GEORGIAN RAILWAY JSC

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR 2014

Contents

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

1. Summary

The Company has shown a solid financial performance in 2014. Despite the decreasing cargo transportation volume, revenue has increased. This is a result of increased share of more profitable freights in the freight mix and a new subsidiary, GR Transit Line LLC that started its operation in April 2014. Finally, favorable change in GEL/USD ensured that the decrease in crude oil transportation was more than offset.

In line with increase in total revenue, the Company's cash flows from operations have increased by 28 per cent in 2014 compared to previous comparable period.

In 2014 the Company has also significantly improved its operating profitability and achieved 12 per cent increase in EBITDA and 2.3 per cent increase in EBITDA margin compared to 2013. Despite improvements in operating results, the Company's net income has decreased significantly in 2014 due to USD appreciation against national currency, which resulted in FX losses on revaluation of debt of the Company.

In 2014 and 2013 the Company has significantly slowed down its investing activities compared to previous years. In June 2013 it has started the work to redesign the Tbilisi-Bypass project and in March 2014 the Government of Georgia decided to temporarily suspend the Tbilisi-Bypass project for up to 18 months until the redesign is completed. As a result of the Tbilisi-Bypass suspension and slowdown in the Modernization project expenditures, cash outflows for acquisition of PPE have decreased by about 42 per cent in 2014 compared to 2013.

As a result of significant improvement in cash flows from operations and reduced investments, the Company has improved its liquidity position. The Company's cash and cash equivalent balances have increased by about 44 per cent at the end of 2014 compared to previous period and amounted to GEL 301 million.

2 Profit & Loss statement

2.1 Railway operating revenue

Most of the Company's revenue, about 75 per cent, derives from freight transportation. Therefore, the Company's results are particularly sensitive to trade flows of cargo, which for the most part comprise of transit shipments accounting for no less than 75 per cent of freight transportation revenue. Freight transit mainly derives from trade between Europe and Central Asia. Main part of the Company's transit freight traffic (about 37 per cent of transportation revenue in 2014) is received from or transported to Azerbaijan direction. Freight flow between Georgian and Armenian railways, accounted for about 15 per cent of transportation revenue in 2014.

Revenue breakdown

For the year ended 31 December	*Numbers in GEL '000*			*Per cent*		
	2014	**2013**	**2012**	**2014**	**2013**	**2012**
Freight transportation	382,732	364,057	350,866	74.8%	75.9%	74.7%
Freight handling	69,049	60,529	50,925	13.5%	12.6%	10.8%
Freight car rental	37,811	34,308	46,382	7.4%	7.1%	9.9%
Passenger traffic	18,317	18,044	17,432	3.6%	3.8%	3.7%
Other	3,661	2,908	4,214	0.7%	0.6%	0.9%
Total revenue	**511,570**	**479,846**	**469,819**	**100%**	**100%**	**100%**

Freight transportation

The Company's freight transportation revenue consists of liquid and dry cargo. The split between liquid and dry cargo revenue in 2014 was 52 per cent and 48 per cent respectively.

Transportation revenue depends on several factors, which generally influence its performance through the periods. They are discussed below.

Transportation volume - this is generally measured by ton-kilometers of cargo transportation, which is the product of tons transported and the distance covered.

Average revenue per ton-kilometer - the term refers to the average revenue that the Company 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 Company's transportation is divided into different cargo categories (such as Grain, Ore, Sugar etc.). These categories however are comprised of many sub-categories, each of which has different tariffs. Therefore, while the actual tariffs for cargo sub-categories may remain the same, the average revenue per ton-kilometer of a parent cargo category may still change due to the changes in the sub-category mix (for example due to the increase in the share of a sub-category with higher tariff, which increases the average revenue per ton-kilometer for the total category).

- Transportation direction mix - as the Company performs transportation to different countries (Kazakhstan, Armenia, Georgia, Azerbaijan etc.), the transportation tariff is different, depending on the country involved. Thus, while the tariffs for different cargo sub-categories as well as the sub-category mix may remain the same, there is still a possibility of a change in average revenue per ton-kilometer due to the changes in transportation direction mix.

GEL/USD exchange rate - one important issue in analyzing Georgian Railway's performance is the fact that most of the Company's tariffs are denominated in USD. As the Company reports its revenue in Georgian Lari, the changes in GEL/USD exchange rate affect the revenue received by the Company in GEL terms. This has its effect on the Company's profitability, as most of the expenses are denominated in Georgian Lari.

Subsidiaries - another factor to consider in analyzing the Company's revenue is its subsidiaries, which have increased their significance from the year 2013:

- Georgia Transit LLC - acquired by Georgian Railway in April 2013, Georgia Transit is one of the largest freight forwarding customers of the Company. It mainly serves crude oil and oil product freights transported by Georgian Railway.
- GR Transit Line LLC - another freight forwarding company, Georgia Transit Line started its operation in April 2014 and mainly serves oil products transported to Armenia and Azerbaijan. Through 2014, the subsidiary was growing and adding margin to the Company's average revenue per ton-kilometer.

It is also important to understand that while the Company's operations are centered in Georgia, the extent of these operations is more far reaching. In fact, the Company is serving not only Georgia's rail cargo, but also significant part of cargoes transported to and from Central Asian and Caucasian regions.

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

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

Central Asia
As Kazakhstan and other Central Asian countries are all land-locked countries, this makes them dependent on their neighbors for access to the Western market. Georgian

Railway is one of the few alternatives for transportation routes that connects these land-locked, but resource rich countries to European market;
The alternative rail routes are:

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

China
The first railway freight transportation from China in the direction of Georgia was performed in 2015. The train was loaded on 29th of January in China and was discharged in Georgia on 6th of February. This is a historical fact of significant importance for GR. The new railway connection will facilitate transportation of cargo from China to Europe and Turkey through Georgia and increase Georgia's importance as a transit country. The new route is cheaper than air and faster and safer than sea transportation. The new route is anticipated to reduce transit duration five times compared with carriage by sea.

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

	Revenues (in GEL million)			tkm (in million)			% Change			
For the year ended 31 December							*Revenue*	*tkm*	*Revenue*	*tkm*
	2014	**2013**	**2012**	**2014**	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Liquid cargoes	**200.5**	**202.8**	**172.5**	**2,639**	**3,249**	**3,348**	**-1.1%**	**-18.8%**	**17.6%**	**-2.9%**
Oil products	163.4	129.2	98.9	1,980	1,706	1,514	26.5%	16.1%	30.6%	12.7%
Crude oil	37.1	73.6	73.6	659	1,544	1,834	-49.7%	-57.3%	0.0%	-15.8%
Dry cargoes	**182.2**	**161.2**	**178.4**	**2,309**	**2,238**	**2,553**	**13.0%**	**3.2%**	**-9.6%**	**-12.3%**
Ores	27.9	31.5	37.3	419	495	587	-11.4%	-15.3%	-15.6%	-15.6%
Construction freight	13.2	11.0	10.9	288	238	250	20.0%	21.2%	1.0%	-4.9%
Grain	23.6	23.6	27.4	263	276	323	0.1%	-4.5%	-14.1%	-14.6%
Ferrous metals and scrap	22.9	16.4	18.1	272	242	278	39.2%	12.7%	-9.1%	-13.2%
Chemicals and fertilizers	9.8	9.3	11.0	151	154	176	5.4%	-2.0%	-15.4%	-12.2%
Cement	3.0	3.2	3.5	39	42	47	-7.0%	-7.1%	-6.8%	-10.4%
Sugar	20.5	16.6	17.5	227	222	244	23.6%	2.2%	-5.2%	-9.1%
Industrial freight	8.9	6.9	9.5	127	106	148	29.9%	20.6%	-27.8%	-28.8%
Other	52.5	42.8	43.3	521	464	499	22.7%	12.3%	-1.2%	-7.0%
Total	**382.7**	**364.1**	**350.9**	**4,948**	**5,487**	**5,900**	**5.1%**	**-9.8%**	**3.7%**	**-7.0%**

Liquid cargo

One of the key drivers of liquid freight traffic is the production of oil and oil products in the Caspian region, which has large oil reserves and growing production. About 84 per cent of total oil and oil products are transported from Caspian region mostly to European countries and about 9 per cent of total oil and oil products are transported from Europe mostly for Georgia.

Most of the Company's liquid cargo revenue derives from oil products and its contribution share has increased significantly in 2014 due to increased cargo flow of oil products and decrease in crude oil volumes.

Oil products

Main directions of cargo

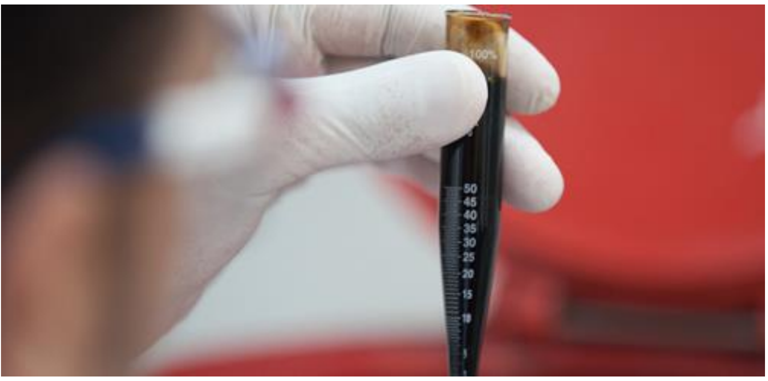
Oil products are currently the main component of liquid cargo. They are mainly transported through rail as there is practically no competition from pipelines. Oil products mostly originate from large refineries in Kazakhstan and Azerbaijan (27 per cent and 38 per cent of total oil products transported in 2014 respectively). Another important origin for oil products in 2014 was refineries in Turkmenistan (about 17 per cent of total oil products transported in 2014). Relatively small part of the volume (about 12 per cent of transportation volume in 2014) came from Europe mostly to Georgia.

Detailed information for oil products transportation

For the year ended 31 December

	2014	2013	2012	% Changes 2014 vs 2013	% Changes 2013 vs 2012
Revenue in GEL million	163.44	129.20	98.92	26.5%	30.6%
Ton-km in million	1,980.09	1,705.51	1,513.62	16.1%	12.7%
Average revenue per 1000 tkm in USD	46.63	45.64	39.61	2.2%	15.2%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance



Ton-kilometers - ton-kilometer of cargo transported shows an increase. The change is mainly due to the increase in transportation of gasoil from Azerbaijan and heavy fuel oil from Kazakhstan, which was quite insignificant in previous years.

Average revenue per 1,000 ton/km in USD - the increase in average revenue per 1,000 ton-kilometers is mainly due to the subsidiaries' margin, which was added to the revenue.

Depreciation of GEL against USD - another factor that has positively contributed to the increase in the revenue is the depreciation of GEL against USD.

Main directions of cargo
Crude oil transported by rail through Caucasus region is mostly from Kazakhstan (about 42 per cent in 2014) and high grade Azeri-light oil from Azerbaijan (about 55 per cent in 2014).

Detailed information for crude oil transportation

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

	2014	2013	2012	2014 vs 2013	2013 vs 2012
Revenue in GEL million	37.08	73.65	73.61	-49.7%	0.0%
Ton-km in million	658.63	1,543.51	1,834.08	-57.3%	-15.8%
Average revenue per 1000 tkm in USD	31.80	28.74	24.32	10.7%	18.2%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the decrease in Ton-kilometer of cargo transported is mainly due to the reduced transportation from Kazakhstan by 76 per cent (2.2 million tons) in the twelve-month period ended 31 December 2014 compared to the same period of 2013 and by 20 per cent (0.7 million tons) in 2013 compared to 2012. Transportation volume from Azerbaijan has also decreased in 2014 by 8 per cent compared to 2013 and by 4 per cent in 2013 compared to 2012.

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

Average revenue per 1,000 ton/km in USD - the increase in average revenue per 1,000 ton-kilometers can be explained by Georgian Transit's (subsidiary) margin that was added to Georgian Railways' revenue. As the subsidiary started its operation in April 2013, its contribution in 2014 was higher.

Depreciation of GEL against USD - another factor that positively contributed to revenue and partly offset the decrease in transportation volume was depreciation of GEL against USD.

Dry cargo

The major factors driving transportation of dry cargo in the region are general economic conditions and economy developments in the partnering countries in a region including Armenia, Azerbaijan, Kazakhstan, Uzbekistan, Turkmenistan and other.

The recent projects should open new geographic markets to the Company, such as Turkey (via near-completed Baku-Tbilisi-Kars rail line) and western China. These two geographies provide significant opportunities to capture principally new dry cargo volumes.

Ore products

Main directions of cargo
The main destination points of ore products transported by the Company are Georgia, Tajikistan and Azerbaijan. About 25 per cent of ore products transported by the Company in 2014 originated in Georgia. The ore products transported by the Company in 2014 mostly comprise of manganese ores and concentrates about 31 per cent, coal about 22 per cent and Aluminum oxide about 18 per cent of total ores products transported.

Detailed information for ores product transportation

For the year ended 31 December	2014	2013	2012	*% Change* 2014 vs 2013	2013 vs 2012
Revenue in GEL million	27.86	31.46	37.28	-11.4%	-15.6%
Ton-km in million	419.40	495.00	586.66	-15.3%	-15.6%
Average revenue per 1000 tkm in USD	37.53	38.29	38.51	-2.0%	-0.6%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the main reason of the decrease in transportation of ore products was the decreased amount of aluminum production within producing factories, due to low prices on aluminum. Another reason was the changes in aluminum manufacturing process. Previously, factories were using bauxite, while at the end of year 2012 it was replaced by aluminum oxide. As the technological process of manufacturing requires proportionally less aluminum oxide compared to bauxite, transportation in tons was lower. The transportation volume from Ukraine such as coke and semi-coke coal also decreased, which can be explained by current tension in Ukraine. The transportation of ore products originated within Georgia continues to increase.

Average revenue per 1,000 ton/km in USD - the decrease in average revenue per 1,000 ton-kilometers is due to the changes in the cargo type mix. Transportation of more profitable sub-categories of ore products, such as bauxite and iron ores and concentrates is decreasing, while the transportation of less profitable sub-categories is increasing.

Depreciation of GEL against USD - the depreciation of GEL against USD has partly offset the decrease in ton-kilometer of cargo transported and the decrease in average revenue per 1,000 ton/km.

Construction materials

Main directions of cargo

The transportation of construction materials is correlated with economic growth in the region and the construction sector activities within Georgia and Azerbaijan.

Detailed information for construction materials transportation

For the year ended 31 December				*% Change*	
	2014	**2013**	**2012**	**2014 vs 2013**	**2013 vs 2012**
Revenue in GEL million	13.17	10.97	10.86	20.0%	1.0%
Ton-km in million	288.36	237.88	250.12	21.2%	-4.9%
Average revenue per 1000 tkm in USD	25.80	27.79	26.32	-7.1%	5.6%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - increase in transportation volumes in 2014 can be explained by the increased contribution of construction activities in Georgian GDP, which experienced a comparably small decrease in 2013 compared to 2012.

Average revenue per 1,000 ton/km in USD - in 2014 construction activities contribution in Georgian GDP has increased which resulted in decreased average revenue per 1,000 ton-kilometers of cargo transported, as the transportation within Georgia is a less profitable direction compared to others. In 2013, consequently, as the share of transportation to Georgia was lower, the average revenue per 1,000 ton-km has increased.

Depreciation of GEL against USD - depreciation of GEL against USD has positively contributed to the increase in revenue in both years.

Main directions of cargo

Grain and grain products transported by the Company largely originate from Russia (about 61 per cent in 2014), Georgia (about 18 per cent in 2014) and Kazakhstan (about 7 per cent in 2014). This cargo is mostly imported for consumption in Georgia and Armenia.

Detailed information for grain and grain products transportation

For the year ended 31 December				*% Change*	
	2014	**2013**	**2012**	**2014 vs 2013**	**2013 vs 2012**
Revenue in GEL million	23.58	23.55	27.43	0.1%	-14.1%
Ton-km in million	263.42	275.82	323.02	-4.5%	-14.6%
Average revenue per 1000 tkm in USD	50.58	51.44	51.46	-1.7%	-0.0%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the decrease in ton-kilometer transported is due to the reduced transportation from Kazakhstan from 2013. This can be explained by the fact that in 2013 the agreement on the supply of flour and grain was reached between Kazakhstan and China. Consequently, Kazakhstan has redirected its grain supply to China, which has become one of the major and most profitable markets for Kazakhstan. Before, Kazakhstan had problems in transporting its goods to this direction, which was due to China's strict conditions for packaging and transportation of grain from other countries, as well as due to the strict sanitary and epidemiological requirements imposed by the country.

Average revenue per 1,000 ton/km in USD - the decrease in average revenue per 1,000 ton-kilometers is mainly due to the changes in cargo type mix and reduced transportation to Armenia, which is one of the most profitable directions.

Depreciation of GEL against USD - depreciation of GEL against USD has partly offset the decrease in average revenue per 1,000 ton-kilometers and decrease in ton-kilometer transported.

Main directions of cargo

The main destination points of ferrous metals and scrap transported by the Company are Azerbaijan, Georgia and Armenia. About 21 per cent of goods transported by the Company in 2014 originated in Georgia.

Detailed information for ferrous metals and scrap transportation

For the year ended 31 December	2014	2013	2012	*% Change* 2014 vs 2013	2013 vs 2012
Revenue in GEL million	22.87	16.43	18.07	39.2%	-9.1%
Ton-km in million	272.37	241.63	278.49	12.7%	-13.2%
Average revenue per 1000 tkm in USD	47.44	40.97	39.32	15.8%	4.2%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - in 2014 the increased transportation of relatively more profitable products such as pipes for oil and gas pipelines and hot-rolled bars and rods of iron or non-alloy steel have partly replaced the reduced transportation of rails and scraps to Azerbaijan and Armenia in 2013.

Decreased transportation of scrap in 2013 compared to 2012 was mainly due to the reduced market price on metals on the global market. Until 2013, scrap metal business was considered as one of the most successful businesses in Georgia. However, after the prices on metal decreased, the profitability has decreased and this affected export volumes as well.

Average revenue per 1,000 ton/km in USD - average revenue per 1,000 ton-kilometers increased due to the changes in cargo type mix and transportation direction mix as transportation to more profitable directions like Azerbaijan and Armenia have increased, while transportation to Georgia have decreased.

Depreciation of GEL against USD - depreciation of GEL against USD has positively contributed to the increase in revenue as well.

Chemicals and fertilizers

Main directions of cargo

Chemicals and fertilizers are mainly transported from Georgia to black sea ports. Relatively small portion of the products is transported to Armenia (about 8 per cent in 2014), Azerbaijan (about 1 per cent in 2014) and to Georgia (about 9 per cent in 2014).

Detailed information for chemicals and fertilizers transportation

For the year ended 31 December	2014	2013	2012	*% Change* 2014 vs 2013	2013 vs 2012
Revenue in GEL million	9.76	9.26	10.95	5.4%	-15.4%
Ton-km in million	151.22	154.27	175.63	-2.0%	-12.2%
Average revenue per 1000 tkm in USD	36.45	36.16	37.78	0.8%	-4.3%
Average exchange rate GEL/USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the decrease in ton-kilometer of cargo transportation was particularly due to the decreased transportation of ammonium nitrate, which is the main component of chemicals and fertilizers.

Average revenue per 1,000 ton/km in USD - the main product transported by Georgian Railway is ammonium nitrate, more than 96 per cent of total transportation of chemicals and fertilizers for the period under review. There were no significant changes in average transportation revenue in 2014, while in 2013 tariff decreased due to minor changes, mainly in transportation direction mix.

Depreciation of GEL against USD - the factor that positively contributed to the revenue is depreciation of GEL against USD.

Cement

Main directions of cargo

Georgia has a strategic location in the corridor and has a strong potential for growth in cement production. Currently, there are three main cement plants in Georgia operated by Heidelberg Cement. During the period under review the main cement transportation directions were internal transportation whithin Georgia and from Georgia to Azerbaijan.

Detailed information for cement transportation

For the year ended 31 December				*% Change*	
	2014	**2013**	**2012**	**2014 vs 2013**	**2013 vs 2012**
Revenue in GEL million	3.01	3.24	3.47	-7.0%	-6.8%
Ton-km in million	39.42	42.42	47.37	-7.1%	-10.4%
Average revenue per 1000 tkm in USD	43.13	45.97	44.42	-6.2%	3.5%
Average exchange rate GEL/ USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the decrease in ton-kilometers transportation can be explained by the opening of cement plants in July 2014 in Azerbaijan, which makes the country largest cement producer in the South Caucasus. This subsequently resulted in lower import of cement by Azerbaijan. The decrease in transportation in 2013 compared to 2012 is due to the reduced construction activities in the region.

Average revenue per 1,000 ton/km in USD - the decrease in average revenue per 1,000 ton-kilometers in 2014 is due to the reduced transportation to more profitable direction - Azerbaijan.

Depreciation of GEL against USD - the decrease in volume was partly offset by depreciation of GEL against USD.

Sugar

Main directions of cargo

Main portion of the sugar transported by Georgian Railway is for the consumption in Georgia, Azerbaijan and Armenia.

Detailed information for sugar transportation

For the year ended 31 December				*% Change*	
	2014	**2013**	**2012**	**2014 vs 2013**	**2013 vs 2012**
Revenue in GEL million	20.50	16.59	17.50	23.6%	-5.2%
Ton-km in million	226.57	221.68	243.95	2.2%	-9.1%
Average revenue per 1000 tkm in USD	51.11	45.08	43.47	13.4%	3.7%
Average exchange rate GEL/ USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - in 2014 transportation of sugar has increased compared to 2013 as reduced transportation of sugar cane to Armenia was offset by an increased transportation to Azerbaijan, which started the expansion of local confectionery manufacturing. The decreased transportation in 2013 compared to 2012 is mainly due to reduced transportation of sugar cane to Armenia, because Armenia started to transport this product from Russia by using road transportation.

Average revenue per 1,000 ton-km in USD - average revenue per 1,000 ton-kilometers has increased due to the change in cargo sub-category mix. Transportation of raw sugar cane in the solid state was replaced by transportation of more profitable product such as cane sugar, which is used for refining.

Depreciation of GEL against USD - depreciation of GEL against USD is another factor that has positively contributed to the increase in revenue.

Industrial freight

Main directions of cargo

Main direction of the cargo in 2014 was Azerbaijan, while in previous years the cargo was mainly transported within Georgia.

Detailed information for industrial freight transportation

For the year ended 31 December				*% Changes*	
	2014	2013	2012	2014 vs 2013	2013 vs 2012
Revenue in GEL million	8.91	6.86	9.50	29.9%	-27.8%
Ton-km in million	127.29	105.58	148.37	20.6%	-28.8%
Average revenue per 1000 tkm in USD	39.53	39.14	38.82	1.0%	0.8%
Average exchange rate GEL/ USD	1.77	1.66	1.65	6.6%	0.6%

Factors influencing the performance

Ton-kilometers - the increased transportation in 2014 compared to 2013 is partly due to the increased transportation of cement clinker to Azerbaijan. The demand was particularly high before the opening of the cement plant in Azerbaijan in 2014, after the opening of the plant the cargo flow has decreased significantly. Consumption of cement clinker has also reduced in Georgia as a result of reduced demand on cement. The decrease in transportation of industrial freight in 2013 compared to 2012 is mainly driven by the reduced volumes of natural barium sulphate and granulated slag (slag sand) transported.

Average revenue per 1,000 ton-km in USD - average revenue per 1,000 ton-kilometers has increased due to the changes in cargo transportation destination. Before it was mainly transported to and within Georgia, while now the principal direction is Azerbaijan with higher tariffs. Changes in cargo type mix have also contributed to the increase in average revenue per 1,000 ton/km.

Depreciation of GEL against USD - depreciation of GEL against USD has positively contributed to the increase in revenue.

Freight handling

General description

Revenue from freight handling is the sum of several components:

- Revenue from station services, which derives from railcar marshaling and freight pick-up and delivery at customer facilities and other related services;
- Revenue from railcar 24-hour delays, which represents a fee paid by customers for failing to unload a railcar within 24 hours of arrival at its agreed destination;
- And revenue from certain other services, which derives from cargo loading/unloading, storage, accelerated service fees and other.

Currency and tariff setting

Most of the freight handling revenue, about 86 per cent as for 2014, is denominated in USD, while the rest is denominated in GEL. The Company sets its tariffs independently.

Driver

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

Freight handling

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Station services	49,340	40,975	39,542	20.4%	8,365	3.6%	1,433
24-hour service	5,944	13,539	7,001	-56.1%	-7,595	93.4%	6,538
Other	13,765	6,015	4,382	128.8%	7,750	37.3%	1,633
Total freight handling	**69,049**	**60,529**	**50,925**	**14.1%**	**8,520**	**18.9%**	**9,604**

Factors influencing the performance
In 2014 total revenue from freight handling increased compared to 2013, due to the increase in revenue from station services and other revenue. However, the revenue from 24-hour delays has decreased.

Abnormally high levels of 24-hour delay revenue in 2013 - revenue from 24-hour delay decreased mainly due to its abnormally high level in 2013. The reason is that in 2013 Georgian Railway had a contract for the capital repair of its railcars with a subcontractor company. However, the subcontractor was not able to carry out its obligations under the contract in time and the railcars of the Company stayed in the Company owned stations. For each day of such delay, Georgian Railway charged the subcontractor its normal fee for railcar delays. In 2014 such occurrences did not repeat, thus 24-hour delays returned to their normal level.

Optimization of station service tariffs in 2014 - revenue from station services increased in 2014 due to the optimization of station service tariffs and starting operations of the subsidiary company, Georgia Transit LLC, in second quarter of 2014.

Other - the increase in other revenue is caused by the fact that revenue from subsidiary company (Trans Caucasus Terminals), which before 2014 was classified in other income was transferred to revenue generated from freight handling.

Freight car rental

General description
Freight car rental revenue derives when the Company's railcars are used by other country's railways. Similarly, Georgian Railway has freight car rental expenses when it uses other country's railcars in its transportation. As the territory of Georgia is significantly smaller compared to the territory of its partner railways, the number of days foreign railcars stay on Georgian territory are smaller than the number of days Georgian railcars stay in other countries. Consequently, the Company receives higher revenue from freight car rentals than it has to pay to other country's railways.

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

The tariffs increase if Georgian railcars are used for more than 30 days on other country's territory. When railcars are used for 30-45 days, freight car rental daily tariff increases by 30 per cent. For the usage of more than 45 days, daily tariff increases by 200 per cent of its normal amount.

Drivers

Freight car rental revenue changes in line with the tariff and the freight car rental days, which is the number of days the railcars are used by other country's railways.

Freight car rental

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Freight car rental	37,811	34,308	46,382	10.21%	3,503	-26.03%	-12,074

Factors influencing the performance

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

Decreased freight car rental days in Turkmenistan in 2013 - revenue decrease in 2013 compared to 2012 was caused by the decrease in freight car rental days charged to Turkmenistan Railway. Before 2013, Georgian railway's railcars were delayed in Turkmenistan due to the bottlenecks on Afghanistan border caused by insufficient number of diesel locomotives to serve the cargo. However in 2013, Turkmenistan Railway acquired diesel locomotives to deal with the bottleneck, in result turnover has improved, leading to decrease in freight car rental days charged to Turkmenistan.

Expiration of railcar exchange contract in 2013 - another reason for the decrease in freight car rental revenue in 2013 was the expiration of the contract according to which Georgian Railway was exchanging 200 open top box (OTB) railcars for 200 tank cars with Ukrainian Railways. The expiration resulted in a decrease in both freight car rental revenue and expense.

Passenger transportation

General description

Passenger transportation is comprised of domestic and international transportation services. Domestic transportation comprise of regional and long distance transportation. Long distance traffic accounts for the majority of the Company's passenger traffic, while the regional services, in particular the suburban component, typically serve the low income section of the community and accordingly low fares apply to such journeys. Georgian rail line is linked to Azerbaijan and Armenia and international transportation services are provided to these directions.

Currency and tariff setting

Tariffs for domestic transportation are set independently by the Company and are denominated in Georgian Lari. Tariffs are not determined by market forces and are remaining relatively low due to the social importance to the State of the Company's provision of affordable passenger transportation services. Besides, given the social importance of its passenger services, Georgian railway may be constrained in removing or reducing services on certain passenger routes, even where such routes are not economical.

Tariffs for international transportation are set by the negotiations between the countries.

Drivers

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

Passenger transportation

For the year ended 31 December	*In million*			*% Change*	
	2014	**2013**	**2012**	**2014 vs 2013**	**2013 vs 2012**
Revenue from Passenger SBU in GEL	18.32	18.04	17.43	1.5%	3.5%
Number of passengers	2.73	2.98	3.09	-8.4%	-3.6%

Factors influencing the performance

Increased share of higher priced seats sold - during the periods indicated above passenger revenue was increasing while the number of passengers transported was decreasing. The lack of correlation between the change in passenger number and change in revenue is caused by the increased share of higher priced seats sold. This can be explained by the addition of new trains to the mainline direction with significantly improved service quality, while some trains for regional transportation (with lower tariffs) were dismissed.

Other revenue

General description
Other revenue is denominated in GEL and it comprise of items such as: revenue from rent of space in the Company owned buildings, sale of scrap, repair services to third parties and other.

Other revenue

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Revenue from rent	2,074	1,659	1,911	25.0%	415	-13.2%	-252
Revenue from repair	1,259	694	538	81.4%	565	29.0%	156
Revenue from realization of materials (scrap)	186	389	1,623	-52.2%	-203	-76.0%	-1,234
Other	142	166	142	-14.5%	-24	16.9%	24
Total other revenue	**3,661**	**2,908**	**4,214**	**25.9%**	**753**	**-31.0%**	**-1,306**

Factors influencing the performance
The increase in total other revenue in 2014 compared to 2013 can be explained mainly by the increased revenue from the repair services and rent. The higher revenue in 2012 compared to the following years is mainly due to the revenue from realization of materials (scrap), which has decreased by 76 per cent in 2013 compared to 2012 and continued to decrease in 2014.

2.2 Other income

General description
Other income mostly comprises of items such as penalties accrued on debtors or creditors, revenue from heavy equipment services and revenue from several subsidiary companies (Georgia Transit LLC and Railway Property Management LLC), which cannot be included in the Company's operating revenue.

In order to better illustrate the operational profitability of the Company, other income is split into two categories: continuing operations (such as revenue from subsidiary company, penalties on creditors and debtors and some other items) and non-continuing operations (such as provision reversals and other items, which are not expected to reoccur in the following periods).

Other income

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Continuing operations	10,390	15,547	14,302	-33.2%	-5,157	8.7%	-1,245
Non-continuing operations	1,963	-96	17,651	N/A	2,059	-100.5%	17,747
Other income	**12,353**	**15,452**	**31,953**	**-20.1%**	**-3,099**	**-51.6%**	**16,501**

Factors influencing the performance

The reduced continuing operations in 2014 compared to 2013 and 2012 can be explained by the fact that before 2014 Trans Caucasus Terminals' (subsidiary of GR) revenue was included in continuing operations. In 2014 however, the revenue generated by the subsidiary was transferred to revenue from freight handling. The reduction in continuing operations can also be explained by reduced fines and penalties received from creditors.

Extrimly high non-continuing operation in 2012 can be explained by one time provision reversal, which is not expected to take place again in the future.

2.3 Railway operating expenses

General description

The Company's operating expenses are mainly fixed. Variable expenses that depend on the volume of transportation are: freight car rental, the most part of electricity and fuel expenses and some part of materials, repair and maintenance, as the increase in usage of rolling stock causes increased need for some types of repairs.

Operating expenses

For the year ended 31 December	*In GEL '000*			*per cent*		
	2014	**2013**	**2012**	**2014**	**2013**	**2012**
Employee benefits expense	145,174	133,509	108,467	38.3%	35.7%	31.3%
Depreciation and amortization expenses	105,258	101,927	97,082	27.8%	27.3%	28.0%
Electricity	20,091	21,236	23,127	5.3%	5.7%	6.7%
Materials	19,280	19,770	20,758	5.1%	5.3%	6.0%
Fuel	7,868	8,160	9,088	2.1%	2.2%	2.6%
Freight car rental	9,790	11,988	18,295	2.6%	3.2%	5.3%
Wagon rent expense	10,202	9,857	6,743	2.7%	2.6%	1.9%
Repair and maintenance	10,001	10,550	7,729	2.6%	2.8%	2.2%
Security, other op. expenses	27,103	33,370	34,950	7.1%	8.9%	10.1%
Taxes other than income tax	24,384	23,554	20,729	6.4%	6.3%	6.0%
Total operating expenses	**379,151**	**373,921**	**346,968**	**100.0%**	**100.0%**	**100.0%**

In 2014 approximately 66 per cent of the Company's operating expenses consisted of employee benefit, depreciation and amortization expenses.

Employee benefit expense

General description

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

Given the size of the Company, Georgian Railway is one of the largest corporate employers and taxpayers in Georgia. This fact underlies the importance of Georgian Railway to Georgian Government along with other important economic benefits to the country.

Employee benefit expenses

For the year ended 31 December		*In GEL '000*		*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Salary	122,428	118,035	94,113	3.7%	4,393	25.4%	23,922
Bonus-reward	7,968	2,890	2,724	175.7%	5,078	6.1%	166
Other benefits	14,778	12,584	11,630	17.4%	2,194	8.2%	954
Total employee benefit expenses	**145,174**	**133,509**	**108,467**	**8.7%**	**11,665**	**23.1%**	**25,042**

Factors influencing changes

Increase in bonuses paid in 2014 - the main reason of the increased employee benefit expenses in 2014 was the increased bonus expenses in 2014 compared to 2013 and 2012. The lower bonuses in previous years were mainly caused by the increase in base salaries at the end of 2012 and in the first quarter of 2013, causing the management to withhold from providing additional monetary incentives to employees at the end of the year.

Increase in base salary in 2013 - the increase in base salary in 2013 compared to 2012 was principally due to the increase in salary expenses at the end of 2012 and in the first quarter of 2013. The reason behind the increase in salaries in 2012 was management's decision to implement its employee benefit program at a faster pace. Before the end of 2012, the management was gradually increasing salaries while reducing the number of employees, as there was an excess capacity of labor in the Company. Consequently, the total salary would stay mostly flat. However, after the parliamentary elections in October 2012 there was a wave of strikes in the country and in the Company as well. As a result, by the end of 2012, GR made a decision to complete its employee benefit program all at once without staff lay-offs. Respectively, the decision was followed by an increase in salary expense.

Higher bulletin funds, damage expenses and business trips - the increase in other benefits in 2014 compared to 2013 is mainly due to the higher bulletin funds, damage compensations paid to employees and business trips outside the country.

Currently, the management withholds from laying off staff because Baku-Tbilisi-Kars (BTK) project completion is expected in 2015 and its operation requires additional staff resources. The management plans to use existing surplus staff for the operations of the new line. Therefore, it is not expected that there will be any significant changes in employee benefit expenses in 2015.

Depreciation and amortization expenses

General description

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

Depreciation and amortization expenses

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Depreciation and amortization	105,258	101,927	97,082	3.3%	3,331	5.0%	4,845

Factors influencing changes

Increase in property, plant and equipment - the increase in depreciation and amortization during the both periods reflected the Company's continuing investment in infrastructure, purchase of new and capital repair of existing railcars. The Company's property, plant and equipment (PPE) increased by 1.3 per cent during 2014 and by 6.8 per cent during 2013.

As capital investments are planned to continue in 2015, depreciation expenses are expected to increase as well.

Electricity expense

General description

Approximately 94 per cent of the Company's railway network is electrified. Until September 2011, the Company purchased most of its electricity on the open market in

Georgia. In September 2011, the Company signed the contract with electricity provider, JSC Energo-pro Georgia, securing the fixed price for more than 90% of its electricity needs. The tariffs are denominated in GEL and might be reviewed once in every 5 years.

In order to better understand the changes in electricity expense, it is split into two categories: electricity consumption for traction, which is driven by transportation volume (the Company mostly uses electric locomotives for transportation of its cargo) and utility expense, which is not related to transportation volume and normally is considered to be fixed.

Electricity expense

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Electricity consumption for traction	17,537	18,709	20,623	-6.3%	-1,172	-9.3%	-1,914
Utility expense	2,554	2,527	2,504	1.1%	27	0.9%	23
Total electricity expense	**20,091**	**21,236**	**23,127**	**-5.4%**	**-1,145**	**-8.2%**	**-1,891**

Factors influencing changes
Decreased transportation volume - decrease in electricity expense can be explained by the decrease in transportation volume (mainly decrease in crude oil transportation). This has driven down the consumption of electricity in 2014 and 2013.

Electricity consumption for traction should change in line with transportation volumes, while utility expense should stay flat. This is subject to electricity tariff, which might be reviewed once during every 5 years.

Fuel expense

General description
The Company's fuel requirements consist principally of the costs of diesel used by supportive diesel locomotives at stations, which are generating freight handling revenue. It should be noted that the main driver for these operations is dry cargo. Liquid cargo volume also affect the expense, however their influence is less than that of the dry cargo. This is due to the fact that liquid cargo is mainly transported to the destinations at which the Company's locomotives are not used for station operations and the customer uses its own locomotives, while dry cargo destinations mainly use GR's locomotives for station operations.

Another factor affecting the fuel expense is the regime of the cargo (whether it is import, export, local or transit). While transit cargo is mainly served in one station of the Company (usually ports), most part of local, export and import cargo is served in two stations (origin station and destination station).

Other minor uses of fuel are lubricants used to serve the equipment of the Company, as well as administrative fuel. The Company purchases fuel based on the market prices, thus the expense is tied to the market price of fuel in Georgia and subsequently the world price.

Fuel expense

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Fuel	6,590	6,755	7,677	-2.4%	-165	-12.0%	-922
Lubricants	1,109	1,213	1,243	-8.6%	-104	-2.4%	-30
Subsidiaries	169	192	168	-12.0%	-23	14.3%	24
Total fuel expense	**7,868**	**8,160**	**9,088**	**-3.6%**	**-292**	**-10.2%**	**-928**

Factors influencing changes

Decrease in transportation volume - one of the reasons for the decrease in fuel expenses was the decrease in transportation volume. As fuel expenses are mainly tied to dry cargo transportation the decrease in fuel expenses was less than the decrease in total volume transportation in 2014.

Decreased prices on fuel - another reason that has contributed to the decrease in fuel expenses was decreased prices per kilogram of fuel purchased.

Fuel prices are likely to move in line with the world prices of fuel. The changes in dry cargo volume should be another affecting factor for this expense, as more volume transform into increased operations for diesel locomotives at stations.

Freight car rental expense

General description

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

Freight car rental expense

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Freight car rental expenses	9,790	11,988	18,295	-18.3%	-2,198	-34.5%	-6,307

Factors influencing changes

The decreased freight car rental expense in 2014 was primarily caused by the decrease of crude oil transportation, which also contributed to the decreased expense in 2013 as crude oil was usually transported with wagons owned by Azerbaijan Railway. The decrease in 2013 compared to 2012 was mainly due to privatization of Ukrainian, Russian and Kazakhstani Railway's wagon fleet. With fewer wagons owned by other railways, the amount of freight car rental expense naturally decreased. Another reason is an expiration of contract in 2013 between Georgian and Ukrainian railways on the exchange of railcars. Ukraine was using Georgian 200 OTB (open top box) railcars in exchange for 200 tank cars, subsequently revenue and expenses were accrued on the Company's balances.

Freight car rental expense is believed to change in line with transported volume and GEL/CHF exchange rate.

Wagon rent expense

General description

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

Wagon rent expense

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Wagon rent expense	10,202	9,857	6,743	3.5%	345	46.2%	3,114

Factors influencing changes

Spacecom wagon rent expense increased in 2014 due to the increase in GEL/USD exchange rate, while in 2013 the increase was caused by the fact that the contract was signed in the mid-2012.

Spacecom wagon rent is believed to decrease, as the contract expires in second quarter of 2015 and management has no current intention to extend it.

Materials, repair and maintenance expenses

General description
Georgian Railway uses materials for repairs that are mainly performed by its own employees. Such material usage represents material expense of the Company. For some types of repairs however, the Company uses outsourcing, in which case the Company does not incur material expenses. This repair outsourcing represents repair and maintenance expense of the Company.

While repair and maintenance are mainly denominated in GEL, materials expense to some extent is affected by foreign currency fluctuations as not all needed materials are produced in Georgia.

Driver
Georgian Railway's materials, repair and maintenance expenses are tied to its rolling stock equipment balance and subsequent utilization level. When transportation by Georgian Railway's own rolling stock increases, material, repair and maintenance expenses increase as well. However, this expense can also be affected by the increased capital expenditures on the fleet and infrastructure, which reduce the need for operating expenditures on repairs.

Materials, repair and maintenance expenses

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Materials	19,280	19,770	20,758	-2.5%	-490	-4.8%	-988
Repair and maintenance	10,001	10,550	7,729	-5.2%	-549	36.5%	2,821
Total materials, repair and maintenance expenses	**29,281**	**30,320**	**28,487**	**-3.4%**	**-1,039**	**6.4%**	**1,833**

Factors influencing changes
Increased number of repairs in rolling stock in 2014 and 2013 - the increase in repair and maintenance expenses in 2014 and 2013 compared to 2012 was mainly caused by the increased number of repairs of rolling stock. The increased need for the rolling stock repair is due to the increased transportation by Georgian Railway's own fleet and increased utilization rate. The decrease in material expenses despite the increase in repair and maintenance expense was caused by the higher amount of repairs completed by third parties.

In case the transportation volume increases, the railcar utilization should increase as well. The managment expects that current rolling stock is enough to handle volumes for the coming years; however, in case new rolling stock would be required it might increase the materials and repair and maintenance expenses. Depreciation of GEL should not have a significant effect on the materials expense as the Company has quite significant existing balances of materials needed for the repairs, limiting the need for additional purchases.

Security and other operating expenses

General description

Security expenses mainly comprises of the protection expense of the Company's buildings and stations. The services are purchased from state security agency.

Other operating expenses mainly consist of items such as: communication, legal costs, consulting services, membership fees, write offs etc.

Security and other operating expenses are denominated in Georgian Lari and are mainly fixed.

Security and other operating expenses

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs. 2013**		**2013 vs. 2012**	
Security	8,495	7,775	7,156	9.3%	720	8.7%	619
Other op. expenses	18,608	25,595	27,794	-27.3%	-6,987	-7.9%	-2,199
Total security and other operating expenses	**27,103**	**33,370**	**34,950**	**-18.8%**	**-6,267**	**-4.5%**	**-1,580**

Factors influencing changes

<u>Reduced write offs and consulting fees</u> - the decrease in other operating expenses in 2014 compared to 2013 is mainly due to the reduced provisions. The lower other operating expenses in 2014 compared to the previous years were also due to the reduction in write offs. The reduced other operating expenses in 2013 compared to 2012 can also be explained by high consulting fees in 2012 due to the issuance of Eurobonds in July.

<u>Increased contract price</u> - the decrease in other operating expenses was partly offset by increase in security expenses as the contract price of the security services increased due to the increased number of the Company's buildings under protection.

No material changes are expected to occur in the Company's security and other operating expenses in 2015.

Property and land taxes

General description

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

Land taxes are determined by the municipalities where the land is located, while property taxes are calculated at one percent of the book value of an asset. Railway infrastructure assets such as rail line are exempt from property tax.

Property land and other taxes

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Property tax	12,892	12,051	10,074	7.0%	841	19.6%	1,977
Land tax	10,225	9,207	9,349	11.1%	1,018	-1.5%	-142
Other taxes	1,267	2,296	1,306	-44.8%	-1,029	75.8%	990
Total property land and other taxes	**24,384**	**23,554**	**20,729**	**3.5%**	**830**	**13.6%**	**2,825**

Factors influencing changes

Increase in asset value in 2014 and 2013 - the increase in property tax in the period under review was due to the increase in the Company's assets, caused by the increased number of GR's rolling stock, capital repair and increase in construction in progress of the Modernization and Tbilisi-Bypass projects.

Increase in land assets and taxation coefficient - the increase in land tax is due to the increase in land held by the Company and also due to the decision of local governments in several regions in Georgia to increase the taxation coefficient on land taxes.

During the next few years property and land taxes is expected to increase in line with the ongoing works on Modernization and Tbilisi-Bypass projects, as well as other capital expenditures. The rise however, will be partly offset by the obsolescence of aging assets and equipment. However, after the completion of these two main projects the Company's property tax is expected to decrease. As significant portion of capital investments within these projects is made in gauge and is taxable while in CIP, but will be free of tax after entering into operation.

2.4 Financial income and cost

General description
Financial income of the Company mainly consists of interest income, which represents the interest accrued on the Company's cash balances.

Financial costs mainly consist of interest expense and foreign exchange losses (*see subheading 3.4 Non-current liabilities*). Part of the Company's interest expense is capitalized, as the main debt obligations of the Company were issued in order to finance capital projects (Modernization and Tbilisi-Bypass). Thus, until the projects are in construction phase, part of the interest accrued is capitalized under IFRS.

Main source of FX gains or losses are the Eurobonds of the Company which are denominated in USD, this is however countered by the USD cash balances of the Company. It must be noted that such FX gains or losses on Eurobonds are not monetary in nature until the maturity of the bonds.

Financial costs and income

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Interest income	11,666	12,334	15,902	-5.4%	-668	-22.4%	-3,568
Premium on the early redemption of issued bonds	0.0	0.0	-41,178	N/A	0.0	-100.0%	41,178
Impairment loss on trade receivables	-5,245	-8,903	-7,681	-41.1%	3,658	15.9%	-1,222
Interest expense	-44,891	-14,251	-10,451	215.0%	-30,640	36.4%	-3,800
FX gain/loss	-61,133	-34,367	3,204	77.9%	-26,766	-1,172.6%	-37,571
Net financial income/loss	**-99,603**	**-45,187**	**-40,204**	**120.4%**	**-54,416**	**12.4%**	**-4,983**

Factors influencing changes
<u>Change in GEL/USD</u> - the main reason for the change in net financial income/loss is FX loss resulting from appreciation of USD against GEL in 2014 and 2013.

<u>Tbilisi-Bypass suspension caused less capitalization of interest in 2014</u> - Another reason of the change was interest expense, which increased in 2014 due to the temporary stoppage of Tbilisi-Bypass project. Due to the suspension, interest expense on the funds spent on the Tbilisi-Bypass project was not capitalized in 2014.

<u>Issue of debt in 2012</u> - in 2013 interest expense increased compared to 2012 as a result of issued Eurobonds in July 2012 (*see subheading 3.4 Non-current liabilities*). The new issue in 2012 was accompanied by buy-back of old issued Eurobonds. As the old Eurobonds were trading with premium, the Company incurred buy-back premium expense in 2012.

In 2015 GR's financial loss is expected to remain high as depreciation of Georgian currency against USD is expected to continue. Interest expense amount depends on the construction works on Tbilisi-Bypass project; in case the project is renewed, interest will be capitalized and interest expense will reduce.

2.5 Income tax expense

Income tax expense

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Income tax expense	5,883	10,960	17,383	-46.3%	-5,077	-36.9%	-6,423

Decrease in income tax expense is in line with the decreased income before taxes in the twelve-month period ended 31 December 2014 compared to 2013 and 31 December 2013 compared to 2012.

3. Balance sheet

3.1 Non-current assets

General description

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

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

Non-current assets

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Property, plant and equipment	2,378,228	2,347,187	2,197,235	1.3%	31,041	6.8%	149,952
Other non-current assets	170,190	180,908	280,884	-5.9%	-10,718	-35.6%	-99,976
Deferred tax assets	1,557	1,557	1,557	0.0%	0.0	0.0%	0.0
Total non-current assets	**2,549,975**	**2,529,652**	**2,479,676**	**0.8%**	**20,323**	**2.0%**	**49,976**

Factors influencing change

Investments in construction in progress - The increase in total non-current assets was mainly due to the increase in property, plant and equipment, which was principaly caused by investments in construction in progress within the framework of Modernization and Tbilisi-Bypass projects, as well as the acquisition of various railway assets, capital repairs and maintenance works. Relatively small increase in 2014 compared to 2013 was due to the slow-down of works for the Modernization project and a temporary stoppage of the Tbilisi-Bypass project.

Decrease in prepayments - the increase in property, plant and equipment was offset by the decrease in other non-current assets. The significant decrease in 2013 compared to 2012 was mainly caused by the decrease in prepayments, due to completed works for wagon repairs and the completion of some parts of the Modernization project, which were previously classified as other non-current assets.

3.2 Current assets

General description

Inventory - current inventory balance consists mainly of inventories needed by the Company for its current repairs and maintenance activities.

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

Current assets

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Inventories	34,008	43,059	35,571	-21.0%	-9,051	21.1%	7,488
Current tax assets	10,924	11,689	0.0	-6.5%	-765	N/A	11,689
Trade and other receivables	53,944	52,402	39,253	2.9%	1,542	33.5%	13,149
Prepayments and other current assets	18,547	39,429	61,648	-53.0%	-20,882	-36.0%	-22,219
Cash and cash equivalents	300,983	208,996	215,397	44.0%	91,987	-3.0%	-6,401
Total current assets	**418,406**	**355,575**	**351,869**	**17.7%**	**62,831**	**1.1%**	**3,706**

Factors influencing changes

Increase in total current assets can be explained mainly by higher cash and cash equivalents balance in 2014 compared to previous years (*see subheading 4 Liquidity and capital resources*) and increase in trade and other receivables, which principaly took place in 2013.

Increased receivables from foreign railway and other - increase in trade and other receivables can be explained by the increased amount to be received from foreign railways due to the usage of Georgian Railway's freight cars and receivables from other activities such as rent, repair services and other.

VAT surplus and advance payments - the decrease in prepayment and other current assets was due to VAT surplus, which was used to compensate for property and land taxes in 2014. The reduction in prepayment and other current assets in 2013 compared to 2012, was mainly caused by completed works for existing advance payments.

Overpayment to the Government - particularly high current tax assets in 2013 can be explained by the fact that the Company has remitted more money to the government for income tax than it was due.

3.3 Equity

Equity

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Share capital	1,052,202	1,050,075	1,049,751	0.2%	2,127	0.0%	324
Non-cash owner contribution reserve	34,214	31,673	31,673	8.0%	2,541	0.0%	0
Retained earnings	476,335	487,379	449,376	-2.3%	-11,044	8.5%	38,003
Total equity	**1,562,751**	**1,569,127**	**1,530,800**	**-0.4%**	**-6,376**	**2.5%**	**38,327**

The decrease in total equity in 2014 compared to 2013 was due to the reduced retained earnings, which was mainly caused by dividend payments in 2014. This decrease was partly offset by the increase in share capital and non-cash owners contribution reserve, as a result of land transfers from the government to Georgian Railway for its projects.

3.4 Non-current liabilities

General description

Eurobonds - Georgian Railways' non-current liabilities mainly consists of non-current borrowings, representing Eurobonds of the Company of USD 527.5 million, from which USD 500 million issued in 2012 with semiannual interest payments (nominal interest rate 7.750%) on 11 January and 11 July and maturing in 2022. USD 27.5 million represents the remaining part of USD 250 million bonds issued in 2010 with semiannual interest payments (nominal interest rate 9.875%) on 22 January and 22 July and maturing on 22 July 2015.

Eurobonds issued in 2012 were partly used to buy back about 89 per cent of Eurobonds issued in 2010, leaving USD 27.5 million to be covered in 2015.

Advances received from the government - another major item in the non-current liabilities is advances received from the government. This item represents the non-monetary prepayment received from the Government of Georgia for the land, which should be freed-up at the completion of the Tbilisi-Bypass project. In April 2012, the Company and the Government entered into the Bypass Project Memorandum. According to the Bypass Project Memorandum the Government is interested and aims to purchase from the Group approximately 70.1 hectares of land plots 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 equivalent in national currency through the reduction in the amount of dividends payable to the Government. In 2012, the Company declared dividends out of which GEL 231,592 thousand (CHF 138 million) were classified as an advance received from the Government for the sale of land in accordance with the Bypass Project Memorandum. The subtraction from retained earnings is already made, however the project is not yet completed and the land remains with the Company. Thus the amount is shown in the balance sheet as a liability.

Non-current liabilities

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Loans and borrowings	929,373	913,194	870,934	1.8%	16,179	4.9%	42,260
Advances received from the gov.	229,377	231,592	231,592	-1.0%	-2,215	0.0%	0.0
Trade and other payables	52	52	52	0.0%	0.0	0.0%	0.0
Deferred tax liability	59,998	58,436	57,302	2.7%	1,562	2.0%	1,134
Total non-current liabilities	**1,218,800**	**1,203,274**	**1,159,880**	**1.3%**	**15,526**	**3.7%**	**43,394**

Factors influencing changes

Depreciation of GEL against USD - the main reason of the increase in total non-current liabilities was loans and borrowings. As the Eurobonds of the Company are denominated in USD, the depreciation of Georgian currency against USD caused the increase in loans and borrowings in Georgian Lari terms. This increase was partly offset by transferring part of the long term loans and borrowings (USD 27.5 million) to current loans and borrowings.

Transfer of land to the government - decrease in advances received from the government by 1 per cent (GEL 2.2 million) was a result of the transfer of the part of the land, which was not needed for current operations, to the State in accordance with the agreement mentioned above.

3.5 Current liabilities

General description

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

Liabilities to the government - is due to the fact that in previous periods certain assets were taken out of the capital of the Company in order to be transferred to the government, but were recorded as a liability as the actual transfer was delayed.

Current liabilities

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Loans and borrowings	87,330	33,747	33,420	158.8%	53,583	1.0%	327
Trade and other payables	78,480	56,161	81,645	39.7%	22,319	-31.2%	-25,484
Liabilities to the government	8,467	11,917	12,956	-29.0%	-3,450	-8.0%	-1,039
Provisions	6,447	6,154	4,132	4.8%	293	48.9%	2,022
Other current liabilities	6,106	4,847	7,170	26.0%	1,259	-32.4%	-2,323
Current tax liabilities	0	0	1,542	N/A	0	-100.0%	-1,542
Total current liabilities	**186,830**	**112,826**	**140,865**	**65.6%**	**74,004**	**-19.9%**	**-28,039**

Factors influencing changes

Reclassification of loans and borrowings - the main reason of the increase in total current liabilities was loans and borrowings, as the remaining portion of Eurobond issued in 2010 (USD 27.5 million) is due in 2015 and was transfered from long-term loans and borrowings to short-term.

Payments made to contractors and advances received from customers - the increase in trade and other payables in 2014 is partially due to the payables for railcar rent and advance payments received from customers. Trade and other payables balance reduced in 2013 due to the payments made to contractors for the completed works on Tbilisi-Bypass and Modernization projects in previous periods.

Assets transferred to the government - the decrease in liabilities to the government in 2014 can be explaned by the fact that certain assets were transferred to the State.

4. Liquidity and capital resources

By the end of 2014, the Company has accumulated quite significant balance of cash and cash equivalents. These cash resources are held in order to support existing and future capital expenditures and debt repayments. Capital expenditures mainly consist of Modernization and Tbilisi-Bypass projects, from which Modernization project is developing in a slower pace than previously, while Tbilisi-Bypass project is suspended.

As at December 31, 2014 and December 31, 2013, the Company had cash and cash equivalents of GEL 301 million and GEL 209 million respectively. The Company can also rely on its available credit lines of approximately GEL 40 million.

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

4.1 Operating activities

General description

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

VAT tax refund from the State - the Company has capital expenditures which includes VAT payments to the Government and provides services for which it has to pay VAT. In case of positive VAT surplus the Company can reclaim the entire VAT surplus from the Government or use it to cover other taxes such as corporate income tax, personal income tax of the employees and other. Georgian Railway took the decision to use this surplus to cover its other taxes since 2013.

Net cash from operating activities

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Cash receipts from customers	526,862	475,455	470,825	10.8%	51,407	1.0%	4,630
Cash paid to suppliers and employees	-243,832	-240,401	-245,997	1.4%	-3,431	-2.3%	5,596
VAT tax refund from the State	0	7,500	23,000	-100.0%	-7,500	-67.4%	-15,500
Income tax paid	-2,925	-23,751	-8,220	-87.7%	20,826	188.9%	-15,531
Net cash from operating activities	**280,105**	**218,803**	**239,608**	**28.0%**	**61,302**	**-8.7%**	**-20,805**

Factors influencing changes

Company's higher revenue - the main reason that positively contributed to the increase in net cash from operating activities, is increase in cash receipts from customers. This was due to higher revenues of the Company in 2014 *(see subheading 2.1 Railway operating revenues).*

Accumulated VAT balance - cash paid to suppliers and employees remains relatively stable compared to the previous years despite the fact that employee salary expense has increased by about GEL 36.7 million from 2012. The reason behind this is the usage of accumulated VAT balance of the Company to cover other taxes including personal income tax of employees and corporate income tax of the Company. Due to this reason, income tax paid in 2014 decreased by GEL 21 million compared to 2013.

Cash receipts from customers should change in line with revenues, while cash paid to suppliers and employees should be in line with the changes in expenses of the Company.

4.2 Investing activities

General description

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

Interest received - the Company receives interest for cash it holds in bank.

Term deposits - the Company holds one part of its cash on current bank accounts and another part on deposits, which provide a higher return. Before 2013, part of the deposits were classified as term deposits. Therefore, the movement of cash between these two accounts were reflected in the statements of cash flow under investment activities. In 2013, all term deposits of the Company met the criteria required for classification as cash and cash equivalents.

Net cash used in investing activities

For the year ended 31 December		*In GEL '000*		*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Net acquisition of property, plant and equipment	-86,776	-148,661	-398,136	-41.6%	61,885	-62.7%	249,475
Interest received	11,523	16,764	11,300	-31.3%	-5,241	48.4%	5,464
Decrease(Increase) in restricted cash	0	0	2,963	N/A	0.0	-100.0%	-2,963
Decrease(Increase) in term deposits	0	95,525	-23,872	-100.0%	-95,525	-500.2%	119,397
Purchase of a company share	0	-48	0.0	-100.0%	48	N/A	-48
Net cash used in investing activities	**-75,253**	**-36,420**	**-407,745**	**106.6%**	**-38,833**	**-91.1%**	**371,325**

Factors influencing changes

Slow-down in works of two main construction projects - net cash used in investing activities significantly decreased in 2014 and 2013 compared to 2012. This was mainly due to the decrease in acquisition of property, plant and equipment, which was caused by the slow-down in works for Modernization project and also the temporary stoppage of Tbilisi-Bypass project.

The Company's cash payments for Modernization project was GEL 28 million, GEL 48 million and GEL 107 million for the years 2014, 2013 and 2012 respectively. Cash payments for the Tbilisi-Bypass project were GEL 9 million, GEL 27 million and GEL 149 million for the years 2014, 2013 and 2012 respectively. The remaining amount was spent on other capital expenditures such as railcar capital repairs, acquisition of new rolling stock and other.

Reduction in interest rate - although, the Company held more cash during the year 2014 compared to previous two years its interest received has decreased. This can be explained by the fact that interest rate offered by Georgian banks on the current accounts and time deposits decreased in 2014.

The change in net cash used in investing activities in 2015 depends mostly on the construction works on its two main projects, Modernization and Tbilisi-Bypass. Modernization project is currently being implemented at a slower pace due to the opportunity to increase the capacity of the projected rail line. The changes to the initial plan require governmental approval and thus need time. Tbilisi-Bypass is currently suspended and is being studied for possible improvements.

4.3 Financing activities

General description

Dividends paid **-** Georgian Railway holds Eurobonds which imposes restrictions on dividend payments. The covenants of bonds include the constraint according to which the maximum amount of cumulated dividend payments starting from 2013 is 50 per cent of the cumulated consolidated net income of the Company starting from 2013.

Interest paid **-** The Company pays interest on its Eurobonds (USD 527.5 million), denominated in USD.

Net cash used for financing activities

For the year ended 31 December	*In GEL '000*			*% Change*	*Abs. Change*	*% Change*	*Abs. Change*
	2014	**2013**	**2012**	**2014 vs 2013**		**2013 vs 2012**	
Dividends paid	-50,330	-25,000	-150,725	101.3%	-25,330	-83.4%	125,725
Interest paid	-72,826	-69,764	-22,915	4.4%	-3,062	204.4%	-46,849
Proceeds from borrowings	0	0	396,182	N/A	0.0	-100.0%	-396,182
Repayment of borrowings	0	-32	-635	-100.0%	32	-95.0%	603
Cash distribution to the owner	0	0	-3,101	N/A	0.0	-100.0%	3,101
Net cash from financing activities	**-123,156**	**-94,796**	**218,806**	**29.9%**	**-28,360**	**-143.3%**	**-313,602**

Factors influencing changes

Proceeds from borrowings - The positive net from financing activities in 2012 was mainly caused by proceeds from borrowings. In July 2012 Georgian Railway issued Eurobonds of USD 500 million, part of which (USD 222.48 million) was used to buy back previously issued Eurobonds (remaining value USD 27.52 million) and cover the accrued interest on the bought-back bonds.

Eurobonds issued and depreciation of GEL against USD - Due to new Eurobonds issue, the Company's interest paid increased in the folowing years. The higher interest paid in 2014 compared to 2013 is due to the depreciation of GEL against USD as the interest accrues on USD denominated debt obligations and is subject to the GEL/USD exchange rate.

Covenants of bonds - The Company paid fewer dividends in 2013 and 2014 compared to 2012. The reason behind is the covenants of bonds, which limits the amount that can be paid in dividends.

In 2015 interest paid is believed to increase due to the continuing depreciation of GEL against USD. Dividend paid is believed to be lower in 2015 as the Company's dividends are restricted by its covenants for the bonds: cumulated dividend payments starting from the year 2013 are restricted to a maximum of 50 per cent of the cumulated consolidated net income of the Company starting from 2013.