel.</p>	<p>The Group would not be able to move forward and could not have achieved what it is today without high professionalism, experience to make long term plans and commitment of the</p>	<ul style="list-style-type: none"> • Promote business education; • Make work challenging and rewarding; • Make efforts to improve conditions of work; • Offer social benefits.
<p>Aging of infrastructure, rolling stock and related assets</p> <p><i>See subheadings 1.5 Railway property, 2.2 Passenger Transportation SBU, subheading 2.3 Infrastructure SBU</i></p>	<p>The Group's infrastructure and its related assets are aging and may need replacement in the future.</p>	<p>Accidents related to poor conditions of the rail infrastructure and its related assets or any failure of the infrastructure to operate properly, could result in interruptions in the Group's business, increase its operating expenses or require significant CAPEX.</p>	<ul style="list-style-type: none"> • Continue to carry out extensive renewal and improvement of rail network, rolling stocks and related assets;
<p>Self-insurance</p> <p><i>See subheading 1.6 Self-insurance</i></p>	<p>The Group does not have full insurance coverage for its property, business interruption or third-party liability.</p>	<p>Until the Group obtains adequate insurance coverage, failures in operational processes or destruction of the property could have a material adverse effect on the Group's operations and financial position.</p>	<ul style="list-style-type: none"> • Keeps operational procedures in place and controls them to minimize the risk; • Periodically analyzes insurance markets and potential risks.
<p>Laws and regulations</p>	<p>The Group is subject to various environmental protection and health and safety laws.</p>	<p>Failure to comply with environmental and health and safety requirements can cause the Group administrative sanctions, penalty fees and civil liabilities. The uncertainties of the Georgian tax system could have an adverse material effect on the Group's business.</p>	<ul style="list-style-type: none"> • Employs qualified personnel; • Provides trainings when there are changes in legislation.

Strategy of the Group

Strategy for sustainable future

We achieve this through...



Employing and investing in professionals

• To create the value we focus on our

• By making right connections we build

core business units

valuable supply chain



2. Focus on core business activities

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



2.1 Freight transportation SBU

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

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

The Freight Transportation SBU is the principal source of the Group's revenue, accounting for 82 percent of the Group's total revenue in 2016. Freight transportation generated 81 percent of the Freight Transportation SBU's revenue in 2016.

Freight transportation volume

	<i>For the year ended 31 December</i>					<i>Million tons</i>					<i>Percent</i>				
	2016	2015	2014	2013	2012	2016	2015	2014	2013	2012	2016	2015	2014	2013	2012
Liquid cargoes	5,494	6,748	7,514	9,087	9,471	46.2%	47.7%	45.1%	50.0%	47.2%					
Oil products	3,686	5,884	5,838	5,131	4,753	31.0%	41.6%	35.0%	28.2%	23.7%					
Crude oil	1,808	864	1,676	3,957	4,718	15.2%	6.1%	10.1%	21.8%	23.5%					
Dry cargoes	6,388	7,395	9,159	9,098	10,605	53.8%	52.3%	54.9%	50.0%	52.8%					
Ores	1,454	1,458	1,820	1,956	2,176	12.2%	10.3%	10.9%	10.8%	10.8%					
Grain and grain products	448	716	861	952	1,424	3.8%	5.1%	5.2%	5.2%	7.1%					
Ferrous metals and scrap	663	892	1,064	931	1,105	5.6%	6.3%	6.4%	5.1%	5.5%					
Sugar	499	464	618	610	689	4.2%	3.3%	3.7%	3.4%	3.4%					
Chemicals and fertilizers	429	507	508	481	508	3.6%	3.6%	3.0%	2.6%	2.5%					
Construction freight	1,065	1,426	1,793	1,410	1,594	9.0%	10.1%	10.8%	7.8%	7.9%					
Industrial freight	271	261	407	546	707	2.3%	1.8%	2.4%	3.0%	3.5%					
Cement	62	80	380	637	672	0.5%	0.6%	2.3%	3.5%	3.3%					
Other	1,496	1,590	1,709	1,574	1,730	12.6%	11.2%	10.2%	8.7%	8.6%					
Total	11,882	14,143	16,673	18,185	20,076	100.0%	100.0%	100.0%	100.0%	100.0%					

The Freight Transportation SBU transports both liquid and dry cargo. Liquid cargo, which consists of crude oil and oil products, accounted for 46 percent of the Group's total freight transportation volume in 2016.

Freight volumes by transportation mode

For the year ended 31 December

	Million tons					Percent				
	2016	2015	2014	2013	2012	2016	2015	2014	2013	2012
Liquid cargoes	5.5	6.7	7.5	9.1	9.5	46.2%	47.7%	45.1%	50.0%	47.2%
Transit	4.0	5.4	6.3	7.9	8.2	33.8%	38.0%	37.7%	43.5%	41.1%
Export	0.0	0.0	0.0	0.1	0.0	0.3%	0.2%	0.3%	0.3%	0.2%
Import	1.2	1.0	1.0	0.9	0.9	9.7%	7.3%	5.7%	4.9%	4.4%
Local	0.3	0.3	0.2	0.2	0.3	2.5%	2.2%	1.4%	1.3%	1.5%
Dry cargoes	6.4	7.4	9.2	9.1	10.6	53.8%	52.3%	54.9%	50.0%	52.8%
Transit	2.2	2.6	3.2	3.3	3.9	18.3%	18.2%	19.3%	18.0%	19.3%
Export	1.0	1.1	1.6	1.7	1.7	8.8%	7.6%	9.5%	9.2%	8.3%
Import	1.5	1.7	2.0	1.9	2.4	12.6%	11.8%	12.1%	10.2%	11.9%
Local	1.7	2.1	2.3	2.3	2.7	14.2%	14.7%	14.0%	12.6%	13.3%
Total	11.9	14.1	16.7	18.2	20.1	100.0%	100.0%	100.0%	100.0%	100.0%

Transit shipment represented about 52 percent of the Group's freight transportation volume in 2016.

Customers

The Freight Transportation SBU's primary clients are freight forwarders, which serve different geographical locations and cargo owners. Although there are a limited number of direct clients 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.

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

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

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

For liquid cargo, the top five customers comprised 71 percent of total liquid cargo transported in 2016. In terms of dry cargo, the top five customers comprised 40 percent of total dry cargo transportation in 2016. Freight forwarders accounted for about 37 percent of the dry cargo transported by the top five customers.

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

Tariffs

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

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

Tariff currency - the Group's freight transportation tariffs are set in U.S. Dollars (USD). Therefore, as its revenue was derived mainly from freight transportation in 2016, the Group received most of its total revenue (about 90 percent) in USD, about 3 percent of total revenue was in Swiss Francs (CHF) and about 7 percent was in GEL. Before 2012, the Group's freight tariffs were quoted in CHF. However, in 2012 before issuing Eurobonds in USD, the Group switched its tariffs from CHF to USD to partially hedge against foreign exchange risk.

Revenue per ton-kilometer

For the year ended 31 December

	2016	2015	2014	2013	<i>In Tetri</i> 2012
Oil products	9.8	8.8	7.0	6.6	6.5
Crude oil	4.0	5.9	4.9	4.4	4.0
Dry cargo	9.9	10.4	7.9	7.2	7.0

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

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

2.2 Passenger Transportation SBU

Passenger transportation is currently a minor segment of the Group's operations as it only accounted for about 4 percent of the total revenue in 2016. The primary activity of the Passenger Transportation SBU is the transportation of passengers within Georgia and on international routes, connecting Georgia with Azerbaijan and Armenia.

One of the Group's medium-term strategic objectives is to transform the Passenger Transportation SBU into a profitable unit by increasing the number of passengers and increasing revenue per passenger. The Group is taking of the following measures to increase average revenue per passenger:

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

In 2016

- *Two double-decker EMUs were purchased from the Swiss company Stadler Bussnang AG.*
- *ISO 9001:2015 certificate has been given to Passenger Transportation SBU.*

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

Additionally, regulation EC 1370/2007, effective from 2018, underlines the need for Passenger Transportation SBU subsidies and prohibits cross subsidizing from Freight Transportation SBU. Respectively, we expect to receive government subsidies to support further development of Passenger Transportation SBU.

The ISO 9001:2015 certificate has been given to the Passenger Transportation SBU. It should be noted that GR was the first company to achieve this standard in Georgia, which reflects passenger transportation by rail being even more reliable and attractive for customers.

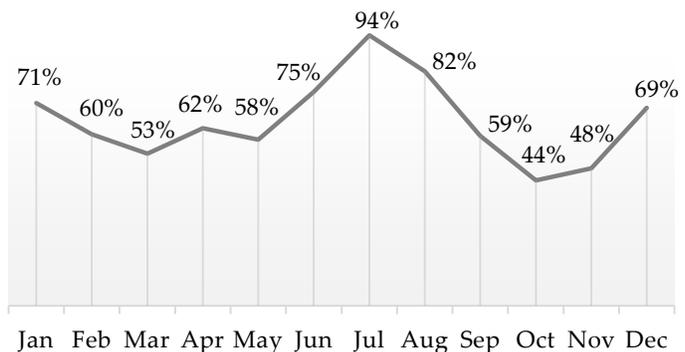
Customers

The Passenger Transportation SBU provides domestic and international transportation services.

As GR's rail line is linked to Azerbaijan and Armenia, international rail transportation is carried out to these directions. After the completion of the Baku-Tbilisi-Kars project it will be possible to transport passengers to Turkey and onward to Europe.

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

Passenger loading rate on main line in 2016





**Value creation
for customers**

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

It is planned to connect Georgia's second largest airport (Kutaisi airport) with railway. A feasibility study was performed and construction works were planned for 2017.

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

Number of passengers

For the year ended 31 December

Numbers in millions

	2016	2015	2014	2013	2012
International	0.1	0.1	0.1	0.1	0.1
Domestic	2.4	2.3	2.6	2.9	3.0
Total	2.5	2.4	2.7	3.0	3.1

The increase in passenger transportation in 2016 was mainly due to two new trains that GR introduced to its customers in July 2016. The decrease in domestic transportation during the previous years was caused by the Management's decision to reduce the number of passenger trains on loss-making routes. This measure had aimed to increase revenue per passenger and to minimize losses.

Tariffs

Similar to the situation for freight transportation tariffs, the Group is not subject to government regulations in establishing fares for passenger transportation. In many cases, however, passenger transportation tariffs are not affected 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 to the Group's services, the provision of new modern trains and inflation. The Group's tariffs are designed to be competitive with those for buses, mini-buses and other passenger transportation services in Georgia.

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

Average revenue per passenger-km

For the year ended 31 December

In Tetri

	2016	2015	2014	2013	2012
Average revenue per passenger-km	3.5	3.3	3.3	3.1	2.8

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

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

2.3 Infrastructure SBU

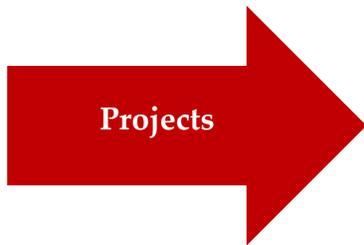
The Infrastructure SBU operates, maintains and manages the Group's principal infrastructure assets, including its track, embankments, signaling, land, electric power lines and other equipment. The Infrastructure SBU is a cost center providing services to the Freight and Passenger Transportation SBUs.

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

GR owns and operates 1,443 km of railway network in total, 296 km of which is double-track line. The Company's rail network is almost fully electrified.

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

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



Commercial project

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

Social project

The Tbilisi Bypass Project is more of a municipal project designed to create value for shareholders and society rather than the railway itself (currently suspended).

Socio-commercial project

Kutaisi Airport Connection Project, which entails connecting Kutaisi airport, the second largest airport in Georgia, with the railway. The construction works on the project are planned to start in 2017.

Railway Modernization Project



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

- Increase the capacity of the Group's infrastructure;
- Eliminate the need for extensive capital expenditures for the maintenance of tracks;

- Increase transportation speed along the line, offering improved services for freight and passenger customers;
- Further increase the safety levels 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 its capacity.

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

The Modernization Project is financed by the Group's operations and the proceeds from its Eurobond placements in 2010 and 2012. The project is expected to be completed by the end of 2019 for which the total remaining payments to be made stand at approximately GEL 335.3 million.

As at 31 December 2016, about 46% of the total works on the Modernization Project had been completed. During 2016, GEL 108.9 million was spent on the project, which is an increase of 22% compared to the previous year. In 2017, construction works on tunnels and railway bridges are planned to be carried out.

Tbilisi Bypass Project

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

Anticipated benefits for stakeholders:

- 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 central Tbilisi, which is currently used for railroad infrastructure;
- Improving Tbilisi residents' quality of life by reducing noise and environmental pollution;
- Improving public transportation infrastructure and easing traffic problems in the center of the city.

Benefits for the Group:

- Environmental - moving dangerous freight outside the city will improve the safety of residents and reduce pollution;
- Proceeds from sale of land - it has been agreed that the land will be transferred to the Government at a price higher than its carrying value.

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.

During 2015 and 2016, the Group was in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. The most recent scenarios under discussion include an option envisaging a change of the original bypass location, because of which the existing bypass infrastructure may become redundant. As at 31 December 2016 and the date these consolidated financial statements were authorized for issue, no decision was made by the Government of Georgia about the redesign of the Tbilisi Bypass project. The Group has not yet developed the plan how this redundant infrastructure may be used in future in case the above mentioned scenario is approved by the Government. Currently, an independent management expert is performing feasibility study for the most recent scenarios of the completion of the Bypass project discussed with the Government. The feasibility study also includes determination of the future use of the existing infrastructure, should it become redundant. The options of future use of the infrastructure are bypass automobile road, light rail/ extension of the Tbilisi Metro System, freight depot. The feasibility study is not completed as at the date these consolidated financial statements were authorized for issue. The Group extended construction contract with the main third party construction companies to allow for the final decision to be made with regards to the project.

Kutaisi Airport Connection Project

Plans are in place to connect Georgia's second largest airport (Kutaisi airport) with railway. The length of the new rail line to be constructed, that will connect GR with Kutaisi airport, is about 3 km. A feasibility study has already been performed and construction works are planned to start in 2017.

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

2.4 Subsidiaries

Freight forwarding and terminal operators

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

In recent years, GR has taken important steps to cover logistical services. In 2013, the Company acquired Georgia Transit LLC and established Georgian Transit LLC (later renamed GR Transit

LLC) in 2015. These subsidiaries are freight forwarders and serve crude oil and oil products transportation mainly from Azerbaijan, Kazakhstan and Turkmenistan. In 2014, GR established GR Transit Line LLC, another freight forwarder that carries oil products mainly transported in the direction of Azerbaijan and Armenia.

The share of revenue from logistical services in total revenue increased from 10 percent in 2015 to 12 percent in 2016.

Property Management

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

3. Building a valuable supply chain

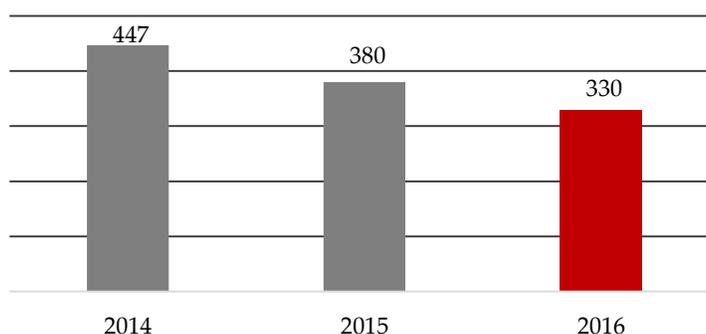
The Group is focused on achieving its key strategic objective, namely building a valuable supply chain, through vertical integration and making suitable connections. The Group forms part of the Caucasus railway corridor, a key segment of the TRACECA. Therefore, the Group's projects are also in line with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

3.1 Containerization

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

On the back of a decrease in transportation volumes in the Caucasus region, the number of containers handled by seaports has also decreased. Based on the Group's calculations, the total volume of containers transported in Georgia by cars and railway was down by 22 percent in 2016 compared to 2015. Backed by internal estimates, GR's transportation share in containers transported within Georgia in 2016 was about 22 percent.

Total handled containers by sea ports



Current levels of containerization are quite low, so there is significant room for improvement.

Share of containerized cargo in total cargo flows transported by the Group

For the year ended 31 December

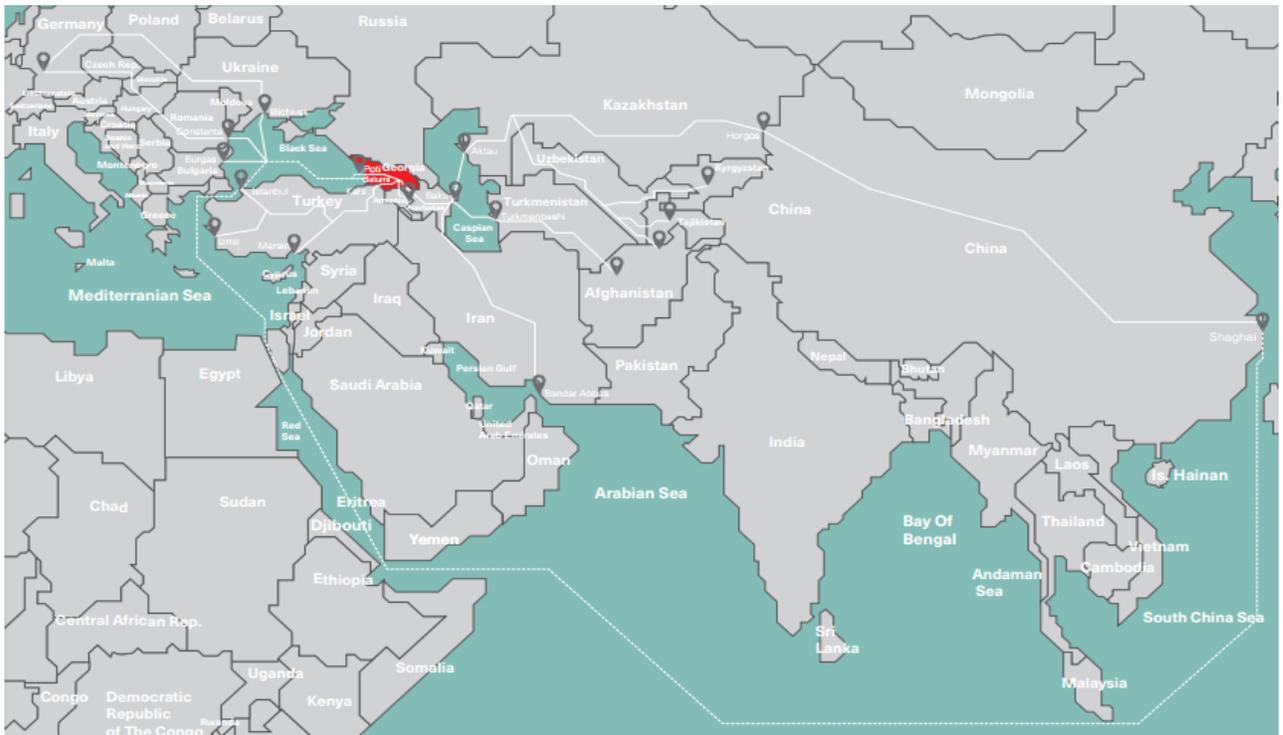
	2016	2015	2014	2013	2012
Share of containerized cargo in total cargo flows	5.1%	5.4%	5.2%	4.6%	4.5%

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

Asia. The Management believes that the availability of sufficient infrastructure would boost containerization rates and potentially bring completely new cargo to the corridor.

3.2 China

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



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

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

In 2015, the first transit train from the Chinese port terminal of Lianyungang arrived in Tbilisi, heralding the official opening of “The Silk Road”. In 2016, four trains arrived from China within the mentioned project, and the main destination for the freight being transported was Turkey.

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

3.3 Persian Gulf-Black Sea Project

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

Negotiations are underway with large European companies interested in freight transportation to Iran via this route. Talks are also being held with Iranian transport companies in order to create a single transportation chain that will transport freight from Europe to Iran.

At the same time, the Group, together with Azerbaijani railway, has been carrying out negotiations with various state structures of Iran to simplify procedures on the Azerbaijan-Iran border. This will help to reduce transportation time and cost for freight transportation.

3.4 International agreements

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

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

In the first half of 2016, Georgia, together with Azerbaijan and Romania, signed a memorandum on the development of the Europe-Asia-Europe transport corridor, through the ports of Constanta in Romania and Batumi in Georgia. Romania trades with Central Asian states, China, Iran and others for which this route may be considered attractive. The throughput tariff between GR and Azerbaijan was agreed in 2016.

3.5 Ongoing projects in the corridor

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



Anaklia Port

Currently three ports are operational 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 overcome this shortcoming, the Government of Georgia decided to start the construction of a new Georgian port on the Black Sea shore in Anaklia. The port is designed to accommodate containers and bulk cargo and should be capable of handling large vessels, carrying at least 10,000 containers. The depth at the planned location is sufficient to accept Panamax and VLC vessels and should have the potential to handle increasing cargo turnover between Europe and Asia.

The new port is expected to become one of the main logistical centers in the South Caucasus and one



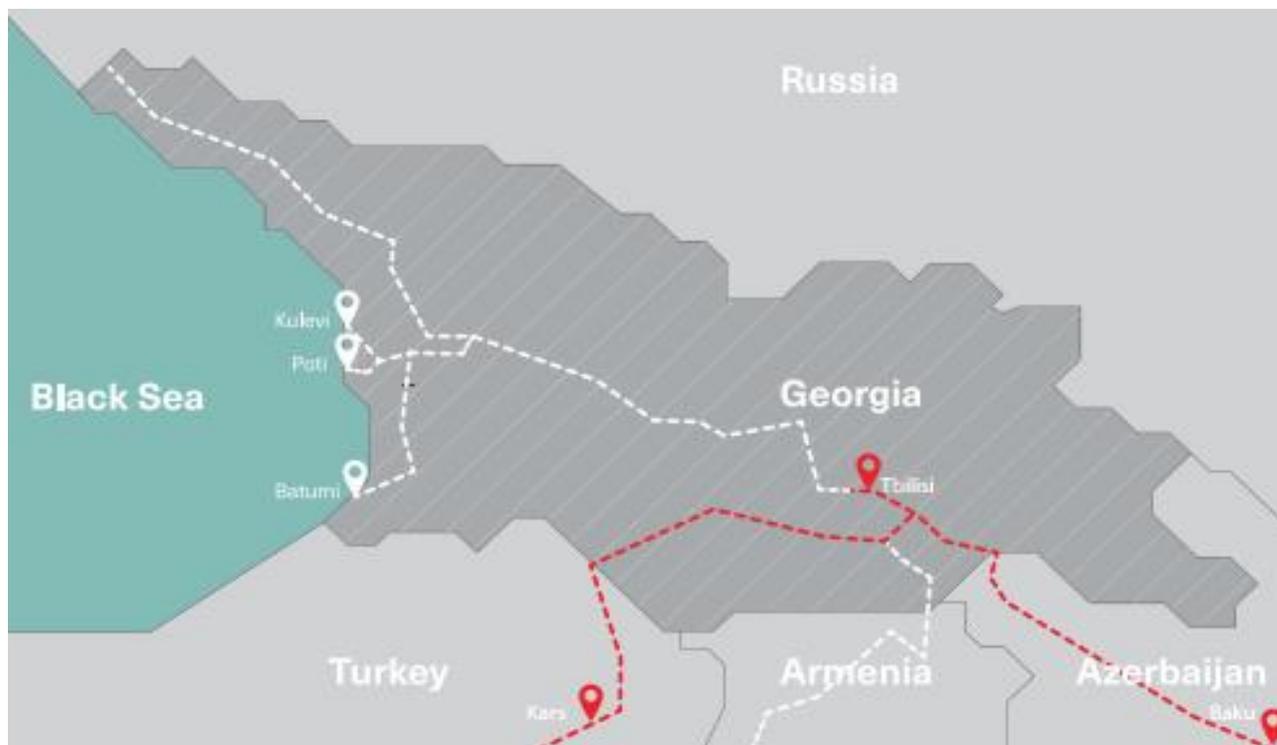
of the main maritime gateway for Georgia. Due to its strategic location, the Government of Georgia considers the project as a priority. In 2016, at the 9th annual CGLA Forum held in Washington, the project was named the Top Strategic Project of the Year.

In 2016, the Georgian government and the Anaklia Development Consortium signed an investment agreement on the construction and operation of the deep-sea port in Anaklia. The Anaklia Development Consortium was jointly established by local company TBC Holding and Conti International (based in the USA). The investment area (340 hectares land area and 225 hectares sea area) was granted to the Consortium for 52 years. The cost of the construction and development of Anaklia Port is expected to be about USD 2.5 billion.

Completion of the preconstruction works and the beginning of the Anaklia Port construction has been earmarked for 2017. The port's construction is expected to go through nine phases according to the growth of cargo turnover. The potential throughput of the port should reach 100 million tons per annum. Once the initial stage has been completed, it is planned that the port will be open in 2020 and it is expected that the port should be able to handle up to 7 million tons of cargo per annum.

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 Bosphorus), 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. The project is being financed by Azerbaijan, who granted a loan to the Georgian government for its construction. However, when the tracks are built, the Group will be granted exclusive rights to operate the Georgian part of the line.

Testing of the Georgian section of the railway in 2015 was performed successfully. Since 2016, diesel locomotives have been able to move freely along the Georgian section of the line. Electrification works on Georgian section of the rail line are near completion. Construction works on the Turkish section are ongoing and nearing completion. The project is expected to be completed and launched in the fourth quarter of 2017.

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

Batumi Sea Port

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

Free trade agreements

In December 2015, talks between China and Georgia regarding a free trade agreement were launched and in October 2016, a free trade memorandum was signed between the two countries, making it the first FTA negotiation of China in Eurasia.

In June 2014, the European Union and Georgia signed an Association Agreement, which entered into force on July 2016. Also free trade agreement between Georgia and European Free Trade Association (EFTA) was signed in June 2016, making the trade between these countries easier.

Infrastructure developments in the corridor

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

Kazakhstan's infrastructure improvements

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

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

Construction of new ferry complex at Kuryk Port

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

In April 2015, the construction of a ferry complex in the port of Kuryk began and by the end of 2016, the first stage was launched. The second stage of construction is planned for 2017. The new ferry complex is designed to handle various types of goods such as consumer goods, petroleum products, fertilizers, chemicals and liquefied petroleum gas.

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

- Good climate;
- Sufficient depth;

- Prospects for increasing throughput capacity.

Development of Aktau Port

The port of Aktau is currently considered the main seaport of Kazakhstan. Due to the port's importance and the expected increase in traffic, it was decided by the Government of Kazakhstan to increase the port's capacity. Since 2015, three new dry cargo terminals have been built in Aktau Port.

Opening of new Zhezkazgan-Beyneu rail line

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

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

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

Azerbaijan's infrastructure improvements

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

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

Construction of the new Alyat Port

The geographical location of Azerbaijan means that it would benefit from the development of an effective maritime transportation system via the Caspian Sea. Baku seaport's current location in the city center limits its operations. Therefore, in 2010 it was decided by the Government of Azerbaijan that the new Baku International Sea Trade Port in Alyat would be built, which is located in 7 km from Baku. The project is expected to be implemented in three phases. The capacity of the port by

the end of the first phase is expected to be up to 11.5 million tons per year of general cargo and up to 50,000 TEU per year and by the end of phase three the capacity is expected to increase to 25 million tons of general cargo and up to 1 million TEU. The construction of Ferry Terminal was completed in 2014, however the completion of the first stage is planned by late 2017. The timeline of phases two and three will depend on cargo volumes.

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

Modernization of Azerbaijan's Railway

Azerbaijan is actively investing in the development of its railway network. By the end of 2016, about 33% of works had been completed on the project concerning the capital repair of the 600-km Baku-Boyuk-Kesik rail line, which started in October 2015. A new 8.3 km rail line was laid from the station at Astara to the Iranian border and in April 2016, the construction works on a railway bridge across the Astarachay River started on the Azerbaijan-Iran border. Works are also underway to replace the signaling system on roads with a microprocessor system, controlled from a single dispatch center.

Azerbaijani railway is also renewing its rolling stock. It signed a contract to purchase 50 locomotives from ALSTOM and plans to purchase 10 diesel locomotives from Kazakhstan. Azerbaijani railway has purchased four electric locomotives and the purchase of new wagons of different categories is also expected.

The modernization of different railway lines in Azerbaijan and the renewal of its rolling stock is expected to increase the speed of trains and its cargo capacity, 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 and is expected to be completed by the end of 2017. It is believed that the port will play an important role in trade between European and Asian countries.

Iran's infrastructure development

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

Construction of the 8.3 km railway section between Astara (Azerbaijan) and Astara (Iran) began in the first half of 2016 and is planned to be completed in 2017. Thereafter, there are plans to connect the line with the Iranian railway network at Qazvin, with the Rasht-Qazvin section planned to be completed in summer 2017 and construction of the Astara-Rasht section expected to start in 2017. This Azerbaijan-Iran project has potential to become one of the main routes connecting India and Europe.

Viking Container Train

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

In 2015, the Group joined the Viking Container Train project. With this participation, Georgia will become the connecting knot of this project and the TRACECA. In May 2016, Azerbaijani railway also joined the project, which will make the Viking Container Train project even more competitive.

4. Employees

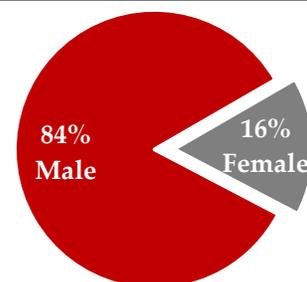
The Group is one of the largest corporate employers in Georgia, with approximately 13,000 employees as of 31 December 2016. Due to the physical nature of much of the work, the Group employs more men than women. The average monthly salary including employee benefits for 2016 was about GEL 944.

The Group continuously promotes employee efficiency and know-how through ongoing training programs at all levels of its workforce. The Group also provides a number of social benefits to its employees such as medical insurance, financing certain expensive operations that are not covered by health insurance. The Company reports a



healthy employee turnover rate, which is about 5% (not considering subsidiaries).

Employee distribution



Employee turnover rate by business unit	31-Dec-16
Head office	13%
Freight Transportation SBU	3%
Infrastructure SBU	5%
Passenger Transportation SBU	6%
Total turnover	5%

As one of the largest employers in Georgia, the Group has certain social responsibilities with respect to its workforce and, therefore, may be unable to make any rapid or significant reductions in the number of employees, if required.

Distribution of the Group's employees, by business unit

For the year ended 31 December

	2016	2015	2014	2013	2012
Freight SBU	44%	43%	43%	43%	42%
Infrastructure SBU	39%	38%	38%	38%	40%
Passenger SBU	10%	11%	11%	12%	12%
Head office	5%	6%	6%	5%	4%
Subsidiaries	3%	2%	2%	2%	2%

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

Employee distribution by age	31-Dec-16
<20	0%
21-30	9%
31-40	20%
41-50	23%
51-60	29%
>60	19%

Labor productivity measures

For the year ended 31 December

	2016	2015	2014	2013	2012
Ton-km per average number of Freight SBU employees (millions)	0.6	0.8	0.9	1.0	1.1
Passenger-km per average number of Passenger SBU employees (millions)	0.4	0.3	0.4	0.4	0.4
Revenue per average employees (GEL thousands)	34.0	44.4	39.5	37.4	36.5
Average salary and employee benefits (GEL thousands)	11.3	11.5	11.2	10.4	8.4

As at December 2016, about 60 percent of the Group's employees were members of two trade unions. Therefore, there is some risk that in the future the Group's business will be subject to interruptions through strikes or lockouts, as has been the case in the past.

Education and training

The Group promotes business education among its employees. By financing employees' trainings and education, the Group increases its human capital and the effectiveness of the workforce. The Group's investment in training and education in 2016 amounted to about GEL 210,000, which was a 37 percent rise compared to 2015.

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

The founders of the college are:

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

The partners of the college are:

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

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

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

Other benefits

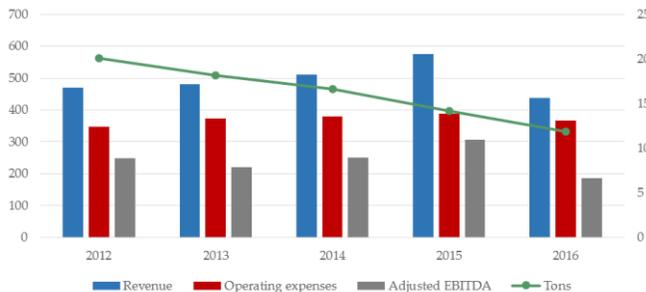
The Group has developed an employee motivation system, which was launched in the summer of 2015. According to the new system, quarterly bonuses are distributed to employees based on their evaluation. Since 2010, the system, which takes into account moral and material incentives, has been active, according to which the leading employees are rewarded once per year.

The Group offers medical insurance to its employees and also finances a number of employee healthcare expenditures, which are not covered by insurance. In 2016, the amount spent on employees' healthcare expenses totaled about GEL 275,000. The Group also offers other financial incentives for occasions such as the birth of a child and a child's first day at school, and offers other bonuses to employees for certain holidays, events, and special occasions.

Working conditions

The working conditions of employees is another major priority for the management of GR. In 2016, upon the initiation of the Management, the inspectors of labor from the Ministry of Labor Health and Social Affairs of Georgia checked GR's working conditions and safety of employees. The inspectors have estimated the conditions of work and safety of labor in GR. The process of inspection was carried out in different structures of GR across the country. Following the inspection, a conclusion was prepared and corresponding recommendations were issued, to be considered by the Company.

The Group's financial performance decreased in 2016. As a result of continued pressure from a challenging market environment, the Group's transportation volume in 2016 declined by 16 percent compared to 2015. Against this backdrop, total revenue declined by 23 percent and the adjusted EBITDA margin dropped from 54 percent in 2015 to 44 percent in 2016.



Despite the rapid pace of implementation of the Modernization Project, the Group's cash balance at the end of 2016 was GEL 278.0 million, giving the Group healthy liquidity and flexibility for its operational and investment requirements.

In 2016, the Group purchased two new double-decker passenger trains from the Swiss manufacturer Stadler Bussnang AG. These trains started to serve customers from the summer of 2016. Two more double-decker trains are planned to be purchased in the first half of 2017. The procurement was mostly financed by the credit. The total credit facility of GR is USD 43.7 million, from which by the end of 2016 the Group had withdrawn USD 23.2 million to finance the procurement of new passenger trains.



Main developments in 2016

- Purchase of two double-decker passenger trains.
- Additional borrowing of USD 23.2 million to finance new passenger trains procurement.
- Transfer of land plots to the Government under the Tbilisi Bypass Project memorandum.
- Freight volume decreased by 16 percent.
- Long-term corporate rating downgrade to 'B+' by S&P Global Ratings and placed on 'Rating Watch Negative' by Fitch Ratings.

5. Profit or loss statement

5.1 Revenue

Most of the Group's revenue (about 67 percent in 2016) is derived from freight transportation. Thus, the Group's results are particularly sensitive to cargo flows, which mainly comprise transit shipments, which accounted for about 68 percent of freight transportation revenue in 2016. The transit transportation volume mainly comes from trade between Europe and Central Asia.

The majority of the Group's freight traffic (about 36 percent of transportation revenue in 2016) was transported from or to Azerbaijan. Other significant trade partners for the Group in 2016 were Armenia, Turkmenistan, Russia and several European countries. Only about 5 percent of total transportation revenue in 2016 was generated by domestic transportation.

Revenue Breakdown

For the year ended 31 December

In GEL '000

	2016	2015	% Change	% Change at constant currency	Abs. change
Freight transportation*	292,612	392,774	-25.5%	-28.5%	-100,162
Freight handling*	52,974	79,177	-33.1%	-35.5%	-26,203
Logistical services*	52,582	56,086	-6.2%	-10.1%	-3,504
Freight car rental	13,948	24,261	-42.5%	-43.5%	-10,313
Passenger transportation	18,007	15,487	16.3%	16.2%	2,520
Other	9,799	6,988	40.2%	39.4%	2,811
Total revenue	439,922	574,773	-23.5%	-26.3%	-134,851
Income from transferred property	80,294	7,503	970.2%	970.2%	72,791
Other income	19,122	23,268	-17.8%	NA	-4,146
Freight transportation	292,612	392,774	-25.5%	-28.5%	-100,162
Liquid cargoes	135,530	193,599	-30.0%	-32.9%	-58,069
Oil products	107,140	173,404	-38.2%	-40.7%	-66,263
Crude oil	28,389	20,195	40.6%	34.8%	8,194
Dry cargoes	157,082	199,175	-21.1%	-24.4%	-42,093
Ores	24,820	25,985	-4.5%	-8.4%	-1,165
Grain	14,320	25,344	-43.5%	-45.8%	-11,024
Ferrous metals and scrap	20,936	32,443	-35.5%	-38.1%	-11,507
Sugar	18,333	17,471	4.9%	0.7%	862
Chemicals and fertilizers	9,397	11,616	-19.1%	-22.4%	-2,218
Construction freight	6,275	11,240	-44.2%	-46.4%	-4,965
Industrial freight	3,440	5,233	-34.3%	-37.0%	-1,793
Cement	933	1,668	-44.1%	-46.3%	-735
Other	58,628	68,175	-14.0%	-17.5%	-9,547
Freight turnover (mm ton-km)	3,391	4,222	-19.7%	-19.7%	-831
Revenue / ton-km (in Tetri)	8.63	9.30	-7.2%	-11.0%	-0.67

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

Freight transportation

The Group's freight transportation revenue is broken down into liquid and dry cargo. The split between liquid and dry cargo revenue in 2016 was about 46 and 54 percent, respectively.

Transportation revenue is affected by multiple factors including the following:

Transportation volume - measured in tons transported.

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

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

- Cargo type mix - the Group transports different cargo categories (such as grain, ore, sugar etc.). These categories themselves are made up 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 destinations 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 when analyzing the performance of the Group is the fact that most of its tariffs are denominated in USD. As the Group reports its revenue in GEL, 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 GEL.

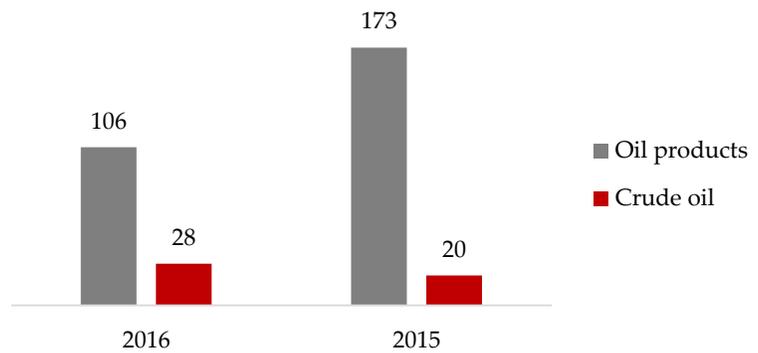
	<i>Average exchange rates</i>			<i>Reporting date spot rates</i>		
	2016	2015	% Change	2016	2015	% Change
GEL/USD	2.37	2.27	4.3%	2.65	2.39	10.5%
GEL/CHF	2.40	2.36	1.7%	2.60	2.42	7.5%

Liquid cargo

One of the key drivers of liquid freight traffic is the production of oil and oil products in the Caspian Sea region, which has large oil reserves. In 2016, about 76 percent of crude oil and oil products coming into Georgia were transported from three Caspian Sea region countries (Kazakhstan, Turkmenistan and Azerbaijan) mostly to European countries and Georgia.

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

Breakdown of liquid cargo revenue in GEL mm



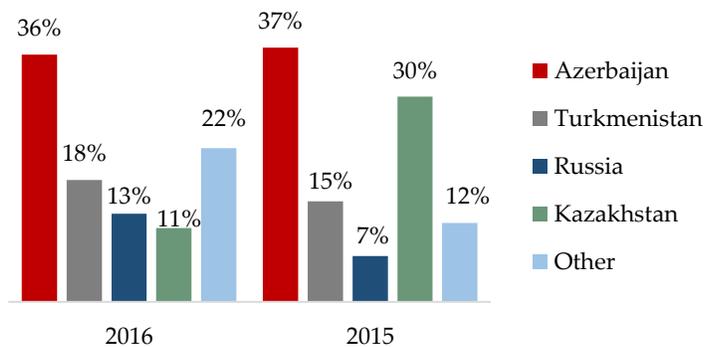
Oil products

Main directions of cargo

Oil products are currently the main type of liquid cargo (67 percent of the transportation volume of liquid cargo in 2016). They are mainly transported by rail, as there is practically no competition from pipelines.

In 2016, oil products coming into Georgia mostly originated from Azerbaijan, Turkmenistan, Russia and Kazakhstan. Azerbaijan's share in the oil products transportation volume remains the largest at 36 percent in 2016 (a small drop from 37 percent in 2015), Kazakhstan's share dipped from 30 percent in 2015 to 11 percent in 2016. Meanwhile, Turkmenistan's and Russia's transportation share in 2016 compared to 2015 rose from 15 percent to 18 percent. Similarly, Russia's share increased from 7 percent to 13 percent.

Transportation volume by country of origin



Oil products

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	107.14	173.40	-38.2%	-40.7%
Freight volume (million ton)	3.69	5.88	-37.4%	-37.4%
Freight turnover (million ton-km)	1,087.94	1,962.72	-44.6%	-44.6%
Revenue / ton-km (in Tetri)	9.85	8.83	11.5%	6.9%

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

Factors influencing performance

Ton-kilometers - freight transportation turnover of oil products fell by 45 percent in 2016. This decrease was mainly due to the reduced transportation volume from Kazakhstan, which dropped by 77 percent, and Azerbaijan, which dropped by 39 percent, as well as the reduction in average transportation distance.

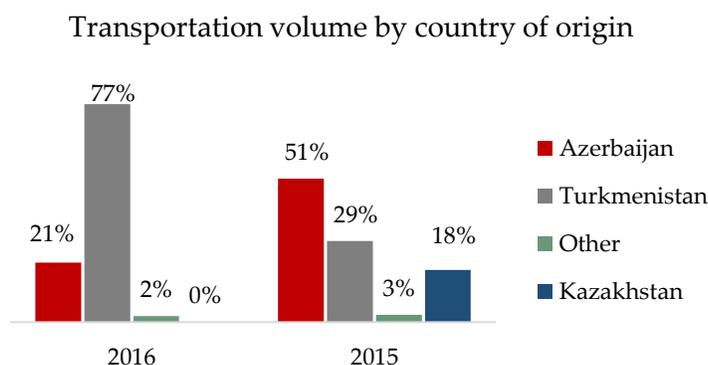
The decrease in transportation volume from Kazakhstan was mainly due to the reduced transportation of heavy fuel oil (1.4 million tons). The reduction in transportation volume from Azerbaijan was caused by reduced transportation of gasoil (0.3 million tons) and fuel diesel (0.4 million tons).

Revenue/ton-km (in Tetri) - increase in revenue per ton-kilometer was caused by the increased transportation volume and transportation share from Russia, for which the average revenue per ton-kilometer was one of the highest.

Crude oil

Main directions of cargo

The crude oil transported by GR in 2016 mostly originated from Turkmenistan (about 77 percent) and Azerbaijan (about 21 percent).



Crude oil

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	28.39	20.19	40.6%	34.8%
Freight volume (million ton)	1.81	0.86	109.3%	109.3%
Freight turnover (million ton-km)	713.65	340.71	109.5%	109.5%
Revenue / ton-km (in Tetri)	3.98	5.93	-32.9%	-35.6%

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

Factors influencing performance

Ton-kilometers – The increase in freight turnover was mainly caused by the increased transportation from Turkmenistan in 2016, which increased by 1.1 million tons compared to 2015, making it the leading country of origin of crude oil transportation in 2016 with a 77 percent share of the total volume. Increased transportation from Turkmenistan has more than offset the decreased volumes from Azerbaijan and Kazakhstan, which had 51 and 18 percent shares of total crude oil transportation in 2015, respectively.

Revenue/ton-km (in Tetri) – The decrease in revenue per ton-kilometer was mainly caused by changes in transportation tariffs and the transportation direction mix. The transportation share from Turkmenistan, which has relatively low average revenue per ton-kilometer, rose from 29 percent in 2015 to 77 percent in 2016. The Group decreased tariffs on crude oil transportation in the first quarter of 2016.

Dry cargo

Dry cargo contributed about 54 percent of total transportation revenue in 2016. The main factors affecting transportation of dry cargo are general national economic conditions and economic developments in Georgia and in partnering countries such as Azerbaijan, Armenia, Turkmenistan, Kazakhstan and other CIS countries.

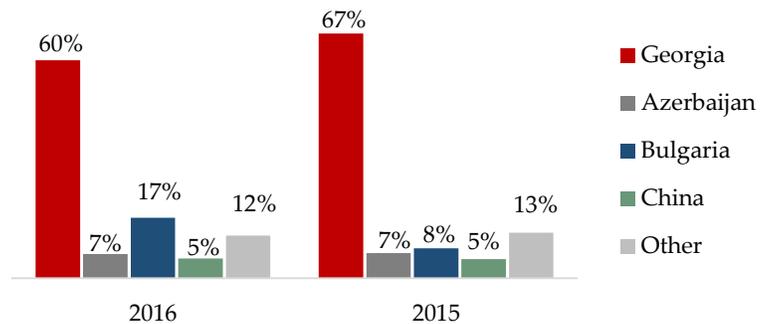
Recent developments should open up new markets to the Group, such as Turkey (via the Baku-Tbilisi-Kars rail line), China (via direct railway connection between Turkey and China through Georgia) and Iran (after the lifting of international sanctions). These three markets provide significant opportunities particularly in terms of dry cargo.

Ore products

Main directions of cargo

The main destination points for ore products transported by the Group are Georgia, Bulgaria and Azerbaijan. About 32 percent of the total ore products transportation volume in 2016 were transported within Georgia. Ore products transported by the Group in 2016 mostly comprised manganese ores and concentrates (about 28 percent), copper ores and concentrates (about 24 percent) and coal (about 20 percent).

Transportation volume by destination country



Ore Products

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	24.82	25.99	-4.5%	-8.4%
Freight volume (million ton)	1.45	1.46	-0.3%	-0.3%
Freight turnover (million ton-km)	310.57	328.66	-5.5%	-5.5%
Revenue / ton-km (in Tetri)	7.99	7.91	1.1%	-3.0%

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

Factors influencing performance

Ton-kilometers - The decrease in freight transportation turnover was mainly due to a reduction in the volume and average transportation distance of coal.

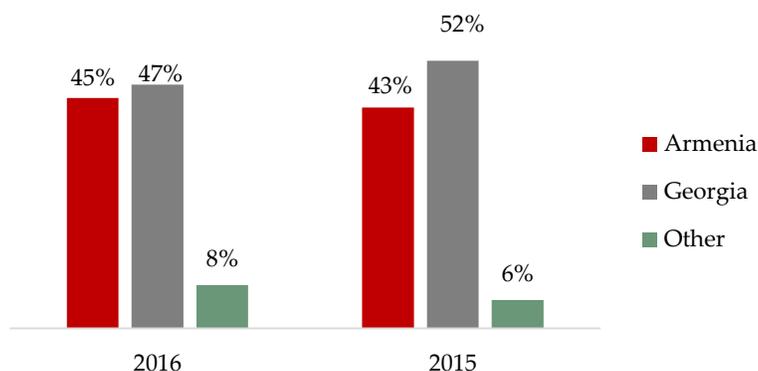
Revenue/ton-km (in Tetri) - average revenue per ton-kilometer in 2016 remained at about the same level in GEL terms, while in USD terms it decreased due to the reduction in tariffs on local transportation in July 2015.

Grain and grain products

Main directions of cargo

Transportation volume of wheat represents about 82 percent of total grain and grain products transported in 2016. The main country of origin for this product category was Russia, about 82 percent of total volume transported in 2016. The main destination countries of grain and grain products are Georgia and Armenia, from which Armenia is more profitable direction.

Transportation volume by destination country



Grain and grain products

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	14.32	25.34	-43.5%	-45.8%
Freight volume (million ton)	0.45	0.72	-37.4%	-37.4%
Freight turnover (million ton-km)	140.64	225.14	-37.5%	-37.5%
Revenue / ton-km (in Tetri)	10.18	11.26	-9.6%	-13.2%

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

Factors influencing performance

Ton-kilometers – The decrease in freight transportation turnover by 38 percent was mainly caused by the decreased transportation volume from Russia (about 39 percent).

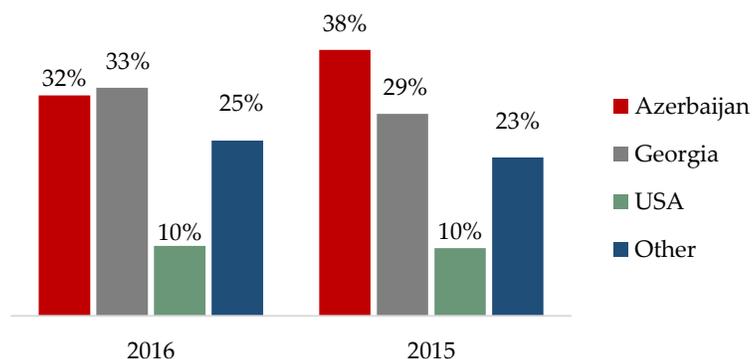
Revenue/ton-km (in Tetri) – The reduction in revenue per ton-kilometer in 2016, compared to 2015, was mainly caused by the change in freight loading terminals, which have affected tariffs. In addition, the decrease in average revenue was significantly affected by the decreased volume in durum wheat being transported to Armenia, which was previously one of the most profitable freight products. There were also some reductions in tariffs on certain grain product categories.

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 2016, about 32 percent of such goods coming into Georgia were transported to Azerbaijan and about 33 percent were transported to Georgia. One of the most profitable products under this product category had been pipes for oil and gas pipelines, which dropped by 66 percent in 2016 compared to 2015.

Transportation volume by destination country



Ferrous metals and scrap

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	20.94	32.44	-35.5%	-38.1%
Freight volume (million ton)	0.66	0.89	-25.7%	-25.7%
Freight turnover (million ton-km)	163.10	248.17	-34.3%	-34.3%
Revenue / ton-km (in Tetri)	12.84	13.07	-1.8%	-5.8%

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

Factors influencing performance

Ton-kilometers – The decrease in freight transportation turnover was mainly due to the decreased transportation volume and average transportation distance for two main destination countries, Azerbaijan and Georgia. Although the freight transportation volume to Georgia has decreased, the transportation share to Georgia in the total product category has increased. The fact that freight transported to Georgia covers shorter distances compared to that transported to Azerbaijan (the transportation share of which has decreased) also contributed to the reduction in transportation turnover in 2016.

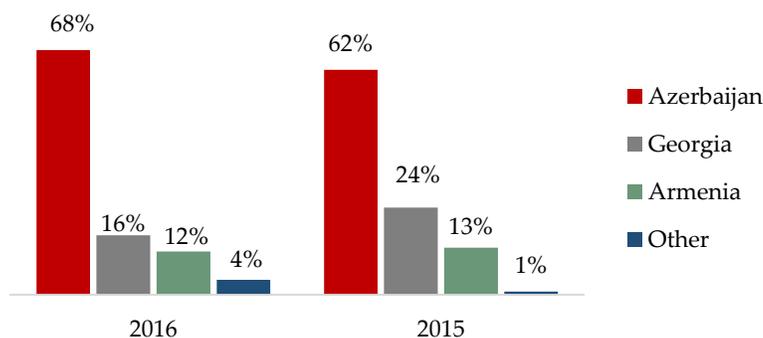
Revenue/ton-km (in Tetri) – The decrease in average revenue per ton-kilometer was due to the reduced transportation volumes of relatively more profitable products including pipes for oil and gas pipelines and increased volumes of relatively less profitable products such as bars and rods of iron or non-alloy steel and rails. The decrease was also caused by changes to the transportation direction mix.

Sugar

Main directions of cargo

Most of the sugar transported by the Group during the period under review was directed to Azerbaijan, Georgia and Armenia. The main country of origin for transported volumes of sugar in 2016 and 2015 was Brazil, respectively with 91 and 89 percent share of total sugar transported by the Group.

Transportation volume by destination country



Sugar

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	18.33	17.47	4.9%	0.7%
Freight volume (million ton)	0.50	0.46	7.6%	7.6%
Freight turnover (million ton-km)	183.89	167.53	9.8%	9.8%
Revenue / ton-km (in Tetri)	9.97	10.43	-4.4%	-8.3%

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

Factors influencing performance

Ton-kilometers – The increase in transportation turnover in 2016 compared to 2015 was driven by the increased transportation volume of cane sugar from Brazil to Azerbaijan.

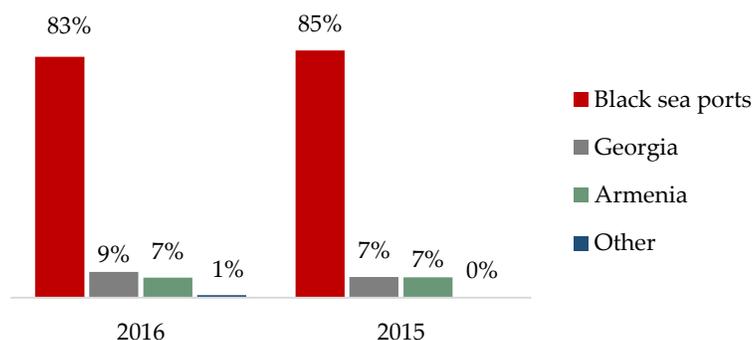
Revenue/ton-km (in Tetri) – The decrease in average revenue per ton-kilometer was mainly caused by the reduced average tariffs in the direction of Azerbaijan.

Chemicals and fertilizers

Main directions of cargo

Chemicals and fertilizers were mainly transported to Black Sea ports. A relatively small portion of these products was transported to Armenia and to Georgia. In 2016 and in this particular product category, the Group mainly transported ammonium nitrate (84 percent).

Transportation volume by destination country



Chemicals and fertilizers

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	9.40	11.62	-19.1%	-22.4%
Freight volume (million ton)	0.43	0.51	-15.3%	-15.3%
Freight turnover (million ton-km)	132.77	158.74	-16.4%	-16.4%
Revenue / ton-km (in Tetri)	7.08	7.32	-3.3%	-7.2%

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

Factors influencing performance

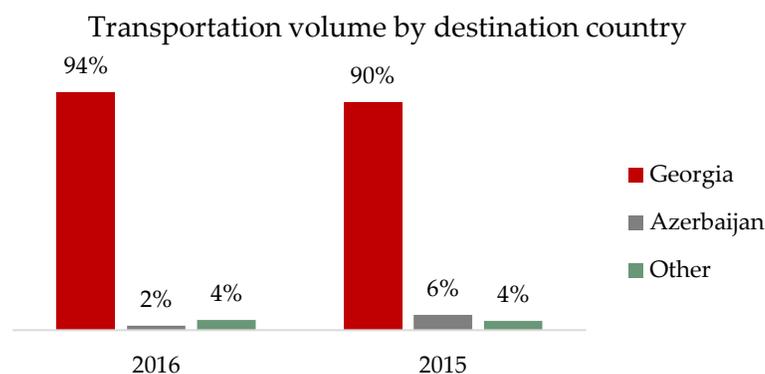
Ton-kilometers – The decrease in transportation turnover was mainly due to the reduced transportation of ammonium nitrate, which was the main type of product transported under this product category.

Revenue/ton-km (in Tetri) – The decrease in average revenue per ton-kilometer was mainly due to the decrease in average tariff for ammonium nitrate in line with changes to the product category mix as the transportation of a relatively less profitable product, urea, has increased.

Construction freight

Main directions of cargo

The transportation of construction freight correlates with activities of the construction sector in Georgia. The share of construction freight transported to Georgia represented about 94 percent of total construction freight transported in 2016.



Construction freight

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	6.28	11.24	-44.2%	-46.4%
Freight volume (million ton)	1.07	1.43	-25.3%	-25.3%
Freight turnover (million ton-km)	141.90	212.93	-33.4%	-33.4%
Revenue / ton-km (in Tetri)	4.42	5.28	-16.2%	-19.6%

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

Factors influencing performance

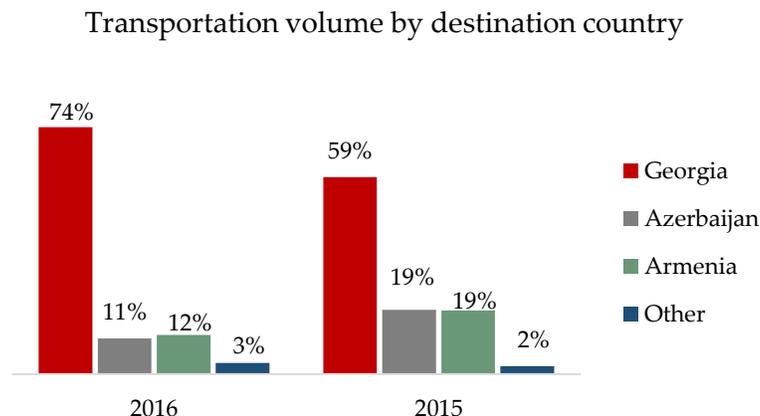
Ton-kilometers – The decrease in transportation turnover was mainly due to the decreased transportation volume to Azerbaijan and Georgia, which is the main destination.

Revenue/ton-km (in Tetri) – The decrease in revenue per ton-kilometer was mainly due to the increased transportation share to Georgia, which is a less profitable direction.

Industrial freight

Main directions of cargo

The main destination countries of this type of cargo during the period under review were Georgia, Armenia and Azerbaijan.



Industrial freight

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	3.44	5.23	-34.3%	-37.0%
Freight volume (million ton)	0.27	0.26	3.8%	3.8%
Freight turnover (million ton-km)	38.67	53.87	-28.2%	-28.2%
Revenue / ton-km (in Tetri)	8.90	9.71	-8.4%	-12.2%

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

Factors influencing performance

Ton-kilometers – The transportation turnover of industrial freight decreased by 28 percent although the transportation volume shows a four percent increase. These disproportional changes were mainly caused by the reduced transportation volume to Azerbaijan and Armenia, while the transportation volume to Georgia, which covers smaller distances and is relatively less profitable, has increased. The increased transportation volume to Georgia was mostly caused by increased transportation of cement clinker from Azerbaijan.

Revenue/ton-km (in Tetri) – The change in the product category mix due to reduced transportation of siliceous sand and quartz to Armenia, and natural barium sulfate to Azerbaijan, as well as the increased transportation of clinker cement to Georgia, combined with changes in transportation direction mix, contributed to the reduction in average revenue per ton-kilometer.

Cement

Main directions of cargo

Cement products are mainly transported within Georgia, the share of which rose from 88 percent in 2015 to 96 percent in 2016.

Cement

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	0.93	1.67	-44.1%	-46.3%
Freight volume (million ton)	0.06	0.08	-22.9%	-22.9%
Freight turnover (million ton-km)	17.08	22.90	-25.4%	-25.4%
Revenue / ton-km (in Tetri)	5.46	7.28	-25.0%	-28.0%

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

Factors influencing performance

Ton-kilometers – The decrease in transportation turnover for cement was mainly due to the decrease in transported volume, while the reduction in volumes was mainly due to a reduction in imports to Georgia and a decrease in local transportation. Meanwhile, the share of domestic transportation has increased.

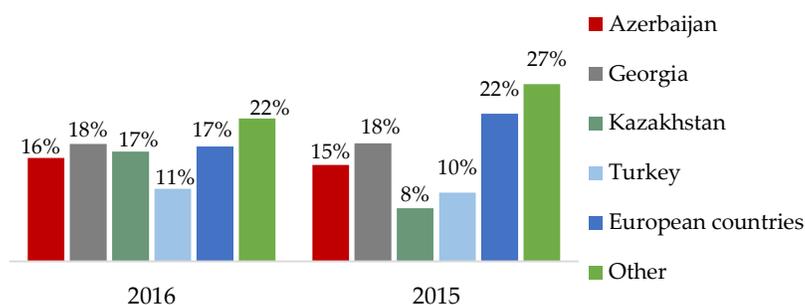
Revenue/ton-km (in Tetri) – The decrease in average revenue per ton-kilometer was caused by the Group reducing its tariffs in July 2015 by 20 percent on freight transported within Georgia and on exported goods. The transportation share within Georgia increased from 88 percent in 2015 to 96 percent in 2016, while the reduced tariffs were applied over a longer period and had a greater effect on average revenue per ton-kilometer in 2016.

Other product categories

Main directions of cargo

In 2016, the main destination countries for other product categories were Azerbaijan, Georgia, European countries, Kazakhstan and Turkey. The main other products transported in 2016 were methanol (about 8 percent of the total volume), meat (about 8 percent of the total volume) and not-alloyed aluminum (about 8 percent of the total volume).

Transportation volume by destination country



Other products

For the year ended 31 December

	2016	2015	% Change	% Change at constant currency
Revenue (GEL million)	58.63	68.18	-14.0%	-17.5%
Freight volume (million ton)	1.50	1.59	-5.9%	-5.9%
Freight turnover (million ton-km)	460.66	500.68	-8.0%	-8.0%
Revenue / ton-km (in Tetri)	12.73	13.62	-6.5%	-10.3%

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

Factors influencing performance

Ton-kilometers – The decreased turnover in 2016 was mainly due to the reduced turnover in the directions of European countries and Armenia, which was partly offset by increased transportation to Kazakhstan.

Revenue/ton-km (in Tetri) – The decrease in revenue per ton-kilometer was mainly due to changes to the transportation direction mix and also due to changes in the product category mix. The Group transported almost no sulfur in 2016 while, in 2015 the transportation share of sulfur was 5 percent of this product category. Transportation of methanol, mostly to European countries, decreased by 27 percent in 2016 compared to 2015 (transportation share was down from 10 percent to 8 percent). A decrease was recorded in cotton, mostly to China and Bangladesh, which resulted in a decreased transportation share of cotton in this product category from 6 percent in 2015 to 3 percent in 2016. In 2016, the Group started to transport of frozen chicken, toffee, caramels and other sweets that had not been transported in previous years and gained a 4 percent share of the transportation volume in this product category. The transportation volume of electrodes increased in 2016, which resulted in an increased share in this product category from 1 percent in 2015 to 4 percent in 2016. In 2015, about 8 percent of electrodes were transported to Georgia, while in 2016 this rose to 36 percent. The average revenue per ton-kilometer of electrodes transported to Georgia in 2016 was materially lower than that transported to Azerbaijan (transportation share of 86 percent in 2015 and 64 percent in 2016). In 2016, the Group also decreased tariffs on some products in this product category such as cotton.

Freight handling

General description

Revenue from freight handling comprises several components:

- Revenue from station services, derived from railcar marshaling, freight pick-up, delivery at customer facilities and other related services;
- Revenue from 24-hour railcar delays, which is represented by a fee paid by customers for failing to load or unload a railcar within 24 hours from delivery of railcar at an 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 90 percent in 2016, was denominated in USD, while the rest was denominated in GEL. The Group sets its tariffs independently.

Driver

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

Freight handling

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Station services	47,205	56,157	-15.9%	-8,952
24-hour service	4,298	21,697	-80.2%	-17,399
Other	1,471	1,323	11.2%	148
Total	52,974	79,177	-33.1%	-26,203

Factors influencing performance

Compared to 2015, revenue from freight handling in 2016 decreased by 33 percent (GEL 26.2 million), which was mainly due to a decrease in revenue from the 24-hour service.

In April 2015, GR terminated freight car rental agreement, but the counterpart company was unable to transport railcars to their original location. As a result, GR accrued 24-hour service fees on the usage of rails. However, the counterpart company managed to finalize transportation of these railcars in 2016. Thus, no such revenues were accrued in 2016. The counterpart company appealed to the court and as a result, about GEL 13 million provision was created against revenue from 24-hour services. In addition, the decrease in revenue was driven by reduced transportation volumes.

Logistical services

General description

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

Currency and tariff setting

Revenue from logistical services is mostly denominated in USD.

Driver

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

Logistical services

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Revenue from logistical services	52,582	56,086	-6.2%	-3,504

Factors influencing performance

The decreased revenue from logistical services was mainly due to the reduced transportation volume and turnover by GR's subsidiary company providing crude oil and oil products transportation mainly from Azerbaijan, Kazakhstan and Turkmenistan. This reduction was partly offset by increased revenue from another of GR's subsidiaries, which serves oil products mainly transported to Azerbaijan and Armenia.

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 according to tariffs and the number of days the Group's railcars are used by other railways.

Freight car rental

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Freight car rental	13,948	24,261	-42.5%	-10,313

Factors influencing performance

The reduction in revenue from freight car rental by 43 percent (GEL 10.3 million) in 2016 compared to 2015 was largely attributable to reduced transportation turnover. The reduction in revenue was significantly affected by GR's agreement with Azerbaijan Railways to charge for freight car rental services with an exemption for the first eight days for each railcar.

Passenger traffic

General description

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

In July 2016, the Group acquired two new double-decker trains meeting European standards, which started to serve the passengers going from Tbilisi to the Black Sea resorts in the summer. Two more double-decker trains are to be procured in 2017.

Currency and tariff setting

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

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

Drivers

Passenger revenue fluctuations are in line with the tariffs and number of passengers transported.

Passenger transportation

For the year ended 31 December

	2016	2015	% Change	Abs. change
Revenue in GEL '000	18,007	15,487	16.3%	2,520
Number of passengers '000	2,463	2,397	2.8%	66

Factors influencing performance

Revenue from passenger transportation increased by 16 percent (GEL 2.5 million) in 2016 compared to 2015, while the number of passengers increased by 3 percent. The marked increase in revenue was driven by an increased number of passengers on the main line, which is more profitable, while there was a reduction in regional transportation. The increased number of passengers was partly driven by the introduction of two new trains since summer of 2016. The average loading rate of the trains on the main line in 2016 was about 65 percent.

Other revenue

General description

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

Other revenue

For the year ended 31 December

	2016	2015	% Change	Abs. change
Revenue from rent	4,871	4,491	8.5%	380
Revenue from repair	450	1,311	-65.7%	-861
Revenue from sale of materials (scrap)	2,663	913	191.5%	1,749
Other	1,815	273	565.5%	1,542
Total	9,799	6,988	40.2%	2,811

Factors influencing performance

There was a 40 percent (GEL 2.8 million) increase in other revenue in 2016 compared to 2015, and the increase was mostly attributable to an increase in the sale of scrap.

5.2 Income from transferred property

General description

In April 2012, GR and the Government signed the Tbilisi Bypass Project Memorandum according to which the Government aims to purchase from the Group approximately 70 hectares of land plots which will be released as a result of the removal of railway infrastructure from Tbilisi city center.

The Company will be reimbursed for the amount of VAT paid for the sale. The Government agreed to pay the equivalent of CHF 138 million in the national currency to the Group by reducing the amount of dividends payable to the Government. In 2012, the Company declared dividends of which GEL 232 million (CHF 138 million) were classified as an advance received from the Government for the sale of the land for the Tbilisi Bypass Project Memorandum.

Income from transferred property

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Income from transferred property	80,294	7,503	970.2%	72,791

Factors influencing performance

In 2016 and 2015, GR transferred 89,166 and 3,266 square meter land plots with attached constructions, respectively, to the Government within the framework of the Tbilisi Bypass Project Memorandum.

The difference between the fair value and the carrying value of the transferred property (GEL 80,294,000 and GEL 7,503,000 respectively in 2016 and 2015) was recognized as income in the consolidated profit or loss statement. The difference between the cost of the transferred property, as agreed between the Group and the Government and used for the reduction of advances received from the Government, and the fair value of the transferred property (GEL 62,345,000 in 2016) was recognized directly in equity as a non-cash owner contribution reserve.

According to the Tbilisi Bypass Project Memorandum, the Government will reimburse the Group for the value added tax payable of transferred property. Respectively, in 2016 the Group recognized GEL 23,690,000 receivable from the Government.

5.3 Other income

General description

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

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

Other income

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Continuing operations	12,165	13,293	-8.5%	-1,128
Non-continuing operations	6,957	9,975	-30.3%	-3,017
Total	19,122	23,268	-17.8%	-4,146

Factors influencing performance

The decrease in continuing operations in 2016 compared to 2015 was mainly due to the decrease of accrued penalties on creditors and debtors.

The decrease in non-continuing operations in 2016, compared to 2015, was mainly due to the decrease in sale of fixed assets other than land transfers to the Government.

5.4 Operating expenses

General description

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

Operating expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Employee benefits expense	146,626	148,625	-1.3%	-1,999
Depreciation and amortization	106,267	104,416	1.8%	1,851
Electricity	21,687	20,424	6.2%	1,263
Materials	14,121	19,276	-26.7%	-5,155
Repair and maintenance	7,175	15,420	-53.5%	-8,245
Fuel	4,306	5,807	-25.8%	-1,501
Freight car rental	4,407	11,210	-60.7%	-6,803
Logistical services	14,270	17,197	-17.0%	-2,927
Security, other op. expenses	18,517	18,829	-1.7%	-312
Taxes other than income tax	26,474	25,969	1.9%	505
Total	363,851	387,173	-6.0%	-23,322

Total operating expenses in 2016 decreased by 6 percent (GEL 23.3 million), compared to 2015. A decrease was recorded in most of the expense categories.

Employee benefits expense

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 cost.

Employee benefits expenses

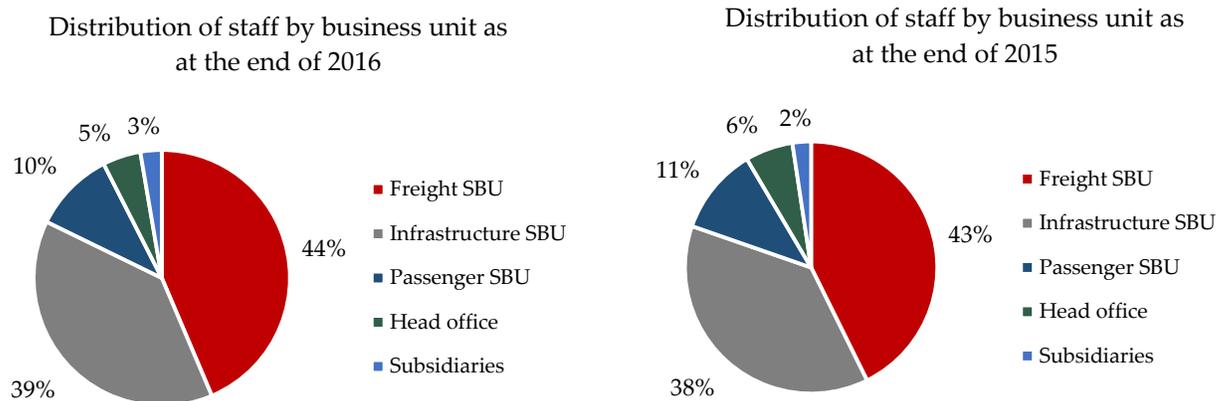
For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Salary	125,938	124,591	1.1%	1,347
Bonus-reward	6,188	11,769	-47.4%	-5,581
Other benefits	14,500	12,265	18.2%	2,236
Total	146,626	148,625	-1.3%	-1,999

Factors influencing changes

The Group is one of the largest corporate employers and taxpayers in Georgia. This fact underlines its importance for the Government of Georgia along with other important economic and social benefits for the country. Total employee benefit expense decreased by about GEL 2.0 million in 2016, driven largely by a decrease in bonuses and rewards.



Depreciation and amortization expenses

General description

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

Depreciation and amortization expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Depreciation and amortization	106,267	104,416	1.8%	1,851

Factors influencing changes

An increase in depreciation and amortization expenses in 2016, compared to 2015, reflected the Group's continuing investment in infrastructure. The increase in expenses was driven by capital expenditures on railroad assets made by the Infrastructure SBU.

Electricity expenses

General description

Approximately 97 percent of GR's railway network is electrified. Until September 2011, the Company purchased most of its electricity on the open market in Georgia. In 2011, the Company signed a ten-year contract with the electricity provider, JSC Energo-pro Georgia, securing a fixed

price for more than 90% of its electricity needs (subject to certain circumstances in which these tariffs can be increased). The tariffs are denominated in GEL.

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

Electricity expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Electricity expenses of traction	18,373	17,654	4.1%	719
Utility expenses	3,314	2,770	19.7%	544
Total	21,687	20,424	6.2%	1,263

Factors influencing changes

The increase in electricity expenses of traction in 2016 compared to 2015, despite a decrease in transportation turnover, was caused by increased electricity tariffs from August 2015. As previously alluded to, GR's agreement on electricity procurement considers tariff review in the case of a change in regulated tariffs. In August 2015, the Georgian National Energy and Water Supply Regulatory Commission (GNERC) increased electricity tariffs, which resulted in increased tariffs for GR. As tariffs were increased in the third quarter of 2015, tariff increases had a greater effect on expenses for 2016.

Purchased electricity and weighted average tariff

For the year ended 31 December

	2016			2015		
	GWH	Gross ton-km (MM)	Weighted av. tariff (GEL)	GWH	Gross ton-km (MM)	Weighted av. tariff (GEL)
January	12.5	491.3	0.119	16.6	763.5	0.088
February	13.5	586.8	0.119	14.4	642.3	0.090
March	12.7	536.2	0.115	16.2	763.1	0.089
April	12.0	498.1	0.116	14.5	681.6	0.088
May	12.0	502.9	0.116	14.8	695.1	0.083
June	12.4	537.8	0.116	14.1	654.0	0.083
July	13.1	562.4	0.116	14.8	678.7	0.083
August	15.5	684.6	0.117	14.1	639.3	0.118
September	13.8	596.4	0.116	14.4	638.2	0.118
October	13.8	593.6	0.117	13.8	612.8	0.117
November	12.4	508.7	0.117	14.5	657.7	0.119
December	13.5	533.4	0.117	15.3	661.9	0.119
Total	157.3	6,632.1	0.117	177.5	8,088.3	0.100

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

Materials, repair and maintenance expenses

General description

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

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

Materials, repair and maintenance expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Materials expenses	14,121	19,276	-26.7%	-5,155
Repair and maintenance	7,175	15,420	-53.5%	-8,245
Total	21,296	34,696	-38.6%	-13,401

Factors influencing changes

There was a 39 percent (GEL 13.4 million) decrease in total materials, repair and maintenance expenses. The decrease in materials expenses by 27 percent (GEL 5.2 million) was largely driven by reduced cargo turnover and fewer repair works. Besides, there was a 54 percent (GEL 8.2 million) decrease in repair and maintenance expenses that was also partly driven by a downturn in cargo volumes and unusually high levels of rolling stock repairs in 2015.

Fuel expenses

General description

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

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

Fuel expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Fuel expenses	4,306	5,807	-25.9%	-1,501

Factors influencing changes

Total fuel expenses decreased by 26 percent (GEL 1.5 million) in 2016, compared to 2015. This change was mainly caused by the reduced handling services driven by a reduction in transportation volume during the given period, while a decrease in fuel prices also contributed to reduced costs.

Freight car rental expenses

General description

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

Long-term rent expenses cover the long-term rent for 425 tank cars, rented since 30 March 2012. The daily rent price was set in USD.

Freight car rental expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Short-term rent	4,407	7,613	-42.1%	-3,206
Long-term rent	0	3,597	-100.0%	-3,597
Total	4,407	11,210	-60.7%	-6,803

Factors influencing changes

Despite the appreciation of CHF against GEL by about 2 percent in 2016 compared to 2015, freight car short-term rent expenses decreased by 42 percent (GEL 3.2 million). This decrease was largely driven by a fall in freight volume and by the agreement signed with Azerbaijan Railways to charge for freight car rental services with an exemption for the first eight days for each railcar.

The contract for the long-term rent of 425 tank cars expired in April 2015, therefore no such expenses were incurred in 2016.

Logistical services

General description

Expenses for logistical services refer to operating expenses relating to transportation and other logistics-related services of GR's subsidiaries, which are operating in freight forwarding and logistics fields. These expenses were separated from "security and other operating expenses" for purposes of simpler presentation.

Logistical services

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Logistical services	14,270	17,197	-17.0%	-2,927

Factors influencing changes

Expenses for logistical services in 2016 decreased by 17 percent (GEL 2.9 million) compared to 2015. The decrease was mainly caused by the overall transportation volume dropping by 16 percent.

Security and other operating expenses

General description

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

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

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

Security and other operating expenses

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Security	8,928	8,734	2.2%	194
Other op. expenses	9,589	10,095	-5.0%	-506
Total	18,517	18,829	-1.7%	-312

Factors influencing changes

The increase in security expenses in 2016, compared to 2015, was mostly due to the procurement of a new cash collection service, which was procured in 2016.

In 2016, compared to the previous year, the increase in security expenses was more than offset by the GEL 0.5 million decrease in other operating expenses resulting in a GEL 0.3 million decrease in total security and other operating expenses.

Taxes other than income tax

General description

Land taxes are determined by the municipalities in which the land is located, while property taxes are calculated at 1 percent of the 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

	2016	2015	% Change	Abs. change
Property tax	14,086	13,200	6.7%	886
Land tax	11,248	10,982	2.4%	266
Other taxes*	1,141	1,787	-36.2%	-646
Total	26,474	25,969	2.0%	505

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

Factors influencing changes

The increase in property tax by 7 percent (GEL 0.9 million) during the period under review was largely driven by the implementation of the Modernization Project. Property tax will be reduced after the Modernization Project is put into operation, as railway-related assets are free from property tax, and assets under the project are taxed according to property tax while under construction.

A decrease in other taxes of 36 percent (GEL 0.6 million) partly offset increases in property and land taxes in 2016.

5.5 Finance income and cost

General description

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

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

The main source of FX gain or loss is the Group's Eurobonds, which are denominated in USD. This is, however, partly countered by the Group's USD cash balances and receivables in foreign hard currencies. It must be noted that such FX gain or loss on Eurobonds is not monetary in nature and will not be realized until maturity, in addition it will be reversed in the event of GEL appreciation.

Finance income and cost

For the year ended 31 December

	<i>In GEL '000</i>			
	2016	2015	% Change	Abs. change
Interest income	23,882	20,932	14.1%	2,950
Impairment loss on trade receivables	-7,972	-28,627	-72.2%	20,655
Interest expenses	-52,822	-59,891	-11.8%	7,069
FX gain/loss	-112,309	-226,837	-50.5%	114,528
Total	-149,221	-294,423	-49.3%	145,202

Factors influencing changes

Net financial loss in 2016 decreased by 49 percent (GEL 145.2 million) compared to the previous year, which was mainly caused by a lower level of depreciation of GEL against USD in 2016, as the Group holds a significant amount of borrowings that are denominated in USD and debt revaluation has the greatest effect on foreign exchange gains and losses. In 2015, there was extremely high depreciation (29 percent) of GEL against USD (as at balance sheet dates 31 December 2015 against 31 December 2014), while GEL depreciated further in 2016 but only by 10 percent (31 December 2016 against 31 December 2015).

In 2016, there was a significant fall in impairment loss on trade receivables as the previous year had seen an abnormally high level of impairment loss on trade receivables, which was significantly driven by the impairment of receivables from the other party in the wagon rent contract. After the

termination of the contract for wagon rent in April 2015, the railcars remained at the Group's stations and generated revenue from the 24-hour service, however in 2015 a provision of about GEL 13 million was made against revenue from freight handling services.

A reduction in interest expenses was partly driven by faster implementation of modernization resulting in higher interest capitalization in 2016, compared to 2015, and was also partly caused by the maturity of Eurobonds (USD 27.5 million) in 2015 (which represented the remaining part of the initial USD 250 million issue in 2010 that was refinanced in 2012).

The Group is significantly exposed to foreign currency exchange rates, as its borrowings are denominated in USD. Although there was a decrease in foreign currency losses in 2016, these were still considerable (GEL 110.9 million), due to the depreciation of GEL against USD. The Group's revenues are mostly denominated in hard currencies, mainly in USD (90 percent) and CHF (3 percent) based on 2016 revenue. As most of the tariffs are set in USD, the Group's revenue creates a natural economic hedge against foreign exchange fluctuations.

5.6 Income tax benefits

General description

In May 2016, the Parliament of Georgia adopted amendments to the Tax Code of Georgia, according to which profit tax regulations will be modified to a "tax on distributed profits" model. The new tax code takes effect from 1 January 2017.

Income tax benefits

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Current tax expense				
Current year	5,532	5,052	9.5%	480
Deferred tax benefit				
Origination and reversal of temporary differences	0	-15,607	-100.0%	15,607
Change in recognized temporary differences (due to change in legislation)	-44,391	0	NM	-44,391
Total	-38,859	-10,555	268.2%	-28,304

Factors influencing changes

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

6. Balance Sheet

6.1 Non-current assets

Non-current assets

As at 31 December	In GEL '000			
	2016	2015	% Change	Abs. change
Property, plant and equipment	2,623,594	2,483,393	5.6%	140,201
Other non-current assets	147,565	147,998	-0.3%	-433
Deferred tax assets	0	1,094	-100.0%	-1,094
Loan receivable	35,717	0	NM	35,717
Total	2,806,876	2,632,485	6.6%	174,391

Factors influencing changes

Property, plant and equipment – A GEL 140.2 million increase in property, plant and equipment in 2016, compared to 2015, was mainly due to the Construction In Progress works, mostly within the scope of the Modernization Project and the purchase of new passenger trains.

Loan receivable - In 2016, the Group issued long-term loans amounting in total to USD 14.5 million. The loans were issued in USD, at market rates. USD 6 million was provided to the shareholder. USD 8.5 million was issued in 2016 to the owner of liquid cargo terminals on the Black Sea, which is under the management of the Group. The Group will manage the liquid cargo terminals for the whole lifespan of the loan for which it will receive a management fee.

6.2 Current assets

Current assets

As at 31 December	In GEL '000			
	2016	2015	% Change	Abs. change
Inventories	29,752	34,768	-14.4%	-5,016
Loan receivable	3,974	38,341	-89.6%	-34,367
Tax assets	7,129	10,993	-35.1%	-3,864
Trade and other receivables	99,649	70,645	41.1%	29,004
Prepayments and other current assets	350	11,901	-97.1%	-11,551
Cash and cash equivalents	277,953	294,784	-5.7%	-16,831
Total	418,807	461,432	-9.2%	-42,625

Factors influencing changes

Loan receivable - At the end of 2015, the Group issued a loan to a Government-owned entity, which was collected in full during 2016. Loan receivables as at the end of 2016 represent the current portion of the loans issued in 2016.

Trade and other receivables – Out of the total increase of GEL 29.8 million, an increase of GEL 23.7 million in 2016 was driven by the VAT receivable from the Government, created as a result of the land plots transfer transaction, mentioned in subheading 5.2 “Income from transferred property”.

Prepayments and other current assets – A decrease in prepayments and other current assets in 2016, compared to 2015, of GEL 11.6 million was mostly attributable to changes in the tax system in Georgia in 2016, under which tax cards were combined in one joint card. Accordingly, at the end of 2016, the Group presented all tax assets and liabilities netted, under “Tax assets”, while at the end of 2015 some tax assets were presented under “Prepayments and other current assets”.

6.3 Equity

Equity

As at 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Share capital	1,053,004	1,052,605	0.0%	399
Non-cash owner contribution reserve	98,312	34,214	187.3%	64,098
Retained earnings	447,960	384,391	16.5%	63,569
Total	1,599,276	1,471,210	8.7%	128,065

There was a GEL 128.1 million increase in total equity in 2016 compared to the previous year. This increase was mainly due to the land plots transfer transaction, mentioned in subheading 5.2 “Income from transferred property”.

6.4 Non-current liabilities

Non-current liabilities

As at 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Loans and borrowings	1,361,602	1,193,301	14.1%	168,301
Advances received from the Gov.	73,809	221,788	-66.7%	-147,979
Trade and other payables	0	52	-100.0%	-52
Deferred tax liability	0	43,928	-100.0%	-43,928
Total	1,435,411	1,459,069	-1.6%	-23,658

Factors influencing changes

Loans and borrowings - In 2016, the Group raised funds through export credit to finance the acquisition of four new passenger trains, two of which were delivered in 2016 and are currently in operation, while another two will be delivered and launched in the first quarter of 2017. The total credit facility was around USD 43.7 million and, as at the end of 2016, USD 23.2 million (equivalent to GEL 61.5 million) had been withdrawn, from which GEL 42.8 million was classified as non-current loans and borrowings. The remainder, GEL 1,318.8 million, of non-current loans and borrowings represents Eurobonds maturing in 2022.

Eurobonds and Export credit facility

For the year ended 31 December

Type	Date of maturity	Amount (in mln)	Currency	Coupon/percent	Payments
Eurobonds	11-Jul-22	500.0	USD	7.75%	Semi-annually
Export credit facility	10-Nov-26	23.2	USD	LIBOR+1.25%	Semi-annually

Advances received from the Government – These decreased, mainly due to land plots transfer transaction, mentioned in subheading 5.2 “Income from transferred property”.

Deferred tax liability - At the end of 2016, deferred tax liabilities had been eliminated through income tax benefits (see subheading 5.6 *Income tax benefit*).

6.5 Current liabilities

Current liabilities

For the year ended 31 December

			In GEL '000	
	2016	2015	% Change	Abs. change
Loans and borrowings	57,172	44,855	27.5%	12,317
Trade and other payables	109,638	89,258	22.8%	20,380
Liabilities to the Government	8,399	8,009	4.9%	390
Provisions	8,547	8,325	2.7%	222
Dividends payable	0	2,762	NM	-2,762
Other current liabilities	7,240	10,429	-30.6%	-3,189
Total	190,996	163,638	16.7%	27,358

Factors influencing changes

Loans and borrowings – Currently, the Group has two debts, Eurobonds and a secured loan, obtained for the sole purpose of the acquisition of passenger trains. As at 31 December 2016, current loans and borrowings include interest payable of about GEL 51.0 million and current portion of long-term borrowing, GEL 6.1 million, which was raised for financing new passenger trains. New funds borrowed in 2016 caused an increase in current loans and borrowings together with the appreciation of USD against GEL by 10.5 percent according to the balance sheet dates for 2016 and 2016, respectively.

Trade and other payables - In 2016, trade and other payables increased by 23 percent (GEL 20.4 million), and the main contributor to this increase was payables under the Modernization Project (GEL 17.6 million).

7. Cash flow statement

By the end of 2016, the Group held GEL 278.0 million of cash and cash equivalents. These cash resources are held to support existing and future capital expenditures. Capital expenditures mainly entail the Modernization Project and the Tbilisi Bypass Project. Works on the Modernization Project developed at a faster pace in 2016 compared to 2015, while the Tbilisi Bypass Project remained suspended.

The Group can also rely on its available credit lines of about GEL 161.4 million as at the end of 2016.

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

7.1 Operating activities

Operating activities

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Cash receipts from customers	456,742	564,849	-19.1%	-108,107
Cash paid to suppliers and employees	-264,102	-260,232	1.5%	-3,870
Income tax paid	-5,229	-5,121	2.1%	-108
Net cash from operating activities	187,411	299,496	-37.4%	-112,084

Factors influencing changes

Net cash from operating activities decreased by GEL 112.1 million in 2016, compared to 2015. This change was driven by a decrease in cash receipts from customers of GEL 108.1 million, mainly due to the decreased transportation volume.

7.2 Investing activities

Investing activities

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Acquisition of property, plant and equipment	-200,274	-156,993	27.6%	-43,281
Proceeds from sale of property, plant and equipment	3,350	0	NM	3,350
Interest received	22,435	20,992	6.9%	1,443
Issuance of loans	-32,563	-38,507	-15.4%	5,944
Repayment of issued loans	37,838	0	NM	37,838
Dividends received	1,075	0	NM	1,075
Net cash used in investing activities	-168,139	-174,508	-3.6%	6,369

Factors influencing changes

Cash paid for the acquisition of property, plant and equipment in 2016 increased by GEL 43.3 million compared to 2015. This increase was mainly due to the faster construction pace of the Modernization Project compared to 2015 and investments being made in new passenger trains.

The increased expenditure on property, plant and equipment was offset by cash inflows from other sources, which caused a decrease in net cash used in investing activities.

The increase in interest received was mainly due to the interest income from loan receivables and the higher average GEL/USD exchange rate.

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

Issuance of loans (GEL 32.6 million) in 2016 represent USD 6 million provided to the parent company and USD 8.5 million provided to the owner of a liquid cargo terminal on the Black Sea (*see subheading 6.1 Non-current assets*). Cash outflows of GEL 38.5 million (USD 16 million) in 2015 include a short-term loan that the Group provided to a state-controlled entity by the end of 2015, which was repaid in full in July 2016.

7.3 Financing activities

Financing activities

For the year ended 31 December

In GEL '000

	2016	2015	% Change	Abs. change
Interest paid	-91,948	-85,731	7.3%	-6,217
Dividends paid	-1,607	-21,852	-92.6%	20,245
Repayment of borrowings	0	-62,514	-100.0%	62,514
Proceeds from borrowings	42,349	0	NM	42,349
Net cash used in financing activities	-51,206	-170,097	-69.9%	118,891

Factors influencing changes

In 2016, compared to 2015, net cash used in financial activities decreased by GEL 118.9 million. This was mainly caused by the fact that in July 2015 the Group repaid USD 27.5 million - the remaining portion of the Eurobonds issued in 2010. Also in 2015, the Group paid GEL 21.9 million in dividends, while in 2016 the dividends paid amounted to GEL 1.6 million. In addition, in 2016 the Group had proceeds from borrowing (GEL 42.3 million) which includes a loan for the purchase of new passenger trains (*see subheading 6.4 Non-current liabilities*).

The amount of interest paid increased in 2016, compared to 2015, due to the higher GEL/USD exchange rate.

Appendix

Appendix 1

Breakdown of freight transportation in tons

For the year ended 31 December

In million tons

	2016	2015	% Change	Abs. change
Liquid cargoes	5.5	6.7	-18.6%	-1.3
Oil products	3.7	5.9	-37.4%	-2.2
Crude oil	1.8	0.9	109.3%	0.9
Dry cargoes	6.4	7.4	-13.6%	-1.0
Ores	1.5	1.5	-0.3%	0.0
Grain	0.4	0.7	-37.4%	-0.3
Ferrous metals and scrap	0.7	0.9	-25.7%	-0.2
Sugar	0.5	0.5	7.6%	0.0
Chemicals and fertilizers	0.4	0.5	-15.3%	-0.1
Construction freight	1.1	1.4	-25.3%	-0.4
Industrial freight	0.3	0.3	3.8%	0.0
Cement	0.1	0.1	-22.9%	0.0
Other	1.5	1.6	-5.9%	-0.1
Total	11.9	14.1	-16.0%	-2.3

Appendix 2

Breakdown of freight transportation in ton-kilometers

For the year ended 31 December

In million ton-kilometers

	2016	2015	% Change	Abs. change
Liquid cargoes	1,802	2,303	-21.8%	-502
Oil products	1,088	1,963	-44.6%	-875
Crude oil	714	341	109.5%	373
Dry cargoes	1,589	1,919	-17.2%	-329
Ores	311	329	-5.5%	-18
Grain	141	225	-37.5%	-84
Ferrous metals and scrap	163	248	-34.3%	-85
Sugar	184	168	9.8%	16
Chemicals and fertilizers	133	159	-16.4%	-26
Construction freight	142	213	-33.4%	-71
Industrial freight	39	54	-28.2%	-15
Cement	17	23	-25.4%	-6
Other	461	501	-8.0%	-40
Total	3,391	4,222	-19.7%	-831

Appendix 3

Calculations of ratio of Net Financial Indebtedness to EBITDA:

'000 GEL	Twelve-month period ended 31-December-16
Revenue	439,922
Income from the transferred property	80,294
Other income	19,122
Employee benefits expenses	-146,626
Depreciation and amortization expense	-106,267
Electricity, consumables and maintenance costs	-47,289
Other expenses	-63,668
Results from operating activities	175,488
Finance income	23,882
Finance costs	-173,103
Net finance costs	-149,221
Profit/(loss) before income tax	26,267
Income tax benefit	38,859
Profit/(loss)and total comprehensive income/(loss) for the year	65,126
Results from operating activities	175,488
Depreciation add-back	-106,267
EBITDA	281,755
Net Financial Indebtedness:	
Financial Indebtedness	1,418,774
less:	
Available Credit Facilities	161,400
Cash	277,953
Net Financial Indebtedness:	979,422
Net Financial Indebtedness/EBITDA	3.48

Glossary

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

BTC: Baku-Tbilisi-Ceyhan

BTK: Baku-Tbilisi-Kars

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

CEO: Chief Executive Officer

CFO: Chief Financial Officer

CIS: Commonwealth of Independent States

CJSC: Closed Joint Stock Company

CPC: The Caspian Pipeline Consortium

EBIT: Earnings before interest and tax

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

EMU: Electric Multiple Unit

EU: European Union

FEZ: Free Economic Zone

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

GDP: Gross Domestic Product

GEL: Georgian Lari

GMS: General Meeting of Shareholders

GR: Georgian Railway

JSC GRC: Georgian Railway Construction

LLC IFRS: International Financial Reporting Standards

JSC: Joint-stock Company

LLC: Limited Liability Company

NM: Not Meaningful

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

OTB: Open Top Box railcars

PPE: Property, plant and equipment

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

SBU: Strategic Business Unit

SEZ: Special Economic Zone

TEU: Twenty-Foot Equivalent Unit

Tetri: Minor unit of Georgian national currency

The Company: Georgian Railway

TITR: Trans-Caspian International Transport Route

The Government: The Government of Georgia

The Group: Georgian Railway and its subsidiaries

The State: Republic of Georgia

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

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

Consolidated Financial Statements



Georgian Railway JSC
Consolidated Financial Statements
for 2016

Contents

Independent Auditors' Report

Consolidated Statement of Financial Position 7

Consolidated Statement of Profit or Loss and Other Comprehensive Income 8

Consolidated Statement of Changes in Equity 9

Consolidated Statement of Cash Flows 10

Notes to the Consolidated Financial Statements 11



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

Independent Auditors' Report

To the Management Board of Georgian Railway JSC

Opinion

We have audited the consolidated financial statements of Georgian Railway JSC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

Key Audit Matters

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

Recoverability of construction of Tbilisi Bypass project	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
Tbilisi Bypass project has been suspended since October 2013. The related construction in progress represents 9% of the balance sheet total and significant judgment is involved in assessing its recoverability. Therefore, it is a key audit matter.	Our audit procedures included: <ul style="list-style-type: none">– assessing the physical condition of the construction in progress with the involvement of an independent management expert;– assessing whether there are necessary plans in place to undertake the construction under various scenarios discussed between the Government of Georgia and the Group. This included analysis of the decisions made by the Government of Georgia and the Group in respect of the Tbilisi Bypass project and review of the agreements signed with the main third party construction companies;

Recoverability of construction of Tbilisi Bypass project	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
	<ul style="list-style-type: none"> – assessing whether there are necessary resources in place to undertake the construction by analyzing the Group's cash flow forecasts; – considering the adequacy of the Group's disclosures about the uncertainties relating to the construction of Tbilisi Bypass project.

Impairment test of non-current assets	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
<p>In 2016, the Group experienced a significant decline in revenues and operating cash flows compared to the prior year. Consequently, the Group determined that there is an indication of impairment and conducted an impairment test of the Group's non-current assets. Although the recoverable amount of the Group's non-current assets was determined to be higher than its carrying amount, the impairment test includes a number of critical estimates and management judgment. Also considering the magnitude of the Group's property, plant and equipment on the balance sheet, we consider the impairment test a key audit matter.</p>	<p>Our audit procedures included:</p> <ul style="list-style-type: none"> – evaluating the main assumptions and methodology used for the impairment test with the involvement of our valuation specialists; – evaluating the consistency of the main inputs used in the impairment test with the Group's existing contracts and publicly available information on future trends in the industry and growth in economy both in Georgia and in the region. Main inputs include, but are not limited to, discount rate, terminal growth rate, forecasted volumes of transported goods, EBITDA margins and capital expenditure; – considering the adequacy of the Group's disclosures about the impairment test of non-current assets.

Fair value of the property transferred to the Government of Georgia	
Please refer to the Note 18 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
<p>Determination of the fair value of the property transferred to the Government of Georgia involves significant judgment and estimates. Other income resulting from that transfer represents 46% of the results from operating activities. Therefore, it is a key audit matter.</p>	<p>Our audit procedures included:</p> <ul style="list-style-type: none"> – evaluating the competence, capabilities and objectivity of the management expert commissioned for the measurement of the fair value; – evaluating the assumptions and methodologies used for the valuation of the transferred property, in particular, those that are based on unobservable inputs, such as size and location adjustments, with the involvement of our valuation specialists. – testing a sample of positions was performed by our valuation specialists with reference to alternative comparable property items. The results of the testing by our valuation specialists was compared to that calculated by the management expert; – considering whether the financial statement disclosures appropriately reflect the Group's approach for the measurement of the fair value of the property.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report but does not include the consolidated financial statements and our auditors' report thereon. The Annual Report is expected to be made available to us after the date of this auditors' report.

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

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

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

Irina Gevorgyan


KPMG Georgia LLC
5 May 2017



Georgian Railway JSC
Consolidated Statement of Financial Position as at 31 December 2016

'000 GEL	Note	2016	2015
Assets			
Property, plant and equipment	11	2,623,594	2,483,393
Deferred tax assets	10	-	1,094
Loans receivable	12	35,717	-
Other non-current assets	13	147,565	147,998
Non-current assets		2,806,876	2,632,485
Inventories	14	29,752	34,768
Loans receivable	12	3,974	38,341
Tax assets		7,129	10,993
Trade and other receivables	15	99,649	70,645
Prepayments and other current assets	16	350	11,901
Cash and cash equivalents	17	277,953	294,784
Current assets		418,807	461,432
Total assets		3,225,683	3,093,917
Equity			
Share capital	18(a)	1,053,004	1,052,605
Non-cash owner contribution reserve	18(b)	98,312	34,214
Retained earnings		447,960	384,391
Total equity		1,599,276	1,471,210
Liabilities			
Loans and borrowings	20	1,361,602	1,193,301
Advance received from the Government	18(e)	73,809	221,788
Trade and other payables		-	52
Deferred tax liabilities	10	-	43,928
Non-current liabilities		1,435,411	1,459,069
Loans and borrowings	20	57,172	44,855
Trade and other payables	21	109,638	89,258
Liabilities to the Government	18(c)	8,399	8,009
Provisions	22	8,547	8,325
Dividend payable	18(d)	-	2,762
Other current liabilities		7,240	10,429
Current liabilities		190,996	163,638
Total liabilities		1,626,407	1,622,707
Total equity and liabilities		3,225,683	3,093,917

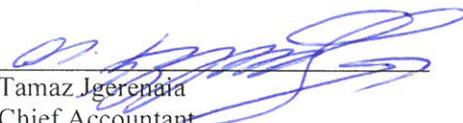
Georgian Railway JSC
Consolidated Statement of Profit or Loss and Other Comprehensive Income for 2016

'000 GEL	Note	2016	2015
Revenue	6	439,922	574,773
Income from the transferred property	18(e)	80,294	7,503
Other income		19,122	23,268
Employee benefits expense		(146,626)	(148,625)
Depreciation and amortization expense		(106,267)	(104,416)
Electricity, consumables and maintenance costs	7	(47,289)	(60,927)
Other expenses	8	(63,668)	(73,205)
Results from operating activities		175,488	218,371
Finance income	9	23,882	20,932
Finance costs	9	(173,103)	(315,355)
Net finance costs		(149,221)	(294,423)
Profit /(loss) before income tax		26,267	(76,052)
Income tax benefit	10	38,859	10,555
Profit /(loss) and total comprehensive income/(loss) for the year		65,126	(65,497)

These consolidated financial statements were approved by the Management Board on 5 May 2017 and were signed on its behalf by:


Mamuka Bakhtadze
General Director




Tamaz Jgerenaia
Chief Accountant

'000 GEL	Share capital	Non-cash owner contribution reserve	Retained earnings	Total equity
Balance at 1 January 2015	1,052,202	34,214	476,335	1,562,751
Total comprehensive loss for the year				
Loss and total comprehensive loss for the year	-	-	(65,497)	(65,497)
Transactions with owners, recorded directly in equity				
Dividends to equity holders (note 18(d))	-	-	(25,537)	(25,537)
Net non-cash contributions by and distributions to owners (note 18(a))	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
Balance at 1 January 2016	1,052,605	34,214	384,391	1,471,210
Total comprehensive income for the year				
Profit and total comprehensive income for the year	-	-	65,126	65,126
Transactions with owners, recorded directly in equity				
Increase in share capital (note 18 (a))	399	122	-	521
Non-cash owner contribution from owners (note 18 (d))	-	1,631	-	1,631
Reversal of deferred tax asset (note 10 (c))	-	-	(1,557)	(1,557)
Transfer of the property to the Government (note 18 (e))	-	62,345	-	62,345
Total transactions with owners, recorded directly in equity	399	64,098	(1,557)	62,940
Balance at 31 December 2016	1,053,004	98,312	447,960	1,599,276

Georgian Railway JSC
Consolidated Statement of Cash Flows for 2016

'000 GEL	Note	2016	2015
Cash flows from operating activities			
Cash receipts from customers		456,742	564,849
Cash paid to suppliers and employees		(264,102)	(260,232)
Cash flows from operations before income taxes paid		192,640	304,617
Income tax paid		(5,229)	(5,121)
Net cash from operating activities		187,411	299,496
Cash flows from investing activities			
Acquisition of property, plant and equipment		(200,274)	(156,993)
Proceeds from sale of property, plant and equipment		3,350	-
Interest received		22,435	20,992
Dividends received		1,075	-
Issuance of the loans		(32,563)	(38,507)
Repayment of the issued loans		37,838	-
Net cash used in investing activities		(168,139)	(174,508)
Cash flows from financing activities			
Proceeds from borrowings		42,349	-
Repayment of borrowings		-	(62,514)
Interest paid		(91,948)	(85,731)
Dividends paid		(1,607)	(21,852)
Net cash used in financing activities		(51,206)	(170,097)
Net decrease in cash and cash equivalents		(31,934)	(45,109)
Cash and cash equivalents at 1 January		294,784	300,983
Effect of exchange rate fluctuations on cash and cash equivalents		15,103	38,910
Cash and cash equivalents at 31 December	17	277,953	294,784

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 11 to 44.

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 28.

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 30 (h)(iii) – useful lives and residual values of property, plant and equipment;
- Note 23 (b)(ii) – impairment allowances for trade and other receivables;
- Note 17 – classification of deposits with original maturities of more than three months as cash and cash equivalents;
- Note 18 (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 11 (b) - impairment test: key assumptions underlying the recoverable amount of non-current assets;
- Note 23 (b)(ii) – recoverability of loans issued.

Measurement of fair values

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

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

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

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

- Note 23 (a) – fair value of financial assets and liabilities;
- Note 18 (e) – fair value of the land plots transferred to the Government of Georgia.

5. Operating segments

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

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

There are no inter-segment charges.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, which are the cost of maintaining the

rail network used by both reportable segments, central overheads, interest and income tax, as included in the internal management reports that are reviewed by the Group's Management Board. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. The Group's Management Board does not monitor segment liabilities.

(i) Information about reportable segments

'000 GEL	Freight transportation		Passenger transportation		Total	
	2016	2015	2016	2015	2016	2015
External revenues	412,116	552,298	18,007	15,487	430,123	567,785
Depreciation and amortization	(41,638)	(42,411)	(9,345)	(9,144)	(50,983)	(51,555)
Reportable segment profit/(loss) before infrastructure costs, net interest cost and income tax	249,699	378,494	(16,946)	(18,810)	232,753	359,684
Reportable segment assets	369,903	361,759	163,350	113,206	533,253	474,965
Capital expenditure and other additions to non-current assets	20,504	36,449	55,998	3,860	76,502	40,309

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

'000 GEL	2016	2015
Revenues		
Total revenue for reportable segments	430,123	567,785
Other revenue	9,799	6,988
Consolidated revenue	439,922	574,773
Profit or loss		
Total profit or loss for reportable segments	232,753	359,684
Employee benefits expense – infrastructure and headquarters	(58,266)	(58,539)
Depreciation expenses – infrastructure and headquarters	(55,284)	(52,861)
Net finance costs	(149,221)	(294,423)
Other net unallocated income/ (expenses)	56,285	(29,913)
Consolidated profit /(loss) before income tax	26,267	(76,052)
Assets		
Total assets for reportable segments	533,253	474,965
Property, plant and equipment - infrastructure and headquarters	2,128,459	2,033,350
Other unallocated assets, principally cash and non-current assets	563,971	585,602
Consolidated total assets	3,225,683	3,093,917

(iii) Other material items 2016

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

(iv) 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

(v) Geographical information

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

(vi) Major customer

In 2016 one customer of the Group's freight transportation segment represented approximately 13% of the Group's total revenue (GEL 57,190 thousand). In 2015 one customer of the Group's freight transportation segment represented approximately 22% of the Group's total revenue (GEL 125,727 thousand).

6. Revenue

'000 GEL	2016	2015
Freight traffic	345,586	471,951
Logistic services*	52,582	56,086
Passenger traffic	18,007	15,487
Freight car rental	13,948	24,261
Other	9,799	6,988
	439,922	574,773

* In 2016 the Group separated revenue generated from logistic services from the freight traffic revenue. As a result, comparatives were also amended.

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

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

states the general rules that apply to and modify tariffs. The agreed tariffs indicate the maximum level of tariffs applicable.

7. Electricity, consumables and maintenance costs

'000 GEL	2016	2015
Electricity	21,687	20,424
Materials	14,121	19,276
Repair and maintenance*	7,175	15,420
Fuel	4,306	5,807
	47,289	60,927

* During 2016 the Group reclassified repair and maintenance costs from other expenses to electricity, consumables and maintenance costs. This presentation is more consistent with the structure of the Group's operations. As a result, comparatives were also amended.

8. Other expenses

'000 GEL	2016	2015
Taxes other than income tax	26,474	25,969
Logistic services	14,270	17,197
Security	8,928	8,734
Freight car rental	4,407	11,210
Other	9,589	10,095
	63,668	73,205

9. Finance income and finance costs

'000 GEL	2016	2015
Recognised in profit or loss		
Interest income	23,882	20,932
Finance income	23,882	20,932
Impairment loss on trade receivables (note 23 (b)(ii))	(7,972)	(28,627)
Interest expense	(52,822)	(59,891)
Net foreign exchange loss	(112,309)	(226,837)
Finance costs	(173,103)	(315,355)
Net finance costs recognised in profit or loss	(149,221)	(294,423)

10. Income tax benefit

(a) Amounts recognized in profit or loss

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

'000 GEL	2016	2015
Current tax expense		
Current year	5,532	5,052
	5,532	5,052
Deferred tax benefit		
Origination and reversal of temporary differences	-	(15,607)
Change in recognised temporary differences (due to change in the legislation)	(44,391)	-
	(38,859)	(10,555)

Reversal of previously recognized deferred tax assets and liabilities is attributable to changes in Georgian tax legislation. On 13 May 2016 the Parliament of Georgia passed a bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly transfers the moment of taxation from when taxable profits are earned to when they are distributed. The law is effective for tax periods starting after 1 January 2017. Considering that the change in the Georgian Tax Code was enacted before the reporting date, the Group has recognized the full effect of the change by derecognizing previously recognized deferred tax assets and liabilities through either the current period consolidated statement of profit or loss or through the retained earnings, depending on where the deferred tax was initially recognized. The deferred tax assets and liabilities initially recognized in equity as part of the Group's transition to IFRSs was reversed through the consolidated statement of profit or loss.

Reconciliation of effective tax rate:

	2016		2015	
	'000 GEL	%	'000 GEL	%
Profit /(loss) before income tax	26,267	100	(76,052)	100
Income tax at applicable tax rate	3,940	15	(11,408)	15
Net non-deductible expenses	-	-	853	(1)
Change in recognised temporary differences (due to change in the legislation)	(42,799)	(163)	-	-
	(38,859)	(148)	(10,555)	14

(b) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

'000 GEL	Assets		Liabilities		Net	
	2016	2015	2016	2015	2016	2015
Property, plant and equipment	-	-	-	(102,133)	-	(102,133)
Other non-current assets	-	-	-	(297)	-	(297)
Inventories	-	10,919	-	-	-	10,919
Trade and other receivables	-	21,136	-	-	-	21,136
Prepayments and other current assets	-	1,636	-	-	-	1,636
Loans and borrowings	-	6,277	-	-	-	6,277
Trade and other payables	-	120	-	-	-	120
Provisions	-	1,249	-	-	-	1,249
Other current liabilities	-	1,041	-	-	-	1,041
Tax loss carry-forwards	-	17,218	-	-	-	17,218
Tax assets/(liabilities)	-	59,596	-	(102,430)	-	(42,834)
Set off of tax	-	(58,502)	-	58,502	-	-
Net tax assets/(liabilities)	-	1,094	-	(43,928)	-	(42,834)

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

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

'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)

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 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
Balance at 1 January 2016	545,471	130,003	903,552	902,225	748,482	3,229,733
Additions	206	681	700	70,640	182,052	254,279
Disposals and write offs	(3,917)	(1,041)	(12,423)	(10,646)	(1,372)	(29,399)
Transfers	102	198	48,437	5,845	(54,582)	-
Balance at 31 December 2016	541,862	129,841	940,266	968,064	874,580	3,454,613
Depreciation						
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
Balance at 1 January 2016	-	29,203	291,436	425,701	-	746,340
Depreciation for the year	-	4,210	44,025	57,853	-	106,088
Disposals and write offs	-	-	(12,167)	(9,242)	-	(21,409)
Balance at 31 December 2016	-	33,413	323,294	474,312	-	831,019
Carrying amounts						
At 1 January 2015	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
At 31 December 2016	541,862	96,428	616,972	493,752	874,580	2,623,594

(a) Construction in progress

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 20).

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% (2015: 8%). Capitalised borrowing costs during 2016 related to the Main Line Modernization project amounted to GEL 42,536 thousand (2015: GEL 33,310 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.

During 2015 and 2016, the Group was in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. The most recent scenarios under discussion include an option envisaging a change of the original bypass location, because of which the existing bypass infrastructure may become redundant. As at 31 December 2016 and the date these consolidated financial statements were authorized for issue, no decision was made by the Government of Georgia about the redesign of the Tbilisi Bypass project. The Group has not yet developed the plan how this redundant infrastructure may be used in future in case the above mentioned scenario is approved by the Government. Currently, an independent management expert is performing feasibility study for the most recent scenarios of the completion of the Bypass project discussed with the Government. The feasibility study also includes determination of the future use of the existing infrastructure, should it become redundant. The options of future use of the infrastructure are bypass automobile road, light rail/extension of the Tbilisi Metro System, freight depot. The feasibility study is not completed as at the date these consolidated financial statements were authorized for issue.

The Group extended construction contract with the main third party construction companies to allow for the final decision to be made with regards to the project.

(b) Impairment test

At 31 December 2016, due to decline of net operating cash flows in 2016 compared to prior year, the Group determined that there is an indication of impairment of the Group's non-current assets (referred as "the CGU"). The recoverable amount of the CGU was based on its value in use, determined by discounting future cash flows to be generated from the continuing use of the CGU. The recoverable amount of the CGU was determined to be higher than its carrying amount and, respectively, no impairment loss was recognized.

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

- Cash flows are projected based on actual operating results and the Group's five-year business plan. A long-term growth rate for the terminal period is determined as approximate long-term economy growth forecast for Georgia and the region affecting the Group's operations;
- Cash flows include annual maintenance capital expenditure and payments for the finalization of the modernization project and bypass project under original scenario;
- A pre-tax discount rate of 9.9% is applied in determining the recoverable amount of the CGU. The discount rate reflects the required rate of return for the cash flows on the invested capital of similar companies denominated in USD.

The above estimates are particularly sensitive towards changes in the discount rate. An increase of 1% point in the discount rate used would have resulted in an impairment loss of approximately GEL 100 million.

(c) Capital contributions

The Government of Georgia contributes certain property, plant and equipment in the form of an increase in share capital. In 2016 and 2015 the share capital has been increased by the fair value of these assets of GEL 521 thousand and GEL 402 thousand respectively (see note 18 (a)).

(d) Security

At 31 December 2016 property with a carrying amount of GEL 52,330 thousand (2015: none) is pledged in respect of the secured loan (see note 20).

12. Loans receivable

This note provides information about the contractual terms of the Group's interest-bearing loans receivable, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and credit risk, see note 23.

'000 GEL	2016	2015
Non-current assets		
Entity managed by the Group*	18,901	-
Parent company	16,816	-
	35,717	-
Current assets		
Entity managed by the Group*	3,974	-
State controlled entity	-	38,341
	3,974	38,341

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

'000 GEL	Currency	Nominal interest rate	Year of maturity	31 December 2016		31 December 2015	
				Face value	Carrying amount	Face value	Carrying amount
State controlled entity	USD	10.5%	2016	-	-	38,341	38,341
Entity managed by the Group*	USD	10%	2023	22,875	22,875	-	-
Parent company	USD	9.75%	2021	16,816	16,816	-	-
Total interest-bearing assets				39,691	39,691	38,341	38,341

* The loan is issued to a terminal storage company, which is under the management of the Group until 2023.

13. Other non-current assets

'000 GEL	2016	2015
Prepayments for non-current assets	100,976	88,341
Construction materials	43,457	56,232
Goodwill	46	46
Other	3,086	3,379
	147,565	147,998

14. Inventories

'000 GEL	2016	2015
Materials	26,727	30,347
Fuel	2,105	2,086
Rails	1,499	2,109
Other	2,857	4,203
	33,188	38,745
Allowance for inventory obsolescence	(3,436)	(3,977)
	29,752	34,768
Reversal of previous write-down of inventories	540	227

15. Trade and other receivables

'000 GEL	2016	2015
Trade receivables	227,117	210,519
Impairment allowance on trade receivables	(151,372)	(140,846)
	75,745	69,673
Receivable from the Government (note 18 (e))	23,690	-
Other receivables	214	972
	99,649	70,645

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 23.

16. Prepayments and other current assets

'000 GEL	2016	2015
Taxes, other than on income	-	10,906
Advances paid to suppliers	350	995
	350	11,901

17. Cash and cash equivalents

'000 GEL	2016	2015
Current accounts in banks	222,047	142,953
Call deposits	55,837	151,770
Petty cash	69	61
Cash and cash equivalents in the consolidated statement of financial position and the consolidated statement of cash flows	277,953	294,784

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

The Group's exposure to interest rate risk is disclosed in note 23.

18. Equity and liabilities to the Government

(a) Share capital

<i>Number of shares</i>	Ordinary shares	
	2016	2015
In issue at 1 January	1,052,604,503	1,052,202,448
Issued for property, plant and equipment (see note 11 (c))	399,172	402,055
In issue at 31 December, fully paid	1,053,003,675	1,052,604,503
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	2016	2015
Liabilities to the Government	8,399	8,009

(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. In 2016 no dividends were declared. In 2016, according to the Government's decision, the dividend payable of GEL 1,631 thousand was set off with the costs incurred by the Group on the construction of Batumi Station infrastructure and was recognized directly in equity as a non-cash owner contribution. The remaining dividend payable was set off with the Group's payment for the acquisition of the property and equipment for the state controlled entity, as decided 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 701,281 square meter 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.

(i) Transfer of the property to the Government

In 2016 and 2015 the Company transferred 89,166 and 3,266 square meter land plots with attached constructions, respectively, to the Government within the framework of the Bypass Project Memorandum. The fair value of these land plots with attached constructions was determined by an independent appraiser based on announced asking prices of similar properties in the similar location and physical condition. The fair value estimate is categorized into Level 3 of the fair value hierarchy, because of significant unobservable adjustments used in the valuation methods. The significant unobservable inputs related to the differences in the characteristics of the properties, such as size, location, access to the property and discount achieved through negotiation, for which the appraiser applied 0% to 15% adjustments to observed asking prices.

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

'000 GEL	2016	2015
Cost of the transferred property, as agreed between the Group and the Government	147,979	7,588
Less: fair value of the transferred property	(85,634)	(7,588)
Recognized in non-cash owner contribution reserve	62,345	-
Fair value of the transferred property	85,634	7,588
Less: carrying value of the transferred property	(5,340)	(85)
Recognized as income from the transferred property	80,294	7,503

The Group has recognized receivable of GEL 23,690 thousand (see note 15) as a result of the transfer of the property to the Government, as according to the Bypass Project Memorandum, the Government will reimburse the Group for the value added tax payable incurred on such transfers.

19. 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.

20. 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 23.

'000 GEL	2016	2015
<i>Non-current liabilities</i>		
Secured loan	42,788	-
Unsecured bonds	1,318,814	1,193,301
Loans and borrowings	1,361,602	1,193,301
<i>Current liabilities</i>		
Secured loan	6,959	-
Current portion of unsecured bonds	50,213	44,855
Loans and borrowings	57,172	44,855

Terms and debt repayment schedule

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

'000 GEL	Currency	Nominal interest rate	Year of maturity	31 December 2016		31 December 2015	
				Face value	Carrying amount	Face value	Carrying amount
Unsecured bonds	USD	7.8%	2022	1,369,027	1,369,027	1,238,156	1,238,156
Secured loan	USD	Libor +1.25%	2026	49,747	49,747	-	-
Total interest-bearing liabilities				1,418,774	1,418,774	1,238,156	1,238,156

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. The 2010 Notes were fully repaid in 2015.

The secured loan was obtained for the sole purpose of the acquisition of passenger trains. The secured loan is collateralized by the underlying passenger trains of GEL 52,330 thousand (see note 11 (d)).

21. Trade and other payables

'000 GEL	2016	2015
Trade payables	91,252	73,064
Advances received from customers	18,386	16,194
	109,638	89,258

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 23.

22. Provisions

'000 GEL	2016	2015
Balance as at 1 January	8,325	6,447
Net provisions made during the year	222	1,878
Balance at 31 December	8,547	8,325

The Group recognised a provision for the estimated cash outflow required to settle legal cases against the Group existing as at 31 December 2016 as well as to settle the legal obligations towards the employees injured during the performance of their duties.

23. Fair values and risk management

(a) Fair value of financial assets and liabilities

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

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

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

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

(b) Financial risk management

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

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

(i) Risk management framework

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

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

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

(ii) Credit risk

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

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

'000 GEL	Carrying amount	
	2016	2015
Cash and cash equivalents	277,884	294,723
Trade receivables	75,745	69,673
Loans receivable	39,691	38,341
Receivable from the Government	23,690	-
	417,010	402,737

Cash and cash equivalents

The Group usually holds the funds with the banks with good credit ratings. As at 31 December 2016, approximately 48% of the bank balances are held 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.

Trade receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the factors that may influence the credit risk of the Group's customer base, including the default risk of the industry and country, in which customers operate, particularly in the currently deteriorating economic circumstances. Approximately 13% (2015: 22%) of the Group's revenue is attributable to sales transactions with a single customer.

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

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

No collateral in respect of trade receivables is generally required.

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

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

'000 GEL	Carrying amount	
	2016	2015
CIS countries	57,152	54,544
Domestic	18,593	15,129
	75,745	69,673

The Group's two most significant customers account for GEL 55,880 thousand of the trade receivables carrying amount as at 31 December 2016 (2015: GEL 41,143 thousand).

Impairment losses

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

'000 GEL	Gross 2016	Impairment 2016	Gross 2015	Impairment 2015
Past due 0- 90 days	18,697	5,434	9,319	8,040
Past due 91-180 days	4,251	1,294	18,814	9,988
Past due 181-365 days	8,920	3,547	37,636	18,355
Past due more than one year	195,249	141,097	144,750	104,463
	227,117	151,372	210,519	140,846

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

'000 GEL	2016	2015
Balance at beginning of the year	140,846	104,463
Increase during the year	7,972	28,627
Write off during the year	(1,333)	-
Net foreign exchange loss	3,887	7,756
Balance at end of the year	151,372	140,846

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 2016 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 44,721 thousand (2015: GEL 42,024 thousand) relate to freight car rental customers with which the Group incurs freight car rental expense and related payables. These receivables and payables are periodically net settled.

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

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

Loans receivable

As at 31 December 2016, the Group has issued loans to the parent company and the entity managed by the Group (see note 12). None of the loans are fully secured.

Management believes that the Group is not exposed to a significant amount of credit risk relating to the parent company loan, as the loan is neither past due nor impaired as at 31 December 2016 and there are no indications that the parent company will fail to meet its obligations, when they fall due.

Scheduled principal and interest payments of around GEL 1.5 million of the loan receivable from the entity managed by the Group are past due as at 31 December 2016. However, management believes,

that as at 31 December 2016 the loan is fully recoverable and the counterparty will be able to follow the loan repayment schedule during 2017 and following years up to the loan maturity. Management bases own analysis on the subsequent payments made in 2017 and the improved financial results of the counterparty subsequent to the reporting date.

Receivable from the Government

The Group has incurred receivable of GEL 23,690 thousand as a result of the transfer of the property to the Government (note 18 (e)). Management believes that the Group is not exposed to a significant amount of credit risk relating to this receivable as the Government is legally committed to reimburse the value added tax payable on the transfer of the property within the framework of Bypass Project Memorandum.

(iii) Liquidity risk

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

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

As at 31 December 2016, the Group maintains a committed credit line of GEL 161,400 thousand.

The Group has significant contractual commitments to purchase property, plant and equipment (see note 26) 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.

2016

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Secured loan	49,747	75,725	4,422	3,954	7,795	22,921	36,633
Unsecured bonds	1,369,027	1,938,781	51,282	51,282	102,564	307,691	1,425,962
Trade payables	91,252	91,252	91,252	-	-	-	-
Other current liabilities	7,240	7,240	7,240	-	-	-	-
	1,517,266	2,112,998	154,196	55,236	110,359	330,612	1,462,595

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

(iv) Market risk

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

Currency risk

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

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

Exposure to currency risk

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

'000 GEL	USD - denominated 2016	CHF - denominated 2016	USD - denominated 2015	CHF - denominated 2015
Cash and cash equivalents	182,617	499	142,233	324
Loan receivable	39,691	-	38,341	-
Trade receivables	234	57,152	494	54,544
Secured loan	(49,747)	-	-	-
Unsecured bonds	(1,369,027)	-	(1,238,156)	-
Trade and other payables	(10,591)	-	(5,717)	-
Net exposure	(1,206,823)	57,651	(1,062,805)	54,868

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2016	2015	2016	2015
USD 1	2.37	2.27	2.65	2.39
CHF 1	2.40	2.36	2.60	2.42

Sensitivity analysis

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

'000 GEL	Profit or loss
2016	
USD (10% weakening)	(120,682)
CHF (10% weakening)	5,765
2015	
USD (30% weakening)	(318,842)
CHF (30% weakening)	16,460

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

(v) **Interest rate risk**

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

Exposure to interest rate risk

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

'000 GEL	Carrying amount	
	2016	2015
Fixed rate instruments		
Financial assets	95,527	190,111
Financial liabilities	(1,369,027)	(1,238,156)
	(1,273,500)	(1,048,045)
Variable rate instruments		
Financial liabilities	(49,747)	-
	(49,747)	-

Fair value sensitivity analysis for fixed rate instruments

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

Cash flow sensitivity analysis for variable rate instruments

A reasonably possible change of 100 basis points in interest rates at the reporting date would have affected profit or loss by GEL 497 thousand. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

24. Subsidiaries

Subsidiary	Country of incorporation	Principal activities	2016 Ownership/ voting	2015 Ownership/ voting
GR Property Management LLC (former Railway Property Management LLC)	Georgia	Property management and development	100%	100%
GR Logistics and Terminals LLC (former Trans Caucasus Terminals LLC)	Georgia	Container transportation	100%	100%
Georgian Railway Construction JSC	Georgia	Construction and other projects	100%	100%
Borjomi Bakuriani Railway LLC	Georgia	Transportation services	100%	100%
Georgia Transit LLC	Georgia	Transportation services	100%	100%
GR Transit Line LLC	Georgia	Transportation services	100%	100%
GR Trans Shipment LLC	Georgia	Transportation services	100%	100%
GR Transit LLC (former Georgian Transit LLC)	Georgia	Transportation services	100%	100%

25. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

'000 GEL	2016	2015
Less than one year	4,499	4,832
Between one and five years	6,663	5,686
More than five years	19,288	17,754
	30,450	28,272

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.

26. Capital commitments

As at 31 December 2016 the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 612,862 thousand (2015: GEL 601,905 thousand) mainly relating to the Main Line Modernization project of GEL 335,250 thousand (2015: GEL 396,012 thousand) and Tbilisi Bypass project of GEL 211,476 thousand (2015: GEL 196,662 thousand).

27. Contingencies

(a) Insurance

The insurance industry in Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its property, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

(b) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(c) Litigation

In the ordinary course of business, the Group is subject to legal actions, litigations and complaints. Management believes that the ultimate liability, 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.

28. Related parties

(a) Parent and ultimate controlling party

At 31 December 2016 and 2015 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	2016	2015
Salaries and bonuses	1,093	1,132

(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 1,379 thousand for 2016 (2015: GEL 1,376 thousand). The Group also purchases security services from a state agency which amounted to GEL 8,968 thousand for 2016 (2015: GEL 8,741 thousand). The Group usually does not have significant balances for these purchases.

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

(iii) Loans issued

'000 GEL	Transaction value for the year ended 31 December		Outstanding balance as at 31 December	
	2016	2015	2016	2015
Loans issued:				
Parent company	12,884	-	16,816	-
State controlled entity	-	38,507	-	38,341

During 2016 interest income of GEL 851 thousand (2015: GEL 22 thousand) was recognised in profit and loss in respect of related party loans.

(iv) Credit line

As at 31 December 2016 the Group has unused credit line of USD 7 million from the parent company (2015: none). The credit line bears interest rate of 10% per annum and matures in June, 2017.

29. 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.

30. 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 acquiree; less
- The net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

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

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

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

(ii) Subsidiaries

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

(iii) Transactions eliminated on consolidation

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

(b) Revenue

(i) Transportation activities

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

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

(ii) Commissions

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

(iii) Rental income

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

(c) Other expense

(i) Lease payments

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

(ii) Social expenditure

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

(d) Finance income and costs

The Group's finance income and finance costs include:

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

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

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

(e) Foreign currency

(i) Foreign currency transactions

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

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

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

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

(f) Income tax

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

(i) Current tax

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

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly transfers the moment of taxation from when taxable profits are earned to when they are distributed. The law has entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective from 1 January 2019.

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

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

(ii) Deferred tax

Due to the nature of the new taxation system described above, the entities registered in Georgia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise.

(g) Inventories

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

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

(h) Property, plant and equipment

(i) Recognition and measurement

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

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

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

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

(ii) Subsequent costs

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

Maintenance and repair expenses are recognised as follows:

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

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

(iii) Depreciation

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

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

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

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

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

(i) Financial instruments

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

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

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

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

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

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

Loans and receivables

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

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

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and highly liquid investments with maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value. Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the

deposits within a few days of providing notification without incurring significant penalties or loss of interest.

(ii) *Non-derivative financial liabilities-measurement*

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

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

(iii) *Share capital*

Ordinary shares

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

Increase of share capital

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

Reduction of share capital

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

(j) *Impairment*

(i) *Non-derivative financial assets*

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

Objective evidence that financial assets are impaired can include:

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

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

are not individually significant are collectively assessed for impairment by grouping together loans and receivables with similar risk characteristics.

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

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

(ii) Non-financial assets

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

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

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

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

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

(k) Employee benefits

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

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

(l) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash

flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(m) Segment reporting

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

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

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

31. 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 2016, 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 has not completed an initial assessment of the potential impact of the adoption of IFRS 15 on its consolidated financial statements.
- IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases. 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. 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.

- Disclosure Initiative (Amendments to IAS 7) requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The amendments are effective for annual periods beginning on or after 1 January 2017, with early adoption permitted. To satisfy the new disclosure requirements, the Group intends to present a reconciliation between the opening and closing balances for liabilities with changes arising from financing activities.