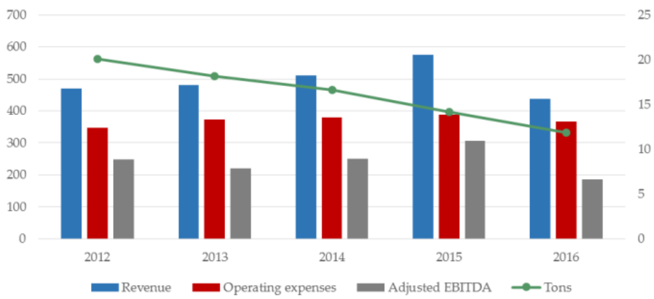
Management Discussion and Analysis for the year ended 31 December 2016

The Group's financial performance has weakened in 2016. As a result of continued pressure from challenging market environment the Group's transportation volume in 2016 has declined by 16 percent compared to 2015. On the back of depressed transportation volumes total revenue declined by 23 percent and adjusted EBITDA margin was down from 54 percent in 2015 to 44 percent in 2016.

Amounts in GEL mm, volumes in tons mm



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

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 The total credit facility is USD 43.7 million from which, by the end of 2016, the Group had withdrawn USD 23.2 million to finance the procurement of new passenger trains.

Main developments in 2016

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

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

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1. Profit or Loss Statement

Profit or loss statement

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

	2016	2015	% Change	Abs. change
Revenue	439,922	574,773	-23.5%	-134,851
Income from transferred property	80,294	7,503	970.2%	72,791
Other income	19,122	23,268	-17.8%	-4,146
Employee benefits expense	-146,626	-148,625	-1.3%	1,999
Depreciation and amortization	-106,267	-104,416	1.8%	-1,851
Electricity, consumables and maintenance cost	-47,289	-60,927	-22.4%	13,638
Other expenses	-63,668	-73,205	-13.0%	9,537
Result from operating activities	**175,488**	**218,371**	**-19.6%**	**-42,883**
Finance income	23,882	20,932	14.1%	2,950
Finance cost	-173,103	-315,355	-45.1%	142,252
Net finance cost	**-149,221**	**-294,423**	**-49.3%**	**145,202**
Profit/(loss) before income tax	**26,267**	**-76,052**	**-134.5%**	**102,319**
Income tax benefit	38,859	10,555	268.2%	28,304
Net income	**65,126**	**-65,497**	**-199.4%**	**130,623**
EBITDA	281,755	322,787	-12.7%	-41,032
EBITDA margin	64.0%	56.2%	N/A	7.9%
Adjusted EBITDA	195,149	307,828	-36.3%	-112,679
Adjusted EBITDA Margin	44.4%	53.6%	N/A	-9.2%

1.1 Revenue

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

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

Revenue Breakdown

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

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

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

Freight transportation

The Group's freight transportation revenue consists of liquid and dry cargoes. The split between liquid and dry cargo revenue in 2016 was about 46 and 54 percent, respectively.

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

Transportation volume - measured in tons transported.

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

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

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

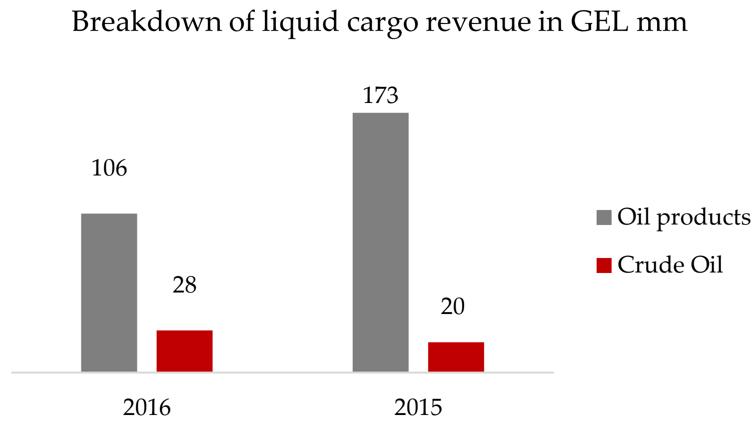
GEL/USD exchange rate - one important issue in analyzing the performance of the Group is the fact that most of its tariffs are denominated in USD. As the Group reports its revenue in GEL, the changes in the GEL/USD exchange rate can have a significant impact on the Group's profitability, as most of its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

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

Liquid cargo

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

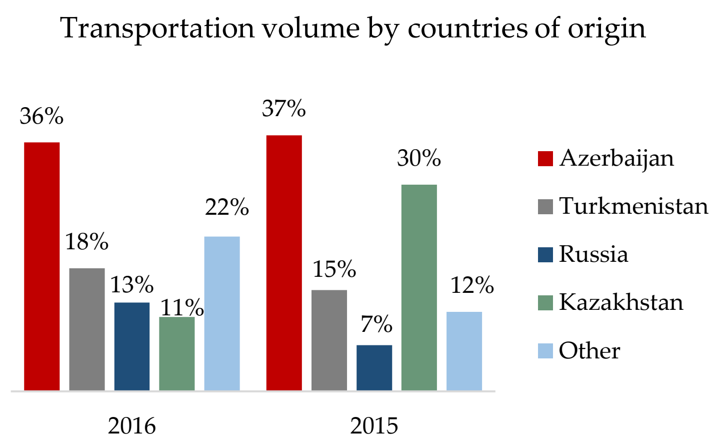
Most of the Group's liquid cargo revenue comes from oil products.



Oil products

Main directions of cargo

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



In 2016 oil products mostly originated from Azerbaijan, Turkmenistan, Russia and Kazakhstan. Azerbaijan's share in oil products transportation volume remains the largest, 36 percent in 2016 versus 37 percent in 2015, Kazakhstan's share was down from 30 percent in 2015 to 11 percent in 2016. Turkmenistan's and Russia's transportation share in 2016 compared to 2015 was up from 15 percent to 18 percent and from 7 percent to 13 percent, respectively.

Oil product

For the year ended 31 December

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

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

Factors influencing performance

Ton-kilometers - freight transportation turnover of oil products was down by 45 percent in 2016. The decrease was mainly due to the reduced transportation volume from Kazakhstan by 77 percent and Azerbaijan by 39 percent and also due to the reduction in average transportation distances.

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

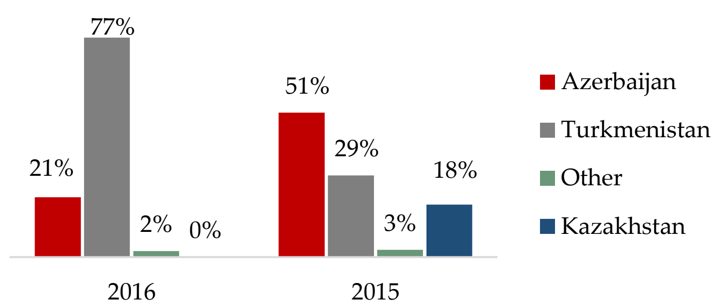
Revenue/ton-km (in Tetri) - increase in revenue per ton-kilometer was caused by the increased transportation volume and transportation share from Russia, which has one of the highest average revenue per ton-kilometer.

Crude oil

Main directions of cargo

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

Transportation volume by countries of origin



Crude oil

For the year ended 31 December

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

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

Factors influencing performance

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

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

Dry cargo

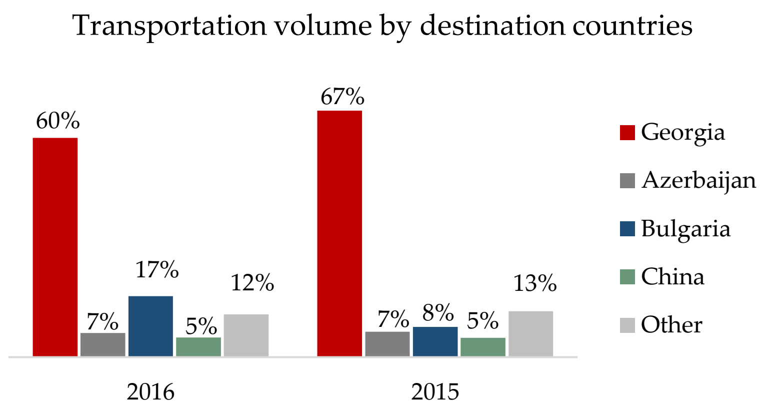
Dry cargo contributed about 54 percent to total transportation revenue in 2016. The major factors driving transportation of dry cargo are general national economic conditions and economic developments in Georgia and in partnering countries such as Azerbaijan, Armenia, Turkmenistan, Kazakhstan and other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

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

Ore products

Main directions of cargo

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



Ore Products

For the year ended 31 December

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

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

Factors influencing performance

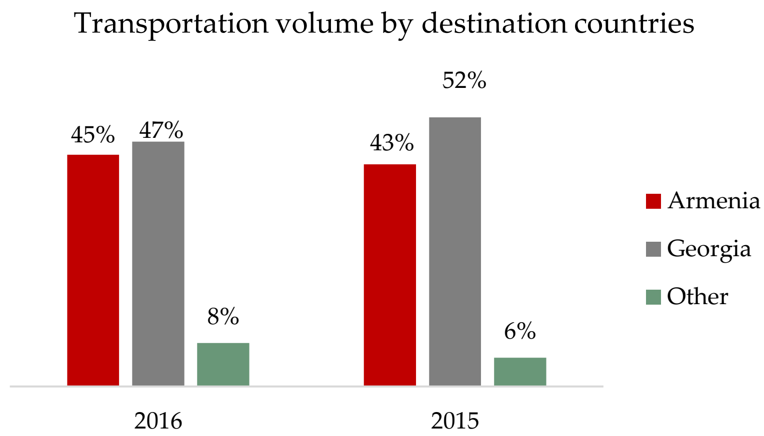
Ton-kilometers - decrease in freight transportation turnover was mainly due to the reduction in volume and average transportation distance of coal.

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

Grain and grain products

Main directions of cargo

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



Grain and grain products

For the year ended 31 December

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

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

Factors influencing performance

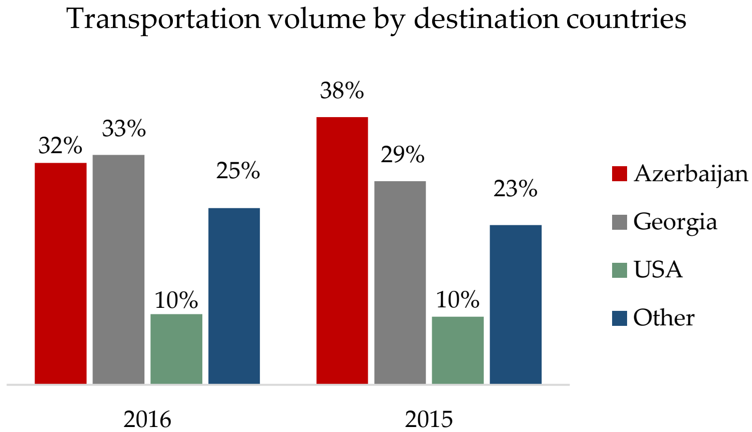
Ton-kilometers - decrease in freight transportation turnover by 38 percent was mainly caused by the decreased transportation volume from Russia by about 39 percent.

Revenue/ton-km (in Tetri) - reduction in revenue per ton-kilometer in 2016, compared to 2015, was mainly caused by the fact that there was change in freight loading terminals, which have impact on tariffs. Also decrease in average revenue was highly affected by the decreased volume in durum wheat to Armenia direction which was one of the most profitable freight. There was also some reductions in tariffs on certain grain product categories.

Ferrous metals and scrap

Main directions of cargo

Main destination points of ferrous metals and scrap transported by the Group are Azerbaijan and Georgia. In 2016, about 32 percent of goods were transported to Azerbaijan and about 33 percent were transported to Georgia. One of the most profitable products under this product category were pipes for oil and gas pipelines, which was down by 66 percent in 2016 compared to 2015.



Ferrous metals and scrap

For the year ended 31 December

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

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

Factors influencing performance

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

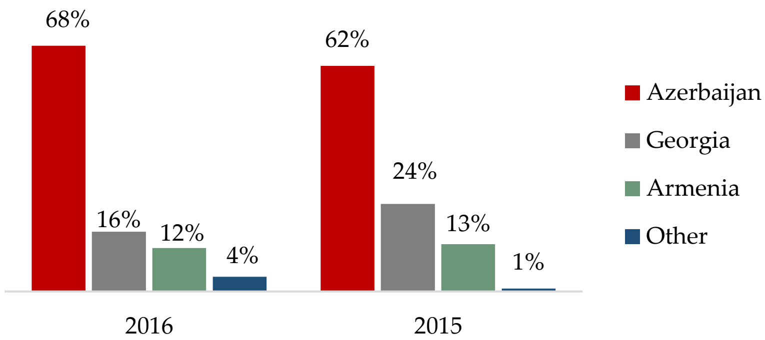
Revenue/ton-km (in Tetri) - decrease in average revenue per ton-kilometer was due to the reduced transportation volumes of relatively more profitable products like pipes for oil and gas pipelines and increased volumes of relatively less profitable products such as bars and rods of iron or non-alloy steel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

Sugar

Main directions of cargo

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

Transportation volume by destination countries



Sugar

For the year ended 31 December

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

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

Factors influencing performance

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

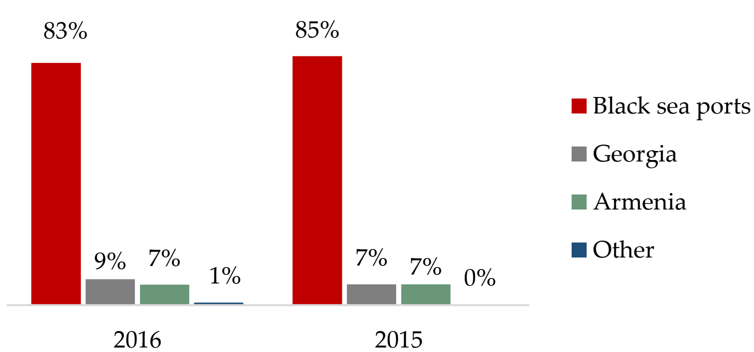
Revenue/ton-km (in Tetri) - decrease in average revenue per ton-kilometer was mainly caused by the reduced average tariffs to Azerbaijan direction.

Chemicals and fertilizers

Main directions of cargo

Chemicals and fertilizers were mainly transported to Black Sea ports. Relatively small portion of the products was transported to Armenia and to Georgia. In 2016 the Group has mainly transported ammonium nitrate under the chemicals and fertilizers freight category with 84 percent of share.

Transportation volume by destination countries



Chemicals and fertilizers

For the year ended 31 December

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

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

Factors influencing performance

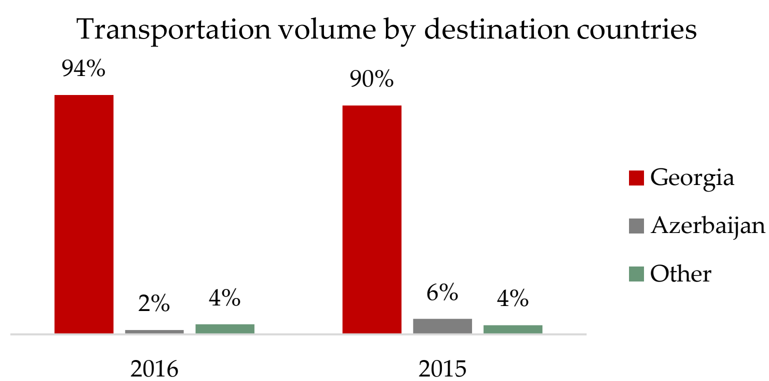
Ton-kilometers - decrease in transportation turnover was mainly due to the reduced transportation of ammonium nitrate, which was the main type of product transported under this product category.

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

Construction freight

Main directions of cargo

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



Construction freight

For the year ended 31 December

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

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

Factors influencing performance

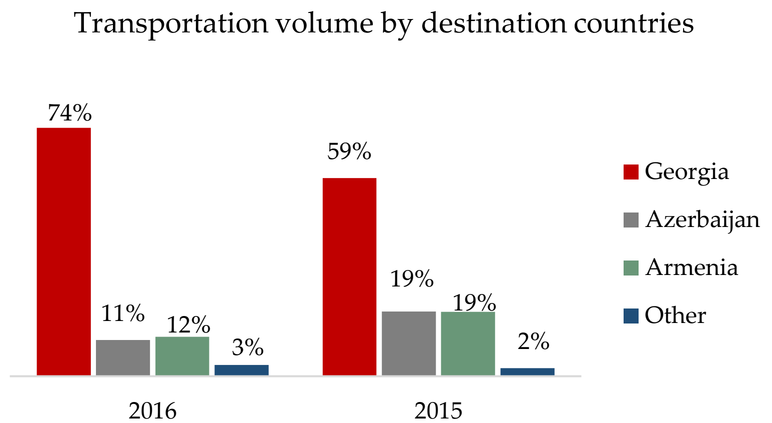
Ton-kilometers - decrease in transportation turnover was mainly due to the decreased transportation volume to Azerbaijan and Georgia which is the main direction.

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

Industrial freight

Main directions of cargo

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



Industrial freight

For the year ended 31 December

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

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

Factors influencing performance

Ton-kilometers - transportation turnover of industrial freight decreased by 28 percent although transportation volume shows 4 percent increase. This was mainly caused by reduced transportation volume to Azerbaijan and Armenia, while transportation volume to Georgia, which covers smaller distances and is relatively less profitable, has increased. The increased transportation volume to Georgia was mostly caused by increased transportation of cement clinker from Azerbaijan.

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

Cement

Main directions of cargo

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

Cement

For the year ended 31 December

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

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

Factors influencing performance

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

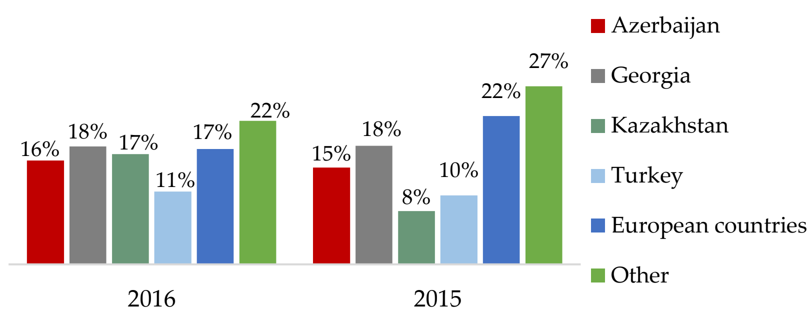
Revenue/ton-km (in Tetri) - decrease in average revenue per ton-kilometer was caused by the fact that in July 2015 the group has reduced tariffs by 20 percent on the freight transported within Georgia and on exported goods. As the transportation share within Georgia was up from 88 percent in 2015 to 96 percent in 2016 and the reduced tariffs were applied to the longer period and had greater effect on average revenue per ton-kilometer in 2016.

Other product categories

Main directions of cargo

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

Transportation volume by destination countries



Other products

For the year ended 31 December

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

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

Factors influencing performance

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

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

Freight handling

General description

Revenue from freight handling is the sum of several components:

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

Currency and tariff setting

Most of the freight handling revenue, about 90 percent in 2016 was denominated in USD, while the rest was denominated in GEL. The Group sets its tariffs independently.

Driver

The revenue from this source 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*

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

Factors influencing the performance

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

Extremely high revenue in 2015 from 24-hour service was caused by wagon delays, because after the termination of the contract for wagon rent in April 2015, the railcars remained at the Group's stations. However, about GEL 13 million provision was created against revenue from 24-hour services in 2015. In addition, decrease in revenue was driven by reduced transportation volumes.

Logistic service

General description

Revenue from logistic service represents the Group's revenue from logistic services generated by GR's subsidiaries.

Currency and tariff setting

Revenue from logistic services is mostly denominated in USD.

Driver

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

Logistic service

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

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

Factors influencing the performance

Decreased revenue from logistic service mainly was due to the reduced transportation volume and turnover by the GR's subsidiary company that serves crude oil and oil product transportation mainly from Azerbaijan, Kazakhstan and Turkmenistan. This reduction was partly offset by increased revenue from the GR's another subsidiary company which, serves oil products mainly transported to the direction of Azerbaijan and Armenia.

Freight car rental

General description

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

Currency and tariff setting

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

Drivers

Freight car rental revenue changes according to tariffs and the number of days the Group's railcars are used by other railways.

Freight car rental

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

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

Factors influencing the performance

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

Passenger traffic

General description

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

In July 2016 the Group acquired two new double-decker trains of the European standard which started to serve the passengers from Tbilisi to the direction of Black Sea resorts in summer. Two more trains are to be procured in the first quarter of 2017.

Currency and tariff setting

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

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

Drivers

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

Passenger transportation

For the year ended 31 December

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

Factors influencing the performance

Revenue from passenger transportation has increased by 16 percent (GEL 2.5 million) in 2016 compared to 2015, while the number of passengers has increased by just 3 percent. The higher increase in revenue was driven by increased number of passengers on the main line, which is more profitable and mainly serves to Georgian resorts' directions, while there was a reduction in regional transportation. The increased number of passengers was partly driven by the two new trains that started to serve customers from summer 2016. The average loading rate of the trains on the main line in 2016 was about 65 percent.

Other revenue

General description

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

Other revenue

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

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

Factors influencing the performance

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

1.2 Income from transferred property

General description

Bypass Project Memorandum was signed between Government of Georgia and Georgian Railway in April 2012. According to this memorandum, it was agreed that the Company will transfer land plots to the State, which will be freed up as a result of the Bypass Project and the Company will be reimbursed for the amount of VAT paid for sale.

In 2012, the Company declared dividends out of which GEL 232 million (equivalent to CHF 138 million) were classified as an advance received from the Government for the sale of the land covered in the Bypass Project Memorandum.

Income from transferred property

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

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

Factors influencing the performance

The increase in income from transferred property was due to the sale of land to the Government of Georgia under the Bypass Project Memorandum. However, sale of land plots was non-cash transaction.

In 2016 and 2015, the Company transferred 89,166 and 3,266 square meter land plots with attached constructions, respectively, to the Government within the framework of the Bypass Project Memorandum. The fair value of the land plots and related attached constructions was determined by an independent appraiser based on announced asking prices of similar properties in the similar location and physical condition. The difference between the fair value and the carrying value of transferred property was recognized as income from transferred property.

1.3 Other income

General description

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

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

Other income

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

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

Factors influencing the performance

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

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

1.4 Operating expenses

General description

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

Operating expenses

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

	2016	2015	% Change	Abs. change
Employee benefits expense	146,626	148,625	-1.3%	-1,999
Depreciation and amortization	106,267	104,416	1.8%	1,851
Electricity	21,687	20,424	6.2%	1,263
Materials	14,121	19,276	-26.7%	-5,155
Repair and maintenance	7,175	15,420	-53.5%	-8,245
Fuel	4,306	5,807	-25.8%	-1,501
Freight car rental	4,407	7,613	-42.1%	-3,206
Wagon rent expense	0	3,597	-100.0%	-3,597
Logistic services	14,270	17,197	-17.0%	-2,927
Security, other op. expenses	18,517	18,829	-1.7%	-312
Taxes other than income tax	26,474	25,969	1.9%	505
Total	**363,851**	**387,173**	**-6.0%**	**-23,322**

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

Employee benefits expense

General description

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

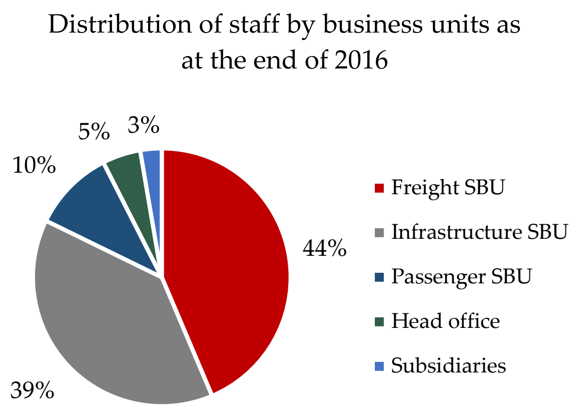
Employee benefits expenses

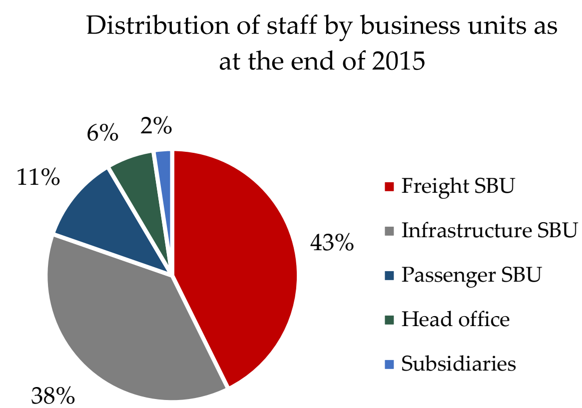
For the year ended 31 December *In GEL '000*

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

Factors influencing changes

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





Depreciation and amortization expenses

General description

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

Depreciation and amortization expense

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

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

Factors influencing changes

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

Electricity expenses

General description

Approximately 94 percent of Georgian Railway's railway network is electrified. Until September 2011, the Company purchased most of its electricity on the open market in Georgia. In 2011, the Company signed a ten-year contract with the electricity provider, JSC Energo-pro Georgia, securing a fixed price for more than 90% of its electricity needs (subject to certain circumstances in which these tariffs can be increased). The tariffs are denominated in GEL.

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

Electricity expenses

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

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

Factors influencing changes

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

Purchased electricity and weighted average tariff

For the year ended 31 December

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

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

Materials, repair and maintenance expenses

General description

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

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

Materials, repair and maintenance expenses

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

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

Factors influencing changes

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

Fuel expense

General description

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

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

Fuel expense

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

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

Factors influencing changes

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

Freight car rental expense

General description

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

Freight car rental expense

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

	2016	2015	% Change	Abs. change
Freight car rental expense	4,407	7,613	-42.1%	-3,206

Factors influencing changes

Despite the appreciation of CHF against GEL by about 1.7 percent in 2016 compared to 2015, freight car rental expenses has decreased by 42 percent (GEL 3.2 million), decrease was driven by the fall in freight volume and by the agreement with Azerbaijan Railways to charge on freight car rental services with an exemption of first eight days for each railcar.

Wagon rent expense

General description

Wagon rent expense covered the rent for 425 tank cars, rented since 30 March 2012. The daily rent price was set in USD. This item is included in "freight car rental" expense in audited financial statements and is separated here for better understanding of changes.

Wagon rent expense

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

	2016	2015	% Change	Abs. change
Wagon rent expense	0	3,597	-100.0%	-3,597

Factors influencing changes

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

Logistic services

General description

Expenses for logistic service represent operating expenses related to transportation and other logistic related services of GR's subsidiaries which are operating in freight forwarding and logistic field. This expense was separated from "security and other operating expenses" for better presentation.

Logistic services

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

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

Factors influencing changes

Expenses for logistic service in 2016 have decreased by 17 percent (GEL 2.9 million) compared to 2015. The decrease was mainly caused by reduced overall transportation volume by 16 percent.

Security and other operating expenses

General description

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

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

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

Security and other operating expenses

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

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

Factors influencing changes

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

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

Taxes other than income tax

General description

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

Taxes other than income tax

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

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

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

Factors influencing changes

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

Decrease in other taxes by 36 percent (GEL 0.6 million) has partly offset increases in property and land taxes in 2016.

1.5 Finance income and cost

General description

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

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

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

Finance income and cost

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

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

Factors influencing changes

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

In 2016 there was significant fall in impairment loss on trade receivables due to abnormal high level of impairment loss on trade receivables in 2015 which was significantly driven by the impairment of receivables from the other party in the wagon rent contract (*see "Wagon rent expense" in subheading 1.4 "Operating expenses"*). After the termination of the contract for wagon rent in April 2015, the railcars remained at the Group's stations and generated revenue from 24-hour service, however in 2015 about GEL 13 million provision was created against revenue from freight handling services.

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

The Group has a significant exposure on foreign currency exchange rates, as its borrowings are denominated in USD. Although there was decrease in foreign currency loss in 2016, still foreign currency loss appeared with considerable amount (GEL 110.9 million), due to depreciation of GEL against USD. The Group's revenues are mostly denominated in hard currencies in USD and CHF, 90 and 3 percent of total revenue respectively (based on 2016 revenue). As most of the tariffs are set in USD, the Group's revenue creates a natural economic hedge against foreign exchange fluctuations.

Average exchange rates

For the year ended 31 December

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
GEL/USD	2.37	2.27	1.77	1.66	1.65	1.69	1.78	1.67	1.49	1.67
GEL/CHF	2.40	2.36	1.93	1.80	1.76	1.91	1.71	1.54	1.38	1.39

1.6 Income tax benefit

General description

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

Income tax benefit

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

	2016	2015	% Change	Abs. change
Current year	5,532	5,052	9.5%	480
Temporary differences	0	-15,607	-100.0%	15,607
Change in recognized temporary differences	-44,391	0	NM	-44,391
Total	**-38,859**	**-10,555**	**268.2%**	**-28,304**

Factors influencing changes

Despite the fact that the Group shows positive income before tax in 2016, income tax benefit has increased to GEL 38.9 million from GEL 10.6 million in 2015, the change was caused by the new tax legislation which is to be effective from 1 January 2017. The deferred tax assets and liabilities previously recognized in equity as part of the Group's transition to IFRSs was reversed through the consolidated statement of profit or loss.

2. Balance Sheet

2.1 Non-current assets

General description

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

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

Loan receivable - represents loans issued by the Group to other parties.

Non-current assets

As at 31 December *In GEL '000*

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

Factors influencing changes

Property, plant and equipment - GEL 140.2 million increase in property plant and equipment in 2016, compared to 2015, was mainly due to the construction in progress works, mostly within the scope of Modernization project, other infrastructure modernization works and purchase of new passenger trains.

Loan receivable - in 2016, the Group issued long term loans with total amount of USD 14.5 million. The loans were issued in USD, at market rates. USD 6 million was provided to the parent company. USD 8.5 million was provided to the owner of liquid cargo terminals on the Black Sea, which is under management of the Group. The Group will manage the liquid cargo terminals for the whole life of the loan and will receive the management fee.

2.2 Current assets

General description

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

Loan receivable - represents loans issued by the group.

Tax assets - represents net tax assets of the Group.

Current assets

As at 31 December *In GEL '000*

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

Factors influencing changes

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

Trade and other receivables - increase in 2016 was driven by the VAT receivable from the Government. In 2016, the Group has transferred land plots and attached buildings, unnecessary for the operation, to the Government under the Bypass project memorandum. According to the agreement, VAT created as a result of this transaction will be reimbursed by the Government. In result, as at the end of 2016, GR has receivable of GEL 23.7 million from the government as a result of land transfer transactions in 2016.

Prepayments and other current assets - decrease in prepayments and other current assets in 2016, compared to 2015, by GEL 11.6 million was mostly attributable to the changes in tax system in Georgia in 2016, under which tax cards were combined in one joint card, accordingly as at the end of 2016 the Group has presented all tax assets and liabilities netted, under "Tax assets", while at the end of 2015 some tax assets are presented under "Prepayments and other current assets".

2.3 Equity

Equity

As at 31 December *In GEL '000*

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

There was GEL 128.1 million increase in total equity in 2016 compared to the previous year. The increase was contributed about equally, GEL 63.6 million increase in retained earnings and GEL 64.1 increase in non-cash owner contribution reserve, which is originated from the difference between the cost of the transferred property, as agreed between the Group and the Government and used for the reduction of advances received from the Government, and the fair value of the transferred property. The difference between the cost and the fair value of the transferred property was recognized directly in equity as a non-cash owner contribution reserve of the land plots transferred to the Government.

2.4 Non-current liabilities

General description

Eurobonds - the Group's non-current liabilities mainly consist of non-current borrowings, representing the Group's Eurobonds (face value - USD 500 million), issued in 2012 with semiannual interest payments (coupon rate - annual 7.750 percent) on 11 January and 11 July and maturing in 2022.

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 upon the completion of the Bypass project. In April 2012, the Company and the Government entered into the Bypass Project Memorandum according to which the Government aims to purchase from the Group approximately 70 hectares of land plots which will be released as a result of the removal of railway infrastructure from Tbilisi city center. The Government agrees to pay the equivalent of CHF 138 million in national currency to the Group by reducing the amount of dividends payable to the Government. In 2012, the Company declared dividends out of which GEL 232 million (CHF 138 million) were classified as an advance received from the Government for the sale of the land covered in the Bypass Project Memorandum. The subtraction from retained earnings has already been made, however the project has not been completed yet and part of the land remains under the ownership of the Group. Thus, the amount is shown in the balance sheet as a liability.

Non-current liabilities

As at 31 December *In GEL '000*

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

Factors influencing changes

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

Advances received from the Government - in 2016, the Group has transferred land plots and attached buildings, unnecessary for the operation, to the Government under the Bypass Project Memorandum, in result liabilities to the Government was reduced.

Deferred tax liability - due to the new tax code of Georgia, effective from 1 January 2017, deferred tax liabilities have been eliminated through income tax benefit as at the end of 2016 (*see subheading 1.6 "Income tax benefit"*).

2.5 Current liabilities

General description

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

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

Current liabilities

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

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

Factors influencing changes

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

Trade and other payables - in 2016 trade and other payables has increased by 23 percent (GEL 20.4 million), main contributors to the increase were payables under the Modernization project, GEL 17.6 million.

3. Cash Flow Statement

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

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

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

3.1 Operating activities

General description

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

Operating activities

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

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

Factors influencing changes

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

3.2 Investing activities

General description

Acquisition of property, plant and equipment - includes capital expenditures for the Group's Modernization Project and other investments in infrastructure as well as the purchase of rolling stock and capital repair services.

Interest received - the Group receives interest mainly for cash it holds in banks and issued loans.

Investing activities

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

	2016	2015	% Change	Abs. change
Property, plant and equipment	-196,924	-156,993	25.4%	-39,931
Interest received	22,435	20,992	6.9%	1,443
Issuance of the loans	-32,563	-38,507	-15.4%	5,944
Repayment of the issued loans	37,838	0	NM	37,838
Dividends received	1,075	0	NM	1,075
Net cash used in investing activities	**-168,139**	**-174,508**	**-3.6%**	**6,369**

Factors influencing changes

Cash paid for acquisition of property, plant and equipment in 2016 increased by GEL 39.9 million. The increase was mainly due to the faster construction pace of the Modernization project compared to 2015 and investments in new passenger trains.

The increased expenditure in property, plant and equipment were offset by cash inflow from other sources, which caused the decrease in net cash used in investing activities.

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

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

Issuance of the loan GEL 32.6 million in 2016 represents USD 6 million provided to the parent and USD 8.5 million, provided to the owner of liquid cargo terminal on the Black Sea (*see subheading 2.1 "Non-current assets"*). Cash outflow of GEL 38.5 million (USD 16 million) in 2015 represents a short-term loan that the Group provided to a state controlled entity by the end of 2015, which was fully received in summer 2016.

3.3 Financing activities

General description

Dividends paid - the Group holds Eurobonds which imposes restrictions on dividend payments. The covenants of bonds include a constraint according to which since 2013 cumulated dividend payments shall be no more than 50 percent of the cumulated consolidated net income of the Group.

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

Financing activities

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

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

Factors influencing changes

In 2016, compared to 2015, net cash used in financial activities decreased by GEL 118.9 million. This was mainly caused by the fact that in July 2015 the Group has repaid USD 27.5 million - the remaining portion of the Eurobonds issued in 2010. Also in 2015 the Group paid GEL 21.9 million in dividends, while in 2016 dividend paid was GEL 1.6 million. In addition in 2016 the Group had proceeds from borrowing GEL 42.3 million which, represents the loan for the purchase of the new passenger trains (*see subheading 2.4 'Non-current liabilities''*).

The interest paid has increased in 2016, compared to 2015, due to the higher GEL/USD exchange rates.

Appendix 1

Breakdown of freight transportation in tons

For the year ended 31 December *In million tons*

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

Appendix 2

Breakdown of freight transportation in ton-kilometers

For the year ended 31 December

In million ton-kilometers

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

Appendix 3

Calculations of ratio of Net Financial Indebtedness to EBITDA:

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