STATE JOINT-STOCK COMPANY
“LATVIJAS DZELZCEĻŠ”

CONSOLIDATED ANNUAL ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2017

Translation from Latvian original*

* This version of financial statements is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of financial statements takes precedence over this translation.

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INFORMATION ON THE PARENT COMPANY

Name of the Parent Company	***LATVIJAS DZELZCEĻŠ***
Legal status of the Parent Company	State joint-stock company
Address	Gogoļa iela 3, Riga, LV-1050
Common registration number	*40003032065*
Date of registration at Enterprise Registry	*01.10.1991*
Date of entry on Commercial Register	*10.09.2004*
Place of registration	*Riga*
Date of issuance of the Parent Company's registration certificate	*10.09.2004*
Shareholder	*Republic of Latvia (100%)*
Representative of shareholder	*Republic of Latvia Ministry of Transport Gogoļa iela 3, Riga, LV-1743*
Supervisory body	*Company Council*
Council	*Jānis LANGE, Chairman of the Council from 02.02.2018* *Ansis ZELTIŅŠ, Chairman of the Council from 22.07.2016 to 27.08.2017* *Aigars LAIZĀNS, Member of the Council from 22.07.2016 until 28.08.2017. Chairman of the Council from 29.08.2017 until 01.02.2018. Member of the Council from 02.02.2018* *Rodžers Jānis GRIGULIS, Member of the Council from 22.07.2016 until 05.11.2017* *Andris MALDUPS, Member of the Council from 06.11.2017 until 01.02.2017, Member of the Council from 02.02.2018*

Management body	*The Board of the Company*
The Board	*Edvīns BĒRZIŅŠ – Chairman of the Board from 25.02.2016*
	Aivars STRAKŠAS – Member of the Board (new term of appointment from 28.08.2017)
	Ēriks ŠMUKSTS – Member of the Board (new term of appointment from 02.12.2017)
	Ainis STŪRMANIS – Member of the Board from 18.07.2016
Reporting year	*1 January – 31 December 2017*
Auditors:	*PricewaterhouseCoopers SIA Common reg. No. 40003142793, Certified audit company licence No.5 Kr.Valdemāra iela 21-21 Riga, LV-1010 Latvia*
	Certified auditor in charge Terēze Labzova-Ceicāne Certificate No. 184

Subsidiaries

LDZ CARGO SIA	
Common registration number	*40003788421*
Address	*Dzirnavu iela 147, k-1, Riga, LV-1050*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
LDZ ritošā sastāva serviss SIA	
Common registration number	*40003788351*
Address	*Gogoļa iela 3, Riga, LV-1050*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
LDZ infrastruktūra SIA	
Common registration number	*40003788258*
Address	*Gogoļa iela 3, Riga, LV-1050*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
LDZ apsardze SIA	
Common registration number	*40003620112*
Address	*Zasas iela 5-3, Riga, LV-1057*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
LatRailNet AS	
Common registration number	*40103361063*
Address	*Dzirnavu iela 16, Riga, LV-1010*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
LDZ Loģistika SIA	
Common registration number	*40003988480*
Address	*Dzirnavu iela 147, k-1, Riga, LV-1050*
Shareholding %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2017–31.12.2017*
Subsidiary of LDZ ritošā sastāva serviss SIA	
SIA Rīgas Vagonbūves uzņēmums "Baltija"	
Common registration number	*40103419565*
Address	*Turgeņeva ielā 21, Rīgā, LV-1050*
Shareholding %	*100% shareholder – LDZ ritošā sastāva serviss SIA*
Reporting year	*01.01.2017. – 31.12.2017.*

MANAGEMENT REPORT
On the operating performance of the Latvijas dzelzceļš Group in 2017

1. An overview of the Latvijas dzelzceļš Group

The Latvijas dzelzceļš Group (hereinafter "*the Group*") is engaged in managing the public access railway infrastructure and providing railway transport services and related services.

The Group consists of: the Group's parent company VAS Latvijas dzelzceļš (hereinafter "Latvijas dzelzceļš"), SIA LDZ CARGO, SIA LDZ ritošā sastāva serviss, SIA LDZ infrastruktūra, SIA LDZ apsardze, AS LatRailNet, SIA LDZ Cargo Loģistika, and the subsidiary of SIA LDZ ritošā sastāva serviss – SIA Rīgas Vagonbūves uzņēmums Baltija.

In terms of the *Group's* governance, the principal task of Latvijas dzelzceļš is to see to the development of the Group's business lines and their competitiveness, by achieving better results than those that could have been achieved if each line of business were operated as a stand-alone entity. To achieve this, a uniform strategy and objectives have been developed for the *Group* to ensure the best allocation of production and investment resources between the lines of business and the *Group's* companies, aligning of the decision-making process and exercising an effective control over its implementation. *Latvijas dzelzceļš* represents the *Group's* interests at the international level.

Latvijas dzelzceļš provides public access railway infrastructure services, railcar treatment services at stations, railcar technical maintenance and inspection services, electricity distribution and trade services, leasing services, information technology services, electronic communications services, and the services of a principal.

SIA LDZ CARGO is engaged in providing domestic as well as international railway freight transport services, traction services, railcar rental services, as well as in organising international passenger transport services.

SIA LDZ ritošā sastāva serviss is engaged in providing locomotive and railcar repair, locomotive staffing and upgrading services.

SIA LDZ infrastruktūra is engaged in building railway tracks and carrying out the capital repairs thereof.

SIA LDZ apsardze provides physical and technical security services to *Group* as well as other companies and private individuals

AS LatRailNet carries out a key railway infrastructure management function. It develops and approves tariffs for access to public railway infrastructure and is engaged in the distribution of the railway infrastructure capacity, and makes decisions regarding the assigning of the trains of a particular carrier.

SIA LDZ Loģistika is engaged in providing forwarding and logistics services, as well as in attracting new freight flows and promoting railway freight transport between European and Asian countries.

The subsidiary of *SIA LDZ ritošā sastāva serviss – SIA Rīgas Vagonbūves uzņēmums Baltija* was founded with a view to developing the manufacturing of railcars in Latvia.

The principal task of the *Group* is to ensure the management of the national public-use railway infrastructure and provide secure, top-quality and efficient railway and logistics services to serve the best interests of the *Group* as well as the country's national and economic interests.

To improve upon the best corporate governance practices and develop awareness of social responsibility within the *Group*, as well as strengthen the sustainable and concurrently innovative approach in the railway sector, which is rich in traditions, since 2016, *Latvijas dzelzceļš* has been preparing sustainability reports under the internationally recognised guidelines set forth in the *Global Reporting Initiative* (GRI) G4.

In 2017, the average number of employees employed by the *Group* was 11,189, by 593 employees fewer than in 2016.

2. Operating performance

In 2017, the *Group's* consolidated revenue was EUR 318,638 thousand. Compared to 2016, the consolidated revenue has declined by EUR 32,483 thousand (9.3 %) due to the declining freight volumes, accounting for the major share of the *Group's* consolidated net turnover.

SIA LDZ CARGO generates most of the *Group's* revenue, which is an important company of the Latvian transit and transport sector. In 2017, 43,785 thous. tonnes of freight were carried by rail, down by 4,034 thousand tonnes (8.4 %) compared to 2016. Import freight accounted for the major share of the total volume (83.6 %); in 2017, their volume reached 36,617 thous. tonnes, down by 12.9 % compared to the previous year. In terms of the origin of the carried freights, the company's largest counterparty is Russia, accounting for 73.7% of the total freights. The shares of carried freight by other countries were as follows: Belarus – 19.3 %, Lithuania – 4.7 %, Ukraine – 0.8 %, Estonia – 0.6 %, Kazakhstan 0.3 %, Uzbekistan 0.3 %, and other countries – 0,3 %.

Transporting of coal makes up the largest share of the freight structure, i.e., 17,689 thous. tonnes (40.4 %). Transporting of oil and oil products was the second largest item in the freight structure with 13,014 thous. tonnes (29.7 %). In 2017, other types of freights made up 29.9 % of the total freight structure.

Using the railway network of *Latvijas dzelzceļš*, 15,016 million tonne kilometres have been run, a decline of 5.4 % against the previous year. In 2017, *SIA LDZ CARGO* ran 9,971 million tonne kilometres. In 2017, the market share of *SIA LDZ CARGO* went down to 66.4 % from 74.6 % in 2016.

One of the key indicators of the *Group's* operating performance is the number of kilometres run by trains (*"train-km"*), which has an impact on revenue from public access railway infrastructure services. In 2017, the public access infrastructure of *Latvijas dzelzceļš* was used to transport 43,785 thous. tonnes of freight (8,844 thous. train-km) and carry 17,494 thousand Passengers (6,075 thous. train-km). The public railway infrastructure access services provided by the *Group* to non-*Group* carriers amounted to 2,690 thousand train-km, whereas those of passenger transport – to 5,707 thousand train-km. In 2017, there were no significant fluctuations in the passenger train traffic intensity compared to 2016.

The *Group* company *SIA LDZ CARGO* is the only surface transport sector player in the Latvian transport and storage sector that provides international passenger carriage services. *SIA LDZ CARGO* provided international passenger transport services on the following routes: Riga – Moscow – Riga; Riga – St. Petersburg – Riga; as well as ensured the operation of the Belarusian train in the route Riga – Minsk. In 2017, 160 thous. passengers were carried, an increase of 5 % from 2016.

The *Group's* after-tax profit was EUR 31,177 thous., up by EUR 30,122 thous. compared to 2016. On 1 January 2018, the new Corporate Income Tax Law came into force, which no longer provides for inclusion of financial and tax depreciation differences as well as changes in created provisions in the taxable income. Derecognition of the deferred tax liability and crediting thereof to the profit and loss increased the after-tax profit by EUR 32,376 thousand. Although the declining freight volumes reduced the profit significantly, the *Group* has managed to achieve savings through efficiency improvements, which has resulted in cost reduction.

At 31 December 2017, the *Group's* consolidated shareholder's equity was EUR 392,574 thousand, up by EUR 35,554 thousand (10 %) from 2016.

The *Group* pursues prudent liquidity risk management to ensure that the necessary funds are available to settle its liabilities as they fall due. At 31 December 2017, the *Group's* current liabilities exceeded its current assets by EUR 18,659 thous., as a result, the total liquidity ratio (current assets/current liabilities) was 0,9 (0.9 in 2016). Current liabilities include deferred income of EUR 20,388 thous., which is related to investments using the EU project and State budget financing in the public access railway infrastructure, hence, the risk of the outflow of finances to cover these liabilities is low. The total liquidity ratio, excluding deferred revenue, was 1. In the light of the above circumstances, we are of the opinion that in 2017, notwithstanding the declining freight volumes, the *Group* managed to maintain financial soundness.

In 2017, the *Group's* capital expenditure amounted to EUR 56,452 thousand. Financial resources were invested to renovate, upgrade and acquire fixed assets, intangible assets, as well as to construct new facilities.

In 2017, the total capital expenditure on the projects carried out by *Latvijas dzelzceļš* amounted to EUR 26,273 thousand. Of these, the most significant projects were:

- Completed railway track renewal works of EUR 19,303 thousand. Completed "A" grade capital repairs of 22.5 km, and completed "B" grade capital repairs of 24.97 km.
- Upgrading of information technologies included completion of works amounting to EUR 1,317 thousand. Within the scope of the project *The Optimization of Freight Transport Infrastructure Flow*, the functionality of the accounting for dangerous freights has been improved. With a view to improving the unified Data warehouse of *Latvijas dzelzceļš*, the following works were carried out: dispatcher as well as management reports can now be generated from the Rail freight transport indicator information system; the software version of the Document management system has been upgraded; the Telegram solution has been implemented; the new version of the system has undergone innovative enhancements aimed to improve the functionality of the system;
- The heating systems in the buildings owned by *Latvijas dzelzceļš* has been upgraded as part of the real estate facility management. The capital repairs of technological and station buildings have been carried out according to the annual budget; heating systems and external engineering networks have been replaced; connection to the central drainage system has been completed, as well as other building-related works have been carried out. The works worth of EUR 1,344 thous. were completed during the reporting period.

With a view to ensuring proper maintaining of the technical condition of the locomotives owned by *SIA LDZ ritošā sastāva serviss* as well as to be able to provide the quantity of locomotives required by carriers, in 2017, seven diesel locomotives underwent major capital repairs (2TE10 type locomotives); the medium-level capital repairs of one diesel 2TE116 type locomotive was carried out, while six 2M62U type diesel locomotives were upgraded for total of EUR 28,898 thousand.

3. Objectives and future development

Due to the changes in the regulation governing the railway sector in the European Union (EU) and the Directive on the Single European Railway Area (2012/34/EU), on 25 February 2016, the Railway Law was amended and the Cabinet Regulation was issued on the basis thereof. They provide for the changes in relation to the provision of services and the service tariff calculation methodology. Regulation (EU) 2015/909 implementing the Directive has been adopted, providing for the procedure for calculating costs arising directly due to the provision of train traffic services, which will change the pricing methodology for the railway capacity sales service. The new methodology shall apply as of 1 January 2019.

Under the Railway Law, the Ministry of Transport has developed the draft indicative railway infrastructure development strategy (plan). The draft plan requires the approval by the Cabinet of Ministers. Based on the draft indicative railway infrastructure development strategy (plan), the public railway infrastructure manager will develop a business plan, which will comprise investment and financing programmes, as well as ensure the consistency between the contractual terms and the business plan. Pursuant to the amendments to the Railway Law, a multi-annual contract would need to be entered into between the infrastructure manager and the Ministry of Transport. Entering into the contract is a very important aspect for achieving financial soundness as infrastructure volume and quality indicators will be set forth therein. The contract should also provide for adequate financing.

The efficiency of infrastructure services will be one of the decisive factors in the competition for the freight carriage by rail. The priority projects for *Latvijas dzelzceļš* will be such that aim to directly improve the efficiency and security of the services, promote the growth of freight transport volumes, and increase the competitiveness of the Latvian transport sector as a whole.

In order to improve the efficiency of freight transport and promote the use of environmentally-friendly technologies and increased international competitiveness of *Latvijas dzelzceļš* transit corridor, the *Company* contemplates carrying out of a project entailing a full electrification of the main railway network (trunk routes), using the 25kV AC technology.

As part of the EU fund and the Cohesion policy funds 2014-2020 programming period Operational programme “Growth and employment”, priority area “Sustainable transport system”, specific aid measure 6.2.1, 6.2.1.1 activity “The electrification of the Latvian railway network”, carrying out of a large project is contemplated (the available Cohesion Fund financing is EUR 346,639 thousand), which would need to be implemented by 2023. By the end of 2023, the electrification of the rail sections Daugavpils –Rezekne and Krustpils – Riga is budgeted. The railway network electrification sections, which can qualify for the objective of the measure 6.2.1.1 comprise the electrification of such railway network sections, which are used for freight transporting most intensively, and the electrification of which would significantly reduce CO_2 emissions in Latvia produced by railway transport. As part of the EU fund and the Cohesion policy funds 2014-2020 programming period, Operational programme “Growth and employment”, priority area “Sustainable transport system”, specific aid measure 6.2.1 “Ensuring a competitive and environmentally friendly TEN-T railway network, contributing to its safety, quality and capacity” as well as the measure 6.2.1.2 “The upgrading and construction of the railway infrastructure”, carrying out of a number of significant projects is contemplated (the available Cohesion Fund financing is EUR 107,288 thousand).

Rebuilding and renewing of the most significant railway junctions will contribute to timely and smooth freight transport flows, concurrently improving the problem sections of the railway infrastructure and stabilising the functioning, as well as security thereof. Currently, the following projects are in progress: "The upgrading of the Rīgas railway junction section Sarkandaugava-Mangaļi-Ziemeļblāzma", with the total costs of EUR 25 million including the co-financing by the CF (85 %), "the Development of Daugavpils Šķirošanas station", with the total costs of EUR 36.6 million including the co-financing by the CF (85 %), and "The development of the Daugavpils acceptance yard and the access roads thereto", with the total costs of EUR 43.5 million including the co-financing of the CF (85 %).

Apart from the above-mentioned projects, preparing of the following projects is contemplated:

- "The implementation of a single train movement planning and management information system", which provides for merging of several management systems currently functioning on a stand-alone basis.
- "The upgrading of the railway passenger service infrastructure" aimed to raise the comfort standards of the passengers travelling by rail, improve the availability and safety of the rail transport, as well as ensure access to railway carriage services by individuals with reduced mobility.

Being aware of the future market trends, the *Group* has been developing a group of advanced, efficient and environmentally friendly infrastructure and logistics companies, by providing railway infrastructure management and logistics services to best serve the interests of Latvian society and economy. Developing of logistics requires the use of the "one-stop-shop" principle in providing services to customers, which *SIA LDZ Loģistika* has already been putting into practice, by working on the development of new routes, providing a single focal point in the chain between the consignor and the consignee, addressing all the matters related to logistics and acting in the interests of the whole sector. The growing importance of container cargo transportation in the Baltic Sea region must be taken into consideration. In their development programmes, Latvian ports have also identified the need to develop freight terminals for handling container freights, and the Group companies in cooperation with ports should be able to come up with competitive offers to attract and process this freight segment.

Among other things, *SIA LDZ Loģistika* has been working at developing the China, Central Asia and North-South transport corridors between the countries in Asia and North Europe, proposing advantageous offers for freight owners. Developing of freight transport within Europe is being contemplated, as well as operating the express train "Minsk-Riga" services, based on the mutual agreement between Latvian and Belarusian railway companies.

One of the priorities of the development of *SIA LDZ CARGO* is raising of the customer service quality and customer satisfaction level. To ensure the company's competitiveness under the current market conditions, keeping of the existing customers and facilitating of customer acquisition process is a must, ensuring, among other things a better awareness of customer expectations and use of modern information exchange channels. In 2018, establishing of a customer service centre pilot project is contemplated, aimed to centralise the customer service functions within the *Company*. In 2018, the development of a new payment system is being contemplated, which would ensure the centralisation of the customer billing process and serve as the basis for centralised communication with customers.

Aimed at achieving a faster and more convenient exchange of information between the carrier and the customer, *SIA LDZ CARGO* has been actively involved in the development and enhancing of the Freight movement management information system. The system's functionality provides for customer messaging, raising and using of electronic railway bills of lading, prior notification of the customs authorities in electronic form of the freight to be imported, and preparation and presenting of information about freights in electronic form. In the future, the use of the Freight movement management information system will be extended with a view to completely getting rid of paper supporting documents in domestic as well as international traffic.

In 2018, the container square in the Riga-Preču station will be upgraded, enabling the provision of a wider range of services to customers and promoting the development of inter-modal transport.

Work will be carried on at the enhancing of the Automated freight wagon and train commercial inspection, wagon number registration and recognition system at Šķirotava and Jelgava objects.

Investments will be made to acquire and upgrade the rolling stock and ensure a phased replacement of the ageing rolling stock.

SIA LDZ ritošā sastāva serviss will carry on the renewing of the primary diesel locomotives, which was started in 2014, i.e., the upgrading of the diesel locomotives 2M62U. The expected project completion time is April 2019. Upgraded locomotives are capable of carrying heavy trains, the period between repairs would increase, the number of repair and maintenance instances as well as fuel consumption would decline; these are environmentally-friendly locomotives. The upgrading will be carried out on the basis of the CZ LOKO project with MTU 16V4000 R34L engines. Overall, the scope of the project provides for the upgrading of 14 primary diesel locomotives. At 31 December 2017, seven upgraded diesel locomotives had been put into operation.

Within the scope of the pilot project carried out by *SIA LDZ ritošā sastāva serviss* and the company "Baltic3D.eu", the spare parts of the locomotives and rolling stock details have been developed for testing using the 3D printer. The initial findings after the implementation of the pilot project support that using of the 3D printing technology for rail purposes offers essential benefits, including time and resource savings, as well as the relative weight of the spare parts compared to their metal counterparts. The new and innovative technologies will also enable the rail sector to successfully implement its objectives in terms of environmentally friendly and green transport solutions.

A significant risk that may affect the performance of *Latvian dzelzceļš* specifically, and that of the Group in general, is the changing political and economic environment in the Eastern region market, as well as the development of Russian ports, as a result of which cargoes may be diverted off Latvian ports.

To reduce the risk associated with dependence on transit freight transport in the East-West direction, the *Group* intends to strengthen cooperation with its neighbouring counterparties, as well as develop alternative lines of business, including the combining of transport and exploiting the North-South direction. The *Group* will continue to participate in the initiatives relating to the legislation governing the transport industry, setting as a priority the development a sustainable railway infrastructure financing model

The Group will seek to continue to raise the productivity of the railway staff and responsibility for their job duties, arrange the necessary training for them, as well as ensure the implementation of the environmental protection policy and traffic safety.

The Group will continue to build up and maintain the reputation and role of *Latvijas dzelzceļš*, taking up an active position on topical matters related to the development of the transportation system and economy.

4. Research and development

With a view to maintaining and contributing to the long-term strengthening of the competitiveness of the *Group* in such an important area as the East-West transit corridor, the Boards of the *Group* companies use scientific and engineering achievements, including new production technologies, electronic devices and applications, information and communications systems and implement them in the Group's operations, as well as optimise the *Group's* organisational structure.

Furthermore, in order to substantially reduce greenhouse gas (GHG) emission sources in Latvia and facilitate the transition to alternative energy sources, as well as to create the conditions for developing new services and markets, the *Group*, in cooperation with its partners from the Czech Republic and Canada have launched work on the development of a hydrogen fuel-cell locomotive model. On 7 February 2017, the project application *for the project"Applying hydrogen in multi-modal Advanced Zero Emission transport (AMAZE)* was submitted to the European Commission Innovation and Networks Executive Agency (hereinafter "*INEA*") for obtaining the European infrastructure connecting instrument (CEF) financing. However, because of the fierce competition among the projects (out of 349 project applications 152 projects were approved), this project was not approved due to the lack of financing, despite receiving a very good expert assessment. However, irrespective of that the *Group* has been carrying on active research related to the development of project plan and is looking for alternative sources of public financing for the implementation of the project plan.

On 28 February 2017, phase two of the energy management system certification audit of *Latvijas dzelzceļš* was successfully completed, and *Latvijas dzelzceļš* obtained the certificate of compliance with the requirements of the standard LVS EN ISO 50 001:2012 and fulfilled the obligations for large companies laid down in the Energy Efficiency Law.

In cooperation with the Riga Technical University, a research project has been launched as part of which, recommendations for the repairs of concrete sleeper cracks, detachment and other defects as well as the choice of materials to be used will be developed. As part of the project, the analysis of the defects of concrete sleepers and the manufacturing and testing of concrete prototypes will be carried out.

Latvian railway environmental management professionals have been actively involved in the work groups of the Environment Protection and Regional Development Ministry and the Riga City Council, seeking solutions to reduce transport noise and mitigate acoustic noise in urban areas and outside the cities.

Work has been continuing on maintaining and monitoring the results of the soil and groundwater-monitoring network in Jelgava, Daugavpils, Rezekne, Krustpils and Riga, which enables early identification of contamination of soil and groundwater and any remedial works, if necessary.

5. Branches and representative offices abroad

In 2012, owing to significant freight volumes with Russia, the representative office of *Latvijas dzelzceļš* was established in the capital of Russia – Moscow. The representation office is engaged in carrying out promoting and marketing activities in the transport area.

On 24 January 2017, the representative office of *Latvijas dzelzceļš* was established in the capital of Belarus – Minsk aimed to promote co-operation between Latvia and Belarus in the field of rail transport and consolidate the cooperation between the transit and logistics sectors.

The *Group* does not have any foreign branches.

6. Events after the reporting period

During the period between the last day of the reporting year and the date of signing this report, there have been no significant events to have a material effect on the *Group's* financial position at 31 December 2017.

Riga, 3 April 2018

Chairman of the Board	E.Bērziņš
Member of the Board	A.Strakšas
Member of the Board	Ē.Šmuksts
Member of the Board	A.Stūrmanis

STATEMENT OF THE MANAGEMENT'S RESPONSIBILITY

The Board of the *Group's* Parent Company (hereinafter "*Management*") is responsible for preparation of the *Group's* consolidated financial statements.

The consolidated financial statements on pages 18 to 59 have been prepared on the basis of the accounting records and source documents, and present fairly the financial position of the *Group* at 31 December 2017, and its performance and cash flows for 2017.

The above-mentioned consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU on a going concern basis. In preparing these consolidated financial statements, the Management made prudent and reasonable judgements and estimates.

The Management of the *Group* is responsible for maintaining proper accounting records, safeguarding the *Group's* assets, and preventing and detecting fraud and other irregularities in the *Group*. The Management is also responsible for compliance with the laws of the Republic of Latvia.

Riga, 3 April 2018.

Chairman of the Board	E.Bērziņš
Member of the Board	A.Strakšas
Member of the Board	Ē.Šmuksts
Member of the Board	A.Stūrmanis

Translation from Latvian original*

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of VAS "Latvijas Dzelzceļš"

Report on the Audit of the Consolidated Financial Statements

Our Opinion

In our opinion, the accompanying consolidated financial statements set out on pages 18 to 59 of the accompanying consolidated annual report give a true and fair view of the financial position of VAS "Latvijas Dzelzceļš" and its subsidiaries (together 'the Group') as at December 31, 2017, and of their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at December 31, 2017,
- the consolidated statement of comprehensive income for the year then ended,
- the consolidated statement of changes in equity for the year then ended,
- the consolidated statement of cash flows for the year then ended, and
- the notes to the consolidated financial statements which include a summary of significant accounting policies.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements and auditor's independence rules that are relevant to our audit of the consolidated financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Reporting on Other Information

Management is responsible for the other information. The other information comprises

- the Management Report, as set out on pages 6 to 13 of the accompanying consolidated annual report,
- the Statement on Management Responsibility, as set out on page 14 of the accompanying consolidated annual report,

but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information included in the consolidated annual report, and we do not express any form of assurance conclusion thereon, except as described in the *Other Reporting Responsibilities in Accordance with the Legislation of the Republic of Latvia* section of our report.

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

If, based on the work we have performed and in light of the knowledge and understanding of the entity and its environment obtained in the course of our audit, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with the International Financial Reporting Standards as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

Other Reporting Responsibilities in Accordance with the Legislation of the Republic of Latvia

In addition, in accordance with the Law on Audit Services with respect to the Management Report, our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports.

Based solely on the work required to be undertaken in the course of our audit, in our opinion, in all material respects:

- the information given in the Management Report for the financial year for which the consolidated financial statements are prepared is consistent with the consolidated financial statements; and
- the Management Report has been prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports.

PricewaterhouseCoopers SIA
Certified audit company
Licence No. 5

Ilandra Lejiņa
Member of the Board

Terēze Labzova-Ceicāne
Certified auditor in charge
Certificate No. 184

Riga, Latvia
3 April 2018

* This version of our report is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 DECEMBER 2017

(EUR'000)

	Note	**2017**	**2016**
Revenue	4	318 638	351 121
Cost of sales	5	(320 571)	(340 409)
Gross profit or loss		**(1 933)**	**10 712**
Administrative expenses	6	(24 616)	(24 461)
Other operating income	7	33 628	37 015
Other operating expenses	8	(6 277)	(13 914)
Income from long-term investments	13	311	250
Financial income	9	2	1
Financial expenses	9	(2 272)	(2 295)
Profit or loss before corporate income tax		**(1 157)**	**7 308**
Corporate income tax for the reporting year	10	32 334	(6 253)
Net profit for the year		**31 177**	**1 055**

Notes on pages 25 to 59 form an integral part of these financial statements.

Riga, 3 April 2018

Chairman of the Board E. Bērziņš

Member of the Board A. Strakšas

Member of the Board Ē. Šmuksts

Member of the Board A. Stūrmanis

Annual accounts were prepared by VAS Latvijas dzelzceļš Finance department:

Deputy Finance Director, Head of the Finance Department S. Gasjūna

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

(EUR'000)

	Note	2017	2016
Net profit for the year		**31 177**	**1 055**
Other comprehensive income:			
Items that will not be reclassified to profit or loss:		4 377	*(9 371)*
Disposals of revalued of property, plant and equipment	18	-	*(11 024)*
Deferred income tax on revalued property, plant and equipment recorded directly in other comprehensive income	18	*4 377*	*1 653*
Other comprehensive income / (loss) for the year		**4 377**	**(9 371)**
Total comprehensive income / (loss) for the year		**35 554**	**(8 316)**
Total net profit and comprehensive income / (loss) for the year attributable to the shareholders of the parent company		**35 554**	**(8 316)**

Notes on pages 25 to 59 form an integral part of these financial statements.

Riga, 3 April 2018

Chairman of the Board E. Bērziņš

Member of the Board A. Strakšas

Member of the Board Ē. Šmuksts

Member of the Board A. Stūrmanis

Annual accounts were prepared by VAS Latvijas dzelzceļš Finance Department:

Deputy Finance Director, Head of the Finance Department S. Gasjūna

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017

(EUR'000)

ASSETS	Notes	31.12.2017	31.12.2016
NON-CURRENT ASSETS			
Property, plant and equipment	12	895 784	908 066
Intangible assets	11	1 360	1 559
Advance payments for property, plant and equipment		745	756
Long-term financial investments	13	494	494
TOTAL NON-CURRENT ASSETS		**898 383**	**910 875**
CURRENT ASSETS			
Inventories	14	24 244	34 355
Trade and other receivables	15	14 779	18 180
Corporate income tax	10	446	1 875
Cash and cash equivalents	16	72 883	61 084
TOTAL CURRENT ASSETS		**112 352**	**115 494**
TOTAL ASSETS		**1 010 735**	**1 026 369**

(continued on the next page)

Notes on pages 25 to 59 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017 (continued)

(EUR'000)

	Notes	31.12.2017.	31.12.2016
LIABILITIES AND EQUITY			
EQUITY			
Attributable to the shareholders of the Parent:			
Share capital	17	256 720	256 720
Long-term investments revaluation reserve	18	51 350	46 973
Reserves and previous years' retained earnings	18	53 327	52 272
Current year's comprehensive income		31 177	1 055
TOTAL EQUITY		**392 574**	**357 020**
LIABILITIES			
LONG-TERM LIABILITIES			
Deferred income tax liabilities	10	-	36 752
Provisions	19	177	178
Loans from credit institutions	20	176 527	177 334
Other borrowings	21	2 321	2 438
Trade creditors		486	491
Deferred income	23	307 639	329 671
TOTAL LONG-TERM LIABILITIES		**487 150**	**546 864**
SHORT-TERM LIABILITIES			
Loans from credit institutions	20	35 114	33 399
Other borrowings	21	117	117
Provisions	19	8 486	15 187
Trade and other payables		52 096	38 738
Corporate income tax	10	2	-
Taxes and the State compulsory social insurance contributions	22	14 808	15 836
Deferred income	23	20 388	19 208
TOTAL SHORT-TERM LIABILITIES		**131 011**	**122 485**
TOTAL LIABILITIES		**618 161**	**669 349**
TOTAL LIABILITIES AND EQUITY		**1 010 735**	**1 026 369**

Notes on pages 25 to 59 form an integral part of these financial statements.
Riga, 3 April 2018

Chairman of the Board E. Bērziņš
Member of the Board A. Strakšas
Member of the Board Ē. Šmuksts
Member of the Board A. Stūrmanis

Annual accounts were prepared by VAS Latvijas dzelzceļš Finance Department:

Deputy Finance Director, Head of the Finance Department S. Gasjūna

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(EUR'000)

		Attributable to the shareholders of the Parent			Total
	Share capital	**Long-term investments revaluation reserve**	**Reserves and previous years retained earnings**	**Current year's profit**	
Balance as at 01.01.2016	**256 720**	**56 344**	**42 318**	**583**	**355 965**
Profit of 2015 transferred to previous years' retained earnings	-	-	583	(583)	-
Total contributions by and distributions to owners	-	-	*583*	*(583)*	-
Disposal of revalued property, plant and equipment	-	(11 024)	11 024	-	-
Decrease of deferred tax liability arising as a result of disposal of revalued assets	-	1 653	(1 653)	-	-
Current year's profit	-	-	-	1 055	**1 055**
Total comprehensive income for the reporting year	-	*(9 371)*	*9 371*	*1 055*	*1 055*
Balance as at 31.12.2016	**256 720**	**46 973**	**52 272**	**1 055**	**357 020**
Balance as at 01.01.2017	**256 720**	**46 973**	**52 272**	**1 055**	**357 020**
Profit of 2016 transferred to previous years' retained earnings	-	-	1 055	(1 055)	-
Total contributions by and distributions to owners	-	-	1 055	(1 055)	-
Decrease of deferred tax liability arising as a result of disposal of revalued assets	-	4 377	-	-	**4 377**
Current year's profit	-	-	-	31 177	**31 177**
Total comprehensive income for the reporting year	-	*4 377*	-	*31 177*	***35 554***
Balance as at 31.12.2017	**256 720**	**51 350**	**53 327**	**31 177**	**392 574**

Notes on pages 25 to 59 form an integral part of these financial statements.

Riga, 3 April 2018

Chairman of the Board	E. Bērziņš
Member of the Board	A. Strakšas
Member of the Board	Ē. Šmuksts
Member of the Board	A. Stūrmanis

Annual accounts were prepared by VAS Latvijas dzelzceļš Finance Department:

Deputy Finance Director, Head of the Finance Department S. Gasjūna

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017

(using indirect method)

(EUR'000)

	Notes	2017	2016
Cash flows from operating activities			
Profit or loss before corporate income tax		**(1 157)**	**7 308**
Adjustments for:			
Depreciation and other impairment adjustments for property, plant and equipment		46 921	55 379
Amortization of intangible assets	11	605	629
Change in provisions		(6 702)	(7 538)
Exchange rate fluctuations	7,8	(848)	104
Income from investments into securities	13	(311)	(250)
Interest income	9	(2)	(1)
Revaluation of related companies		-	382
Interest expenses	9	2 272	2 295
Cash flow from operating activities before adjustments in working capital		**40 778**	**58 308**
Decrease / (increase) of trade receivables		3 403	(826)
Decrease / (increase) of inventory		9 554	(4 634)
Increase / (decrease) of trade payables		14 080	(8 856)
Gross cash flow from operating activities		**67 815**	**43 992**
Interest paid		(2 276)	(2 353)
Corporate income tax paid	10	(471)	(3 232)
Net cash generated from operations		***65 068***	***38 407***
Cash flows from investing activities			
Acquisition of related companies		-	(267)
Purchase of property, plant and equipment		(55 608)	(53 197)
Proceeds from sale of property, plant and equipment		160	215
Funding received	23	-	32 794
Interest received		2	1
Dividends received		311	406
Net cash used in investing activities		***(55 135)***	***(20 048)***

(continued on the next page)

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

(EUR'000)

	Notes	2017	2016
Cash flows from financing activities			
Loans received		34 658	43 377
Funding received		590	-
Loans repaid		(33 337)	(28 859)
Finance lease payments		-	(7)
Net cash generated from financing activities		***1 911***	***14 511***
Result of foreign exchange rate fluctuations		**(45)**	**5**
Net increase / (decrease) in cash and cash equivalents		**11 799**	**32 875**
Cash and cash equivalents at the beginning of the reporting year		61 084	28 209
Cash and cash equivalents at the end of the reporting year	16	**72 883**	**61 084**

Notes on pages 25 to 59 form an integral part of these financial statements.

Riga, 3 April 2018

Chairman of the Board E. Bērziņš

Member of the Board A. Strakšas

Member of the Board Ē. Šmuksts

Member of the Board A. Stūrmanis

Annual accounts prepared by VAS Latvijas dzelzceļš Economic analysis department:

Finance Deputy Director, Head of the Finance Department S. Gasjūna

NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

The Group provides a public railway infrastructure manager's services and railway transportation services.

The parent company of the Group is VAS Latvijas dzelzceļš, a company that fulfills public railway infrastructure management functions.

The parent company has been registered in the Commercial Register of the Republic of Latvia as a state joint-stock company and is 100% owned by the Republic of Latvia. The Parent Company's registered office is at 3 Gogoļa iela, Riga LV-1050, Latvia.

All companies within the Group are registered in the Republic of Latvia and the Groups parent company has direct as well as indirect controlling interest. The Group includes:

Name	Nature of services
LDZ CARGO SIA	Cargo transportation
LDZ ritošā sastāva serviss SIA	Rolling-stock maintenance and repair
LDZ infrastruktūra SIA	Railway track repair
LDZ apsardze SIA	Security services
LatRailNet AS	Infrastructure essential function management
LDZ Loģistika SIA	Transport forwarding and logistics services
Rīgas Vagonbūves uzņēmums "Baltija" SIA	Established to develop production of freight carriages in Latvia

The financial statements were approved for publication by the Board of the Parent Company on 3 April 2018. The consolidated financial statements are approved by the general meeting of shareholders to be convened by the Board of VAS Latvijas dzelzceļš after receiving the auditor's opinion and the report of the Council.

2. ACCOUNTING POLICIES AND VALUATION METHODS

The consolidated financial statements have been prepared according to the accounting policies described below. These policies have been consistently applied to all comparative periods unless stated otherwise.

2.1. ACCOUNTING POLICIES AND VALUATION METHODS

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU (IFRS).

The consolidated financial statements have been prepared on a historical cost basis as modified by revaluation of cargo carriages used for cargo transportation (included under property, plant and equipment).

The accounting and valuation methods remain unchanged.

The consolidated financial statements cover the period from 1 January 2017 to 31 December 2017.

In preparing the financial statements in accordance with IFRS, the Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Future events may affect the assumptions made by the Management. Any changes in assumptions are immediately reflected in the consolidated financial statements as incurred. Despite estimates being prepared based on the comprehensive information about current events and actions available to the Management, the actual results may differ. Significant assumptions and estimates are described in Note 3.

The following new and amended IFRS and interpretations became effective in 2017, but have no significant impact on the operations of the Group and these financial statements:

➢ Amendments to IAS 12 "Income taxes" – recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017).

➢ Amendments to IAS 7 "Statement of Cash Flows" – Disclosure initiative (effective for annual periods beginning on or after 1 January 2017).

Certain new standards and interpretations have been published that become effective for the accounting periods beginning on 1 January 2018 or later periods or are not yet endorsed by the EU, and are relevant to the operations of the Company:

➢ IFRS 9 "Financial instruments" (effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:
- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL). Majority of the requirements of the IAS 39 in relation to the classification and measurement of financial liabilities have stayed unchanged in IFRS 9. The management of the Group has performed an evaluation of the effect of implementation of IFRS 9 and has concluded that the classification and measurement of the Group's financial assets and liabilities will remain unchanged.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables. The management of the Group has made an estimate of ECL and has concluded that the additional allowance which would be required as at 1 January 2018 is not material in the context of the Group's financial statement.
- Hedge accounting requirements were amended to align accounting more closely with risk management. As the Group does not use hedge accounting, this requirement is not applicable.

➢ IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The management of the Group has performed an evaluation of the implementation of IFRS 15 and has concluded that it will not have any significant impact on the Group's financial statement in 2018.

➢ IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Currently the management of the Group is in process of evaluation of the effect of implementation of the new standard. Although precise effect has not been determined, it is estimated, that as a result of implementation of IFRS 16 the Group's assets and liabilities will increase.

➢ Amendments to IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018);

➢ Annual improvements to IFRS's 2016. The amendments include changes that affect 3 standards:

- IFRS 12 "Disclosure of Interests in Other Entities" (effective for annual periods beginning on or after 1 January 2017, not yet endorsed in the EU),
- IFRS 1 "First-time Adoption of International Financial Reporting Standards" (effective for annual periods beginning on or after 1 January 2018, not yet endorsed in the EU), and
- IAS 28 "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after 1 January 2018, not yet endorsed in the EU).

➢ IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018, not yet endorsed in the EU).

➢ IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019, not yet endorsed in the EU).

➢ Amendments to IAS 40 "Investment Property" – Transfers of investment property (effective for annual periods beginning on or after 1 January 2018, not yet endorsed in the EU).

- Amendments to IFRS 9 "Financial instruments" – Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019, not yet endorsed in the EU).

- Annual improvements to IFRS's 2017 (effective for annual periods beginning on or after 1 January 2019, not yet endorsed in the EU). The amendments include changes that affect 4 standards:
  - IFRS 3 - "Business Combinations",
  - IFRS 11 - "Joint Arrangements"
  - IAS 12 - "Income taxes"
  - IAS 23 - "Borrowing costs".

The Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Group anticipates that the adoption of standards, revisions and interpretations will have no material impact on the financial statements of the Group in the period of initial application, except as described above.

2.2. FOREIGN CURRENCY TRANSLATION

Functional and presentation currency

Items included in the financial statements of each of the Group entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The consolidated financial statements are presented in the euro (EUR) as the official currency of the Republic of Latvia, which is the Group's presentation currency. The functional and presentation currency of each Group company is the euro.

Foreign currency transactions and balances

All transactions denominated in foreign currencies are converted into euro at the exchange rate set by the European Central Bank prevailing on the day the transactions took place. Monetary assets and liabilities denominated in foreign currencies are converted into euro at the rate set by the European Central Bank. Foreign currency gains or losses are recognized in the consolidated statement of profit or loss.

Exchange rates

Currency	EUR 31.12.2017.	EUR 31.12.2016
USD	1,1993	1.05410
CHF	1,17020	1.07390
RUB	69,39200	64.30000

2.3. INTANGIBLE ASSETS

Intangible assets primarily consist of software licenses initially recognized at cost. Estimated useful life for each type of intangible assets is finite and determined. Intangible assets are recorded at historical cost net of accumulated amortization and accumulated impairment losses.

Subsequent costs are included in the asset's carrying amount or recognized as separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Other subsequent costs are charged to the consolidated statement profit or loss as incurred.

Amortization of intangible assets is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives and are reflected in consolidated profit or loss statement. Intangible assets are mainly amortized over five years.

2.4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost or revalued amounts, as described below, less accumulated depreciation and provision for impairment, where required.

Cargo carriages used in railway transportation are subject to revaluation with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Increases in the carrying amount arising on revaluation are credited to other comprehensive income and increase the revaluation surplus in equity. Decreases that offset previous increases of the same asset are recognized in other comprehensive income and decrease the previously recognized revaluation surplus in equity; all other decreases are charged to profit or loss for the year. The revaluation reserve for property, plant and equipment included in equity is transferred directly to retained earnings when the revaluation surplus is realized on the retirement or disposal of the asset.

When an item of cargo carriages is revalued, any accumulated depreciation at the date of the revaluation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. As a result, book value of cargo carriage after revaluation equals to its revalued amount.

All other classes of property, plant and equipment are stated at cost, less accumulated depreciation and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the fixed assets. The costs of self-constructed fixed assets consist of purchase price and other direct expenditures, as well as all ancillary charges related to its implementation in use, costs incurred in demolishing or rearranging existing assets and modernization of assets' location place. The costs of software licenses that are inseparable from the equipment and ensure its proper functioning are capitalized as part of equipment.

The Group capitalizes fixed assets, if their value exceeds EUR 300 and estimated useful life exceeds one year. Leasehold improvements are capitalized and treated as fixed assets.

If fixed assets are comprised of major components having different useful lives, they are accounted for as separate items of fixed assets. The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year end, and adjusted prospectively, if appropriate.

Subsequent costs are included in the asset's carrying amount or recognized as separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Other repairs and maintenance are charged to the consolidated statement of profit or loss during the period in which they are incurred.

Gains or losses on disposals are determined by comparing carrying amount with proceeds and are charged to the consolidated statement of profit or loss in the period in which they are incurred.

Where the carrying amount of fixed asset exceeds its estimated recoverable amount, it is written down immediately to its recoverable amount (see Note 2.5).

Depreciation

Depreciation of fixed assets is calculated using the straight-line method. Depreciation is charged to the consolidated statement of profit or loss.

Depreciation of leasehold improvements is calculated over the shorter of the assets estimated useful life or the lease term depending on the asset category into which leasehold improvement is falling into. Land is not depreciated.

Depreciation is calculated for each class of assets using their residual values by applying the depreciation rates specified for each asset:

Asset category	Useful life
Buildings and rail roads	10-130 years
Perennial plants	40 years
Railway transport – carriages for technological needs and cargo transportation	22-40 years
Railway transport – locomotives, diesel trains and technological equipment	5-40 years
Rail track machines	30 years
Computing equipment, means of communication, copiers and related equipment	3-10 years
Other fixed assets	5-28 years

Fixed assets under construction

Fixed assets that are not ready for their intended use or are in installation process are classified as „Fixed assets under construction". Historical cost of assets under construction includes borrowing costs incurred during the period of construction, and other direct expenditure, related to fixed assets implementation in use. Borrowing costs are not capitalized during periods in which active development of a qualifying asset is suspended.

When assets have reached their working condition for their intended use, they are reclassified to an appropriate class of property, plant and equipment and depreciation is started from that moment. Fixed assets under construction are regularly evaluated for impairment.

2.5. IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS

There is defined estimated useful life for each tangible and intangible asset (except land and museum collections). Value of assets, that are depreciated or amortized, is assessed for whether or not there are indications that an asset may be impaired.

The impairment loss is the difference between the book value of the asset and its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. To evaluate for impairment, the assets are grouped at the lowest level for which there are identifiable cash flow (cash generating units). If an asset is impaired, the Group writes it down to its recoverable amount and recognizes an impairment loss in the consolidated statement of profit or loss.

For assets previously impaired an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in previous years.

2.6. FINANCIAL INSTRUMENTS

The financial instruments consist of financial assets (available for sale investments, loans and receivables and cash and cash equivalents) and financial liabilities (borrowings, trade liabilities and other creditors).

Financial Assets

Financial assets include available for sale investments, accounts receivable and other debtors, cash and cash equivalents and loans issued. The classification depends on purpose of financial asset. The Group determines the classification of financial asset upon its initial recognition.

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Purchases and sales of financial assets are recognized on the trade date, the date on which the Group commits to purchase or sell the asset.

All of the Group's financial assets are non-derivative financial assets that are not quoted in an active market. Financial assets with maturity of less than 12 months are shown as current assets and others as long-term investments.

Available for sale investments

Available for sale financial assets are non-derivatives that are not classified in any of the other categories. They are included in non-current assets unless the investment matures or *Management* intends to dispose of it within 12 months of the end of the reporting period. Unquoted equity instruments where fair value cannot be measured reliably are carried at cost, less any impairment losses. Dividends on available for sale equity instruments are recognized in the profit or loss statement when the Group's right to receive payments is established.

Loans and receivables

Loans and receivables are non-derivative financial assets, with fixed or determinable payment schedule. They are not quoted in an active market and not held for sale. Loans and receivables consist of trade and other receivables. Short-term receivables are not discounted.

Loans and receivables initially are recognized at their fair value, and subsequently accounted for at their amortized cost, using effective interest rate, less provisions for impairment loss. Provisions for impairment loss are established when there is objective evidence the Group will not be able to collect all amounts due according to the original terms of receivables. Evidence of impairment may include indications that the debtor will enter bankruptcy or other financial reorganization, as well as default or delinquency in payments. Provision for impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows that is discounted at the financial assets original effective interest rate. Impairment loss for doubtful debts is recorded using an allowance account and the amount of the loss is recognized in the statement of profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized (for example, improvement of debtor's credit rating), the previously recognized impairment loss is reduced by adjusting the allowance account and recognized in statement of profit or loss.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances of current account with bank and short-term deposits with original maturities up to 90 days and short-term highly liquid investments that can be easily converted into cash and are not subject to a substantial risk of changes in value.

Financial Liabilities

Financial liabilities are comprised of borrowings, trade and other creditors. Recognition of financial liabilities is stopped if the contractual liabilities per agreement has ended, are met or voided.

Creditors

Trade and other creditors are initially recognized at fair value. After initial recognition financial liabilities are measured at amortized cost using the effective interest rate. If maturity term of liabilities is less than a year, they are classified as short-term creditors. If maturity exceeds one year, liabilities are classified as long-term.

Borrowings

Borrowings are initially recognized at fair value, net of transaction costs. Borrowings are subsequently measured at amortized cost using the effective interest rate method.

Gains and losses are recognized in the profit or loss statement when the borrowings are derecognized as well as through the effective interest rate method amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate. The amortization is included in finance cost in the profit or loss statement.

Borrowings are classified as short-term liabilities, except, if the Group has the inalienable right to defer settlement for at least 12 months after the balance sheet date.

The financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

2.7. INVENTORIES

Inventories are valued at the lower of acquisition cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. Acquisition cost is determined using the weighted average stock valuation method for fuel and gas and FIFO (first in, first out) method for other inventory items.

Where required, a provision for impairment of obsolete, slow moving or damaged stock is created. Provision is recognized in the consolidated profit or loss statement.

2.8. SHARE CAPITAL AND PAYMENTS FOR USE OF STATE CAPITAL (DIVIDENDS)

The Parent Company's share capital consists of common shares. All shares are dematerialized. The nominal value per share is one euro.

Dividends paid to the Parent Company's shareholders or payments for use of state capital are recognized as liabilities within consolidated financial statements during the period, when the amount of dividends is approved by the shareholder of the Parent Company.

2.9. OTHER RESERVES

After approval of the consolidated financial statements, the shareholder's meeting makes decision about the distribution of the profit. Part of Parent Company's net profit, based on the shareholder's meeting decision, can be included in „Other reserves". Usage and distribution of other reserves is subject to shareholder meeting decisions.

2.10. PROVISIONS FOR UNUSED ANNUAL LEAVE

Amount of provisions for unused annual leave is determined by multiplying the average daily wage of employees for the last 6 months of the reporting year by the amount of unused annual leave in days at the end of the reporting year.

2.11. PROVISIONS

Provisions are recognized when there is a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount have been reliably estimated.

When the Group expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset, when the reimbursement is virtually certain. Expenses relating to provisions are presented in the consolidated statement of profit or loss net of any reimbursements.

2.12. CORPORATE INCOME TAX AND DEFERRED INCOME TAX

The income tax includes both current and deferred tax payable. Income tax is recognized in consolidated statement of profit or loss.

Corporate income tax is calculated in accordance with tax legislation that is in force at the end of reporting year. Current legislation enforces application of 15% tax rate.

Until 31 December 2016 deferred tax was provided for, using the liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arose from different fixed asset depreciation rates, accrued costs and provisions which were deductible in the future taxation periods as well as tax losses carried forward.

On July 28, 2017, a new Corporate Income Tax Law was adopted, which stipulates that from January 1, 2018, the corporate income tax is levied on profit that arose after 2017 if it is distributed. The new tax law does not include rules which result into timing differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Transitional provisions of the law provide that taxpayers will be able to utilise the unused tax losses accumulated by 31 December 2017 during next 5 taxation years for reducing the tax payable on distributed profits by no more than 50% each year, as well as to use provisions created by 31 December 2017 that resulted in the increase of taxable income during the respective tax periods, for reduction of taxable profits, in the amount of their reduction. Such amounts, if any, do not give rise to deferred income tax assets as at 31 December 2017 and thereafter, as in the situation where there is a different tax rate on distributed profit and retained earnings, the deferred tax is calculated according to the tax rate applicable to retained earnings, i.e. 0%. Given the circumstances, there is no longer any reason for the existence of a deferred tax asset or liability at 31 December 2017, and the deferred tax liability recognized by the Company as at 31 December 2016 was reduced to zero, including a reduction in that liability in the profit and loss account for the year 2017, except for the deferred tax recognised outside the profit or loss as the amount of this tax is allocated to the same item in shareholders' equity against which it was attributed when recognised.

From taxation year 2018, corporate income tax will be calculated on the basis of distributed profit (20/80 of the net amount payable to shareholder). Corporate tax on distributed profit will be recognized when the shareholder of the Company make a decision about profit distribution.

2.13. REVENUE RECOGNITION

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for services rendered, stated net of discounts and value added tax. The Group recognized revenue when the amounts of revenue can be reliably measured, when it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities, as described below.

The Group provides the following services:

- *Cargo transportation services* – transportation of coal, oil, chemicals, fertilizers, metals, foodstuff, containers and other types of cargo and goods using all major East-West and North-South corridors. Revenue is recognized based on the number of tone/kilometers the cargo was transported during the accounting period.
- *Sale of infrastructure capacity* – provides the access to railway infrastructure. The manager of infrastructure without discrimination provides these services to all carriers. Revenue is calculated by multiplying the fee as determined by the independent fee settler LatRailNet AS based on pricing methodology approved by Public Utilities Commission (PUC), with the number of kilometres run by the train and recognized in the period when movement of train has taken place. The fee was approved by the decision of LatRailNet AS Board dated 5 November 2014 for the periods after 31 December 2014 and determined based on the Railway Act and the Regulators of Public Services Act and approved by PUC Council decision No. 1/21 related to "Methodology for fee calculation for public usage infrastructure services" dated 21 September 2011.
- *Auxiliaries of infrastructure manager services* – freight train processing, by train formation, and without it, vehicle maintenance and repairs. Revenue is recognized when the actual service has been provided to the customer.
- *Specific services related with the service and maintenance of infrastructure* – rail track and bridge construction and repair, replacement of switches, railway machinery, instruments and mechanisms repair and modernization of carriages, rail welding and transportation of long rails, water canalization system installation and repair, as well as

earth structures' preparation. Revenue is recognized upon provision of maintenance or when the repair works are finished.

- *International passenger traffic services* – ensures passenger transportation on international routes Riga-Moscow-Riga and Riga-St. Petersburg-Riga, Riga-Minsk-Riga. Revenue is recognized when the ticket is sold.
- *Expedition services* – development of cargo transportation routes, organization of railways traffic process, including preparation of transit documents, processing and customs clearance, transport route development, cargo delivery to the warehouse. Revenue is recognized when the actual service has been provided to the customer.
- *Rental services* – the Group rents out buildings, constructions, land and other property, plant and equipment items that are not needed for the operations, primarily to other carriers and other companies and organizations related to the operations of the railway infrastructure. Empty space and objects that are not needed for the Group operations are rented out in an open market. Renting out the unused space located in the railway infrastructure objects reduces the cost of basic services rendered. As a result, the competitiveness of basic services increases, as does the efficiency of object usage. Revenue is recognized in the period when services are provided.
- *Electricity distribution services* – electricity distribution and sales services to individuals and legal entities as well as dependent subsidiaries, and the purchase of electrical power for the electrical traction of passenger trains. Power distribution (traction substations and contact network) needed for a passenger rail traction purpose is included in the cost of infrastructure and is not included in electricity distribution services. Latvijas dzelzceļš provides individuals with general services fulfilling its obligations laid down by the Electricity market law, law on Regulators of Public Services and Rulings of the Cabinet of ministers Nr50 "Rules on sale and use of Electricity". The Group acts as a principal in provision of these services, thus revenue and related costs are recognized on a gross basis. Revenue is calculated applying the tariff on the amount of actual kilowatts used during the respective period.
- *Principal services* include transit clearance in the border stations, transit declaration in the base stations temporary storage. Revenue is recognized when the actual service has been provided to the customer.
- *Rolling stock repair and maintenance services.* Revenue is recognized upon provision of maintenance or when the repair works are finished.
- *Traction provision services* – provides locomotive crews services to other carriers, lacking locomotive crews for ensuring own transportation. Revenue is recognized when the actual service has been provided to the customer based on usage of crew in the respective accounting period.
- *Electronic communications services* – data and electronic messages transmission services, leased line services, services of access points to the electronic infrastructure, public fixed electronic voice telephony services and interconnection services. Revenue is recognized based on actual usage of network capacity during respective accounting period.
- *Other services* – these services include fuel storage and sale, equipment services, IT services, self-produced heating sales, maintenance services and various other small-scale services for corporate clients and individuals. Revenue is recognized when the actual service has been provided to the customer.

Interest income

Interest income is recognized on all interest bearing instruments on accruals basis, by applying effective interest rate. Interest income from cash and cash equivalents is classified as financial income.

Income from penalties

In accordance with the prudence principle, penalties, including late payment charges, are recognized as income only when payment is received.

2.14. LEASE AGREEMENTS

Operating lease

Leases in which a significant portion of the risk and rewards of ownership are retained by the lessor are classified as operating leases.

The Group as a lessor

Assets that are leased out under operating lease terms are recorded within property, plant and equipment at historic cost less depreciation. Depreciation is calculated using diminishing balance method. Rental income from operating lease including advances received is recognized over the period of the lease on a linear basis in the statement of profit or loss.

The Group leases buildings, constructions, land and other fixed assets that are not used in operating activities as well as provides locomotive rental services. Insignificant portion of building and land is leased out; therefore, it is not classified as investment property.

There are no significant non-cancellable lease receivables or payables arising from operating lease agreements were the Group acts as a lessor.

The Group as a lessee

Payments made under operating leases are charged to the profit and loss account over the period of lease on a linear basis.

Finance lease – the Group as a lessee

Finance lease transactions under which the Group has substantially all risks and rewards, which are inherent to the ownership rights on the asset, to the lessee are classified as fixed assets in amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability, to provide to each period a constant periodic rate of interest on the remaining balance of the liability. Finance lease expenses are reflected in statement of profit or loss.

If there is reasonable certainty that the lessee will obtain ownership at the end of the lease term, the period of expected use is the useful life of the asset. Otherwise the asset is depreciated over the shortest of the lease term and its useful life.

2.15. GOVERNMENT GRANTS AND EU FUNDS

Government grants and EU funds are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants and EU funds related to assets (fixed assets) are recorded as „Deferred income" and periodically recognized in consolidated statement of profit or loss proportionately to assets (property, plant and equipment items) depreciation over their estimated useful life.

2.16. RELATED PARTIES

Related parties are defined as the State, members of the Board of the Group companies, their close relatives, and companies in which they have significant influence or control.

2.17. SUBSEQUENT EVENTS

Such events after the balance sheet date that provide additional information about the financial position of the Group at the balance sheet date – adjusting events – are appropriately reflected within consolidated financial statements. If events after the balance sheet date are not adjusting events, they are disclosed in the notes to the consolidated financial statement only if material.

2.18. EMPLOYEE BENEFITS

Social insurance and pension plan contribution

The Group makes social insurance contributions to the state pension scheme in accordance with Latvian legislation. The state-funded pension scheme is a fixed contribution pension plan under which the Group must make payments at statutory levels. The Group will have no additional legal or constructive obligation to make further payments if the state-funded pension scheme is unable to settle its liabilities to employees. Social insurance contributions are recognized as expenses on an accrual basis and included in employee costs. Under the Cabinet of Ministers' Regulation No. 759 dated 6 December 2016 on the apportionment of the national social insurance contribution rate between the types of national social insurance in 2017, the defined level of social insurance contributions to be used for the state funded pension scheme in 2017 is 71.99% (69.99% in 2016).

2.19. CONSOLIDATION PRINCIPLES

The Group's subsidiary is a company in which the Parent Company has financial or operating control. Control is assumed to exist if the parent owns more than 50% of shares in the subsidiary and has the ability to govern all operational decisions made by the subsidiary.

Financial statements of subsidiaries are consolidated starting from the moment when parent company has gained control over subsidiary and consolidation is ceased when control is lost.

The financial statements of the Companies comprising the Group are prepared by using uniform accounting and financial policies for similar transactions and other events in similar circumstances. If needed, the accounting and valuation methods of subsidiaries are aligned with the methods used by the Group. The consolidated financial statements include the parent company's and subsidiaries' financial statements for the year ended 31 December 2016. The Group companies' annual reporting period is the same and follows the calendar year.

All transactions between the Group companies, settlements and unrealized profit or losses from transactions between the Group companies are eliminated.

3. SIGNIFICANT JUDGMENTS AND ASSUMPTIONS

The preparation of the Group's financial statements in accordance with IFRS requires Management to make significant assumptions. It also requires Management to make its judgment and assumptions in the process of applying the Group's accounting policies.

Preparation of the financial statements in accordance with IFRS requires making estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of information at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The areas that are affected by judgments are *Management* judgment and assumptions, used in determining assets recoverable value and amount of provision, as described below.

Useful life of property, plant and equipment

The Group at each reporting date assesses useful lives of property, plant and equipment. Based on latest Management assessments performed by Economic analysis department of the Parent Company of the Group, current useful lives are representative of the usage of property, plant and equipment items.

Provisions

Determination of the amount of provision is based on judgment about potential amount of liabilities, and term when they fall due. If the events do not realize or fulfil otherwise than expected, the amount of actual expenses may differ from initial estimates. For more details of estimations in respect of provisions see Note 19.

4. REVENUE

(EUR'000)

	2017	2016
Cargo transportation	188 558	239 718
Sale of infrastructure capacity	62 589	58 452
Expedition services	26 969	13 533
International passenger traffic services	7 682	7 747
Auxiliaries of infrastructure manager	7 656	6 896
Electricity distribution services	5 621	5 967
Lease income	4 305	4 532
Rolling-stock repair and maintenance	3 791	3 366
Principal services	2 561	3 264
Traction provision services	1 315	1 111
Specific services related to maintenance and repairs of infrastructure	445	693
Electronic communications services	412	530
Other services	6 734	5 312
Total	**318 638**	**351 121**

5. COST OF SALES

(EUR'000)

	2017	2016
Salary expenses	111 912	116 170
Employer's state compulsory social security contributions	26 246	27 171
Fuel and gas	31 857	34 362
Materials	13 801	14 279
Electricity	9 590	10 618
Depreciation of fixed assets and intangible assets	63 769	69 089
Other expenses	63 396	68 720
Total	**320 571**	**340 409**

6. ADMINISTRATIVE EXPENSES

(EUR'000)

	2017	2016
Salary expenses	17 043	17 051
Employer's state compulsory social insurance contributions	3 988	3 964
Materials, fuel and gas, electricity	340	336
Depreciation of fixed assets and intangible assets	555	498
Other expenses	2 690	2 612
Total	**24 616**	**24 461**
From those remuneration to the board members and the council members of the parent company of the Group	567	393
Including salary expenses	*459*	*318*
State compulsory social insurance employer's contribution	*108*	*75*

7. OTHER OPERATING INCOME

(EUR'000)

	2017	2016
Deferred income (see also Note 23)	20 377	19 146
Sale of scrap metal	2 934	643
Profit on sale of property, plant and equipment	337	494
Exchange rate fluctuations	848	-
Penalties	500	361
Provisions for unused annual leave	-	3 919
Provisions for materials that are not used for more than one year	-	72
Reversal of other provisions	7 289	11 214
State budget subsidy for damages	230	-
Other income	1 113	1 166
Total	**33 628**	**37 015**

8. OTHER OPERATING EXPENSES

(EUR'000)

	2017	2016
Loss on disposals of fixed assets	1 844	7 763
Costs not directly related to economic activities and costs associated with the Trade union collective agreement	1 287	1 379
Foreign exchange rate fluctuations	-	104
Currency exchange	23	21
Penalties	24	20
Social infrastructure expenses	22	53
Increase of allowance for doubtful accounts	59	226
Allowance for inventory unused for more than one year	910	-
Impairment of property, plant and equipment	724	-
Accrued liabilities for vacations	123	3 566
Increase and usage of other provisions	599	386
Other expenses	662	396
Total	**6 277**	**13 914**

9. FINANCIAL EXPENSES, NET

(EUR'000)

	2017	2016
Financial income		
Bank interest	2	1
Financial expenses		
Bank interest	(2 272)	(2 295)
Including interest on long-term loans	*(2 272)*	(2 295)
Financial expenses, net	**(2 270)**	**(2 294)**

10. CORPORATE INCOME TAX

Corporate income tax is calculated in accordance with tax legislation that is in force at the end of reporting year. Current legislation enforces application of 15% tax rate.

With the entry into force of the new Corporate Income Tax Law on 1 January 2018, there will no longer be temporary differences between the carrying amounts of assets and liabilities in the financial statements and their tax base.

The principal temporary differences arise from different accounting and tax depreciation rates used, as well as allowance for obsolete and slow-moving inventories, accruals for bonuses and compensations for work-related injuries. Considering that these will no longer be taken into account in the calculation of the Corporate income tax, the deferred tax liability was reduced to zero, including a reduction in the profit and loss account.

Corporate income tax overpayment / (liabilities) at the end of the reporting year

(EUR'000)

	2017	2016
Overpaid on 1st January	1 875	905
(Tax liabilities) on 1st January	-	(1 335)
Calculated for the reporting year	(42)	(24)
Paid during the reporting year	471	3 232
Transferred from other taxes	(1 860)	(839)
Return of tax overpayment	-	(64)
Overpayment on 31 December	**446**	**1 875**
(Tax liabilities) on 31 December	**(2)**	**-**

Overpaid corporate income tax and corporate income tax liabilities relate to separate legal entities within the Group. The Group has no legal rights to offset these amounts.

Corporate income tax expenses for the reporting year

(EUR'000)

	2017	2016
Current corporate income tax for the reporting year	42	24
Change in deferred income tax liabilities during the reporting year	(32 376)	6 229
Total	**(32 334)**	**6 253**

Corporate income tax differs from the theoretically calculated tax amount that would arise applying the rate stipulated by the law to profit before taxation:

(EUR'000)

	2017	2016
Profit before corporate income tax	(1 157)	7 308
Theoretically calculated tax at a tax rate 15%	(174)	1 096
Permanent differences, 15%*	216	5 157
Tax credit resulting from de-recognition of deferred tax liability	(32 376)	-
Corporate income tax charge for the reporting year	**(32 334)**	**6 253**

* Permanent differences mainly result from expenses that are not deductible for corporate income tax calculation purposes, as well as from adjustments for consolidation purposes (mainly dividend payments from subsidiaries to the parent company) and write-off of deferred tax liabilities resulting from the changes in the law.

Deferred corporate income tax

The movement of deferred income tax:

(EUR'000)

	Accelerated tax depreciation	Accrued unused annual leave expenses	Other accrued expenses	Total
31.12.2015	**31 323**	**(546)**	**(254)**	**30 523**
Profit / (loss) in consolidated profit or loss statement	7 373	546	(36)	7 883
Deferred income tax change recognized directly in other comprehensive income	(1 654)	-	-	(1 654)
31.12.2016	**37 042**	-	**(290)**	**36 752**
Profit / (loss) in consolidated profit or loss statement	(32 666)	-	290	(32 376)
Deferred income tax change recognized directly in other comprehensive income	(4 376)	-	-	(4 376)
31.12.2017	-	-	-	-

Net deferred income tax liabilities

(EUR'000)

	31.12.2017.	**31.12.2016.**
Net deferred tax assets recoverable within 12 months	-	(290)
Net deferred tax liabilities payable in more than 12 months	-	37 042
Total net deferred income tax liabilities	-	**36 752**

11. INTANGIBLE ASSETS

(EUR'000)

	Licenses and rental rights	
	2017	**2016**
Opening cost	**6 255**	**5 719**
Additions	406	491
Reclassified	-	61
Disposals	(5)	(16)
Closing cost	**6 656**	**6 255**
Opening amortization	**4 696**	**4 083**
Charge	605	629
Disposals	(5)	(16)
Closing amortization	**5 296**	**4 696**
Opening net book value	**1 559**	**1 636**
Closing net book value	**1 360**	**1 559**

12. Property, plant and equipment

(EUR'000)

	Land	Buildings, long-standing plantations	Rail roads	Lease-hold improvements	Technological equipment and machinery	Cargo carriages	Computing equipment and facilities, means of communication, copiers and related equipment	Other fixed assets	Fixed assets under construction	Total
Cost/ revalued 01.01.2016	**1 280**	**121 671**	**578 962**	**2 678**	**320 080**	**212 321**	**24 222**	**25 235**	**83 839**	**1 370 288**
Purchased and completed property, plant and equipment	60	21 815	22 207	-	63 658	1 095	3 208	2 111	(65 764)	**48 390**
Reclassified	-	35	(9)	4	(1 201)	-	1 124	47	-	-
Disposed fixed assets	-	(335)	(6 000)	(11)	(11 552)	(11 499)	(725)	(516)	(7)	**(30 645)**
Cost/ revalued 31.12.2016	**1 340**	**143 186**	**595 160**	**2 671**	**370 985**	**201 917**	**27 829**	**26 877**	**18 068**	**1 388 033**
Depreciation 01.01.2016	-	**37 314**	**159 469**	**538**	**120 197**	**81 524**	**15 406**	**15 758**	-	**430 206**
Charge for the year	-	4 223	29 639	124	22 044	9 630	2 683	1 500	-	**69 843**
Reclassified	-	72	(5)	(6)	(118)	-	28	29	-	-
Booked depreciation	-	-	861	-	-	-	-	-		**861**
Disposed fixed assets	-	(302)	(4 397)	(11)	(10 481)	(4 597)	(652)	(503)	-	**(20 943)**
Depreciation 31.12.2016	-	**41 307**	**185 567**	**645**	**131 642**	**86 557**	**17 465**	**16 784**	-	**479 967**
Impairment 01.01.2016	-	**(10)**	**(229)**	-	**(28)**	**(3 942)**	-	-	-	**(4 209)**
Impairment reversal / (charge)	-	10	**229**	-	28	3 942	-	-	-	**4 209**
Impairment 31.12.2016	-	-	-	-	-	-	-	-	-	-
Net book value 01.01.2016	**1 280**	**84 347**	**419 264**	**2 140**	**199 855**	**126 855**	**8 816**	**9 477**	**83 839**	**935 873**
Net book value 31.12.2016	**1 340**	**101 879**	**409 593**	**2 026**	**239 343**	**115 360**	**10 364**	**10 093**	**18 068**	**908 066**

(EUR'000)

	Land	Buildings, long-standing plantations	Rail roads	Leasehold improvements	Technological equipment and machinery and rolling stock	Cargo carriages	Computing equipment and facilities, means of communication, copiers and related equipment	Other fixed assets	Fixed assets under construction	Total
Cost/ revalued 01.01.2017	1 340	**143 186**	**595 160**	**2 671**	370 985	**201 917**	27 829	**26 877**	**18 068**	**1 388 033**
Purchased and completed property, plant and equipment	-	637	18 699	-	28 762	304	2 738	1 687	3 227	**56 054**
Reclassified	-	(234)	-	-	228	-	6	-	-	-
Disposed fixed assets	-	(165)	(3 723)	(26)	(4 655)	(61)	(577)	(684)	(1 917)	**(11 808)**
Cost/ revalued 31.12.2017	1 340	**143 424**	**610 136**	**2 645**	395 320	**202 160**	29 996	**27 880**	**19 378**	**1 432 279**
Depreciation 01.01.2017	-	**41 307**	**185 567**	**645**	131 642	**86 557**	17 465	**16 784**	-	**479 967**
Charge for the year	-	4 087	29 115	112	19 769	7 489	2 791	1 472	-	**64 835**
Reclassified	-	(11)	-	-	7	-	4	-	-	-
Disposed fixed assets	-	(144)	(3 105)	(26)	(4 449)	(46)	(559)	(703)	-	**(9 032)**
Depreciation 31.12.2017	-	**45 239**	**211 577**	731	146 969	**94 000**	19 701	**17 553**	-	**535 770**
Impairment01.01.2017	-	-	-	-	-	-	-	-	-	-
Impairment reversal / (charge)	-	-	-	-	(725)	-	-	-	-	**(725)**
Impairment 31.12.2017	-	-	-	-	(725)	-	-	-	-	(725)
Net book value 01.01.2017	1 340	**101 879**	**409 593**	2 026	239 343	**115 360**	10 364	**10 093**	**18 068**	**908 066**
Net book value 31.12.2017	1 340	**98 185**	**398 559**	**1 914**	247 626	**108 160**	10 295	**10 327**	**19 378**	**895 784**

During the reporting year, as well as comparative periods the Group used land of 15 027 hectares owned by the Ministry of Transport of the Republic of Latvia (mainly it is land under railways tracks which forms part of railway infrastructure and its sole purpose is serving as a location of railway infrastructure objects in order to ensure development of railways and their safe operations).

Salary expenses capitalized within additions during the reporting year amount to EUR 3 915 thousand (EUR 4 400 thousand in 2016). The amount of cash paid for repairs, modernization and purchases of property, plant and equipment items, as well as purchases of intangible assets and building of new objects was EUR 55 608 thousand in 2017 (EUR 53 197 thousand in 2016).

13. LONG-TERM FINANCIAL INVESTMENTS

(EUR'000)

Company's name	Share of „Latvijas dzelzceļš" %	Net book value	
		31.12.2017	31.12.2016
Belarus-Latvia joint company Mirigo	3,0	420	420
Strek SIA	5,84	74	74
Total:	**x**	**494**	**494**

Fair value of these investments cannot be measured reliably and therefore these assets are carried at cost. In Management's view the fair value of these investments is not materially different from their book values.

During the year, dividends amounting to EUR 311 thousand were received from other investments for the results of prior years. Revenue is recognized when there is a legal right to receive dividends.

14. INVENTORY

(EUR'000)

	31.12.2017.	31.12.2016.
Road repair materials	6 276	8 599
Repair parts	12 246	19 077
Other materials	4 498	4 574
Fuel and gas	2 351	2 797
Other inventory	907	432
Gross book value	**26 278**	35 479
Allowances for inventory not used more than one year	(2 034)	(1 124)
Net book value	**24 244**	**34 355**

15. TRADE AND OTHER RECEIVABLES

(EUR'000)

	31.12.2017.	31.12.2016.
Trade accounts receivable	10 733	13 282
Prepaid value added tax	2 351	3 201
Doubtful accounts receivable	1 336	1 294
Other debtors	1 695	1 697
Gross book value	**16 115**	19 474
Allowance for doubtful debts	(1 336)	(1 294)
Net book value	**14 779**	**18 180**

Movement in allowance for doubtful debts was as follows:

(EUR'000)

	2017	2016
Opening allowance for doubtful debts	1 294	1 097
Decrease of allowance due to repayments received	(55)	(239)
Decrease of allowance due to write-off of bad debts	(17)	(31)
Additional allowance created	114	467
Closing allowance for doubtful debts	**1 336**	**1 294**

16. CASH AND CASH EQUIVALENTS

(EUR'000)

	31.12.2017.	31.12.2016.
Cash in bank	72 882	61 082
Cash on hand	1	1
Cash in transit	-	1
Total	**72 883**	**61 084**

17. SHARE CAPITAL

Registered and fully paid share capital of the Parent Company of the Group

Registered and fully paid share capital of "Latvijas dzelzceļš" is EUR 256 720 375 thousand. It consists of two hundred fifty-six million seven hundred twenty thousand three hundred and seventy-five shares. The value of one share is EUR 1.00 (one euro).

All shares are owned by the Republic of Latvia and are fully paid for. State shares are held by the Ministry of Transport. All of the Parent Company's shares provide common rights to receive dividends, rights to receive a liquidation quota and voting rights at shareholders' meetings.

Payments for use of state capital (dividends)

Dividends for the reporting year are calculated by the Group's Parent Company as a fixed percentage of net profit in accordance with sections 94(2), 56(1) and 28(1–2) of the Governance of a Public Person's Shares and Companies Act and the Cabinet of Ministers' Regulation No.806 of 22 December 2015, *„Order, in which state corporations and public private corporations, in which state is a shareholder, predict and set percentage of net profit to be paid as dividends and make payments to the state budget for use of state capital"* paragraph 5.

In accordance with the Cabinet of Ministers' Regulation No.445 of 21 August 2017 "On share of the profit of SJSC Latvijas dzelzceļš to be paid as dividends to the State for the year 2016" Latvijas dzelzceļš was not required to make payments from net profit of year 2016 to the state budget for the use of state capital.

18. LONG-TERM INVESTMENTS REVALUATION RESERVE, OTHER RESERVES AND RETAINED EARNINGS

Starting from 1 July 2013 cargo carriages used in railways transportation that were previously included in rolling stock are valued by the Group using revaluation method. Revaluation of these assets performed in 2013 resulted in increase in their fair value, as a result of which revaluation reserve was recognized (net of tax effect).

Other reserves consist of transfers from previous year's retained earnings made based on the Group's Parent Company shareholder decision. After annual report is approved, the Group's Parent Company Board members propose on the distribution of the profit for the reporting period, with one of the possible proposition being transfer of the profit to reserves. Final decision about distribution of profit for the year is made by the Group's Parent Company's shareholder's meeting.

19. PROVISIONS

(EUR'000)

	31.12.2017.	31.12.2016.
Other provisions	177	178
Total long-term portion	**177**	**178**
Provisions for public railway infrastructure services	6 922	13 843
Provision for termination benefits	487	634
Other provisions	1 077	710
Total short-term portion	**8 486**	**15 187**
Total	**8 663**	**15 365**

Movement in provisions for each type of provision in 2017:

(EUR'000)

	01.01.2017	Increase	Decrease due to usage	31.12.2017
Provisions for public railway infrastructure services	**13 843**	6 922	(13 843)	**6 922**
Provisions for losses from court cases	**15**	192	(12)	**195**
Provision for termination benefits	**634**	-	(147)	**487**
Other provisions	**873**	407	(221)	**1 059**
Total	**15 365**	**7 521**	**(14 223)**	**8 663**

Movement in provisions for each type of provision in 2016:

(EUR'000)

	01.01.2016	Increase	Decrease due to usage	31.12.2016
Provisions for public railway infrastructure services	**20 765**	13 843	(20 765)	**13 843**
Provisions for losses from court cases	**990**	6	(981)	**15**
Provision for termination benefits	**323**	311	-	**634**
Other provisions	**826**	75	(28)	**873**
Total	**22 904**	**14 235**	**(21 774)**	**15 365**

In 2017 the amount of provisions for financing the public use of railway infrastructure services was reduced in total by EUR 13 843 thousand, with a remaining balance equal to EUR 6 922 thousand. Total decrease of provisions was made taking into account amendments to the Railways law enforced as at 10 March 2016 and planned changes in related legislative acts, which provide the adoption of European Parliament and Council Directive 2012/34/EU requirements in the national laws.

Usages and increases of provisions are reflected in their net amount under other operating expenses or other operating income.

In 2017 provisions for probable losses from litigation were made in amount of 192 thousand EUR, and in total the Group has liabilities for probable losses in amount of 195 thousand EUR as at 31 December 2017.

Provisions for termination benefits are made in accordance with the collective agreement between the Group and the trade union about payments upon termination to employees released within five years before reaching retirement age. The provisions are based on the best estimate of termination benefits amounting to EUR 487 thousand.

Other accruals as at 31 December 2017 include liabilities for probable compensations of work-related injuries in amount of 177 thousand EUR; provisions for lost cargoes and damages of cargo railcars in amount of 475 thousand EUR; and termination benefits in amount of 407 thousand EUR.

20. LOANS FROM CREDIT INSTITUTIONS

(EUR'000)

	31.12.2017.	31.12.2016.
Long-term loans from credit institutions	176 527	177 334
Short-term loans from credit institutions	35 114	33 399
Total loans from credit institutions	**211 641**	**210 733**

Loans have been received from Swedbank AS, Nordea Bank AB, Luminor Bank AS, SEB Banka AS, Danske Banka AS Latvian branch, European Investment Bank and OP Corporate Bank Plc Latvian branch. During the reporting period total amount of loans repaid was EUR 34 703 thousand, while EUR 33 337 thousand were received. Concluded credit agreements with banks have certain financial indicators that company has to follow during the contract period, if the figures are not met, letters from banks are received while preparing the annual report, saying that the lender will not require repayment of funds at a faster period.

"Latvijas dzelzceļš" and its subsidiaries signed a Group account agreement with Luminor Bank AS, under which there was a short-term loan facility of EUR 60 000 thousand and a current limit of EUR 40 000 thousand. Overdraft contract is binding until 2019. As at 31 December 2017 the overdraft has not been used.

State Treasury has records of the state guarantees for loans of *Latvijas dzelzceļš* (creditor European Investment Bank):

- guaranteed contract amount 7 004 thousand EUR, balance as at 31 December 2017 is 467 thousand EUR;
- guaranteed contract amount 27 129 USD, balance as at 31 December 2017 is 1 809 USD.

In 2009 LDZ CARGO SIA has signed two loan agreements providing security in form of pledge. Cargo carriages with total value of EUR 8 230 thousand owned by LDZ CARGO SIA are pledged in favour of Swedbank AS and Luminor Bank AS.

One of operating activities of LDZ ritošā sastāva serviss SIA is selling of diesel fuel. In accordance with the part 1 of section 31 of the law "On excise tax" in order to carry out activities with excise goods and to use deferred tax payment option tax payer should provide security. During the year LDZ ritošā sastāva serviss SIA prolonged the guarantee issued by SEB Banka AS in the form of general security for excise purposes amounting to EUR 4 000 thousand until 1 June 2018.

Loan balances and interest rates as at 31 December 2017 are:

Loan currency	Loan, EUR'000	Interest rate
EUR	30 473	1M EURIBOR + 1,089% to 1,33%
	123 377	3M EURIBOR + 0,13% to 1,61%
	52 891	6M EURIBOR + 1,05% to 1,8%
	2 026	6M EUR LIBOR + 1,6%
USD	915	5,55%
	593	3M USD LIBOR + 0,13%
	1 366	6M USD LIBOR + 1,65%
Total	**211 641**	

Loan balances and interest rates as at 31 December 2016 are:

EUR	228	Dienas EUR LIBOR + 1,65%
	40 922	1M EURIBOR + 1,089% to 1,7%
	116 907	3M EURIBOR + 0,13% to 1,61%
	43 614	6M EURIBOR + 1,05% to 1,8%
	3 142	6M EUR LIBOR + 1,6%
USD	2 082	5,55%
	1 350	3M USD LIBOR + 0,13%
	2 488	6M USD LIBOR + 1,65%
Total	**210 733**	

The effect of currency fluctuations on foreign currency borrowings

(EUR'000)

Borrowing currency	**Borrowing amount as at 31.12.2016.**	**Paid during reporting period**	**Fluctuations on foreign currency**	**Borrowing amount as at 31.12.2017.**
USD	5 920	(2 587)	(459)	2 874
Kopā	**5 920**	**(2 587)**	**(459)**	**2 874**

21. OTHER BORROWINGS

(EUR'000)

	31.12.2017.	**31.12.2016.**
Payments for ownership rights of optical telecommunication cable Liepaja – Jelgava – Riga – Valka*1), including: Long-term portion	2 321	2 438
Incl. payable after five years	*1 853*	*1 970*
Incl. payable within one to five years	*468*	*468*
Short-term portion	117	117
Total other borrowings	**2 438**	**2 555**

*1) Agreement was signed on 2013 for the total amount EUR 2 925 thousand and maturity of 2038.

22. TAXES AND THE STATE COMPULSORY SOCIAL SECURITY CONTRIBUTIONS (EUR'000)

	31.12.2017.	31.12.2016.
State compulsory social security contributions	5 434	6 841
Personal income tax	3 036	3 879
Value added tax	4 862	3 231
Excise tax	1 423	1 820
Natural resources tax	15	15
State fee for the maintenance of safety reserves	33	43
Risk duty	4	4
Company tax for vehicles	-	3
Vehicle operating tax	1	-
Total	**14 808**	**15 836**
Corporate income tax	2	-

Tax liabilities incurred mainly during December 2017, the Group does not have any overdue payments to the State budget.

Calculated taxes and the state compulsory social security contributions

(EUR'000)

	2017	2016
State compulsory social security contributions	47 233	48 400
Personal income tax	25 057	25 336
Excise tax	13 844	16 626
Value added tax	9 370	3 666
Real estate tax	645	650
Company tax for light-duty vehicles	55	61
Natural resources tax	56	44
Corporate income tax	42	24
Corporate income tax from non-residents	2	-
Customs duty	21	16
Total taxes payable	**96 325**	**94 823**
Security reserve storage duty	325	426
Risk duty	48	51

23. DEFERRED INCOME

(EUR'000)

	31.12.2017.	31.12.2016.
The long-term part of deferred income (Cohesion fund's and State fund's resources)	307 639	329 671
Total long-term part	**307 639**	**329 671**
The short-term part of deferred income (Cohesion fund's and State fund's resources)	19 860	19 208
Other deferred income	528	-
Total short-term part	**20 388**	**19 208**
Total deferred income	**328 027**	**348 879**

Major part of the deferred income is comprised of EU funds and State budget funding, received for the purpose of development of the railway infrastructure. 590 thousand EUR, which are presented as Other deferred income, relates to funding received from the State budget for compensation of losses caused by heavy rain floods in August 2017, which caused damage to the railway infrastructure, based on the law "On state budget for 2017" and Cabinet of Ministers regulation No 569 "On granting of funding from state budget program "Funding for unexpected cases""dated 11 October 2017.

Movement in deferred income from EU projects in 2017:

(EUR'000)

Deferred income	Balance as at 01.01.2017	Reclassified	Adjust-ments	Decrease in fixed assets depreciation amount	Balance as at 31.12.2017
Long-term part	**329 671**	(21 029)	(1 003)	-	**307 639**
Short-term part	**19 208**	21 029	-	(20 377)	**19 860**
Total	**348 879**	-	**(1 003)**	**(20 377)**	**327 499**

In 2017 no funding has been received for projects from EU funds and the state budget.

Movement in deferred income from EU projects in 2016:

(EUR'000)

Deferred income	Balance as at 01.01.2016	Received during reporting year		Reclassified	Adjust-ments	Decrease in fixed assets depreciation amount	Balance as at 31.12.2016
		EU funds	State budget				
Long-term part	318 618	28 767	4 027	(21 695)	(46)	-	**329 671**
Short-term part	**16 659**	-	-	21 695	-	(19 146)	**19 208**
Total	**335 277**	**28 767**	**4 027**	-	**(46)**	**(19 146)**	**348 879**

EU funds and state budget resources received for projects in 2016:

(EUR'000)

Project name	EU funds financing	State budget financing
Project 3DP/3.3.2.1.0/13/IPIA/SM/002 Passenger rail infrastructure modernization	5 430	-
Project CCI2009LV161PR001 The second railroad construction Skriveri-Krustpils	4 717	-
Project 3DP/3.3.1.2.0/13/IPIA/SM/003 Station Skirotava centralization modernization	3 343	-
Project 3DP/3.3.1.2.0/10/IPIA/SM/002 Building of station Bolderaja 2 with connecting railroads to the Krievu sala terminals	2 988	-
Project 3DP/3.3.1.2.0/10/IPIA/SM/001 Station Skirotava sorting mount reconstruction	2 370	686
Project 2007-LV-27060-P Reconstruction of the Rail Baltica corridor railroad	2 235	3 341
Project 3DP/3.3.1.2.0/14/IPIA/SM/001 Railroads reconstruction	2 156	-
Project 3DP/3.3.1.2.0/13/IPIA/SM/005 Liepaja alarm systems modernization with rail road reconstruction	1 940	-
Project 3DP/3.3.1.2.0/13/IPIA/SM/001 Turnouts replacement and delivery	1 350	-
Project 3DP/3.3.1.2.0/10/1PIA/SM/003 Modernization of alarm system, telecommunication and electricity system at Bolderaja 1 - Zasulauks	1 135	-
Project 3DP/3.3.1.2.0/13/IPIA/SM/004 Data transmission network modernization	883	-
Project 2011-LV-93133-S LDZ Design development of electrification network	220	-
Total	**28 767**	**4 027**

24. FINANCIAL RISK MANAGEMENT

The Group's significant financial instruments are loans from credit institutions, other borrowings, cash and bank deposits, as well as accounts receivable and payable. The main financial instrument's purpose is to provide financing resources for the operations of the Group. There are many other financial assets and liabilities from the Group's operating activities, for example, trade receivables and trade payables.

Operations with financial instruments expose the Group to market risk, credit risk and liquidity risk.

Risk management is carried out by the Finance Department and the Group's Finance Committee.

The Group's financial instruments by category can be presented as follows:

(EUR'000)

	31.12.2017.	**31.12.2016.**
Loans and receivables		
Trade and other receivables excluding prepayments	10 733	13 282
Cash and cash equivalents	72 883	61 084
Available for sale		
Long-term financial investments	494	494
Total financial assets	**84 110**	**74 860**
Other financial liabilities at amortized cost		
Loans from credit institutions	211 641	210 733
Other borrowings	2 438	2 555
Trade and other payables, excluding advances (including long-term part)	36 940	35 360
Total financial liabilities	**251 019**	**248 648**

Market risk

The market risk arises from the changes in the market risk factors, for example, foreign currency rate and interest rate that have an influence on the Group's income or on the value of financial instruments. Market risk includes currency risk and interest rate risk.

Interest rate risk

The interest rate risk is risk to suffer losses from changes in interest rates applied to the Group's assets and liabilities. The Group is exposed to interest rate risk mainly from its long-term liabilities being at variable interest rates.

All of the Group's borrowings are with variable interest rates, except for funds borrowed in the end of the 90s at a fixed interest rate. For more details of interest rates on borrowings see Note 20. The Group manages interest rate risk by regular evaluation of interest rates available at the market. If lower interest rates are available, the Group evaluates the refinancing possibilities.

Management of the Group has decided not to use any derivative financial instruments in managing interest rate risk.

Interest rate sensitivity

The table below summarizes the sensitivity of the Group's profit before tax to the possible interest rate changes, with other variables being constant. The Group's equity, except for the reporting year's result, is not affected.

	2017		2016	
	Base rate increase/ decrease (base points)	**Impact on profit before tax (thousand EUR)**	**Base rate increase/ decrease (base points)**	**Impact on profit before tax (thousand EUR)**
EURIBOR	(+100)	(2 088)	(+100)	(2 048)
	(-100)	2 088	(-100)	2 048
LIBOR	(+50)	(14)	(+50)	(30)
	(-50)	14	(-50)	30

Foreign exchange risk

The foreign exchange risk is risk to suffer losses due to unfavorable foreign exchange rate fluctuations. Foreign exchange risks are mainly arising from the Group's operating activities – income and expenses are denominated in different currencies from loans received. Trade receivables are mainly denominated in EUR, while bank loans mainly in EUR, and USD. For more details of amounts see Note 27.

Main tool used by the Group for foreign exchange rate risk management is identification of foreign currency reserves within the Group companies and matching of those with liability settlements in foreign currencies.

Management of the Group has made a decision not to use any derivative financial instruments in managing foreign exchange rate risk.

Foreign exchange rate sensitivity

The table below summarizes the sensitivity of the Group's profit before tax to possible foreign exchange rate changes, with other variables being constant. The Group's equity, except for reporting year's result, is not affected.

	2017		2016	
	Changes in foreign currency exchange rate	**Impact on profit before tax (thousand EUR)**	**Changes in foreign currency exchange rate**	**Impact on profit before tax (thousand EUR)**
USD	(+5%)	124	(+5%)	407
	(-5%)	(124)	(-5%)	(407)

Credit risk

Credit risk is risk due of counterparty's inability to meet its obligations against the Group that may result in significant losses. The Group is exposed to credit risk that arises from its operating activities – mainly trade receivables and from its financing activities – mainly bank deposits.

Trade receivables

In accordance with the Group policies, each Group company manages its trade receivable risk. Before signing an agreement, credit ability of a potential customer is evaluated. Most of the

Group companies are reducing the credit risk by providing services or selling goods only after prepayment is received.

The Group monitors its trade receivable balances on a regular basis to minimize amount of doubtful debts. The impairment of doubtful debts is analyzed on a regular basis.

The Group has not received any pledges for customer debts.

The Group evaluates its credit risk concentration as being moderate. As at 31 December 2017 the Group had 3 customers (3 customers in 2016) which owed the Group more than EUR 700 thousand, and comprised 55.7% (66.4% in 2016) of total trade receivables.

The Group does not have an internal credit rating system for evaluating trade receivables.

Cash deposits

In accordance with the Group's financial management policies, credit risks arising from the Group's cash deposits are managed by the Group's Finance Committee. Based on this policy the Group's free resources are invested only in deposits or money market funds. Before investing in bank deposit or money market funds, the Group's Finance Committee evaluates credit rating of the bank and offered interest rates.

Credit ratings according to Moody's applied credit rates used by the Group and outstanding cash/deposit balances were as follows:

(EUR'000)

Credit rating	**31.12.2017.**	**31.12.2016.**
Aa2	-	8 316
Aa3	67 867	45 757
A1	5 015	-
A2	-	7 009
Total	**72 882**	**61 082**

The table below summarizes the Group's exposure to credit risk:

(EUR'000)

	31.12.2017.	**31.12.2016.**
Cash and cash equivalents	72 883	61 084
Trade and other receivables (gross) excluding prepayments	12 069	14 576
Total	**84 952**	**75 660**

Additional information on credit risk:

(EUR'000)

	31.12.2017.	31.12.2016.
Financial assets, which are not overdue with no provisions for impairment		
Not overdue, including	82 608	70 002
Cash deposits	*72 883*	*61 084*
Trade receivables	*9 725*	*8 918*
The analysis of aging structure for overdue financial assets, with no provision for impairment		
Less than 3 months	580	3 875
From 3 to 12 months	428	489
Total financial assets with no provisions for impairment	**83 616**	**74 366**
Financial assets, with provisions for impairment (created in full)	1 336	1 294
Total	**84 952**	**75 660**

Liquidity risks

Liquidity risk refers to the Group's inability to meet its obligations in defined term.

The Group's Finance Committee manages the liquidity risk, by making sufficient reserves and providing appropriate financing, using loans, credit lines, finance leases and other, as well as monitors forecasted and actual cash flows and coordinates the term structure of financial assets and liabilities.

The Group performs long-term cash flow forecasting for a year and operative cash flow forecasting for a week. By this the Group maintains appropriate amount of recourses to provide financing of operating expenses, to settle the Group's liabilities and to make necessary investments.

Short-term liabilities of the Group include deferred income related to support received from EU projects in form of investments into development of railways public infrastructure. As a result of this, short-term liabilities exceed current assets and show negative liquidity. It should be noted that no financial resources will be required for settlement of these liabilities; therefore the Group will be able to cover its current payments and retain its financial stability.

The table below provides the analysis of the Group's liability term structure, based on undiscounted cash flows and including interest payments in accordance with agreements:

(EUR'000)

On 31 December 2017	Less than 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total
Loans from credit institutions	9 036	28 311	128 972	54 996	**221 315**
Other liabilities (including other borrowings and trade and other payables)	27 279	9 292	954	1 853	**39 378**
Total	**36 315**	**37 603**	**129 926**	**56 849**	**260 693**

(EUR'000)

On 31 December 2016	Less than 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total
Loans from credit institutions	8 112	27 523	122 833	61 015	**219 483**
Other liabilities (including other borrowings and trade and other payables)	23 285	11 706	954	1 970	**37 915**
Total	**31 397**	**39 229**	**123 787**	**62 985**	**257 398**

25. FAIR VALUE ESTIMATIONS

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

The objective of the fair value measurement, even in inactive markets, is to arrive at the price at which an orderly transaction would take place between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

In order to arrive at the fair value of a financial instrument different methods are used: quoted prices, valuation techniques incorporating observable data and valuation techniques based on internal models. These valuation methods are divided according with the fair value hierarchy in Level 1, Level 2 and Level 3.

The level in the fair value hierarchy within which the fair value of a financial instrument is categorized shall be determined on the basis of the lowest level input that is significant to the fair value in its entirety.

The classification of financial instruments in the fair value hierarchy is a two-step process:

1. Classifying each input used to determine the fair value into one of the three levels;
2. Classifying the entire financial instrument based on the lowest level input that is significant to the fair value in its entirety.

Quoted market prices – Level 1

Valuations in Level 1 are determined by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted prices are readily available and the prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques using observable inputs – Level 2

Valuation techniques in Level 2 are models where all significant inputs are observable for the asset or liability, either directly or indirectly. Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (that is, as price) or indirectly (that is, derived from prices).

Valuation technique using significant unobservable inputs – Level 3

A valuation technique that incorporates significant inputs that are not based on observable market data (unobservable inputs) is classified in Level 3. Unobservable inputs are those not readily available in an active market due to market illiquidity or complexity of the product.

Level 3 inputs are generally determined based on observable inputs of a similar nature, historic observations on the level of the input or analytical techniques.

Such financial assets and liabilities are included in Level 3:

- Assets: cash and cash equivalents 72 883 thousand EUR; net trade receivables 10 733 thousand EUR. Long term investments 494 thousand EUR.
- Commitments: loans from credit institutions 211 641 thousand EUR; debts to suppliers and contractors 36 940 thousand EUR; other liabilities 2 438 thousand EUR.

Assets and liabilities for which fair value is disclosed

The carrying amount of liquid and short-term financial instruments (with maturity below 3 months), for example, cash and cash equivalents, short-term deposits, short-term trade payables and trade receivable, corresponds to its fair value.

The carrying amount of bank loans, finance lease liabilities and other long-term liabilities is evaluated by discounting future cash flows and applying market interest rate. As interest rates applied on loans from credit institutions, finance lease liabilities and other long-term liabilities are mainly floating and do not significantly differ from market rates, and the risk margin applicable to the Group has not changed significantly, the fair value of long-term liabilities approximates their net book value.

Assets measured at fair value

Revaluation analysis of cargo carriages was performed based on requirement of the Commercial Act of the Republic of Latvia, as well as definition of active market available in the International valuation standards. Valuation of carriages was performed using two methods – comparative market prices and replacement cost method for all cargo carriages. Revaluation result reflects mainly comparative market prices, as active and liquid market for second-hand carriages was identified and prices from that market used. Replacement cost method used as well in order to make sure that additional aspects, which are significant for determination of carriage value are taken into account, which may be not evaluated using only comparative market price method. However, results of application of replacement cost method did not significantly influence the total results – value based on market prices was adjusted by 1.9% only, which forms insignificant part of total value, and it is therefore considered that value of cargo carriages corresponds to the Level 3 inputs.

26. CAPITAL MANAGEMENT

VAS „Latvijas dzelzceļš" is wholly owned by the Republic of Latvia.

The goal of capital management is to ensure the Group's ability to continue on a going concern basis and provide appropriate profitability level to the Group's shareholder. The Republic of Latvia, as sole shareholder has rights to make decision about the Group's capital changes, dividends to be paid or investments in the Group's development.

In light of capital management, the Group evaluates proportion of borrowed capital to its total capital. The risk management policy of the Group does not define the level of this ratio. However, signed agreements between the Group and credit institutions define capital ratio requirements, all of which were met as at 31 December 2016 and 31 December 2017. While making long-term and short-term financial plans and budgets, the Group takes into account bank's defined capital ratio requirements of equity to total liabilities.

(EUR'000)

	31.12.2017.	31.12.2016.
Loans from credit institutions and other borrowings	214 079	213 288
Trade and other payables (including taxes)	67 392	55 065
Other liabilities	336 690	400 996
Total liabilities	**618 161**	**669 349**
Equity	392 574	357 020
Total liabilities and equity	**1 010 735**	**1 026 369**
Borrowed capital to total capital	61%	65%
Equity to total liabilities	64%	53%

27. THE ANALYSIS OF FINANCIAL ASSETS AND LIABILITIES BY CURRENCY

The table below summarizes the Group's financial instruments in currency on 31 December 2017:

	EUR	USD	Other currencies	Total
	EUR'000	EUR'000	EUR'000	EUR'000
Trade receivables, except for advances	10 201	60	472	10 733
Cash and cash equivalents	72 203	285	395	72 883
Total financial assets	**82 404**	**345**	**867**	**83 616**
Loans from credit institutions	208 767	2 874	-	211 641
Other borrowings	2 438	-	-	2 438
Trade and other payables, except for advances	34 027	92	2 821	36 940
Total financial liabilities	**245 232**	**2 966**	**2 821**	**251 019**

The table below summarizes the Group's financial instruments in currency on 31 December 2016:

	EUR	USD	Other currencies	Total
	EUR'000	EUR'000	EUR'000	EUR'000
Trade receivables, except for advances	12 249	97	936	13 282
Cash and cash equivalents	60 419	276	389	61 084
Total financial assets	**72 668**	**373**	**1 325**	**74 366**
Loans from credit institutions	204 813	5 920	-	210 733
Other borrowings	2 555	-	-	2 555
Trade and other payables, except for advances	29 850	2 664	2 846	35 360
Total financial liabilities	**237 218**	**8 584**	**2 846**	**248 648**

28. CAPITAL COMMITMENTS

The Group plans to make capital investments into fixed and intangible assets in the next reporting year as well, which include:

- Main signed, but unfinished agreements:

Counterparty's name; the object of the agreement	Date of agreement	Maturity	Amount, EUR'000
SIA "KATISS" Construction of a cable optical line at the Rīga-Skulte branch	04.08.2017.	30.09.2018.	418
SIA "LVS Building" Replacement of roofing and structures in the building at Brīvības 103A, Liepaja	06.10.2017.	02.12.2018.	300
SIA "KATISS" Reconstruction of the contact network at the Ogre station and at the Šķirotava station	31.10.2017.	29.06.2018.	275
SIA "ANVO" VED 118A repair kit	16.03.2017.	30.03.2018	1 416
AS CZ LOKO 2M62UM manufacturing and supplying parts needed for rebuilding the frame	20.07.2017.	01.02.2018.	598

- Main approved projects, where agreements are not signed during the reporting year:

Counterparty's name; the object of the agreement	The type of purchase procedure, date	Maturity	Amount, EUR'000
SIA "KATISS" Construction of the optical fiber line in the Pļaviņas-Madona block	Negotiated procedure 10.10.2017.	30.09.2018.	835

29. CONTINGENT TAX LIABILITIES

The tax authorities have the power to examine the Group accounting records at any time during three years after reporting year and may calculate additional tax liabilities and penalties. The Group management is not aware of any events that could result in significant potential liabilities in the future.

30. FUTURE LEASE PAYMENT

Under the signed operating lease agreements, lease expenses for 2017 amounted to EUR 3 175 thousand (EUR 3 223 thousand in 2016).

As at 31 December 2017 the Group has irrevocable operating lease agreements for 212 vehicles. Irrevocable operating lease payments under these agreements amount to EUR 2 081 thousand (EUR 1 232 thousand as at 31.12.2016).

Termination of other operating lease agreements would not have a significant impact on the financial position and operations of the Group.

31. PERSONNEL EXPENSES

(EUR'000)

	2017	2016
Salary	131 553	135 796
State compulsory social security contributions (employer's part)	30 845	31 738

The average number of employees during the reporting year was 11 189 (11 782 in 2016).

32. RELATED PARTIES

The Group has entered into transaction with Ministry of Transport of the Republic of Latvia (the holder of 100% *Latvijas Dzelzsceļš* shares) and with other state-owned companies. The major transactions were carried out with Pasažieru vilciens AS (sale of railway infrastructure capacity for purposes of passenger transportation and purchase of tickets) amounting to EUR 51 466 thousand (EUR 51 236 thousand in 2016) and VAS Latvenergo (purchase of electricity) amounting to EUR 11 904 thousand (EUR 12 969 thousand in 2016). All transactions with related parties are related to the operating activities of the companies.

33. EVENTS AFTER THE END OF THE REPORTING PERIOD

During the period between the last day of the financial year and the date of signing of this report there have been no significant events that would have a material effect on the year end results.

Riga, 3 April 2018

Chairman of the Board	E. Bērziņš
Member of the Board	A. Strakšas
Member of the Board	Ē. Šmuksts
Member of the Board	A. Stūrmanis

The financial statement has been prepared by the Financial department of VAS "Latvijas Dzelzceļš":
Deputy finance director, Head of finance department S. Gasjūna