Georgian Railway
Est. 1872

Management Discussion and Analysis for the nine months ended 30 September 2018

Financial and non-financial highlights

Revenue

Q3 2018	9M 2018
115,627	**314,219**
+6% from Q3 2017 +13% from Q2 2018	+4% from 9M 2017

Result from operating activities

Q3 2018	9M 2018
28,827	**47,626**
+54% from Q3 2017 +165% from Q2 2018	+9% from 9M 2017

EBITDA

Q3 2018	9M 2018
58,117	**136,248**
+19% from Q3 2017 +42% from Q2 2018	+8% from 9M 2017

EBITDA margin

Q3 2018	9M 2018
50.26%	**43.36%**
+5 points from Q3 2017 +10 points from Q2 2018	+2 points from 9M 2017

Adjusted EBITDA

Q3 2018	9M 2018
51,994	**122,610**
+11% from Q3 2017 +42% from Q2 2018	+4% from 9M 2017

Adjusted EBITDA margin

Q3 2018	9M 2018
45.97%	**39.02%**
+2 points from Q3 2017 +9 points from Q2 2018	0 points from 9M 2017

Net debt to EBITDA

30 September 2018

4.82

3.59 as at 30-Sep-2017
4.51 as at 30-Jun-2018

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1.Profit or Loss Statement

Profit and loss statement

9 month period ended 30 September

GEL '000	Q3 2018	Q3 2017	y-o-y	Q2 2018	q-o-q	9M 2018	9M 2017	y-o-y % change	y-o-y Abs. change
Revenue	115,627	108,967	6.1%	102,082	13.3%	314,219	303,297	3.6%	10,922
Other income	8,672	3,595	141.2%	4,497	92.8%	17,449	13,478	29.5%	3,971
Employee benefits expense	-36,292	-35,559	2.1%	-37,411	-3.0%	-110,280	-109,394	0.8%	-887
Depreciation and amortization	-29,289	-30,297	-3.3%	-30,079	-2.6%	-88,622	-82,273	7.7%	-6,349
Electricity, consumables and maintenance costs	-12,358	-10,383	19.0%	-10,423	18.6%	-32,903	-31,682	3.9%	-1,221
Other expenses	-17,532	-17,575	-0.2%	-17,778	-1.4%	-52,237	-49,861	4.8%	-2,375
Result from operating activities	**28,827**	**18,747**	**53.8%**	**10,889**	**164.7%**	**47,626**	**43,565**	**9.3%**	**4,061**
Net finance income/loss	**-84,694**	**-40,969**	**106.7%**	**-14,134**	**499.2%**	**-27,834**	**50,677**	**-154.9%**	**-78,511**
Profit before income tax	**-55,866**	**-22,222**	**151.4%**	**-3,245**	**1621.4%**	**19,792**	**94,242**	**-79.0%**	**-74,450**
Income tax expense(benefit)	-332	-94	252.6%	-865	-61.6%	-1,546	-542	185.1%	-1,004
Profit and total comprehensive income	**-56,198**	**-22,316**	**151.8%**	**-4,111**	**1267.1%**	**18,246**	**93,700**	**-80.5%**	**-75,454**
EBITDA	58,117	49,045	18.5%	40,968	41.9%	136,248	125,838	8.3%	10,410
EBITDA margin	50.26%	45.0%	NA	40.1%	NA	43.36%	41.5%	NA	1.9%
Adjusted EBITDA	51,994	46,698	11.3%	36,621	42.0%	122,610	118,048	3.9%	4,563
Adjusted EBITDA Margin	44.97%	42.9%	NA	35.9%	NA	39.02%	38.9%	NA	0.1%

1.1 Revenue

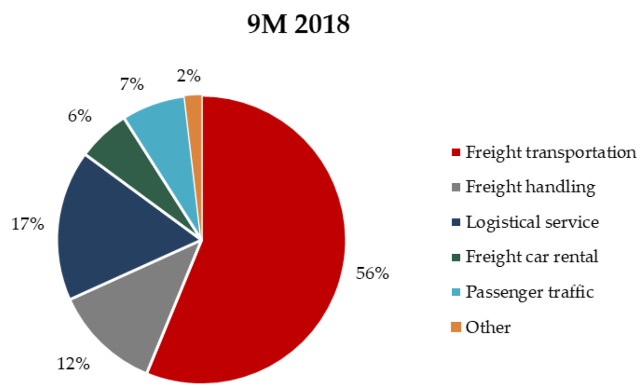
Revenue breakdown

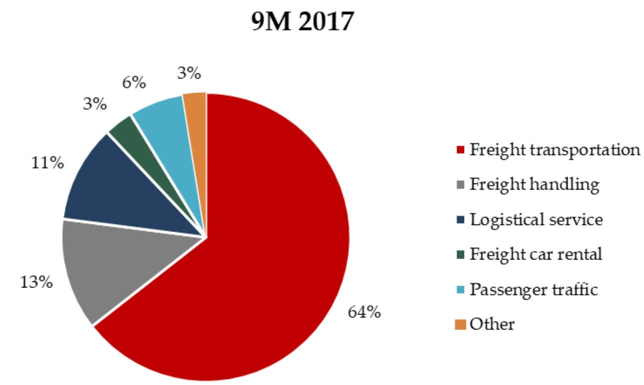
9 month period ended 30 September

GEL '000	Q3 2018	Q3 2017	y-o-y	Q2 2018	q-o-q	9M 2018	9M 2017	% Change	% Change at constant currency	Abs. Change
Freight transportation*	61,152	68,538	-10.8%	60,391	1.3%	176,620	195,474	-9.6%	-9.9%	-18,854
Freight handling*	12,851	13,201	-2.7%	12,614	1.9%	37,795	38,174	-1.0%	-1.3%	-379
Logistical service*	20,331	10,462	94.3%	16,921	20.1%	52,983	33,203	59.6%	59.1%	19,780
Freight car rental	6,506	4,044	60.9%	4,846	34.2%	18,523	9,910	86.9%	86.4%	8,612
Passenger traffic	12,997	10,846	19.8%	5,240	148.0%	22,463	18,787	19.6%	19.2%	3,676
Other	1,790	1,876	-4.6%	2,070	-13.5%	5,835	7,749	-24.7%	-24.9%	-1,914
Revenue	**115,627**	**108,967**	**6.1%**	**102,082**	**13.3%**	**314,219**	**303,297**	**3.6%**	**3.3%**	**10,922**
Other income	**8,672**	**3,595**	**141.2%**	**4,497**	**92.8%**	**17,449**	**13,478**	**29.5%**	**29.1%**	**3,971**
Freight transportation	**61,152**	**68,537**	**-10.8%**	**60,391**	**1.3%**	**176,620**	**195,474**	**-9.6%**	**-9.9%**	**-18,854**
Liquid cargoes	**27,082**	**29,983**	**-9.7%**	**22,754**	**19.0%**	**74,414**	**86,586**	**-14.1%**	**-14.3%**	**-12,172**
Oil products	26,553	28,949	-8.3%	21,374	24.2%	71,627	80,134	-10.6%	-10.9%	-8,506
Crude oil	529	1,034	-48.9%	1,380	-61.7%	2,787	6,453	-56.8%	-56.9%	-3,666
Dry cargoes	**34,070**	**38,554**	**-11.6%**	**37,636**	**-9.5%**	**102,206**	**108,887**	**-6.1%**	**-6.4%**	**-6,682**
Ores	6,746	7,357	-8.3%	7,359	-8.3%	20,591	19,779	4.1%	3.8%	811
Grain	911	1,982	-54.0%	1,192	-23.6%	5,624	5,959	-5.6%	-5.9%	-334
Ferrous metals and scrap	2,533	3,170	-20.1%	2,254	12.4%	6,928	8,291	-16.4%	-16.7%	-1,362
Sugar	1,995	2,499	-20.2%	4,810	-58.5%	6,994	10,833	-35.4%	-35.6%	-3,838
Chemicals and fertilizers	3,056	3,687	-17.1%	3,535	-13.6%	10,330	8,900	16.1%	15.7%	1,429
Construction freight	1,476	1,970	-25.0%	1,501	-1.7%	4,708	5,312	-11.4%	-11.6%	-604
Industrial freight	1,274	1229.5686	3.6%	1,856	-31.4%	3,927	3,733	5.2%	4.9%	194
Cement	437	381.1369	14.5%	490	-10.9%	1,262	1,050	20.2%	19.9%	212
Other	15,643	16,278	-3.9%	14,638	6.9%	41,842	45,030	-7.1%	-7.3%	-3,189
Freight turnover (million ton-km)	651	716	-9.0%	672	-3.0%	1,960	2,218	-11.6%	-11.9%	-258
Revenue / ton-km (in Tetri)	9.39	9.58	-1.9%	8.99	4.4%	9.01	8.81	2.3%	2.0%	0.20

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

The following charts represent revenue breakdown for the nine months ended 30 September 2018 and 2017:





Freight transportation revenue

Most of the Group's revenue (about 56 percent in first 9 months of 2018) is derived from freight transportation. GR's freight transportation revenue consists of liquid and dry cargoes. The split between liquid and dry cargo revenue in first 9 months of 2018 was about 42 and 58 percent, respectively.

Freight transportation revenue, has decreased by 10 percent (GEL 18.9 million) during the nine months ended 30 September 2018, compared to the same period of the previous year.

	Average rate			*Reporting date spot rates*			
	9M 2018	**9M 2017**	**% Change**	**30-Sep-18**	**31-Dec-17**	**30-Sep-17**	**31-Dec-16**
USD	2.49	2.48	0.28%	2.62	2.59	2.48	2.65
CHF	2.56	2.52	1.55%	2.68	2.66	2.55	2.60

The Group's transportation revenue depends on several factors, including GEL/USD exchange rate as the Group's tariffs for freight transportation are denominated in USD. Fluctuations in GEL/USD exchange rate also affect the Group's profitability, as significant part of the expenses are denominated in GEL.

Total freight volume transported by the Group during the nine months ended 30 September 2018 has decreased by 6 percent, compared to the same period of the previous year. Transported volumes of liquid cargo has decreased by 25 percent, while transported volumes of dry cargo has increased by 8 percent (*see Appendix 1*).

Oil Products

9 month period ended 30 September

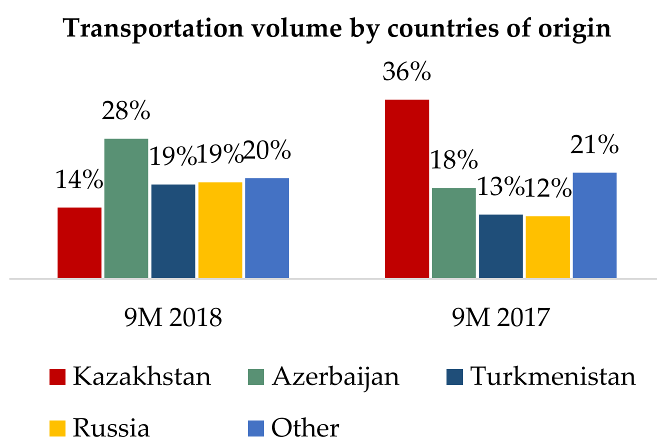
	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	71,627	80,134	-10.6%	-10.9%
Freight volume (ton '000)	2,335	2,970	-21.4%	NA
Freight turnover (million ton-km)	686	933	-26.4%	NA
Revenue / ton-km (in Tetri)	10.43	8.59	21.5%	21.1%

Oil products

Revenue from the transportation of oil products for Q3 2018 decreased by 8 percent, compared to Q3 2017 and increased by 24 percent, compared to Q2 2018.

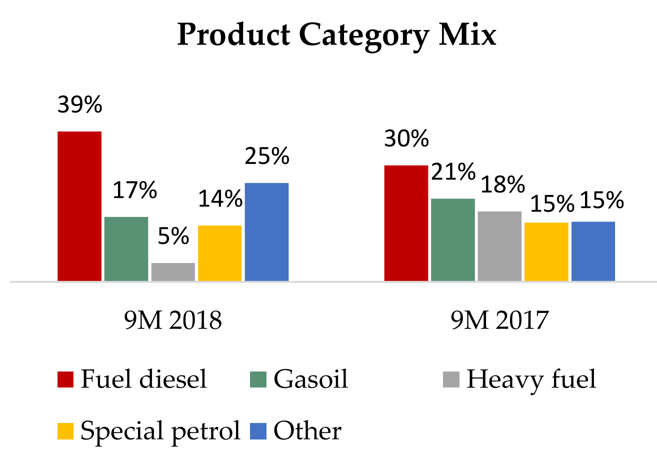
Main directions of cargo

Oil products currently are the main component of liquid cargo (96 percent of the transportation volume of liquid cargo in 9M 2018). They are mainly transported by rail, as there is practically no competition from pipelines.



Oil products transported by the Group during nine months period ended 30 September 2018 mainly originated from Azerbaijan, Turkmenistan, Russia and Kazakhstan, with significant changes in transportation direction mix compared to the same period of 2017. The share of Kazakhstan was down to 14 percent from 36 percent, while the share of Azerbaijan, Turkmenistan and Russia increased by about 10 percent, 6 percent and 7 percent, respectively in total oil products transported by the Group.

Factors influencing performance



Ton-kilometers – 26 percent decrease in transportation turnover was mainly driven by decreased transported volume by 21 percent, mainly caused by decreased transportation of heavy fuel oil and gasoil from Kazakhstan by 361,000 tons and 369,000 tons, respectively. Another reason was decreased average transportation distance by 6 percent, mainly driven by change in product direction mix. Share of transported volume from Kazakhstan (which covers relatively longer distances) in total transportation volume of oil products has significantly decreased.

Revenue/ton-km (in Tetri) - increase in average revenue per ton-kilometer during the period under review, compared to the same period of the previous year, was mainly due to changes in product category mix. The shares of fuel diesel and aviation light fuel (which are relatively more profitable products) have increased and shares of gasoil and heavy fuel (which are relatively less profitable products) have decreased in total oil products transported by Georgian Railway.

Crude Oil

9 month period ended 30 September

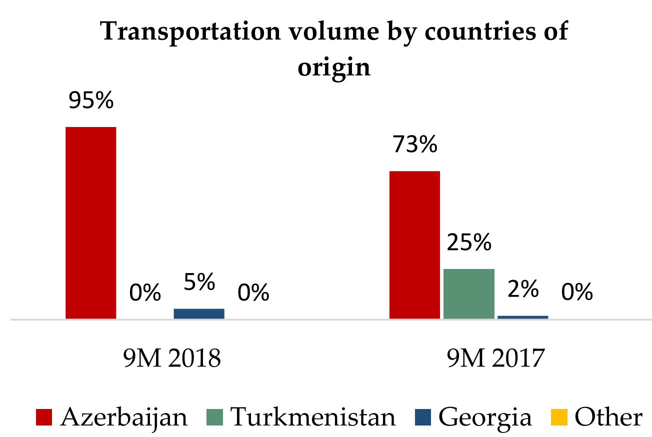
	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	2,787	6,453	-56.8%	-56.9%
Freight volume (ton '000)	124	321	-61.2%	NA
Freight turnover (million ton-km)	49	126	-60.7%	NA
Revenue / ton-km (in Tetri)	5.64	5.12	10.0%	9.7%

Crude oil

Revenue from the transportation of crude oil for Q3 2018 decreased by 49 percent, compared to Q3 2017 but increased by 62 percent, compared to Q2 2018.

Main directions of cargo

Within the nine months ended 30 September 2018, the countries of origin were Azerbaijan and Georgia, while 80,000 tons were transported from Turkmenistan in the same period of the previous year.



Factors influencing performance

Ton-kilometers – 61 percent decrease in transportation turnover was caused by decreased volumes from Azerbaijan and Turkmenistan, by 117,000 tons and 80,000 tons, respectively.

Revenue/ton-km (in Tetri) – 10 percent increase in average revenue per ton-kilometer at constant currency during the period under review, compared to the same period of the previous year was driven by change in product direction mix. The share of freight volumes from Azerbaijan (relatively more profitable direction) was 95 percent in the nine months ended 30 September 2018, compared to 73 percent in the same period of 2017, in total transported volumes of crude oil.

Chemicals and fertilizers

9 month period ended 30 September

	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	10,330	8,900	16.1%	15.7%
Freight volume (ton '000)	432	401	7.7%	NA
Freight turnover (million ton-km)	150	125	20.2%	NA
Revenue / ton-km (in Tetri)	6.88	7.13	-3.5%	-3.7%

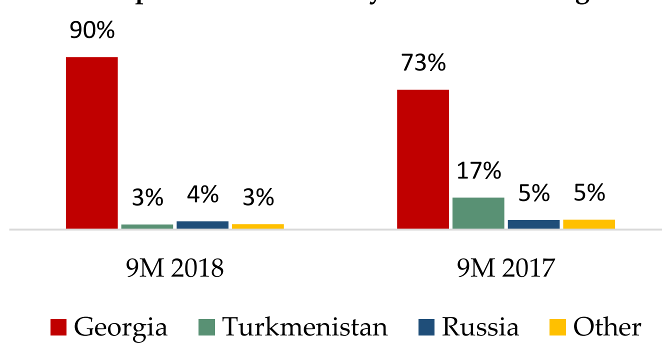
Chemicals and fertilizers

Revenue from the transportation of chemicals and fertilizers for Q3 2018 decreased by 17 percent, compared to Q3 2017 and by 14 percent, compared to Q2 2018.

Main directions of cargo

Chemicals and fertilizers transported by the Group during nine months ended 30 September 2018, was mainly originated from Georgia.

Transportation volume by countries of origin



Factors influencing performance

Ton-kilometers – 20 percent increase in transportation turnover was mainly driven by increased volumes from Georgia by 96,000 tons.

Revenue/ton-km (in Tetri) – decrease in average revenue per ton-kilometer was mainly caused by decreased share of transported urea fertilizer (which is relatively more profitable product).

Ferrous metals and scrap

9 month period ended 30 September

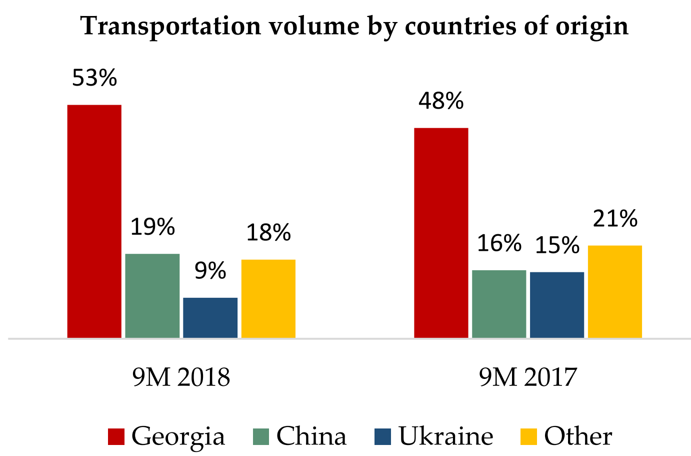
	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	6,928	8,291	-16.4%	-16.7%
Freight volume (ton '000)	406	403	0.7%	NA
Freight turnover (million ton-km)	87	96	-8.7%	NA
Revenue / ton-km (in Tetri)	7.93	8.66	-8.5%	-8.7%

Ferrous metals and scrap

Revenue from the transportation of ferrous metals and scrap for Q3 2018 decreased by 20 percent, compared to Q3 2017 but increased by 12 percent, compared to Q2 2018.

Main directions of cargo

Ferrous metals and scrap transported by the Group during nine months ended 30 September 2018 was mainly originated from Georgia, China and Ukraine.



Factors influencing performance

Ton-kilometers – 9 percent decrease in freight turnover was mainly caused by decreased transportation of non-alloy steel rods from Ukraine.

Revenue/ton-km (in Tetri) – decrease in average revenue per ton-kilometer was mainly driven by changes in product direction mix and product category mix. The share of freight transported to Turkmenistan as well as product volume originated from Ukraine (which are relatively more profitable directions) has decreased and the share of iron rods and rails (which are relatively more profitable products has decreased in total ferrous metals and scrap transported by the Group.

Sugar

9 month period ended 30 September

	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	6,994	10,833	-35.4%	-35.6%
Freight volume (ton '000)	250	305	-18.2%	NA
Freight turnover (million ton-km)	90	107	-16.4%	NA
Revenue / ton-km (in Tetri)	7.81	10.11	-22.8%	-23.0%

Sugar

Revenue from the transportation of sugar for Q3 2018 decreased by 20 percent, compared to Q3 2017 and by GEL 2.8 million, compared to Q2 2018.

Main directions of cargo

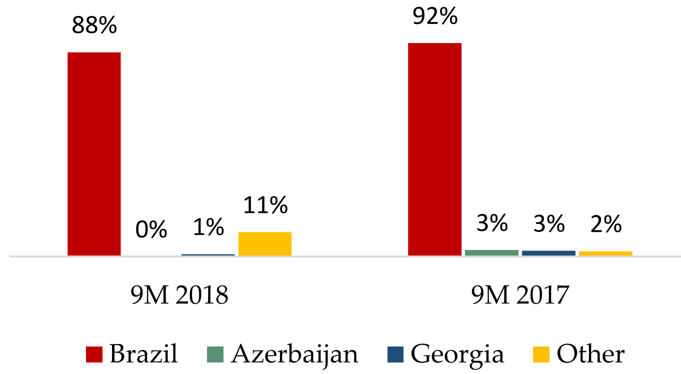
Sugar transported by the Group during nine months ended 30 September 2018 was mainly directed to Azerbaijan, Georgia and Armenia. Significant country of origin was Brazil with transportation of 221,000 tons in nine months of 2018 and 282,000 tons in the same period of the previous year.

Factors influencing performance

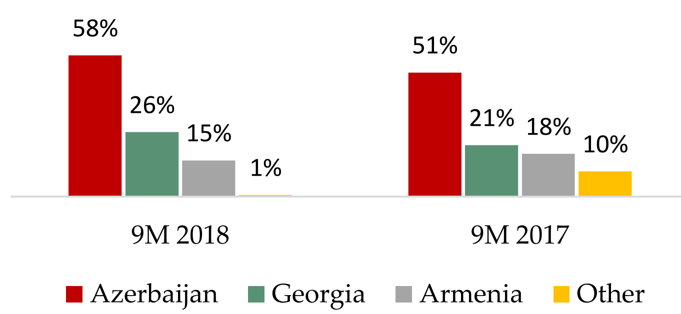
<u>Ton-kilometers</u> – 16 percent decrease in freight turnover during the period under review, compared to the same period of the previous year, was mainly driven by reduced transportation of sugar from Brazil by 61,000 tons in nine months ended 30 September 2018 compared to same period of 2017.

<u>Revenue/ton-km (in Tetri)</u> – decrease in average revenue per ton-kilometer was caused by change in product category mix. The share of cane sugar (relatively more profitable product) has decreased significantly in total sugar transportation volume.

Transportation volume by countries of origin



Transportation volume by destination countries



Other

9 month period ended 30 September

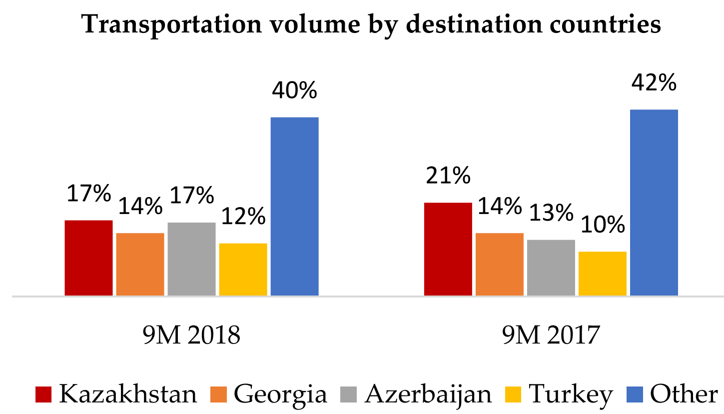
	9M 2018	9M 2017	% Change	% Change at constant currency
Revenue (GEL'000)	41,842	45,030	-7.1%	-7.3%
Freight volume (ton '000)	1,192	1,133	5.2%	NA
Freight turnover (million ton-km)	380	368	3.1%	NA
Revenue / ton-km (in Tetri)	11.02	12.23	-9.9%	-10.1%

<u>Other product categories</u>

Revenue from the transportation of other product categories for Q3 2018 decreased by 4 percent, compared to Q3 2017 but increased by 7 percent, compared to Q2 2018.

Main directions of cargo

Freight from other products category in nine months ended 30 September 2018 was mainly directed to Azerbaijan, Kazakhstan Georgia and Turkey. Main products transported in first nine months period of 2018 were mineral waters (about 7 percent of total volume), meat products (about 7 percent of total volume), unalloyed aluminum (about 5 percent of total volume), and palm oil (about 3 percent of total volume).



Factors influencing performance

Ton-kilometers – 3 percent increase in transportation turnover was mainly driven by increased volumes transported to Azerbaijan and Turkey by 54,000 tons and 28,000 tons, respectively.

Revenue/ton-km (in Tetri) – decrease in average revenue per ton-kilometer was driven by changes in product direction mix and product category mix. The share of Kazakhstan (relatively more profitable direction) has decreased, while the share of Turkey (relatively less profitable directions) has increased in total volumes transported. The share of certain sort of chicken meat (relatively more profitable product) decreased from 7 percent to 0 percent in total other products category transported.

Logistical services

Revenue from logistical service for Q3 2018 increased by 94 percent, compared to Q3 2017 and by 20 percent, compared to Q2 2018.

The increase in logistical services by GEL 19.8 million during the nine months ended 30 September 2018, compared to the same period of the previous year, was mostly attributable to increased logistical revenue from oil products, mainly transported from Azerbaijan and Turkmenistan as well as increased volumes of container transportation by 162% compared to the first nine months of 2017.

Freight car rental

The increase in revenue from freight car rental by 87 percent (GEL 8.6 million) during the nine months ended 30 September 2018, compared to the same period of 2017, was mainly caused by increased usage of the Group’s semi-wagons and grain carriers by Kazakhstan.

Passenger transportation

9 month period ended 30 September *In '000 GEL*

	9M 2018	9M 2017	% Change	Abs. change
Revenue	21,462	18,755	14.4%	2,707
Number of passengers	2,201	2,104	4.6%	97

Revenue from passenger transportation has increased by 14 percent (GEL 2.7 million) during the nine months ended 30 September 2018, compared to the same period of the previous year, while the number of passengers has increased by 4.6 percent. The higher increase in revenue was driven by significant rise in number of passengers on the main line transportation (which is relatively more profitable direction).

Other revenue

The reduction in other revenue by GEL 1.9 million during the first nine months of 2018, compared to the same period of 2017 was mostly attributable to reduced revenues from realization of scrap metal and communication services.

1.2 Other income

In order to better illustrate the operational profitability of the Group, other income is devided into two categories: continuing operations (such as income from services of heavy equipment, penalties on creditors and debtors, etc.) and non-continuing operations (such as gain or loss from sale of fixed assets and other items which are not expected to reoccur in the following periods).

Other income

9 month period ended 30 September *In GEL '000*

	9M 2018	9M 2017	% Change	Abs. change
Continuing operations	2,897	5,163	-43.9%	-2,265
Non-continuing operations	14,552	8,316	75.0%	6,237
Total	**17,450**	**13,478**	**29.5%**	**3,972**

The decrease in other income from continuing operations during the nine months ended 30 September 2018, compared to the same period of the previous year, was mainly due to the lower accrued penalty on creditors and debtors. The increase in non-continuing operations was mainly due to the revenue from sales of fixed assets.

1.3 Operating expenses

Operating expenses for Q3 2018 increased by 2 percent, compared to Q3 2017 and remained at about the same level compared to Q2 2018.

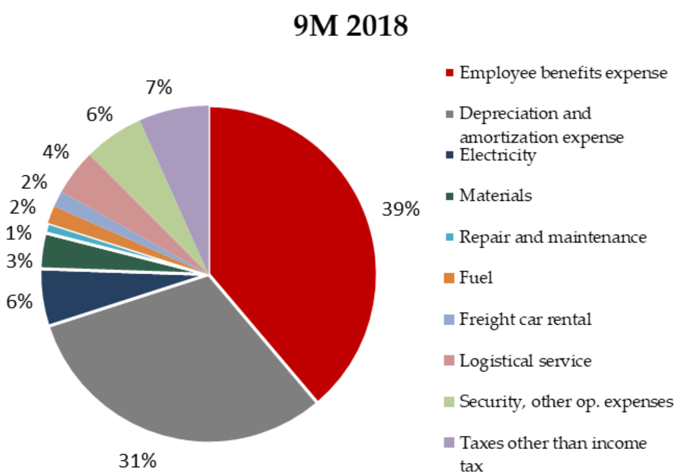
Total operating expenses for the nine months ended 30 September 2018 increased by GEL 10.8 million, compared to the same period of the previous year. This was mainly caused by increase in depreciation and amortization expense and higher expenses in logistical services. This was partly offset by decrease in taxes other than income tax.

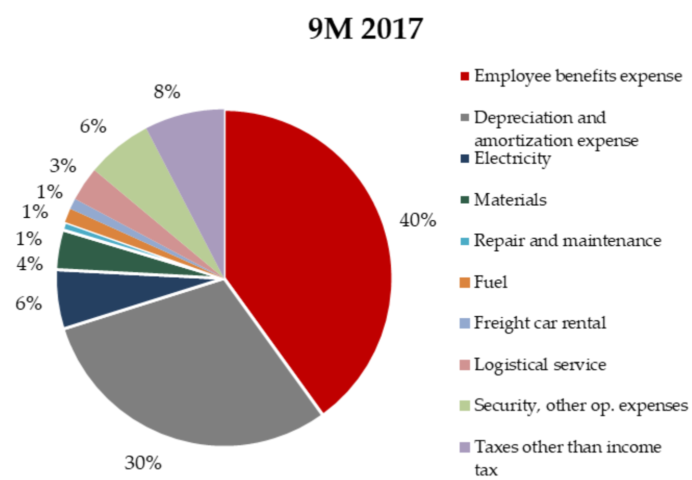
Operating expenses

9 month period ended 30 September *In GEL '000*

	9M 2018	9M 2017	% Change	Abs. change
Employee benefits expense	110,280	109,394	0.81%	887
Depreciation and amortization expense	88,622	82,273	7.72%	6,349
Electricity	15,640	15,504	0.88%	136
Materials	9,765	10,410	-6.20%	-645
Repair and maintenance	2,749	2,128	29.19%	621
Fuel	4,749	3,640	30.48%	1,109
Freight car rental	4,385	2,829	55.00%	1,556
Logistical service	12,488	8,953	39.48%	3,535
Security, other op. expenses	16,353	17,230	-5.09%	-877
Taxes other than income tax	19,010	20,849	-8.82%	-1,839
Total	**284,043**	**273,210**	**3.96%**	**10,833**

The following charts represent the cost structure for nine months ended 30 September 2018 and 2017:



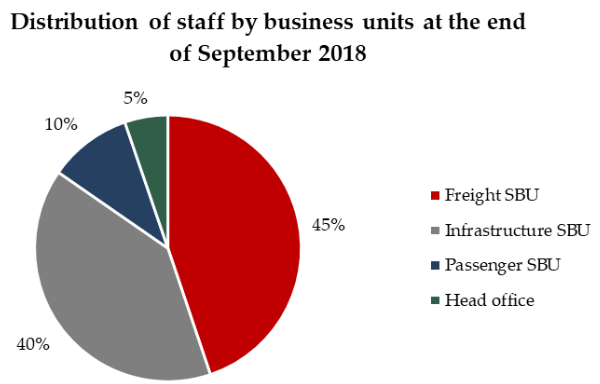


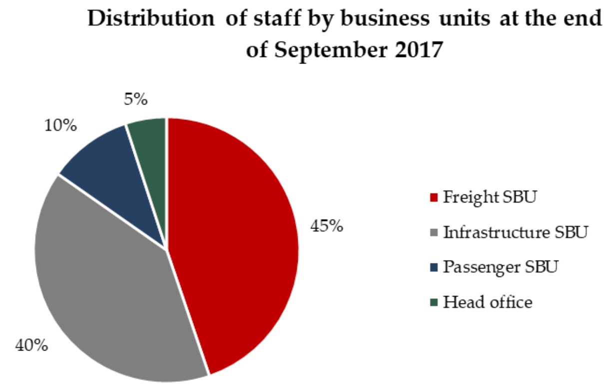
Employee benefits expense

Employee benefits expense during the nine months ended 30 September 2018, compared to the same period of the previous year, remained at about the same level. Employees' salaries are mostly fixed and normally are not affected by changes in transportation volumes.

Number of employees (excluding subsidiaries) by the end of September 2018 was equal to 12,261 and by the end of September 2017 was 12,356.

Following charts show the headcount by strategic business units and head office of the Company.





Materials, repair and maintenance expenses

The Group's materials, repair and maintenance expenses are influenced by its rolling stock equipment balance and subsequent utilization level. During nine months ended 30 September 2018 materials, repair and maintenance expenses remained about the same level, compared to the same period of 2017.

Electricity expenses

9 month period ended 30 September *In GEL '000*

	9M 2018	9M 2017	% Change	Abs. change
Electricity expense of traction	13,121	13,118	0.03%	4
Utility expenses	2,519	2,386	5.54%	132
Total	**15,640**	**15,504**	**0.88%**	**136**

Electricity expenses of traction remained at about the same level during the nine months ended 30 September 2018, compared to the same period of 2017, while gross ton-kilometers have decreased by about 12 percent. This change was driven by higher weighted average tariff in the first nine months of 2018 compared to the same period of 2017. Georgian Railway has fixed price for more than 90 percent of its electricity needs under agreement on electricity procurement, the rest of the electricity is procured on open market.

Purchased electricity and weighted average tariff

9 month period ended 30 September

	9M 2018			9M 2017		
	GWh	Gross ton-km (million)	Weighted av. tariff (GEL)	GWh	Gross ton-km (million)	Weighted av. tariff (GEL)
January	10.9	361.4	0.130	14.5	620.3	0.121
February	10.9	416.9	0.130	12.6	497.4	0.121
March	11.5	435.8	0.130	12.5	490.7	0.119
April	11.0	424	0.129	11.4	416.7	0.118
May	10.1	364.3	0.129	10.9	408.3	0.117
June	11.9	481.4	0.129	11.5	451.7	0.116
July	12.8	501.1	0.130	12.4	459.5	0.116
August	11.2	400.5	0.130	12.3	465.8	0.117
September	10.8	386.7	0.130	12.6	489.3	0.118
Total	**101.2**	**3,772.1**	**0.130**	**110.8**	**4,299.7**	**0.118**

Note: The table above includes only electricity consumed of traction

Freight car rental expense

Freight car rental expense in the first nine months ended 30 September 2018, compared to the same period of the previous year, increased by about GEL 1.6 million mostly due to the increased usage of open-wagons and tank cars by GR from partnering railways.

Logistical services

Expenses for logistical services represent operating expenses of Georgian Railway's logistical subsidiaries. The expenses for logistical services in the nine months ended 30 September 2018 have increased by about 39 percent (GEL 3.5 million), compared to the same period of the previous year. The increase was mainly caused by increased expenses of GR's subsidiary, which serves container transportation, which was partly offset by reduced expenses of another subsidiary that mainly serves crude oil and oil products transported by the Company.

Taxes other than income tax

9 month period ended 30 September *In GEL '000*

	9M 2018	9M 2017	% Change	Abs. change
Property tax	9,887	11,889	-16.8%	-2,002
Land tax	8,864	8,865	0.0%	-1
Other taxes*	259	96	170.6%	163
Total	**19,010**	**20,849**	**-8.8%**	**-1,839**

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

In the nine months ended 30 September 2018, compared to the same period of 2017, property tax has decreased by 16.8 percent (GEL 2.0 million), which was mainly caused by impairment of Tbilisi Bypass Project at the end of 2017. Property tax will also be reduced after putting the Modernization project into operation, as railway infrastructure related assets are free of property tax and assets under the project are taxed by property tax, while under construction in progress. The land tax remained at about the same level during the first nine months of 2018, compared to the same period of previous year.

1.4 Finance income and cost

Finance income and cost

9 month period ended 30 September *In GEL '000*

	9M 2018	9M 2017	% Change	Abs. change
Interest income	12,387	12,873	-3.8%	-485
Impairment gain/loss on doubtful debts	6,149	-1,598	484.8%	7,747
Impairment loss on loans	-1,579	0	-100.0%	-1,579
Interest expense	-34,326	-39,078	-12.2%	4,751
FX gain/loss	-10,465	78,480	-113.3%	-88,944
Net finance income/loss	**-27,834**	**50,677**	**-154.9%**	**-78,511**

In the nine months ended 30 September 2018 the Group showed GEL 27.8 million net finance loss, compared to GEL 50.7 million net finance income in the same period of 2017. The negative difference of GEL 78.5 million was mainly due to the fluctuation of GEL against foreign currencies and for impairment loss on loans of GEL 1.6 million in the first nine months of 2018.

GEL/USD exchange rate fluctuation has significant effect on net finance income/loss. Due to GEL depreciation against USD by 6 percent as at 30 September 2018 compared to 30 September 2017 (GEL/USD exchange rate 2.62 versus 2.48), the Group experienced net foreign exchange loss of GEL 10.5 million in first nine months of 2018, however due to appreciation of GEL against USD (about 6 percent) as at 30 September 2017 compared to 31 December 2016 (GEL/USD exchange rate 2.48 versus 2.65), the Group showed net foreign exchange gain of GEL 78.5 million in the same period of 2017.

Lower interest expense during the nine months ended 30 September 2018, compared to the same period of 2017, was mainly due to reduced interest expense on long-term borrowings.

Lower interest income by GEL 485,000 in the nine months ended 30 September 2018 compared to the same period of 2017, was mainly due to the lower average cash balances and lower interest rates.

Impairment loss on loans during first nine months of 2018 GEL 1.6 million represents provision made against loan provided to the entity managed by the group.

GEL 7.7 million impairment gain on doubtful debts during first nine months of 2018 represents reversal of GEL 7.5 million provision made against trade receivables from the partnering entity, remainder is reversal of receivables for GR's subsidiaries.

1.5 Income tax expense/benefit

In May 2016, the Parliament of Georgia adopted amendments to the Tax Code of Georgia. The new tax code is effective from 1 January 2017. According to the new tax code, previously active profit tax regulation was changed to so-called "tax on distributed profits" model. During the first nine months of 2018 income tax expense increased by GEL 1.0 million compared to the same period of previous year and equaled GEL 1.5 million.

2. Balance Sheet

Balance sheet

9 month period ended 30 September *In GEL '000*

	30-Sep-18	30-Jun-18	% Change	Abs. change	31-Dec-17	% Change	Abs. change
TOTAL ASSETS	**2,885,417**	**2,881,083**	**0.2%**	**4,333**	**2,862,237**	**0.8%**	**23,180**
Changes are mainly due to:							
Property, plant and equipment	2,440,493	2,426,963	0.6%	13,530	2,368,380	3.0%	72,113
Other non-current assets	99,068	98,923	0.1%	144	123,516	-19.8%	-24,448
Trade and other receivables	58,448	54,974	6.3%	3,474	73,614	-20.6%	-15,166
Cash and cash equivalents	235,515	243,486	-3.3%	-7,972	243,018	-3.1%	-7,504
TOTAL LIABILITIES	**1,619,835**	**1,559,787**	**3.8%**	**60,047**	**1,617,389**	**0.2%**	**2,446**
Changes are mainly due to:							
Loans and borrowings (LT)	1,382,700	1,295,665	6.7%	87,035	1,374,363	0.6%	8,337
Trade and other payables	131,258	140,118	-6.3%	-8,860	112,221	17.0%	19,037

Significant changes in assets

During the first nine months of 2018, GEL 72.1 million increase in property, plant and equipment was mainly due to the Construction in Progress (mostly under the Modernization Project).

GEL 24.4 million decrease in other non-current assets was mainly due to the decrease in prepayments for non-current assets, mostly attributable to Modernization project and reduction in construction materials that were reclassified from inventory as non-current assets.

There was GEL 15.2 million decrease in trade and other receivables in the first nine months ended 30 September 2018. The decrease was mainly due to cash inflows from partnering railway who paid part of it's payables in the beginning of current year.

Cash and cash equivalents decreased by GEL 7,5 in the nine months ended 30 September 2018, compared to the 31 December 2017, which was mainly caused by cash payments to suppliers and employees. (*see heading 3 "Cash Flow Statement"*).

Significant changes in liabilities

The increase of GEL 8.3 million in long-term borrowings, in the first nine months of 2018, was mainly due to debt revaluation, as GEL has depreciated against USD by about 1 percent and the Group's debts are denominated in USD as well as GEL 5.3 million principal payment of long-term debt issued for acquisition of four new passenger trains.

GEL 19.0 million increase in trades and other payables in 30 September 2018 compared to the end of 2017, was caused by the increase in trade payables, which was mainly due to the new agreement on

Modernization project, according to which, GR renegotiated with Chinese partner on bulk payments before completion of project and rest of the payables will be paid within two years after project is finalized.

3. Cash Flow Statement

Cash flow statement

9 month period ended 30 September — *In GEL '000*

	9M 2018	9M 2017
Cash flows from operating activities		
Cash receipts from customers	363,685	329,524
Cash paid to suppliers and employees	-202,901	-196,317
Cash flows from operations before income taxes paid	**160,785**	**133,134**
Income tax paid	-	-2,691
Net cash from operating activities	**160,785**	**130,443**
Cash flows from investing activities		
Acquisition of property, plant and equipment	-92,654	-154,062
Proceeds from sale of property, plant and equipment	15,688	2,456
Interest received	9,600	9,671
Refund of the loan	-	1,036
Net cash used in investing activities	**-67,367**	**-140,826**
Cash flows from financing activities		
Proceeds from borrowings	-	50,248
Repayment of borrowings	-5,337	-5,310
Interest paid	-99,047	-101,643
Net cash from used in financing activities	**-104,384**	**-56,705**
Net increase/(decrease) in cash and cash equivalents	**-10,966**	**-67,088**
Cash and cash equivalents at 1 January	243,018	277,953
Effect of exchange rate fluctuations on cash and cash equivalents	3,463	-7,546
Cash and cash equivalents at the end of the period	**235,515**	**203,319**

Operating activities

Net cash from operating activities increased by GEL 30.3 million in the nine months ended 30 September 2018, compared to the same period of the previous year. The change was driven by increase in cash receipts from customers by GEL 34.2 million, mostly caused by higher cash generated from VAT tax return, and also due to the cash collection from partnering railway to cover its old accounts payables.

The increase in cash paid to suppliers and employees by about GEL 6.5 million, was mainly caused by higher property tax paid and personal income tax, higher cash payments for business trips as well as higher cash outflows for repair work.

Investing activities

Cash used in investing activities decreased by GEL 73.5 million in the nine months ended 30 September 2018, compared to the same period of the previous year. In the first half of 2017, GR invested in the two new double decker trains, causing the significant reduction of investment in PPE in the first nine months of 2018.

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

Financing activities

Proceeds from borrowings in the first nine months of 2017 represents the loan for new double decker passenger trains purchased in the first half of previous year.

Lower interest paid in the nine months ended 30 September 2018, compared to the same period of the previous year, was mainly due to reduced interest expense on long-term borrowings.

Appendix 1

Breakdown of freight transportation in tons

9 month period ended 30 September — *In thousand tons*

	9M 2018	9M 2017	% Change	Abs. Change
Liquid cargoes	**2,459**	**3,291**	**-25.26%**	**-831**
Oil products	2,335	2,970	-21.37%	-634
Crude oil	124	321	-61.24%	-197
Dry cargoes	**5,039**	**4,650**	**8.36%**	**389**
Ores	1,182	1,055	12.03%	127
Grain	353	223	58.32%	130
Ferrous metals and scrap	406	403	0.72%	3
Sugar	250	305	-18.19%	-55
Chemicals and fertilizers	432	401	7.65%	31
Construction freight	837	870	-3.79%	-33
Industrial freight	285	198	44.21%	87
Cement	102	62	65.01%	40
Other	1,192	1,133	5.19%	59
Total	**7,498**	**7,941**	**-5.57%**	**-442**

Appendix 2

Breakdown of freight transportation in ton-kilometers

9 month period ended 30 September — *In million ton-kilometers*

	9M 2018	9M 2017	% Change	Abs. Change
Liquid cargoes	**736**	**1,059**	**-30.49%**	**-323**
Oil products	686	933	-26.40%	-246
Crude oil	49	126	-60.75%	-77
				0
Dry cargoes	**1,224**	**1,160**	**5.58%**	**65**
Ores	240	221	8.76%	19
Grain	75	54	37.84%	21
Ferrous metals and scrap	87	96	-8.70%	-8
Sugar	90	107	-16.40%	-18
Chemicals and fertilizers	150	125	20.22%	25
Construction freight	132	138	-4.44%	-6
Industrial freight	50	37	36.12%	13
Cement	21	14	47.41%	7
Other	380	368	3.12%	11
Total	**1,960**	**2,218**	**-11.64%**	**-258**

Appendix 3

According to Condition 3 (d) of the "Terms and Conditions of the Notes" (The U.S. $500,000,000 7.75% Notes due 11 July 2022 issued by Georgian Railway JSC on 5 July 2012), Georgian Railway and/or its subsidiary is entitled to incur financial indebtedness if the ratio of Net Financial Indebtedness of the Issuer and its Subsidiaries as of the date of such Incurrence to the aggregate amount of EBITDA for the most recent annual financial period for which consolidated financial statements have been delivered, does not exceed 3.5 to 1.

Given table sets forth calculation of Net Financial Indebtedness to EBITDA as at 30 September 2018 and according to the above mentioned Condition 3 (d) of the "Terms and Conditions of the Notes". However, this calculation is for information only and does not implicate that 30 September 2018 is the Incurrence date (or "the date of determination") as defined in Condition 3 of the "Terms and Conditions of the Notes".

Calculations of ratio of Net Financial Indebtedness to EBITDA:

In 000 GEL

Net Financial Indebtedness as at:	**30-Sep-18**	**30-Sep-17**
Financial indebtedness	1,417,326	1,350,423
less:		
Available credit facilities	159,910	136,068
Cash	235,515	203,319
Net Financial Indebtedness:	**1,021,902**	**1,011,036**

	Twelve-month period ended	**Twelve-month period ended**
The most recent annual financial period	**31-Dec-17**	**31-Dec-16**
Results from operating activities	-280,467	175,488
Depreciation add-back	109,703	106,267
Impairment loss on property, plant and equipment add-back	382,616	
EBITDA	**211,852**	**281,755**
Net Financial Indebtedness/EBITDA	**4.82**	**3.59**