Management Discussion and Analysis for the six month period ended 30 June 2014

საქართველოს რკინიგზა
GEORGIAN RAILWAY

Contents

Summary

Financial results for the six months 2014 have shown a healthy improvement from 2013 levels. Revenues increased by 6.9%, while EBITDA has shown an 8.9% improvement. Main drivers behind the increase were addition of freight forwarding subsidiaries to the group accounts, namely Georgian Transit LLC and GR Transit Line LLC. This move has consolidated freight forwarding revenue to the groups' performance, while had no monetary effect for the cargo owners.

Cash balances of the company increased to GEL 247 million compared to GEL 157 million by the end of June 2013 and GEL 215 million as at Dec 31 2013, promising high accessibility of liquid funds. The accumulation of cash balances is due to the lower CAPEX spending as Bypass project is being postponed and the pace of Modernization Project is lower.

Growth of cargo transportation and revenue in the months following June promises further speed up in growth rates adding effect there to improved financial performance.

1. Profit & Loss Statement

Following table sets forth profit and loss statement of the Company for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
’000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Revenues	229,761	6.9%	14,851	214,910
Other income	9,436	73.5%	3,997	5,439
Payroll expenses	-72,826	10.6%	-6,950	-65,876
Depreciation and amortization expense	-51,041	1.5%	-736	-50,305
Electricity and materials used	-24,208	14.7%	-3,109	-21,099
Other expenses	-36,760	0.6%	-207	-36,553
Result From Operating Activities	**54,362**	**16.9%**	**7,846**	**46,516**
Finance Income	4,910	-33.4%	-2,464	7,374
Finance Cost	-22,285	309.5%	-16,843	-5,442
Net finance income	**-17,375**	-999.3%	-19,307	**1,932**
Profit before income tax	**36,987**	**-23.7%**	**-11,461**	**48,448**
Income tax	-2,758	-58.2%	3,834	-6,592
Net income	**34,229**	**-18.2%**	**-7,627**	**41,856**
EBITDA	**105,403**	**8.9%**	**8,582**	**96,821**
EBITDA margin	**45.9%**			**45.1%**

Net income amounted to GEL 34.2 million in the six month period ended 30 June 2014 compared to GEL 44.9 million in the same period of the previous year.

2. P&L Analysis

Following paragraphs present the analysis of the profit and loss statement of Georgian Railway JSC for the six month periods ended 30 June 2014 and 2013:

2.1. Revenues

The following table sets forth revenue breakdown and comparison of six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
’000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Freight transportation	175,757	6.0%	9,982	165,775
Freight handling	26,156	0.7%	184	25,972
Freight car rental	17,957	19.7%	2,961	14,996
Passenger transportation	7,724	10.2%	712	7,012
Other revenue	2,168	87.9%	1,014	1,154
Total Revenue	**229,761**	**6.9%**	**14,851**	**214,910**
Other Income	**9,436**	**73.5%**	**3,997**	**5,439**

Below, you can find detailed discussion for the reasons of the above-mentioned changes.

2.1.1 Freight revenues

Freight transportation revenues increased by 6.0 per cent (GEL 10.0 million) in the six month period ended 30 June 2014 compared to the same period of the previous year.

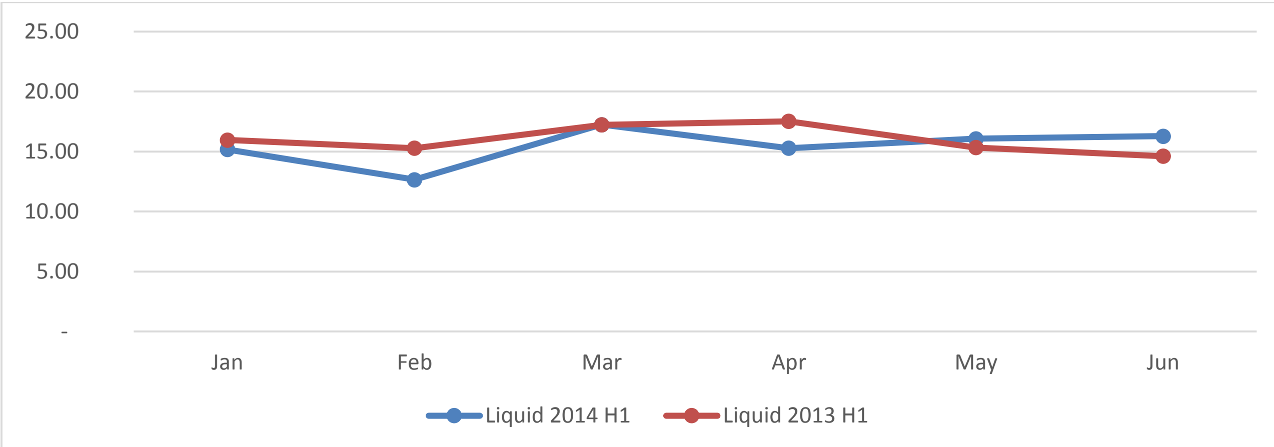
The following table sets forth freight transportation revenue by types of freight for the six month periods ended 30 June 2014 and 2013:

GEL, Millions	**6 month period ended 30 June**			
	2014 H1	***% Change***	***Abs. Change***	**2013 H1**
Liquid Cargoes	**94.2**	**-0.3%**	**-0.3**	**94.5**
of which				
Crude Oil	24.3	-32.1%	-11.5	35.8
Oil Products	69.9	19.1%	11.2	58.7
Dry Cargoes	**81.5**	**14.5%**	**10.3**	**71.2**
of which				
Grain	6.3	14.5%	0.8	5.5
Construction Freight	5.9	3.5%	0.2	5.7
Cement	1.8	20.0%	0.3	1.5
Industrial Freight	5.3	55.9%	1.9	3.4
Ferrous Metals and Scrap	10.6	24.7%	2.0	8.5
Ores	15.8	-2.5%	-0.3	16.2
Sugar	9.1	56.9%	3.3	5.8
Chemicals, fertilizers	4.9	44.1%	1.5	3.4
Other	21.9	3.3%	0.7	21.2
Total	**175.8**	**6.0%**	**10.0**	**165.8**

The types of freight that positively contributed to the six month period-over-period change in freight transportation revenue were mainly Oil products and Dry cargo. This was partly offset by the decrease in revenue from transportation of Crude oil.

Liquid cargo revenues:

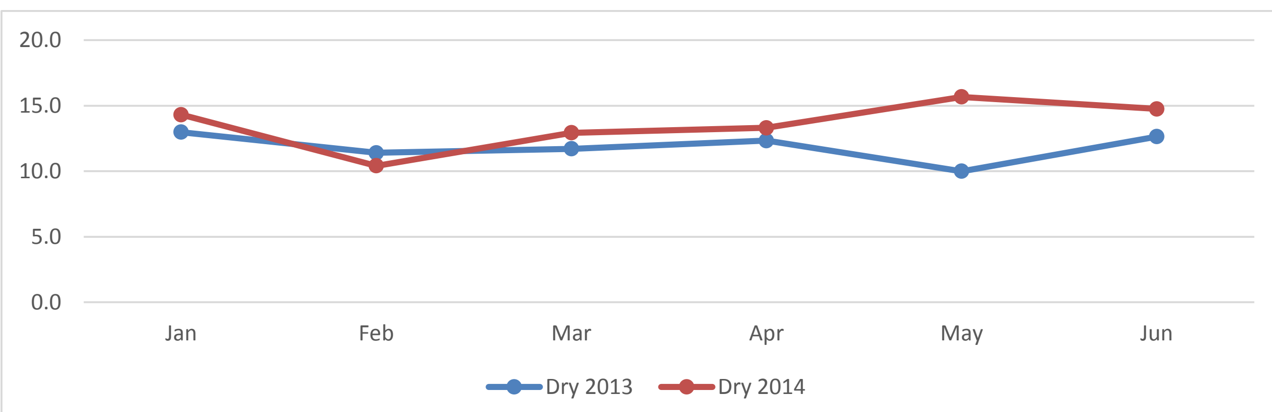
The following graph presents distribution of revenue from liquid cargo transportation by months, for the six month periods ended 30 June 2014 and 2013:



Revenue from transportation of liquid cargo was decreased by 0.3 per cent (GEL 0.3 million) in H1 2014 compared to H1 2013 as a result of decreased amount of transported cargo. However this was compensated by higher tariffs and the addition of Georgian Transit LLC and GR Transit Line LLC as subsidiaries to the company. As Georgian Transit is mainly a liquid freight forwarding company, the margin of freight forwarding was added to the revenue of the company from cargo transportation. Another factor for the improved performance is the appreciation of USD against Georgian Lari, as the tariffs for transportation are set in USD.

Dry cargo revenues:

The following graph shows distribution of revenues from dry cargo transportation by months in six month periods ended 30 June 2014 and 2013:



Dry cargo volumes for the six month period ended 30 June 2014 increased by 0.6 per cent and revenues increased by 14.5 per cent compared to the previous year. The main reasons for the increased revenues was increased revenue from transportation of industrial freight, Chemicals and fertilizers, Ferrous Metals and Scrap and sugar.

Revenue from Industrial freight increased by 56 per cent (GEL 1.9 million) while there was only insignificant change in transported amount of this cargo. The reason of the increased revenue from industrial freight transportation was the switch of the cargo to a higher yielding transportation direction. During H1 2013 GR transported 114 thousand tonnes of industrial freight internally in Georgia with an average tariff of 4.1 GEL per ton, while in H1 2014 internal transportation of industrial freight was only 10 thousand tons. In H1 2014 GR transported 142 thousand tons from several countries to Azerbaijan with average tariff 26.1 GEL per ton.

Revenue from transportation of Chemicals and fertilizers increased by 44.1 per cent (GEL 1.5 million), reason of this increase was increase in transported amount of this type of cargo during H1 2014 compared to H1 2013 by 40 per cent (78 thousand tonnes).

Increase in revenue from Ferrous Metals and Scrap resulted from respective increase in transported volumes by 9 per cent, another reason was changes in transportation direction causing an increase in average distance of transportation by 11 per cent.

Revenue from sugar increased by 57 per cent (GEL 3.3 million) this increase had two main reasons. One of the reasons is increased transportation volumes, while the second reasons is the change of destination country. In H1 2014 cargo was directed to Armenia, for which transportation tariffs are higher.

Another general cause for improved revenue was increase in USD average exchange rate against Georgian Lari, as the tariffs for transportation are set in USD.

Freight handling revenue:

The following table sets forth the breakdown of freight handling revenue for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Station service	21,493	21.4%	3,786	17,707
Delay of railcars	3,241	-38.9%	-2,065	5,306
Contractual Terms	119	-92.4%	-1,440	1,559
Other	1,303	-7.0%	-98	1,401
Freight handling	**26,156**	**0.7%**	**184**	**25,972**

Revenue from freight handling increased by 0.7 per cent (GEL 184 thousand) in the six month period ended 30 June compared to the same period of the previous year. Increase was caused by the increase in GEL/USD exchange rate. Another reasons was optimization of station service tariffs which were increased in H2 2013.

Total increase in freight handling was partly offset by the decrease in revenue from delay from railcars by 39 per cent (GEL 2.1 million). The reason is the contracts for wagon capital repairs, which was active in 2013. The contractor could not fulfil duties in a timely manner, which caused fines for railcar delays in stations. In 2014 this contract no longer had an effect.

Freight car rental revenue:

The following table sets forth the revenues from freight car rental for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Freight car rental revenue	17,957	19.8%	2,961	14,996

Revenue from freight car rental increased by 19.8 per cent (GEL 3.0 million) in the six month period ended 30 June 2014 compared to the same period in 2013. The increase was mainly caused by the increased freight car rental days in Turkmenistan. Management believes the reason of this were bottlenecks on Afghanistan border as the Afghanistan government has changed recently and the cargo would be halted on the border for a long periods of time. Adding to the effect is the fact that when railcars are delayed for 30-45 days, freight car rental daily tariff is multiplied by a coefficient of 1.3x, while for the delay of more than 45 days the tariff gets a coefficient of 3x.

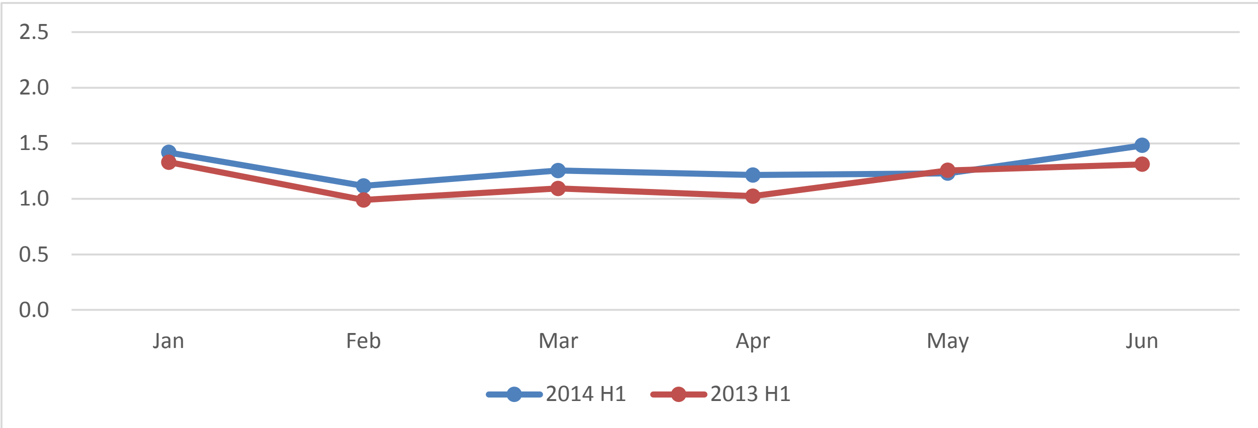
2.1.2. Passenger revenues

The following table sets forth the revenues from passenger transportation for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Passenger revenues	7,724	10.2%	712	7,012

Passenger revenues increased by 10.2 per cent (GEL 0.7 million) in the six month period ended 30 June 2014 compared to the same period of the previous year. In the six month period of 2014, GR transported 5.2 per cent less passengers than in the same period of 2013. The disproportion between the change in passenger number and change in revenues is caused by the increased share of expensive seats sold. This is caused by the addition of new trains to the mainline direction, while some trains for regional transportation were dismissed. As a rule, regional transportation tickets cost a lot less than the main-line direction.

The following graph shows distribution of revenues from passenger transportation by month in the six month periods ended 30 June 2014 and 2013:



2.1.3. Other revenues

The following table sets forth other revenue for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Other revenue	2,168	87.9%	1,014	1,154

Other revenues comprise of items such as: revenue from rent of space in buildings, sale of scrap, repair services and such. Other revenue increased by 87.9 per cent (GEL 1.0 million), this increase was mainly caused by the increased revenue from construction and repair works by 248 per cent (GEL 691 thousand) and also because of increased revenues from rent of spaces which in H1 2014 increased by 30 per cent (GEL 250 thousand).

2.1.4. Other income

The following table sets forth other income for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
’000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Other Income	**9,436**	**73.5%**	**3,997**	**5,439**
Of which:				
Continuing Operations	9,283	84.3%	4,246	5,037
Non-Continuing Operations	153	-61.9%	-249	402

In the six month period ended 30 June 2014 other income increased by 73.5 per cent (GEL 4.0 million), compared to the same period of the previous year. Other income mostly comprises of items such as penalties accrued on debtors or creditors, gain on inventory revaluation, revenue from communication services, revenue for inflicted loss on company from third parties, revenue from the surplus of inventory, revenue from heavy equipment services, revenue from subsidiary companies (namely Trans Caucasus Terminals LLC) and other.

In order to better illustrate the operational profitability of the company, GR divides other income into two categories: income which is reoccurring between the periods due to their nature (for example such are revenue from subsidiary company (TCT), penalties on creditors and debtors, different types of non-core revenues and some other items) – this is classified as income from continuing operations. Second type of other income comes from one time sources, such as provisions, gain/loss on inventory revaluation and other items, which are not expected to reoccur in the following periods.

The increase in other income was caused by the increase in continuing operations and mainly by the increase in revenue from electricity transit which increased by 22 per cent (GEL 863 thousand) and by the increase in other operating revenue by 77 per cent (GEL 3.1 million). The reason behind this increase was changes in accounting procedures, during year 2013 revenue from subsidiary company Trans Caucasus Terminals was included in revenues from freight operations, while in H1 2014 revenue from subsidiary company Trans Caucasus Terminals (GEL 3.2 million) was included in other income.

2.2. Operating expenses

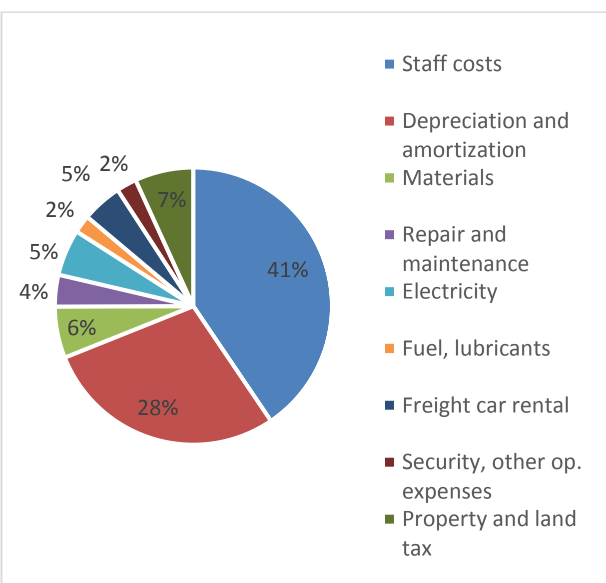
The following table sets forth total expenses of Georgian Railway JSC, excluding Finance Costs, Interest Income/Expense and Profit Tax, for the six month periods ended 30 June of years 2014 and 2013:

	6 month period ended 30 June			
	2014 H1	***% Change***	***Abs. Change***	**2013 H1**
Staff costs	-72,826	10.6%	-6,950	-65,876
Depreciation and amortization	-51,041	1.5%	-736	-50,305
Materials	-10,775	59.1%	-4,001	-6,774
Repair and maintenance	-6,659	61.2%	-2,529	-4,130
Electricity	-9,708	-5.0%	513	-10,221
Fuel, lubricants	-3,726	-9.2%	378	-4,104
Freight car rental	-8,406	-23.1%	2,525	-10,931
Security, other op. expenses	-4,237	17.7%	-636	-3,601
Property and land tax	-12,290	10.9%	-1,209	-11,081
Other op. expenses	-5,170	-24.1%	-1,639	-6,809
Total	**-184,838**	**6.3%**	**-11,006**	**-173,832**

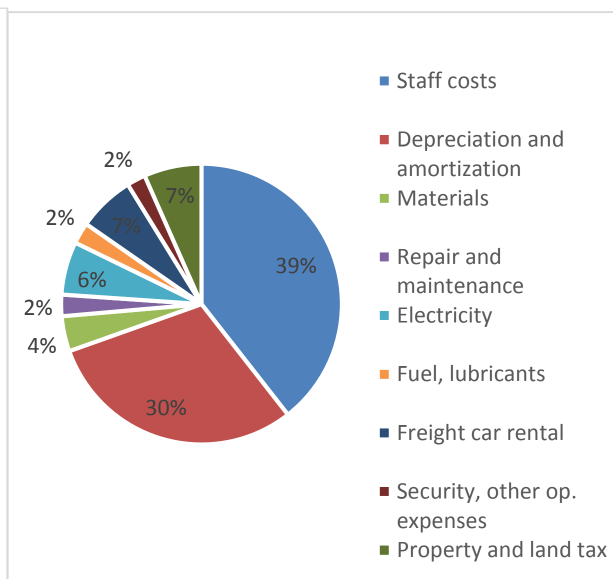
Total expenses for the six month period ended 30 June 2014 decreased by 6.3 per cent (GEL 11.0 million) compared to the six month period ended 30 June 2013, the main reasons of which was the increase in salary expense and materials for repairs.

The following charts sets forth the cost structure for the six month periods ended 30 June of years 2014 and 2013:

Cost structure for the H1 2014



Cost structure for the H1 2013



2.2.1. Staff cost

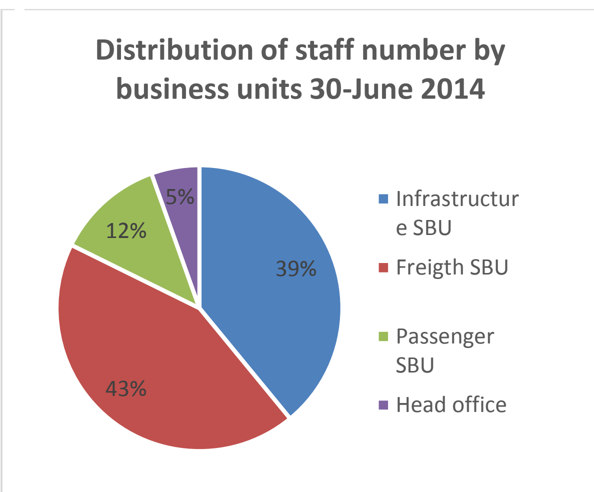
The following table sets forth staff costs for the six month periods ended 30 June for years 2014 and 2013:

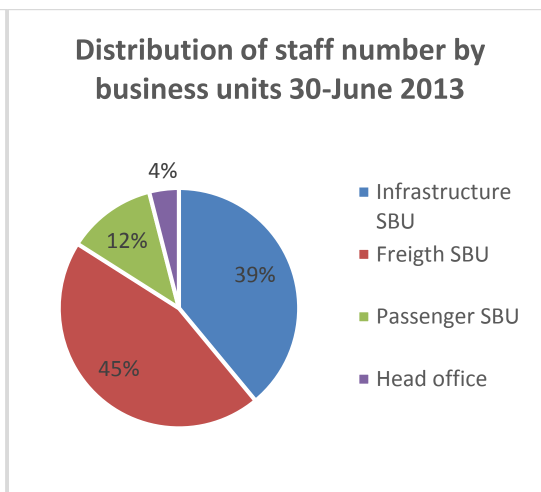
	6 month period ended 30 June			
’000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Staff costs	72,826	10.6%	6,950	65,876

Main reason for increase in staff costs by 10.6% (GEL 7.0 million) was increase in salary expenses that took place during 2013, showing full effect in 2014. The increase was also partly a result of higher bonuses paid during 2014.

Employee number at the end of June 2014 was equal to 12,767 and accordingly at the end of June 2013 the number of employees was 12,622. Average salary during the year H1 2014 was GEL 957 compared to GEL 871 in the same period of 2013.

Following charts show the distribution of staff number by strategic business units and head office of the company (excluding subsidiaries):





2.2.2. Materials, Repair and Maintenance Expenses

The following table sets forth materials and repair and maintenance expenses for the six month periods ended 30 June for years 2014 and 2013:

	6 month period ended 30 June			
’000 GEL	**2014 H1**	***% Change***	***Abs. Change***	**2013 H1**
Materials	10,775	59.1%	4,001	6,774
Repair and maintenance	6,659	61.2%	2,529	4,130
Total	**17,434**	**59.9%**	**6,530**	**10,904**

Total expense for materials, repair and maintenance services for the six month period ended 30 June 2014 increased by 60 per cent (GEL 6.5million) compared to the six month period ended 30 June 2013. Materials expenses increased by 59 per cent (GEL 4.0 million). Main reason of the increase in materials expense was increased expenses on purchase of new types of materials, which are used for scheduled wagon repairs. These are done periodically and were started in H2 2013. Repair and maintenance expense increased by 61.2 per cent in H1 2014 compared to the same period in 2013. This was caused by increased number of routine repairs of rolling stock between the periods.

2.2.3. Electricity and Fuel Expenses

The following table sets forth electricity expense for the six month periods ended 30 June 2014 and 2013:

Electricity Expense:

	6 month period ended 30 June			
’000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Electricity	9,708	-5.0%	-513	10,221

Electricity expense for the six month period ended 30 June 2014 decreased by 5 per cent (GEL 0.5 million) compared to the six month period ended 30 June 2013. The decrease was mainly caused by the decrease in cargo transportation volumes in H1 2014.

The following table shows purchased electricity for cargo transportation purposes and an average electricity expense per gross ton-kilometre of cargo:

	2014			2013		
	GW	**Gross ton km (mln.)**	**GW per gross bln ton.km**	**GW**	**Gross ton km (mln.)**	**GW per gross bln ton.km**
January	15.0	722.6	20.8	18.2	928.2	19.6
February	12.4	580.3	21.4	16.2	835.1	19.4
March	15.4	771.4	20.0	17.4	907.1	19.2
April	14.3	701.7	20.4	15.9	819.7	19.5
May	15.0	750.7	19.9	13.6	675.2	20.2
June	14.6	729.7	20.0	13.7	709.5	19.4
Total	**86.8**	**4,256.4**	**20.4**	**95.0**	**4874.8**	**19.6**

Fuel expenses:

The following table sets forth fuel expense for the six month period ended 30 June for years 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Fuel and Lubricants	3,726	-9.2%	-378	4,104

Fuel (and lubricants) expense in the six month period ended 30 June 2014 decreased by 9.2 per cent compared to the six month period ended 30 June 2013. The reason for the decrease was decreased prices per kilogram of fuel purchased (by 13 per cent) and to some extent, by lower volumes of cargo.

2.2.4. Freight car rental expense

The following table sets forth freight car rental expense for the six month period ended 30 June for years 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Freight car rental	8,406	-23.1%	-2,525	10,931

Freight car rental expenses for the six month period ended 30 June 2014 decreased by 23.1 per cent compared to the six month period ended 30 June 2013. The decrease was mainly caused by the fact that some railways (Russian, Kazakhstan and Ukrainian) have privatized their wagon fleet. This is causing decrease in freight car rental expense, as GR does not have to pay for transportation using wagons owned by private companies. Usage of customers own wagons decreases freight car rental cost for GR, while the customer receives a discount from transportation tariff.

2.2.5. Security and other expenses

The following table sets forth security and other operating expenses for the six month period ended 30 June for years 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Security	4,237	17.7%	636	3,601
Other op. expenses	5,170	-24.1%	-1,639	6,809
Total	**9,407**	-9.6%	-1,003	**10,410**

Total security and other operating expenses for the six month period ended 30 June 2014 decreased by 9.6 per cent (GEL 1.0 million) compared to the six month period ended 30 June 2013. Other operating expenses mainly consist of items such as: municipal, communication, legal costs, consultancy, membership fees, write offs and etc. The decrease in other operating expenses was partly offset be the increase in security expenses.

2.2.6. Property and land taxes

The following table sets forth the breakdown of Property and Land taxes for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Property tax	6,437	10.2%	596	5,841
Land Tax	5,112	11.0%	508	4,604
Other taxes	741	16.5%	105	636
Total	**12,290**	**10.9%**	**1,209**	**11,081**

Property tax increased due to the increase in property, caused by the increased value of our wagon park and also because of increase in construction in progress in H1 2014 compared to H1 2013. Other taxes consist of additional expenses for tax purposes and property and land taxes of subsidiaries. Increase in other taxes is caused by addition of Georgian Transit LLC as a subsidiary company during April 2013, which means that the absence of Georgian Transit LLC in Q1 2013 caused the difference between H1 2014 and 2013.

2.3. Finance costs and income

The following table sets forth the breakdown of financial costs and income for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Interest income	4,910	-24.3%	-1,578	6,488
Impairment loss on trade receivables	-1,609	30.3%	-374	-1,235
Interest expense	-6,321	50.2%	-2,113	-4,208
FX gain/loss	-14,354	-1720.1%	-15,240	886
Net finance income/(loss)	**-17,374**	**-999.3%**	**-19,306**	**1,932**

There was a net finance loss in H1 2014 compared to the net finance gain in H1 2013. Main reason was FX change, namely the appreciation of USD against GEL, causing revaluation of company's liabilities denominated in USD (USD appreciated against GEL by 6 per cent). This FX effect is not of monetary nature, until the maturity of the bonds and changes in line with USD movement against GEL.

2.4. Income Tax Expense

The following table shows the Income Tax Expense for the six month period ended 30 June of years 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Income Tax Expense	2,758	-58.2%	-3,834	6,592

Decrease in income tax expense is in line with the decreased income before taxes in the twelve month period ended 30 June 2014.

2.5. Profitability

The following Table show the calculation of EBITDA, EBITDA margin, Adjusted EBITDA and Adjusted EBITDA margin for the twelve month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
'000 GEL	**2014 H1**	**% Change**	**Abs. Change**	**2013 H1**
Revenues	229,761	6.9%	14,851	214,910
Other income	9,436	73.5%	3,997	5,439
Expenses	-184,838	6.3%	-11,006	-173,832
Result from Operating Activities	**54,362**	**16.9%**	**7,846**	**46,516**
Depreciation add-back	51,041	1.5%	736	50,305
EBITDA	**105,403**	**8.9%**	**8,582**	**96,821**
EBITDA Margin	**45.9%**			**45.1%**
Non-continuing operations from other income	153	-61.9%	-249	402
Wright-offs	33	-119.2%	205	-172
Adjusted EBITDA	**105,217**	**8.93%**	**8,626**	**96,591**
Adjusted EBITDA Margin	**45.8%**			**44.9%**

Adjusted EBITDA for the six month period ended 30 June 2014 amounted to GEL 105.2 million, representing an increase of 8.9 per cent (GEL 8.6 million) compared to the same period of the previous year. Adjusted EBITDA margin amounted to 45.8 per cent, compared to the 44.9 per cent for the six month period ended 30 June 2013.

3. Cash flows

’000GEL	6 month period ended 30 June 2014	6 month period ended 30 June 2013
Cash flows from operating activities		
Cash receipts from customers	231,912	209,737
Cash paid to suppliers and employees	-110,865	-104,722
Cash flows from operations before income taxes and interest paid	**121,047**	**105,015**
Income tax paid	-1,670	-15,324
Net cash from operating activities	**119,377**	**89,691**
Cash flows from investing activities		
Acquisition of property, plant and equipment	-32,121	-106,133
Purchase of a company share	-	-48
Decrease/Increase in term deposits	-	40,781
Interest received	4,706	6,753
Net cash used in investing activities	**-27,415**	**-58,647**
Cash flows from financing activities		
Repayment of borrowings	-	-17
Interest paid	-36,163	(35,444)
Dividends paid	-20,000	(12,000)
Net cash from /(used in) financing activities	**-56,163**	**-47,461**
Net increase/(decrease) in cash and cash equivalents	**35,799**	**-16,417**
Cash and cash equivalents at 1 January	208,996	115,076
Effect of exchange rate fluctuations on cash and cash equivalents	2,474	-720
Cash and cash equivalents at the end of the period	**247,269**	**97,939**
Bank deposits	-	58,780
Total Cash and cash equivalents	**247,269**	**156,719**

3.1. Net cash from operating activities

The following table shows cash from operating activities for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
’000GEL	**2014 H1**	**% change**	**Abs. Change**	**2013 H1**
Cash flows from operating activities				
Cash receipts from customers	231,912	10.6%	22,175	209,737
Cash paid to suppliers and employees	-110,865	5.9%	-6,143	-104,722
Cash flows from operations before income taxes and interest paid	**121,047**	**15.3%**	**16,032**	**105,015**
Income tax paid	-1,670	-89.1%	13,654	-15,324
Net cash from operating activities	**119,377**	**33.1%**	**29,685**	**89,691**

Net cash from operating activities in the six month period ended 30 June 2014 has increased by 33.1 per cent (GEL 29.7 million) compared to the same period in 2013. This was mainly caused by the increase in cash receipts from customers by 10.6% (GEL 22.2 million) caused by the increased revenue from cargo transportation. Another reason of increase in net cash from operating activities was decrease in income tax paid by 89.1 per cent (GEL 13.7 million) caused by the existing surplus of value added tax, giving GR an ability not to pay other taxes.

The increase of net cash from operating activities was partly offset by the increase in cash paid to suppliers and employees by 5.9 per cent (GEL 6.1 million) mainly caused by the increase of salary expenses.

3.2. Net cash used in investing activities

The following table shows cash from investing activities for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
Cash flows from investing activities	**2014 H1**	**% change**	**Abs. Change**	**2013 H1**
Acquisition of property, plant and equipment	-32,121	-69.7%	74,012	-106,133
Purchase of a company share	-	-	48	-48
Decrease/Increase in term deposits	-	-	-40,781	40,781
Interest received	4,706	-30.3%	-2,047	6,753
Net cash used in investing activities	**-27,415**	**-53.3%**	**31,234**	**-58,647**

During six month period ended 30 June 2014 net cash used in investing activities has decreased by 53.3 per cent (GEL 31.2 million), which was mainly caused by the decrease in acquisition of property, plant and equipment by 69.8 per cent (GEL 74.0 million) and by the decrease of interest received by 30.3 per cent (GEL 2.0 million).

Total decrease in net cash used in investing activities was partly offset by the absence of changes in term deposits during H1 2014, while during the same period 2013 there was a decrease in term deposits, which amounted to GEL 40.8 million. This is caused by the changed accounting treatment of bank deposits. Due to their nature, at the year end of 2013, GR along with the external auditors classified these bank cash balances as cash and cash equivalents. Subsequently no movement between cash and cash equivalents and term deposits had taken place, as they have been merged.

Cash paid for Bypass project was GEL 8.2 million in the H1 2014 and GEL 21.7 million in the H1 2013, this decrease was caused by the fact that Bypass project is negotiated to be postponed for about 3 years. Cash paid for Modernization Project was GEL 11.9 million in the H1 2014 and GEL 30.3 million in H1 2013, the reason of this is a slow-down of the project pace. This is caused by the fact that GR has an opportunity to build two tunnels in the mountainous gorge section instead of one with no additional cost. This would double the capacity of the track. This however has to be approved by the government, which requires certain procedures and time. Until the necessary approvals are collected, the project continues in a slower pace.

3.3 Net cash used in financing activities

The following table shows cash from financing activities for the six month periods ended 30 June 2014 and 2013:

	6 month period ended 30 June			
Cash flows from financing activities	**2014 H1**	**% change**	**Abs. Change**	**2013 H1**
Interest paid	-36,163	2.0%	-719	-35,444
Dividends paid	-20,000	66.7%	-8,000	-12,000
Repayment of borrowings	-	-	17	-17
Net cash used in financing activities	-56,163	18.3%	-8,702	-47,461

The Company's total net cash used in financing activities increased by 18.3 per cent (GEL 8.7 million). This was mainly caused by the increase in dividends paid in the six month periods by 66.7 per cent (GEL 8.0 million).

Company's dividend payments are restricted by its covenants for the bonds, according to which starting from 2013, 50% of previous year's consolidated net income is the maximum amount that can be paid in any given year.

4. Balance Sheet

’000GEL	30 June 2014	% change	Abs. change	31 Dec 2013
ASSETS				
Non-current assets				
Property, plant and equipment	2,380,539	1%	33,352	2,347,187
Deferred tax assets	1,557	0%	-	1,557
Other non-current assets	171,248	-5%	-9,614	180,862
Goodwill	46	0%	-	46
Total non-current assets	**2,553,390**	**1%**	**23,738**	**2,529,652**
Current assets				
Inventories	30,755	-29%	-12,304	43,059
Current tax assets	10,622	-9%	-1,067	11,689
Trade and other receivables	59,286	13%	6,884	52,402
Prepayments and other current assets	24,462	-38%	-14,967	39,429
Total cash and cash equivalents	247,269	18%	38,273	208,996
Total current assets	**372,394**	**5%**	**16,819**	**355,575**
Total assets	**2,925,784**	**1%**	**40,557**	**2,885,227**
EQUITY AND LIABILITIES				
Equity				
Share capital	1,050,697	0%	622	1,050,075
Non-cash owner contribution reserve	34,212	8%	2,539	31,673
Retained earnings	501,622	3%	14,243	487,379
Total equity	**1,586,531**	**1%**	**17,404**	**1,569,127**
Non-current liabilities				
Loans and borrowings	930,654	2%	17,460	913,194
Advance received from the Government	231,592	0%	-	231,592
Trade and other payables	52	0%	-	52
Deferred tax liabilities	58,357	0%	-79	58,436
Total non-current liabilities	**1,220,655**	**1%**	**17,381**	**1,203,274**
Current liabilities				
Loans and borrowings	34,029	1%	282	33,747
Trade payables and advances received	57,215	2%	1,054	56,161
Liabilities to the Government	11,901	0%	-16	11,917
Provisions	6,471	5%	317	6,154
Other current liabilities	8,982	85%	4,135	4,847
Total current liabilities	**118,598**	**5%**	**5,772**	**112,826**
Total liabilities	**1,339,253**	**2%**	**23,153**	**1,316,100**
Total equity and liabilities	**2,925,784**	**1%**	**40,557**	**2,885,227**

4.1. Non-current Assets

The following table sets forth breakdown of non-current assets as of 30 June 2014 and 2013:

’000 GEL	30 June 2014	% change	Abs. change	31 Dec 2013
ASSETS				
Property, plant and equipment	2,380,539	1.4%	33,352	2,347,187
Deferred tax assets	1,557	0.0%	-	1,557
Other non-current assets	171,248	-5.3%	-9,614	180,862
Goodwill	46	0.0%	-	46
Total non-current assets	**2,553,390**	**0.9%**	**23,738**	**2,529,652**

Total non-current assets increased by 0.9 per cent (GEL 23.7 million) as at the 30 June 2014, comparing to the 31 Dec 2013. The increase was mainly caused by increase in property, plant and equipment by 1.4 per cent (GEL 33.3 million). This increase was due to increase in construction-in-progress in the framework of Modernization and Tbilisi Bypass project and the completion of some prepaid works, which were previously accounted for in other non-current assets. Hence the decrease of GEL 9.6 million that took place in this account.

4.2. Current Assets

The following table sets forth breakdown of current assets as of 30 June 2014 and 2013:

’000 GEL	30 June 2014	% change	Abs. change	31 Dec 2013
Inventories	30,755	-28.6%	-12,304	43,059
Current tax assets	10,622	-9.1%	-1,067	11,689
Trade and other receivables	59,286	13.1%	6,884	52,402
Prepayments and other current assets	24,462	-38.0%	-14,967	39,429
Total cash and cash equivalents	247,269	18.3%	38,273	208,996
Total current assets	**372,394**	**4.7%**	**16,819**	**355,575**

Total current assets has increased by 4.7 per cent (GEL 16.8 million) as at the 30 June 2014 compared to the 31 Dec 2013. Increase in trade and other receivables and total cash and cash equivalents was partly offset by decrease in current tax assets, inventories and prepayments and other current assets. Increase in Trade and other receivables was caused by increase in payments receivable from foreign destinations (GEL 6.7 million) mainly from Azerbaijan. Decrease in inventories is mainly caused by the used materials and temporarily increased number of repairs, while the decrease in prepayment and other current assets was caused by the usage of tax surpluses for compensating income tax payable and property and land taxes.

4.3. Equity

The following table sets forth breakdown of equity as of 30 June 2014 and 2013:

’000 GEL	30 June 2014	% change	Abs. change	31 Dec 2013
Share capital	1,050,697	0.1%	622	1,050,075
Non-cash owner contribution reserve	34,212	8.0%	2,539	31,673
Retained earnings	501,622	2.9%	14,243	487,379
Total equity	**1,586,531**	**1.1%**	**17,404**	**1,569,127**

Total equity increased by 1.1 per cent (GEL 17.4 million) as at the 30 June 2014, comparing to the 31 Dec 2013. The increase mainly was caused by an increase in retained earnings by 2.9 per cent (GEL 14.2 million) in line with net income for the six month and dividend payments.

4.4. Non-current liabilities

The following table sets forth breakdown of non-current liabilities as of 30June 2014 and 2013:

’000 GEL	30 June 2014	% change	Abs. change	31 Dec 2013
Loans and borrowings	930,654	1.9%	17,460	913,194
Advance received from the Government	231,592	0%	-	231,592
Trade and other payables	52	0%	-	52
Deferred tax liabilities	58,357	-0.1%	-79	58,436
Total non-current liabilities	**1,220,655**	**1.4%**	**17,381**	**1,203,274**

Total increase in non-current liabilities was 1.4 per cent as of 30 June 2014, comparing to the 31 Dec 2013. Increase in loans and borrowings was caused by the difference in USD/GEL exchange rate between 30 June 2014 and 31 Dec 2013, as the liabilities are mostly in USD.

GEL 231.6 million relating to the advances received from the government, represent the amount for which the company has made an agreement with the government of Georgia, that when the Bypass project is completed, the company would transfer the freed-up land to the government. In return, the amount of GEL 231.6 million would be subtracted from the retained earnings of the company. The subtraction is already made, however the project is not yet complete and the land remains with the company. Thus the amount is shown in the balance sheet as a liability. As already stated, Bypass project is negotiated to be postponed for about 3 years. In case the project is cancelled, the liability indicated in the balance sheet will be added back to the retained earnings of the company, without any monetary effect for the company.

4.5. Current liabilities

The following table sets forth breakdown of current liabilities as of 30June 2014 and 2013:

'000 GEL	30 June 2014	% change	Abs. change	31 Dec 2013
Loans and borrowings	34,029	0.8%	282	33,747
Trade payables and advances received	57,215	1.9%	1,054	56,161
Liabilities to the Government	11,901	-0.1%	-16	11,917
Provisions	6,471	5.2%	317	6,154
Other current liabilities	8,982	85.3%	4,135	4,847
Total current liabilities	**118,598**	**5.1%**	**5,772**	**112,826**

Total current liabilities increased by 5.1 per cent (GEL 5.8 million) as at the 30 June 2014, compared to the 31 December 2013, which was mainly caused by the increase other current liabilities by 85.3 per cent (GEL 4.1 million) caused by increase in salary payables. This is due to the abnormally low salaries payable at December 31 2013, caused by the early payment of a portion of salaries before the coming holidays.

5. Operational Performance Report

5.1. Traffic report

5.1.1. Freight traffic data

The following table sets forth breakdown of the freight transportation volumes, by type of freight transported, for the six month periods ended 30 June 2014 and 2013:

Ton, Millions	**6 month period ended 30 June**			
	2014 H1	***% Change***	***Abs. Change***	**2013 H1**
Liquid Cargoes	**3.5**	**-20.6%**	**-0.92**	**4.5**
of which				
Crude Oil	1.0	-48.8%	-0.96	2.0
Oil Products	2.5	1.5%	0.04	2.5
Dry Cargoes	**4.3**	**0.6%**	**0.02**	**4.3**
of which				
Grain	0.3	18.3%	0.04	0.2
Construction Freight	0.8	6.0%	0.04	0.7
Cement	0.2	-32.0%	-0.11	0.3
Industrial Freight	0.2	-11.1%	-0.03	0.3
Ferrous Metals and Scrap	0.5	8.6%	0.04	0.5
Ores	1.0	-0.8%	-0.01	1.0
Sugar	0.3	17.2%	0.04	0.2
Chemicals, fertilizers	0.3	39.9%	0.08	0.2
Other	0.7	-9.9%	-0.08	0.8
Total	**7.87**	**-10.2%**	**-0.90**	**8.8**

In the six months of 2014 total freight transportation volumes decreased by 10.2 per cent, compared to the same period of the previous year. The decrease was caused by the decrease in liquid cargo transportation by 20.6 per cent (0.9 million tons) which in its turn was due to the decrease in Crude Oil. The reason for a decrease of crude oil is an expansion of CPC pipeline and redirection of Kazakh TCO oil from GR. Production of crude oil from Kashagan field was postponed as well. Decrease of crude oil was offset by increase in oil products, which is very important for the company, because tariff on oil products is much higher and this type of cargo compared to crude oil is more profitable for the company.

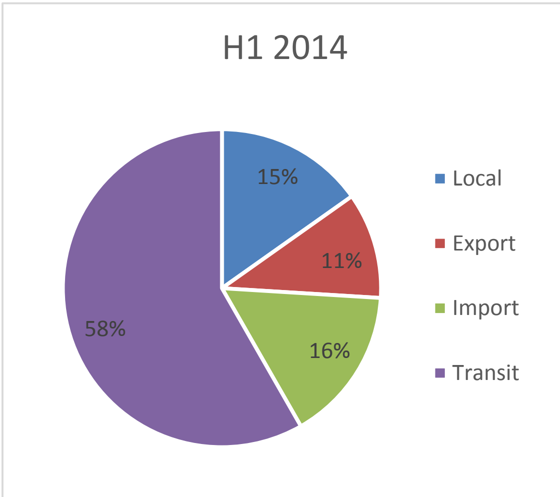
Transportation of sugar in H1 2014 increased by 17.2 per cent (41 thousand tonnes) and reason of this increase was the fact that during first half or year 2014 GR transported 68 thousand ton from Turkey to Azerbaijan and 74 thousand tons from Switzerland to Azerbaijan , while in H1 2013 we did not transported sugar on these direction at all. Transportation of chemicals and fertilizers during H1 2014 increased by 40 per cent (80 thousand tonnes). Reason of this increase was the fact that in H1 2014 GR exported 200 thousand tonnes of chemicals and fertilizers from Georgia, while in H1 2013 GR exported only 129 thousand tonnes.

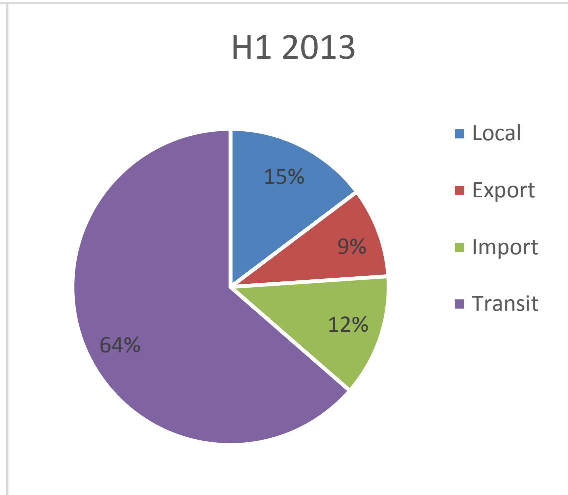
The following table sets forth the breakdown of freight transportation volumes by types of freight transported by months in 2014:

Tons, Millions	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**
Liquid Cargoes	**0.58**	**0.52**	**0.67**	**0.57**	**0.61**	**0.60**	**0.71**	**0.67**
of which								
Crude Oil	0.20	0.12	0.25	0.23	0.07	0.14	0.10	0.13
Oil Products	0.39	0.40	0.42	0.34	0.54	0.46	0.61	0.54
Dry Cargoes	**0.71**	**0.60**	**0.71**	**0.70**	**0.81**	**0.78**	**0.92**	**0.85**
of which								
Grain	0.07	0.03	0.04	0.05	0.04	0.05	0.09	0.13
Construction Freight	0.10	0.10	0.14	0.13	0.16	0.16	0.19	0.18
Cement	0.03	0.03	0.04	0.04	0.04	0.04	0.05	0.04
Industrial Freight	0.02	0.04	0.04	0.03	0.07	0.04	0.07	0.03
Ferrous Metals and Scrap	0.10	0.07	0.10	0.08	0.10	0.09	0.09	0.08
Ores	0.15	0.14	0.17	0.15	0.19	0.15	0.18	0.17
Sugar	0.07	0.05	0.01	0.04	0.06	0.06	0.04	0.08
Chemicals, fertilizers	0.07	0.04	0.05	0.04	0.04	0.03	0.05	0.01
Other	0.10	0.10	0.13	0.14	0.11	0.15	0.16	0.13
Total	**1.30**	**1.12**	**1.38**	**1.27**	**1.42**	**1.38**	**1.63**	**1.52**

On the table above we can see that transportation of grain has been increased in last months. Management expects that this positive trend will be continued, as grain transportation is seasonal and H2 demonstrates better performance than H1. Transportation of construction freight cargo has also been increased during last months. Reason of this increase was increased construction activity in Georgia as the political situation stabilized.

The following graphs show the freight transportation volumes by type of transportation for the six month periods ended 30 June 2014 and 2013:

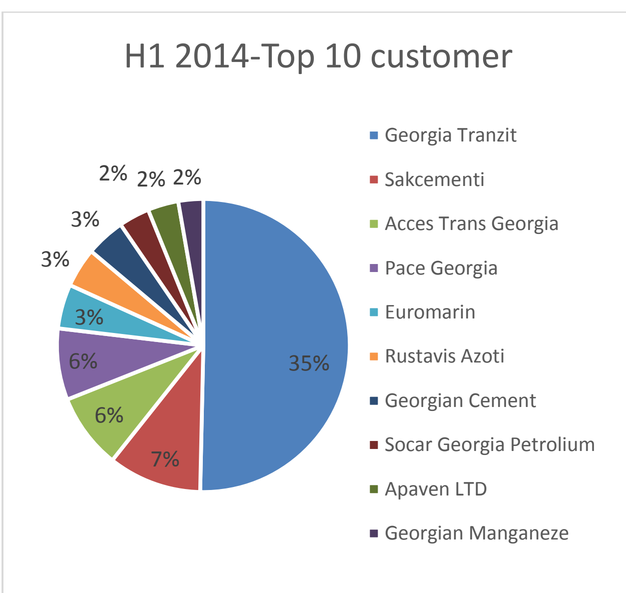


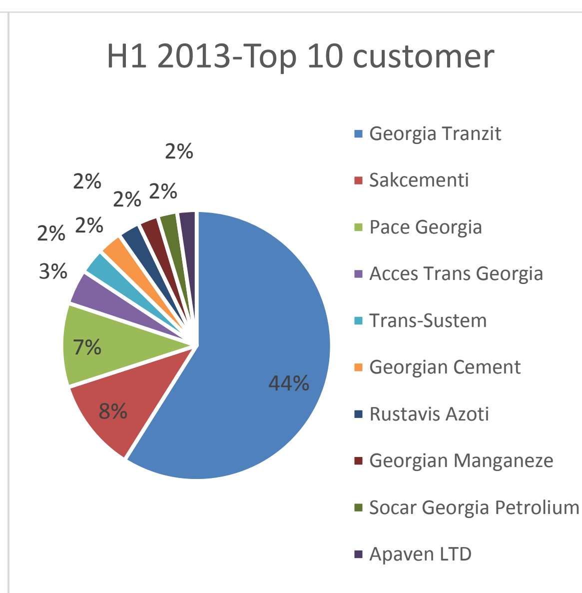


Top 10 freight customers in six month periods ended 30 June 2014 and 2013:

In H1 month 2014 top ten freight customers transported 71% (5.4 million ton) of total freight volume – 7.9 million ton:

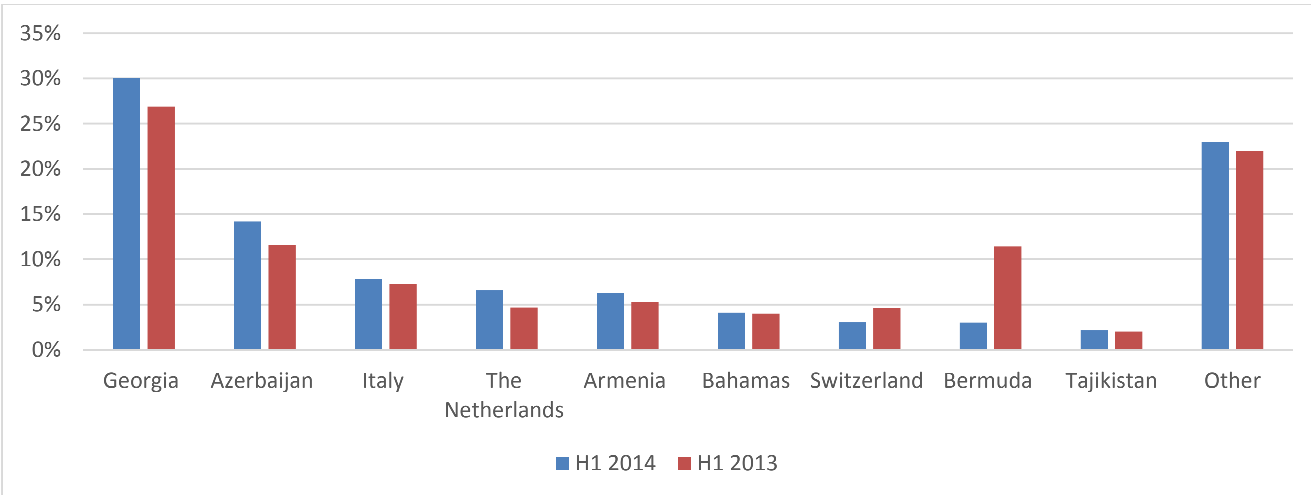
In H1 month 2013 top ten freight customers transported 74% (6.3 million ton) of total freight volume – 8.8 million ton:





The following graphs show the breakdown of countries of destination of freight transported:

Countries of destination H1 2014 and H1 2013



The following graphs show the breakdown of countries of origin of freight transported:

Countries of origin H1 2014 and H1 2013