STATE JOINT-STOCK COMPANY

"LATVIJAS DZELZCEĻŠ"

CONSOLIDATED FINANCIAL STATEMENTS FOR 2018

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INFORMATION ABOUT THE PARENT COMPANY

Name of the parent company	***LATVIJAS DZELZCEĻŠ***
Legal status of the parent company	*State joint stock company*
Registered office	*Gogoļa iela 3, Riga, LV-1050*
Uniform registration number	*40003032065*
Date of registration in the Register of Enterprises	*01.10.1991*
Date of registration in the Commercial Register	*10.09.2004*
Place of registration	*Riga*
Date of issue of the merchant's registration certificate	*10.09.2004*
Shareholder	*Republic of Latvia (100%)*
Shareholder's representative	*The Ministry of Transport of the Republic of Latvia Gogoļa iela 3, Riga, LV-1743*
Supervisory body	*Company Council*
Council	*Jānis LANGE – Chairman of the Council from 02.02.2018* *Aigars LAIZĀNS – Chairman of the Council from 29.08.2017 until 01.02.2018, Member of the Council from 02.02.2018* *Andris MALDUPS – Member of the Council from 06.11.2017 until 01.02.2018, Member of the Council from 02.02.2018*

Management body	*The Board of the Company*
Board	*Edvīns BĒRZIŅŠ – Chairman of the Board from 25.02.2016*
	Aivars STRAKŠAS – Member of the Board (appointed to the office for a new term from 28.08.2017)
	Ēriks ŠMUKSTS – Member of the Board (appointed to the office for a new term from 02.12.2017)
	Ainis STŪRMANIS – Member of the Board from 18.07.2016
Auditors	*SIA PricewaterhouseCoopers uniform registration No.40003142793 Certified auditor commercial company licence No. 5 Kr.Valdemāra iela 21-21 Riga, LV-1010 Latvia Sworn auditor in charge Terēze Labzova-Ceicāne Certificate No. 184*
Reporting year	*1 January 2018 to 31 December 2018*

Subsidiaries

SIA "LDZ CARGO"	
Uniform registration number	*40003788421*
Registered office	*Dzirnavu iela 147, k-1, Riga, LV-1050*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
SIA "LDZ ritošā sastāva serviss"	
Uniform registration number	*40003788351*
Registered office	*Gogoļa iela 3, Riga, LV-1050*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
SIA "LDZ infrastruktūra"	
Uniform registration number	*40003788258*
Registered office	*Gogoļa iela 3, Riga, LV-1050*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
SIA "LDZ apsardze"	
Uniform registration number	*40003620112*
Registered office	*Zasas iela 5-3, Riga, LV-1057*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
AS "LatRailNet"	
Uniform registration number	*40103361063*
Registered office	*Dzirnavu iela 16, Riga, LV-1010*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
SIA "LDZ Loģistika"	
Uniform registration number	*40003988480*
Registered office	*Dzirnavu iela 147, k-2, Riga, LV-1050*
Shareholding, %	*100% shareholder – VAS Latvijas dzelzceļš*
Reporting year	*01.01.2018 to 31.12.2018*
Subsidiary of "SIA LDZ ritošā sastāva serviss" – SIA Rīgas Vagonbūves uzņēmums "Baltija"	
Uniform registration number	*40103419565*
Registered office	*Turgeņeva iela 14, Riga, LV-1050*
Shareholding, %	*100% shareholder - SIA LDZ ritošā sastāva serviss*
Reporting year	*01.01.2018 to 31.12.2018*

MANAGEMENT REPORT

on the operating performance of the Latvijas dzelzceļš Group in 2018

1. An overview of the Latvijas dzelzceļš Group

Latvijas dzelzceļš Group (hereinafter referred to as "*the Group*") is engaged in operating the public-use railway infrastructure and providing railway transport services and services related to them.

The *Group* consists of: the *Group's* parent company – VAS "Latvijas dzelzceļš" (hereinafter referred to as *"Latvijas dzelzceļš"),* SIA "LDZ CARGO", SIA "LDZ ritošā sastāva serviss", SIA "LDZ infrastruktūra", SIA "LDZ apsardze", SIA "LDZ Loģistika", AS "LatRailNet", as well as 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 ensure the development of the *Group's* business lines and the competitiveness thereof, by achieving better results than those that could have been achieved if each line of business was 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, coordination of the decision-making process and exercising an effective control over its implementation. *Latvijas dzelzceļš* represents the *Group's* interests at international level.

Latvijas dzelzceļš provides public-use railway infrastructure use services, freight wagon marshalling services at stations, rolling stock technical maintenance and inspection services, electricity distribution and trade services, lease 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, rolling stock lease services, as well as in organising international passenger transport services.

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

SIA "LDZ infrastruktūra" is engaged in providing rail track machinery repairs and lease as well as providing rail track welding services.

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

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.

AS "LatRailNet" performs essential functions of the public railway infrastructure manager. It develops and approves the infrastructure charges and decides on allocation of railway infrastructure capacity and on scheduling the trains of a particular carrier.

The subsidiary of SIA "LDZ ritošā sastāva serviss" – SIA "Rīgas Vagonbūves uzņēmums Baltija" was established with a view to developing rolling stock manufacturing 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 best serve the interests of the state, community and Latvian economy.

With a view to improving upon the best corporate governance practices and developing understanding of social responsibility within the *Group*, as well as to consolidating the sustainable and concurrently innovative mindset in the traditional railway sector, *Latvijas dzelzceļš* has been preparing sustainability reports according to the internationally recognised guidelines set forth by the Global Reporting Initiative (GRI) G4 (currently the GRI standard) since 2016. As part of their performance in the sustainability area, the *Group's* companies have also been taking part in the Sustainability Index every year. In 2018, *Latvijas dzelzceļš* received the highest assessment, i.e., the Platinum category, SIA "LDZ CARGO" was ranked in the Gold category, whereas SIA "LDZ ritošā sastāva serviss" was ranked in the Silver category.

In 2018, the average number of the *Group's* employees was 10,400. Compared to 2017, the number of employees dropped by 789.

2. Operating performance

In 2018, the *Group's* consolidated revenue was EUR 365,044 thousand. Compared to 2017, the consolidated revenue has increased by EUR 46,406 thousand (14.6%) due to an increase in freight volumes, accounting for the major share of the *Group's* consolidated net turnover.

SIA "LDZ CARGO", being an important company of the Latvian transit and transport sector, generates most of the *Group's* revenue. In 2018, 49,260 thousand tonnes of freight were carried by rail, up by 5,475 thousand tonnes (12.5%) compared to 2017. Import freight accounted for the major share of the total volume (82.2%); in 2018, its volume reached 40,470 thousand tonnes, up by 10.5% compared to the previous year. In terms of the origin of the carried freights, the largest geographical counterparty is Russia, accounting for 66.5% of the total freights. The shares of freight originated from other countries were as follows: Belarus – 27.1%, Lithuania – 4%, Ukraine – 0.9%, Kazakhstan – 0.7%, Estonia – 0.5%, Uzbekistan 0.1%, and other countries – 0.2%. In recent years, there has been a significant increase in the cargo volume from Belarus, owing to the contribution of the representative office established by *Latvijas dzelzceļš* in the capital of Belarus – Minsk in 2017.

The transportation of coal accounts for the largest share of the freight structure, i.e., 22,669 thousand tonnes (46%). The transportation of oil and oil products was the second largest item in the freight structure with 11,183 thousand tonnes (22.7%). In 2018, other types of freights accounted for 31.3% of the total freight structure.

Using the railway network of *Latvijas dzelzceļš*, 17,508 million tonne-kilometres have been run, which is an increase of 16.6% against the previous year. In 2018, SIA "LDZ CARGO" ran 12,186 million tonne-kilometres. In 2018, the market share of SIA "LDZ CARGO" increased from 66.4% to 69.6%.

One of the *Group's* key operating performance indicators is the number of kilometres run by trains ("train-km"), which has an impact on revenue from public access railway infrastructure services. In 2018, the public access infrastructure of *Latvijas dzelzceļš* was used to transport 49,260 thousand tonnes of freight (9,989 thousand train-km) and carry 18,242 thousand passengers (6,116 thousand train-km). The public railway infrastructure access services provided by the *Group* to non-Group carriers amounted to 2,724 thousand train-km, whereas those of passenger transport – to 5,796 thousand train-km. In 2018, there were no significant fluctuations in the passenger train traffic intensity compared to 2017, however the total number of passengers carried along the railway during the year increased by 4.3%.

The *Group* company SIA "LDZ CARGO" is the only transport enterprise in the Latvian transport and storage sector that provides international passenger carriage services by rail. SIA "LDZ CARGO" provided international passenger transport services on the following routes: Riga – Moscow – Riga; Riga – St. Petersburg – Riga; Minsk – Riga – Minsk, but from September 2018, also on the route developed by Ukrainian railway Riga – Vilnius – Minsk – Kiev in the territory of Latvia. In 2018, 160 thousand passengers were carried, at the same level as in the previous year.

The *Group's* after-tax profit was EUR 14,408 thousand, down by EUR 16,769 thousand compared to 2017. However, it should be taken into account that in 2017, the profit arose to the derecognition of the deferred tax liability, which increased the profit for 2017 by EUR 32,376 thousand.

At 31 December 2018, the *Group's* consolidated shareholder's equity was EUR 406,366 thousand, up by EUR 13,792 thousand (3.5%) compared to 2017.

The *Group* pursues prudent liquidity risk management to ensure that the necessary credit resources are available to settle its liabilities when they fall due. At 31 December 2018, the *Group's* current assets exceeded current liabilities by EUR 2,589 thousand, as a result, the total liquidity ratio (current assets/current liabilities) was 1 (0.9 in 2017). Current liabilities include deferred income of EUR 19,394 thousand, which is related to investments in public access railway infrastructure financed by the EU fund and State budget financing, hence, the risk of an outflow of financial resources to cover these liabilities is low. The total liquidity ratio, excluding deferred revenue, was 1.2. In the light of the above circumstances, we are of the opinion that in 2018, the *Group* managed to maintain financial stability.

In 2018, the *Group's* capital expenditure amounted to EUR 38,200 thousand. Financial investments were made with a view to renovating, upgrading and acquiring property, plant and equipment, intangible assets, as well as to constructing new objects.

In 2018, the total capital expenditure on the projects carried out by *Latvijas dzelzceļš* amounted to EUR 24,904 thousand. Of these, the most significant projects were:

➢ EUR 20,937 thousand were invested in renovation, including,

- with a view to increasing the safety of the train traffic, EUR 16,925 thousand were invested in the renewal of infrastructure (including such projects as reconstruction of the railway tracks – capital repairs of types "A" and "B", replacement of switch points, replacement of lengthwise rails with new rails, renewal of energy supply, restoration of automation devices (SCB), etc.), as well as acquisition of the property, plant and equipment necessary for carrying out the repairs and maintenance of railway tracks;
- investments in the equipment required for carrying out repair works and for the development of information systems and communications, as well as intangible assets for projects amounted to EUR 2,931 thousand;
- during the reporting period, EUR 1,081 thousand were invested in projects related to the launching of new products: Digitalisation and Optimisation of the Freight Transport Information Flow, acquisition of Security Solution Modules, Traffic Control and Centralisation Improvement, the Document Management System, etc.

EUR 3,967 thousand were invested in development of infrastructure (building optic cable lines, change of information systems, development of technological and local lines, etc.).

In 2018, capital investments in the renovation of property, plant and equipment, upgrading and acquisition of SIA "LDZ CARGO" totalled EUR 2,399 thousand.

In order to ensure proper maintaining of the technical condition of the locomotives owned by SIA "LDZ ritošā sastāva serviss", as well as to provide carriers with the necessary number of locomotives, in 2018, one diesel-powered locomotive was repaired (capital repairs for the locomotive of the type ČME3 series) for EUR 119 thousand, and five diesel-powered locomotives type 2M62UM series for locomotives were upgraded for EUR 10,100 thousand. Thus continued work on the formation of the rolling stock fleet, which is more economical in operation (lower fuel consumption) and more environment friendly (less emissions). In 2018, various property, plant and equipment worth EUR 275 thousand were acquired, capital repair works of structures worth EUR 179 thousand were carried out and upgrading of property, plant and equipment worth EUR 151 thousand had been made.

In 2018, capital investments in other subsidiaries totalled EUR 73 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 charging calculation methodology. Regulation (EU) 2015/909 on the modalities for the calculation of the cost that is directly incurred as a result of operating the train service has been adopted, and the said approach will change the methodology for calculating the price of the railway capacity provision to operators. On 30 June 2017, the entity carrying out the essential functions of the public-use rail infrastructure manager approved the Regulations "The Infrastructure Charge Calculation System" and "The Infrastructure Charging System", which among other things lay down the requirements for determining the new charges for the use of the public rail infrastructure for transport, and they would be applied from 1 July 2019.

Under Cabinet Order No. 588 of 6 November 2018, the "Indicative Railway Infrastructure Development Plan for 2018-2022" was approved, whereas on 9 November 2018, the Ministry of Transport and *Latvijas dzelzceļš* entered into the Multi-annual agreement for maintaining the existing public-use railway infrastructure managed by *Latvijas dzelzceļš* and planning the development, and ensuring the financial equilibrium for the period from 9 November 2018 to 31 December 2022. Pursuant to Section 9, Paragraph 3 of the Railway Law, the infrastructure manager shall ensure the consistency between the provisions of the Multi-annual agreement and the Business plan, *Latvijas dzelzceļš* has developed the Business plan for the period up to 2022, which was approved by the Board of *Latvijas dzelzceļš* on 7 March 2019.

Latvijas dzelzceļš together with the whole transport and logistics industry of the state directly competes with its nearest neighbouring countries, Lithuania and Estonia, on the attraction of shipments to the Latvian transit corridor. The effectiveness of infrastructure services will be one of the decisive factors in the competition for the carriage of goods by rail. During the validity of the above mentioned documents, projects, which will directly improve service efficiency and security and which improve the Latvian transport and logistics industry's competitiveness and contribute to the increase in the volume of freight transport will be the priority projects for *Latvijas dzelzceļš*.

Despite the geopolitical developments and being aware of the future market trends, the strategic direction of *Latvijas dzelzceļš* will remain unchanged – it is aimed at developing a modern, efficient and environmentally-friendly group of infrastructure and logistics companies, ensuring the management of the railway infrastructure and logistics services in the interests of Latvian community and economy. At the same time, *Latvijas dzelzceļš* sees more possibilities in the development of new technologies, including IT solutions that will facilitate successful implementation of the above-mentioned strategic objective, increasing the *Group's* competitiveness.

To increase efficiency, promote the use of environmentally-friendly technologies and increase the international competitiveness of *Latvijas dzelzceļš* transit corridor, the *Company* intends to carry out a gradual electrification of the main railway network (main tracks) using alternating current (AC) 25kV. At present, only around 14% of the rail network has been electrified, in contrast to European countries, where the average indicator exceeds 55%. The use of electric traction is an environmentally friendly as well as economically advantageous solution compared to the use of diesel-pulling, thus by implementing the electrification, *Latvijas dzelzceļš* will lay down the basis for the competitiveness of Latvian transport and logistics industry with regard to the nearest neighbouring countries.

As part of the EU fund and the Cohesion policy funds 2014-2020 forecast period Operational programme "Growth and Employment", priority area "Sustainable transportation system", specific support measure 6.2.1, activity 6.2.1.1 "Latvian railway network electrification", implementation of a large project is contemplated (the available Cohesion Fund financing is EUR 346,639 thousand). Within the framework of the project electrification of the railway sections Daugavpils-Krustpils, Rezekne-Krustpils and Krustpils-Riga needs to be implemented by 2023. The total project costs are estimated at EUR 441 million, and within the scope of the project, the railway line of 314 km in length would be electrified.

In 2018, the project documentation for the project application was completed. In March 2018, a positive opinion was received from the Central Finance and Contracting Agency, whereas in 28 December 2018, it received a favourable opinion from the independent experts of the EC technical assistance – *JASPERS Independent Quality Review*. The Project documentation will be further submitted for evaluation with a view to making the final decision on the project approval in the European Commission. After the positive EC decision, a contract will be signed with the Central Finance and Contracting Agency for the implementation of the project. At the same time, in August 2018, the procurement procedure was launched for the implementation of the project, thereby enabling the implementation of the project immediately upon receiving a favourable decision from the European Commission and signing the agreement.

As part of the EU fund and the Cohesion policy funds 2014-2020 forecast period Operational programme "Growth and Employment", priority area "Sustainable transport system", specific support measure 6.2.1, activity 6.2.1.2 activity "Modernisation and building of railways infrastructure", implementation of several other significant projects is contemplated. The volumes of investments are specified in the "Indicative Railway Infrastructure Development Plan for 2018 – 2022", and in the medium-term strategy of *Latvijas dzelzceļš* for 2017-2022.

In 2019, work on the development of the *Group's* long-term development strategy will begin, as well as further steps will be taken to implement the new visual identity of the *Group's* companies in Latvia and in the formats of international cooperation, where *Latvijas dzelzceļš* represents the interest of Latvian transport and logistics industry.

Considering 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

For the purpose of achieving its objectives, SIA "LDZ Loģistika" maintains communication with cargo shippers, identifying their needs, developing proposals, summarising information on the capabilities of the industry players and their prices for a specific service, offers them to customers and is engaged in organising the logistics of cargo from the seller to the buyer.

In the meantime, SIA "LDZ Loģistika" works on the development of the North-South transport corridor between India and Northern Europe.

In order to achieve a faster and handier information exchange between the shipper and the customer, "LDZ CARGO" has been actively involved in the development and complementing of the Cargo Traffic Management Information System. The system functionality provides for customer messaging, drawing up and use of electronic railway bills of lading, giving prior notice to the Customs authorities in an electronic form on the shipments to be imported, preparation and submission of information on shipments in an electronic form. All empty wagons in the direction to the Russian Federation are carried using the paperless technology, and the use of electronic invoices for the carriage of empty wagons to Belarus has been launched. In addition, empty wagons from the Russian Federation and Belarus are also carried using the digital invoice. In the future the use of the Cargo Traffic Management Information System is to be expanded with a view to fully abandon paper documents in domestic as well as international traffic.

In 2018, work was carried out on the Automated Cargo Wagon and Train Commercial inspection, the expansion of the wagon number recording and recognition system at Šķirotava and Jelgava objects. The implementation of the system helps improve the competitiveness of the railway transport, ensure a higher job safety and traffic security level, as well as serves as one of the stages in developing the digital corridor. System objects are expected to be put into operation in the first half of 2019. Work is being continued on the development of a centralized freight billing system that will ensure the centralisation of customer accounts and serve as the basis for the provision of centralised communication with customers. The centralised billing system is scheduled for completion and putting into operation by the end of 2019.

The upgrading stage of the travel document sale website *travel.ldz.lv* for international passenger trains was started in 2018 and would be continued in 2019, within the scope of which a functionality would be developed that would provide customers with an opportunity to buy travel documents electronically, buy travel documents at special rates, as well as the necessary changes will be introduced to improve the usability of the portal.

Investments will also be made in purchasing the rolling stock and in the upgrading thereof to ensure freight shipments and gradually renew the ageing rolling stock.

SIA "LDZ ritošā sastāva serviss" has been continuing the renewing of the main diesel locomotive fleet, which was started in 2014, i.e., the upgrading of the diesel locomotives

2M62U. The expected project completion time is April 2019. The benefits are – the upgraded locomotives are capable of carrying heavy trains, the period between repairs increase, the number of repair and maintenance cases decline; furthermore, these are environmentally-friendly locomotives characterised by lower fuel consumption and harmful emissions. The upgrading is 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 present, twelve upgraded diesel locomotives have been put into operation.

Given the traction rolling stock fleet unification plan, preparation works have been started in order to implement the 2TE10 diesel locomotives project, using a more economical and eco sustainable D49-type diesel engines. It would lead to the unification of the type 2TE10 and 2TE116 diesel engines, through replacing the two-stroke type 10D100 diesel engines.

Work shall be continued at researching the use of alternative fuels for the needs of the rolling stock (such as natural gas, hydrogen, etc.).

Based on the *Group's* positioning to become a *Smart railway*, projects have been launched for the digitalisation of production processes (scheduling of repairs, documentation management, arranging of procurement).

With a view to developing new services, in November-December 2018, a number of record-breaking long and record-breaking heavy freight trains (above 7,000 tonnes, the average weight of a freight train is approx. 3,000 tonnes, to date the maximum weight has been approx. 6,000 tonnes) were carried using *Latvijas dzelzceļš* infrastructure. In cooperation with other institutions, the professionals of the *Group* successfully managed to provide such a service, laying down the basis for the development of similar shipments in the future.

Latvijas dzelzceļš also sees the potential for the development of inland freight transport, however, this would require cooperation within the sector as well as incentivising mechanisms for the freight owners to give preference to rail transport over road.

Considering that the rail infrastructure maintenance must be carried out notwithstanding the transport volume, whereas the revenue of *Latvijas dzelzceļš* used to absorb infrastructure maintenance costs, directly depends on transport volumes and their fluctuations, *Latvijas dzelzceļš* will continue to participate in the transport sector legislative initiatives, setting as a priority a sustainable rail infrastructure financing model. In 2018, having approved the "Indicative Railway Infrastructure Development Plan" and entering into Multiannual agreement with the Ministry of Transport, steps have been taken towards the development of such a model.

A significant risk, that may affect the performance of *Latvijas dzelzceļš* as well as that of the whole *Group*, is related to the development of the mutual sanctions between the EU and Russia, as well as the development of Russian ports, as a result of which cargoes may be redirected from Latvian ports and therefore rail traffic flow would decline.

To reduce the risk associated with dependence on transit cargoes in the East-West direction, the *Group* intends to strengthen cooperation with the business partners of the neighbouring countries, including Russia as well as Belarus. The representative office established by *Latvijas dzelzceļš* in Belarus in 2017 has helped increase the cargo volumes in *Latvijas dzelzceļš* network, as well as develop alternative business lines, including combined and container train shipments within the scope of Eurasian shipment routes. *Latvijas dzelzceļš* sees potential in the development of new transport offers for the convenience of freight owners and, therefore, in cooperation with the Belarusian railway, in 2018, freight express train Minsk-Riga has been operating successfully, which, thanks to the effective cooperation between the railway operators as well as cooperation with customs and border guard authorities, carries freight from one capital to the other in less than 24 hours.

The key risks to which *Latvijas dzelzceļš* might be exposed over the next operational period, is the risk of a declining use of the railway infrastructure, and the risk of fluctuating oil, metal and electricity prices. The performance for 2018 shows that *Latvijas dzelzceļš* has exceeded the freight volume budgeted in the medium-term strategy for 2017-2022 and the financial indicators related to them (47 million tonnes of cargoes were budgeted, whereas 49.3 million tonnes were actually transported; the budgeted profit is around EUR 3.3 million, actual – EUR 4.2 million), however, being aware of the market situation and risks, work is being carried on at the diversification of the carriage routes and types of cargos as well as entering new markets.

The *Group* will continue to increase the productivity of the railway staff and responsibility for the tasks to be discharged, organise the necessary training, as well as ensure the implementation of the environmental protection policy and traffic safety. A key role is assigned to the implementation of the *Group's* Environmental and Energy Management Programme, ensuring the implementation of energy efficiency measures as well as staff training.

The *Group* will continue to build and maintain the image and role of *Latvijas dzelzceļš*, taking an active stance on topical matters of the transportation system and economic development.

4. Research and development

In 2018, *Latvijas dzelzceļš* started work at the draft Action plan for the reduction of noise along railway lines with traffic intensity greater than 30,000 trains a year. The Plan identifies acoustic discomfort zones as well as the anti-noise measures to be taken. The public consultation of the Action plan took place from 21 December 2018 to 21 January 2019.

The professionals of *Latvijas dzelzceļš* carried on work as part of the working groups of the Ministry of Environment Protection and Regional Development and the Riga City Council, seeking solutions to reduce transport noise and improve acoustic noise situation both in urban environment and outside the city.

In the autumn of 2018, a centralised inspection of the groundwater monitoring network was carried out and samples were taken in Jelgava, Daugavpils, Rēzekne, Krustpils, Ventspils un Rīga. According to the aggregated results, the situation with groundwater has been improving, and no urgent actions are required in this regard. In 2019, the groundwater monitoring wells network would also be installed in the territories of Torņakalns, Gulbene and Pļaviņas stations.

In connection with the implementation of the solutions based on research and development *(R&D)* at the end of 2018, *Latvijas dzelzceļš* participated in the student research and development projects with industries of the international innovation platform "Demola" of the University of Latvia. To meet the needs of *Latvijas dzelzceļš*, students were looking for solutions for replacing the chemical glyphosate with a different solution, which would be more environmentally friendly, but equally effective kind of weed management in railway partition zones. Weed destruction is an important rail traffic safety factor, however, no methods have been found that would efficiently replace glyphosate. Furthermore, this problem is topical not only in Latvia, but throughout Europe, where the use of glyphosate would be banned in the coming years, whereas the national rail companies of all countries in cooperation with universities and research institutes have been looking for solutions for the substitution thereof, while not reducing the level of road safety and not significantly increasing the weed destruction costs. The idea of using electrodes for destruction of weeds has been developed within the *Group*, and is being assessed by the environmental experts and technical experts of *Latvijas dzelzceļš*.

In 2018, the experts of *Latvijas dzelzceļš* continued work at the implementation of the pilot project, which was identified within the scope of a cross-industry hackathon organised by the Latvian Information Technology Cluster. Within the scope of the project, a prospective solution for the use of security technology is being used so that the railway crossings would be made safer to the users thereof and the manager of the infrastructure in case of sudden and unexpected obstacles on crossings and/or at the critical proximity thereof. A pilot project is being implemented in cooperation with SIA "Datakom".

Considering the challenges of the forthcoming years in attracting skilled labour, *Latvijas dzelzceļš* has been not only developing the continuing training opportunities offered by the *Group's* Training centre, but in recent years, in cooperation with the Riga Technical University, has launched several new specialised railway ecosystem and railway telecommunications training programmes. The mastering of these programmes will help not only develop the technological capacity in the *Group* but also ensure the specialists required for the maintenance of the electrified railway infrastructure in the future.

5. Branches and representative offices abroad

Owing to an important cargo flow to Russia, in 2012 the representative office of *Latvijas dzelzceļš* was established in the capital of Russia – Moscow. The representative office is engaged in carrying out transport sales promotion and marketing activities.

To promote co-operation between Latvia and Belarus in the field of rail transport and strengthen cooperation between the transit and logistics industries, on 24 January 2017, the representative office of *Latvijas dzelzceļš* was opened in the capital of Belarus – Minsk.

The *Group* does not have any foreign affiliates.

6. Events after the date of preparation of the financial statements for 2018

In the period since the last day of the reporting year have been no such events, which would significantly affect the *Group's* financial position at 31 December 2018.

Riga, 21 March 2019

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 BOARD'S RESPONSIBILITY

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

The consolidated financial statements on pages 19 to 70 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 2018, and its performance and cash flows for the year 2018.

The above-mentioned consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, based on the going concern principle. 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, 21 March 2019

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"

Our Opinion

In our opinion, the accompanying consolidated financial statements set out on pages 19 to 71 of the accompanying consolidated annual report give a true and fair view of the financial position of VAS "Latvijas dzelzceļš" (the Company) and its subsidiaries (together 'the Group') as at 31 December 2018, 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 31 December 2018,
- the consolidated statement of profit or loss fot the year then ended,
- 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 significant accounting policies and other explanatory information.

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) and the ethical requirements of the Law on Audit Services 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 and the ethical requirements of the Law on Audit Services.

Reporting on Other Information Including the Management Report

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

- the Management Report, as set out on pages 6 to 14 of the accompanying consolidated annual report,
- the Statement of the Board's Responsibility, as set out on page 15 of the accompanying consolidated annual report,

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

PricewaterhouseCoopers SIA, Kr. Valdemāra iela 21-21, Rīga, LV-1010, Latvia, LV40003142793
T: +371 6709 4400, F: +371 6783 0055, www.pwc.lv

Our opinion on the consolidated financial statements does not cover the other information including the Management Report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above 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.

With respect to the Management Report, we also performed the procedures required by Law on Audit Services. Those procedures include considering whether the Management Report is prepared in accordance with the requirements of the Law on Annual Reports and Consolidated Annual Reports.

Based on the work 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 requirements of the Law on Annual Reports and Consolidated Annual Reports.

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of our audit, we are required to report if we have identified material misstatements in the Management Report and other information. We have nothing to report in this respect.

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.

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
21 March 2019

* 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 2018

(EUR'000)

	Note	2018	2017
Revenue	4	365,044	318,638
Cost of sales	5	(343,112)	(320,571)
Gross profit or (loss)		**21,932**	**(1,933)**
Administrative costs	6	(25,668)	(24,616)
Other operating income	7	31,821	33,628
Other operating expenses	8	(11,076)	(6,277)
Income from long-term investments	13	776	311
Financial income	9	3	2
Adjustments related to impairment of long-term and short-term financial investments	13	(410)	-
Financial costs	9	(2,225)	(2,272)
Profit or (loss) before corporate income tax		**15,153**	**(1,157)**
Corporate income tax	10	(745)	32,334
Profit for the reporting year		**14,408**	**31,177**

Notes on pages 26 to 70 form an integral part of these consolidated financial statements.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR 2018

(EUR'000)

	Note	2018	2017
Profit for the reporting year		**14,408**	**31,177**
Other income:			
Items that will not be reclassified to profit or loss:		(5,194)	4,377
Disposals of revalued of property, plant and equipment	*18*	*(5,194)*	-
Deferred income tax on revalued property, plant and equipment recorded directly in other comprehensive income	*18*	-	*4,377*
Other comprehensive income for the reporting year		**9,214**	**4,377**
Total comprehensive income for the year		**9,214**	**35,554**
Total net profit and comprehensive income for the year attributable to the shareholders of the Group's parent company		**9,214**	**35,554**

Notes on pages 26 to 70 form an integral part of these consolidated financial statements.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2018

(EUR'000)

ASSETS	Note	31.12.2018	31.12.2017
LONG-TERM INVESTMENTS			
Property, plant and equipment	12	861,199	895,784
Intangible assets	11	1,467	1,360
Advance payments for property, plant and equipment		387	745
Long-term financial investments	13	84	494
TOTAL LONG-TERM INVESTMENTS		**863,137**	**898,383**
CURRENT ASSETS			
Inventories	14	18,541	24,244
Trade and other receivables	15	19,886	14,779
Corporate income tax	10	28	446
Cash and cash equivalents	16	89,904	72,883
TOTAL CURRENT ASSETS		**128,359**	**112,352**
TOTAL ASSETS		**991,496**	**1,010,735**

(continued on the next page)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2018 (continued)

(EUR'000)

EQUITY AND LIABILITIES	Note	31.12.2018	31.12.2017
EQUITY AND LIABILITIES			
EQUITY			
Attributable to the shareholders of the *Group's* Parent company:			
Share capital	17	256,720	256,720
Long term investment revaluation reserve	18	46,156	51,350
Reserves and retained earnings b/f	18	89,082	53,327
Total comprehensive income for the year		14,408	31,177
TOTAL EQUITY		**406,366**	**392,574**
LIABILITIES			
NON-CURRENT LIABILITIES			
Deferred tax liability		745	-
Provisions	19	162	177
Borrowings from credit institutions	20	165,409	176,527
Other borrowings	21	2,204	2,321
Trade payables		486	486
Deferred income	23	290,354	307,639
TOTAL NON-CURRENT LIABILITIES		**459,360**	**487,150**
CURRENT LIABILITIES			
Borrowings from credit institutions	20	36,110	35,114
Other borrowings	21	117	117
Provisions	19	4,521	8,486
Trade and other payables		49,568	52,096
Corporate income tax	10	-	2
Taxes and mandatory national social insurance contributions	22	15,948	14,808
Deferred income	23	19,506	20,388
TOTAL CURRENT LIABILITIES		**125,770**	**131,011**
TOTAL LIABILITIES		**585,130**	**618,161**
TOTAL EQUITY AND LIABILITIES		**991,496**	**1,010,735**

Notes on pages 26 to 70 form an integral part of these consolidated financial statements.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(EUR'000)

	Attributable to the shareholders of the *Group's* parent company				Total equity
	Share capital	Long term investment revaluation reserve	Reserves and retained earnings b/f	Retained profit for the reporting year	
			for 2017		
At 01.01.2017	**256,720**	**46,973**	**52,272**	**1,055**	**357,020**
The profit for 2016 was transferred to prior year retained earnings	-	-	1,055	(1,055)	-
Transactions with the Group's shareholders	-	-	*1,055*	*(1,055)*	-
Decrease of the deferred tax liabilities due to the disposal of the revalued property, plant and equipment	-	4,377	-	-	**4,377**
Profit for the reporting year	-	-	-	31,177	**31,177**
Total comprehensive income for the year	-	*4,377*	-	*31,177*	***35,554***
At 31.12.2017	**256,720**	**51,350**	**53,327**	**31,177**	**392,574**
			for 2018		
At 01.01.2018	**256,720**	**51,350**	**53,327**	**31,177**	**392,574**
The profit for 2017 was transferred to prior year retained earnings	-	-	31,177	(31,177)	-
Transactions with the Group's shareholders	-	-	*31,177*	*(31,177)*	-
Payments for the use of State capital from the profit for 2017	-	-	(616)	-	**(616)**
Disposals of revalued of property, plant and equipment		(5,194)	5,194	-	-
Profit for the reporting year	-	-	-	14,408	**14,408**
Total comprehensive income for the year	-	*(5,194)*	*5,194*	-	-
At 31.12.2018	**256,720**	**46,156**	**89,082**	**14,408**	**406,366**

Notes on pages 26 to 70 form an integral part of these consolidated financial statements.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR 2018
(using the indirect method)

(EUR'000)

	Note	2018	2017
Operating cash flow			
Profit or loss before taxes		**15,153**	**(1,157)**
Adjustments:			
Depreciation of and other impairment adjustments for property, plant and equipment		48,713	46,921
Amortisation of and other impairment adjustments for intangible assets	11	592	605
Provisions created		(3,980)	(6,702)
Gain or loss from foreign exchange rate fluctuations	7, 8	80	(848)
Income from investments into share capital of affiliated and other companies	13	(776)	(311)
Other interest and other income	9	(3)	(2)
Adjustments related to impairment of long-term and short-term financial investments	13	410	-
Interest and similar expenses	9	2,225	2,272
Cash flow from operating activities before adjustments in the working capital		**62,414**	**40,778**
Decrease / (increase) in trade receivables		(4,227)	3,403
Decrease in inventories		5,746	9,554
Increase in trade and other payables		1,176	14,080
Gross cash flows from operating activity		**65,109**	**67,815**
Interest expense		(2,246)	(2,276)
Corporate income tax expense	10	(88)	(471)
Net cash flow from operating activity		***62,775***	***65,068***
Cash flow from investing activity			
Acquisitions of plant, property and equipment		(42,353)	(55,608)
Proceeds from sale of property, plant and equipment		4,886	160
Interest received		3	2
Dividends received		484	311
Net cash flow from investing activity		***(36,980)***	***(55,135)***

(continued on the next page)

CONSOLIDATED STATEMENT OF CASH FLOWS FOR 2018 (continued)

(EUR'000)

	Note	2018	2017
Cash flow from financing activity			
Borrowings received		24,966	34,658
Subsidies, grants, gifts or donations received		2,000	590
Expenses for repayment of borrowings		(35,127)	(33,337)
Dividends paid		(616)	-
Net cash flow from financing activity		*(8,777)*	*1,911*
Gain/(loss) on foreign exchange rate fluctuations		**3**	**(45)**
Increase in cash and cash equivalents during the reporting year		**17,021**	**11,799**
Cash and cash equivalents at the beginning of the reporting year		72,883	61,084
Cash and cash equivalents at the end of the reporting year	16	**89,904**	**72,883**

Notes on pages 26 to 70 form an integral part of these consolidated financial statements.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL INFORMATION

Latvijas dzelzceļš is engaged in operating the public access railway infrastructure and providing railway transport services and related services.

The *Group's* parent company, i.e., the state joint stock company *Latvijas dzelzceļš* is the *Group's* dominant company and performs the functions of the public railway infrastructure manager.

The *Group's* parent company has been registered with the Commercial Register of Enterprises as state joint stock company, and the Republic of Latvia is the sole shareholder thereof. The registered office of the *Group's* parent company is at Gogoļa iela 3, Riga, Latvia.

All of the *Group's* companies have been registered in the Republic of Latvia and the *Group's* parent company has a direct or indirect decisive influence. The *Group* consists of:

Name	Type of activity
SIA LDZ CARGO	freight transport
SIA LDZ ritošā sastāva serviss	maintenance and repair of the rolling stock
SIA LDZ infrastruktūra	the rail car and machinery repairs, track welding works
SIA LDZ apsardze	security guard services
SIA LDZ Loģistika	transport expedition and logistics services
AS LatRailNet	performing the key functions of the infrastructure manager
SIA Rīgas Vagonbūves uzņēmums "Baltija"	founded with the aim of developing wagon manufacturing in Latvia

The financial statements were approved for publishing by the Board of the *Group's* parent company on 21 March 2019. The consolidated financial statements are approved by the shareholders' meeting convened by the Board of the state joint stock company *Latvijas dzelzceļš* and receipt of the Council's report.

2. ACCOUNTING AND MEASUREMENT PRINCIPLES

These financial statements have been prepared using the accounting and measurement principles set out below. Unless otherwise specified, these principles have been applied to all relevant comparatives.

2.1. Accounting and measurement principles

These consolidated financial statements have been prepared in accordance with the IFRS as adopted in the EU.

The consolidated financial statements have been prepared based on historical cost method, in addition to using the revaluation method for freight wagons used for the carriage of freights (included in property, plant and equipment).

Accounting and measurement methods have not changed compared to the previous financial year, except for IFRS 9 and 15, as described below.

Consolidated financial statements cover the period from 1 January 2018 to 31 December 2018.

To prepare the financial statements in accordance with IFRS, the *Management* used certain estimates and assumptions that affect the balances of items in stand-alone statements, as well as contingent liabilities. Future events may affect the assumptions based on which the relevant estimates were made. Any effect of the changes in estimates are reflected in the financial statements as soon as they are identified. Although these estimates have been prepared on the basis of comprehensive management information at the *Management's* disposal about current events and actions, the actual results may differ from these. Key assumptions and judgments are described in Note 3.

Several new standards and interpretations have been published, and they will become effective in fiscal periods beginning 1 January 2018 or later, and are applicable to the *Group's* activities:

➢ IFRS 9 "Financial instruments"(effective for the reporting periods beginning 1 January 2018 or later).

- *The Group* has opted to apply the practical expedients provided for in the standard, without changing the comparatives and presenting the impact of the implementation of the whole standard as an adjustment to retained earnings at 1 January 2018.

➢ Classification and measurement:

- The *Group's Management* has assessed the classification applicable to financial assets as at 1 January 2018.

- All the *Group's* debt instruments that were previously reported as Loans and receivables, were classified as financial assets at amortised cost, because the *Group's* business model does not provide for the trading thereof, in addition, the contractual cash flows consist solely of payments of the principal and interest.

- As of 2018, such equity instruments, which were previously classified by the *Group* as Available for sale, will be measured at fair value through profit or loss (FVTPL), without applying an option to measure equity instruments at fair value through other comprehensive income (FVOCI).

- All the *Group's* financial liabilities, which were previously classified as Other financial liabilities should be classified as financial liabilities at amortised cost.

- The change of the classification has not led to significant changes in financial assets or financial liabilities.

➢ Impairment of financial assets:

- IFRS 9 introduces a new model for impairment recognition – the expected credit loss (ECL) model. The model is a three-tier approach, based on changes in the credit quality of financial assets, compared with the initial recognition.

- The *Group's* financial assets for which impairment calculation is made are all financial assets at amortised cost. Estimating the ECL, the *Group's* management concluded that the provisions, which would be additionally required on 1 January 2018, are not material in the context of the *Group's* financial statements, therefore the effect of IFRS 9 on the opening balances is zero.

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

- The new standard introduces the main principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. If there are individual goods or services that are offered as a bundle, any sale of an individual service or good must be recognised as an individual transaction, and any discounts on the contract price must generally be allocated to each element of the transaction. For transactions with a variable consideration 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 validity term of the contract.

- Pursuant to the transition rules of IFRS 15, the *Group* has opted to use a simplified transition method, disclosing the impact of the transition as an adjustment to retained earnings at 1 January 2018.

- The *Group's Management* has analysed the implementation of IFRS 15 and concluded that in 2018, the implementation of the standard had no significant impact on the *Group's* financial statements, because the *Group* does not have compound services, nor does it offer significant discounts or compensations of other kind, furthermore, it does not have customer attraction related costs, and the contracts do not contain any financing elements.

➢ Amendments to IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018). The amendments do not introduce changes to the standard basic principles, but rather explain the application of these principles. The *Group's Management* has assessed the implications of the implementation of IFRS 15 concluding as a result that in 2018, it will not have a material effect on the *Group's* financial statements.

➢ Amendments to IFRS 2 "Share-based payment – classification and measurement" (effective for accounting periods beginning 1 January 2018 or later).

➢ Amendments to IFRS 4 – IFRS 9 "Financial instruments", applied together with IFRS 4 "Insurance contracts" (effective for annual periods beginning on or after 1 January 2018, or later for the companies that have opted to apply the temporary relief, or as of the moment when IFRS 17 is applied, using the overlapping approach).

➢ Annual IFRS improvements 2014-2016 (effective for annual periods beginning on or after 1 January 2018 (amendments to IFRS 1 and IAS 28)). These amendments include changes to the following standards:

- IFRS 1 "First-Time Application of IFRS";
- IAS 28 "Investments in associates and joint ventures".

➢ Amendment to IAS 40 "Investment property" – Reclassification of investment properties (effective for annual periods beginning 1 January 2018 or later).

➢ IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018).

➢ IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019).

- The new standard lays down the principles for 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 within a particular term, they also include the financing component. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as was required under IAS 17. Instead, IFRS 16 introduces a uniform lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities from all leases with a term of more than 12 months, other than where the underlying asset is of low value; and (b) the depreciation charge of the lease assets separately from interest on lease liabilities. Accounting by lessors under IFRS 16 is largely similar to the requirements laid down in IAS 17. Consequently, lessors continue to classify lease agreements as operating or finance leases, and different accounting is maintained depending on the classification.

- The *Group* intends to apply the standard starting from 1 January 2019, applying the simplified approach provided for in transition provisions of IFRS 16. Consequently, comparables will not be adjusted, whereas the value of the right to use the asset will correspond to the lease liability value (adjusting by the amount of prepayments or other accrued costs, where necessary).

- The *Group's Management* has estimated the impact of the implementation of the new standard and found that due to IFRS 16, total assets and liabilities have increased by EUR 9,778 thousand. The results of the impact assessment may still be adjusted because of the automation of the accounting for lease transactions in the SAP system, as well as work on the assessment of the lease agreements is being continued.

➢ IFRIC 23 "Uncertainty over income tax treatments" (effective for annual periods beginning on or after 1 January 2019).

➢ Amendments to IFRS 9 "Financial instruments" – prepayment instruments with negative compensation (effective for annual periods beginning 1 January 2019 or later).

➢ Amendments to IAS 28 "Long-term investments in associates and joint ventures" (effective for annual periods beginning 1 January 2019 or later have not yet been approved for use in the EU).

➢ Annual IFRS improvements for 2015-2017 (effective for annual periods beginning on or after 1 January 2019, not yet endorsed in the EU). These amendments include changes to the four standards:

- IFRS 3 – "Business combinations";
- IFRS 11 – "Joint agreements"
- IAS 12 – "Income taxes";
- IAS 23 – "Borrowing costs". Amendments to IAS 23 were made to include guidelines that specific borrowings, the purpose of which was financing the creation of a particular asset, may be excluded from total liabilities for the purpose of capitalising borrowing costs only until the relevant asset is completed.

➢ Amendments to IAS 19 "Plan Amendment, Curtailment or Settlement" (effective for annual periods beginning on or after 1 January 2019, not yet endorsed in the EU).

➢ Changes to the Conceptual Framework for Financial Reporting, (effective for annual periods beginning on or after 1 January 2020, not yet endorsed in the EU).

➢ Amendments to IFRS 3 "Business Combinations" (effective for annual periods beginning on or after 1 January 2020, not yet endorsed in the EU).

➢ Amendments to IAS 1 and IAS 8 "Definition of material" (effective for annual periods beginning on or after 1 January 2020, not yet endorsed in the EU). The amendments explain the definition of "material" and the application thereof, consolidating the guidelines previously scattered in various standards within a uniform definition. In addition, the explanations that were previously available together with the definition have been complemented. In addition, the amendments ensure a uniform definition of materiality throughout the IFRS framework. Information is material if the omission of it, or an erroneous or false presentation thereof may have reliable consequences on decisions made by the basic users of the general purpose financial statements on the basis of the financial statements that provide information about a specific reporting unit.

- IFRS 17 "Insurance contracts" (effective for annual periods beginning on or after 1 January 2021, not yet endorsed in the EU).
- Amendments to IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture" (date of entry into force is not specified yet, not yet endorsed by the EU).

The *Group's Management* has decided not to apply the new standards and interpretations before the date of their entry into force. The *Group's Management* is of the opinion that the implementation of new standards, amendments and interpretations, other than IFRS 16, will not have a material impact on the *Group's* financial statements.

2.2. Foreign currency revaluation

Functional and presentation currency

Items included in the financial statements of each of the *Group's* entities are presented using the currency of the primary economic environment in which the *Group* operates (functional currency). The financial statements are presented in euro (EUR) as the official currency of the Republic of Latvia, which is the *Group's* functional currency. The functional and presentation currency of the *Group's* entities is 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 translated into euro at the rate set by the European Central Bank ruling at the end of the last day of the reporting year. Foreign currency gain or loss is recognised in the consolidated profit or loss.

Foreign exchange rates

Foreign currency	EUR at 31.12.2018	EUR at 31.12.2017
USD	1.14500	1.1993
CHF	1.12690	1.17020
RUB	79.71530	69.39200

2.3. Intangible assets

Intangible assets primarily consist of software licences initially recognised at cost. Estimated useful life for each type of intangible assets is specific and finite. Intangible assets are presented at cost, net of accumulated amortisation and accumulated impairment losses.

Subsequent costs are capitalised by increasing the existing value of an intangible asset, or recognised as a separate intangible asset only if the *Group* expects that future economic benefits will flow to the *Group* and these costs can be measured reliably. Other expenses are charged to the consolidated profit or loss when incurred.

Intangible assets are amortised using the straight-line method to write down their cost over their estimated useful lives and are charged to the consolidated profit or loss for the relevant period. Generally, intangible assets are amortised over five years.

2.4. Property, plant and equipment

Property, plant and equipment are measured at cost or revalued amounts, as described below, less accumulated depreciation and accumulated impairment provisions, if necessary.

Freight wagons used for transport are measured using the revaluation method and are revalued on a regular basis, with a view to ensuring that their book value is not materially different from their fair values at the end of the year. An increase in the carrying amount arising on revaluation is recognised in other income and as a revaluation reserve in equity. Decreases in the carrying value that offset previous increases of the same asset are recognised in other income and decrease the previously recognised revaluation reserve in equity. In other cases, the decrease resulting from revaluation is recognised in the consolidated profit or loss. The revaluation reserve for property, plant and equipment included in equity is reclassified to retained earnings.

At the date of the revaluation, accumulated depreciation is eliminated against the historical cost of the asset, the net amount is included in the revalued value of the asset so that the book value of the property, plant and equipment after revaluation were equal with its revalued value.

Other property, plant and equipment categories are measured at cost, and property, plant and equipment is carried at its cost, less accumulated depreciation and accumulated impairment, if any. Acquisition cost includes the costs directly attributable to the acquisition of property, plant and equipment. The cost of the assets constructed by the *Group* consists of materials and direct labour costs, as well as any other costs directly associated with bringing the property, plant and equipment in its working position for the intended purpose, and the costs of demolition and removal of the property, plant and equipment, and the renewal of the site where the item of the property, plant and equipment should be located. The cost of software, which is closely linked to the system's functionality and may not be separated from it, is capitalised as a component part of the relevant equipment.

The *Group* capitalises such property, plant and equipment items, the value of which exceeds EUR 300 and the useful life whereof exceeds one year. Investments in the leased assets are capitalised and presented as property, plant and equipment.

If the useful lives of individual property, plant and equipment items are different, they are listed as separate components of fixed assets. The estimated residual value of property, plant and equipment and useful lives are reviewed, and adjusted if appropriate, at the reporting date of each year.

Subsequent costs are included in the asset's carrying amount or recognised as a 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 profit or loss when incurred.

Profit or loss on disposal of fixed assets are calculated as the difference between the asset's book value and sales revenue in the period concerned and included in the consolidated profit or loss.

When the book value of a property, plant and equipment item is higher than its recoverable value, the value of the relevant property, plant and equipment item is immediately written down to its recoverable value (see Note 3).

Depreciation

Depreciation of property, plant and equipment is calculated on a straight-line basis. Depreciation is charged to the consolidated 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 of the *Group's* property, plant and equipment is calculated for each class of assets using their residual values by applying the depreciation rates specified for each asset.

Property, plant and equipment	**Useful life**
Buildings and structures	10-130 years
Perennial plantations	40 years
Railway rolling stock-carriages for technological needs and freight transportation	22-40 years
Railway rolling stock-locomotives, diesel-powered trains, and technological equipment	5-40 years
Rail track machines	30 years
Computing equipment, communications means, copiers and related equipment	3-10 years
Other property, plant and equipment	5-28 years

Assets under construction

Such assets, which are not ready for their intended use or which are being installed 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 expenditures, related to the relevant object until putting it into operation. The historical cost of the relevant fixed asset is not increased by the borrowing costs in the periods, in which no active construction works of an asset under construction take place.

When assets have reached their working condition for their intended use, they are reclassified to an appropriate class of property, plant and equipment and their depreciation is started to be calculated. Assets under construction are reviewed for impairment on a regular basis.

2.5. Impairment of tangible and intangible assets

All of the *Group's* tangible and intangible assets (other than land and the museum inventories) have a definite useful life. Depreciable assets are reviewed for impairment whenever any events and circumstances indicate that their book value may not be recoverable.

An impairment loss is recognised in the amount equal to the difference between the book value of the asset and its recoverable amount. Recoverable amount is the higher of the relevant asset's fair value less selling costs of disposal and its value in use. To determine the impairment, the assets are grouped at the lowest level, for which there is an identifiable cash flow (cash generating units). Impairment losses are charged to the consolidated profit or loss.

Asset impairment losses that have been recognised in previous periods, are reviewed at each balance sheet date to determine whether or not there is evidence that the impairment has decreased or no longer exists. Impairment losses are reversed, if changes are made to the estimates used to determine the recoverable amount. Impairment losses are reversed only to the extent the book value of the relevant asset does not exceed their book value less depreciation that would have been determined had impairment losses not been recognised.

2.6. Financial instruments

Accounting policy that became effective as of 1 January 2018.

Classification of financial instruments

As of 1 January 2018, the *Group's* financial instruments consist of financial assets (financial assets at amortised cost and financial assets at fair value through consolidated profit or loss) and financial liabilities (financial liabilities at amortised cost).

The classification of debt instruments depends on the *Group's* financial assets management business model in place, as well as whether the contractual cash flows consist solely of Payments of Principal and Interest (SPPI). If a debt instrument is being held to collect cash flows, it can be carried at amortised cost, if it meets the SPPI requirements. Such debt instruments, which meet the SPPI requirements and are held in the portfolio with a view to collecting cash flows from assets as well as selling them, may be classified as FVOCI. Financial assets the cash flows of which do not meet the SPPI requirements, must be measured at FVTPL (such as derivative financial instruments). Embedded derivatives are not separated from financial assets but they are included under financial assets, subject to the evaluation of the SPPI requirements.

Equity instruments are always measured at fair value. However, the *Management* may make an irrevocable choice to charge the change in fair value in other income, unless the instrument is held for trading. If an equity instrument is held for trading, changes in fair value must be reported in the consolidated profit or loss.

Recognition and derecognition

Financial assets are recognised when the *Group* has become a contracting party and has fulfilled the terms of the transaction, i.e. at the date of the trade.

Financial assets are derecognised when the *Group's* contractual obligations to the cash flows generated by financial assets are terminated or the *Group* transfers the financial asset to another party, or upon transferring the main risks and rewards incidental to the asset, the acquisition and selling of financial asset in the course of the operating activity are accounted for at the date of trading, i.e., at the date when the *Group* makes the decision to buy or sell assets.

Financial liabilities are derecognised when the obligation underlying the liability is revoked, cancelled or expires.

Measurement

At initial recognition financial instruments are measured at their fair value. For the financial assets and financial liabilities carried at amortised cost, at initial recognition, the fair value is adjusted for transaction costs that are directly attributable to the relevant financial instrument.

Financial assets at fair value through consolidated profit or loss

This category includes the *Group's* equity instruments that make up Other securities and investments. These investments are carried under Long-term assets unless the *Management* intends to sell them within 12 months from the reporting year date. The fair value of these financial assets is determined based on the *Group's Management's* estimates, made based on the financial information of these investments. Fair value changes are reported through profit or loss.

Dividends from investments are recognised in the consolidated profit or loss when the *Group* acquires legitimate rights to them.

Financial assets at amortized cost

Financial assets at amortised cost are debt instruments with fixed or determinable payments, which are not held for trading and the future cash flows from which consist solely of principal and interest payments. Financial assets at amortised cost include Trade and other receivables, Related party receivables and Cash and cash equivalents. Financial assets at amortised cost are classified as short-term assets, if the term to maturity is one year or less. If the maturity term is longer than one year, then they are shown as long-term assets. Short-term receivables are not discounted.

Financial assets at amortised cost initially are recognised at fair value and subsequently they are measured at amortised cost, using the effective interest rate method, less provisions for impairment.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances on current accounts and short-term deposits with original maturity of 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.

Impairment of financial assets at amortised cost

IFRS 9 introduces a new model for impairment recognition – the expected credit loss (ECL) model. The model has a three-stage approach, based on changes in the credit quality of financial assets, compared with the initial recognition. In practice, the new requirements will mean that at the initial recognition of a financial asset the *Group* will need to recognise immediate losses, which will be equal to 12-months ECL, even if the financial assets have no impairment signs (for trade receivables it will be measured as lifetime ECL). In the event of a significant increase in credit risk, the impairment will be measured using the lifetime ECL of the asset, rather than the 12-months ECL. The model provides for operational simplifications for trade receivables.

The *Group* has applied operational simplifications permitted by IFRS 9 in relation to the measurement of trade receivables - trade receivables are grouped by reference to the credit quality thereof and days outstanding, applying the ECL percentage to each relevant group.

The ECL rates are estimated, taking into account the last three years of payment history, adjusting the indicator taking into account the present information as well as future prospects.

Related party receivables, as well as loans issued to related parties are categorised into a separate group the ECL of which is calculated taking into account not only the past experience, but also the ultimate beneficiary thereof (the Republic of Latvia) credit rating and future development prospects. Loans issued to subsidiaries are regarded as assets with such credit risk, which has not significantly increased since initial recognition, therefore the ECL calculation includes the credit losses expected within the next 12 months.

A provision for impairment is accounted for in a separate provision account and losses are recognised in the consolidated profit or loss. If in the period following the recognition of the impairment the loss amount decreases and the amount of such reduction can be objectively related to an event after the recognition of the impairment (for example, improving of the debtor's credit rating), the reversal of the previously recognised impairment losses is recognised in the consolidated profit or loss.

Financial liabilities at amortised cost

Financial liabilities at amortised cost comprise Borrowings from credit institutions, Other borrowings, Trade payables and Other payables, as well as Related-party payables.

Financial liabilities at amortised cost are initially recognised at their fair value. In subsequent periods, financial liabilities at amortised cost are measured at amortised cost, using the effective interest rate. Financial liabilities at amortised cost are classified as current liabilities if their term to maturity is one year or less. If the maturity term is longer than one year, then they are presented as non-current liabilities.

Borrowings

Borrowings are initially recognised at fair value, net of the costs related to the receiving of borrowings. Subsequently borrowings are measured at amortised cost using the effective interest rate method. The difference between the amount of funds received, less borrowing related costs and loan amortization value is gradually charged to profit or loss using the effective interest rate on the loan. This difference is recognised under financial costs.

Borrowings are classified as current liabilities, except, if the *Group* has the irrevocable right to defer the settlement for at least 12 months after the balance sheet date.

Offsetting financial assets and liabilities

Financial assets and liabilities are mutually offset and reported in the balance sheet at net value if there are legal rights to carry out such offsetting, and the settlement shall occur at net values or transferring the asset and paying for the liability simultaneously.

Accounting policies that were in force until 31 December 2017

The *Group's* financial instruments consist of financial assets (available-for-sale investments, loans, receivables and cash and cash equivalents) and financial liabilities (borrowings, trade and other payables).

Financial assets

Financial assets comprise investments in the share capital of other companies, receivables, cash and cash equivalents and issued loans. The classification depends on the purpose of the acquisition of financial assets. The *Group* determines the classification of financial assets at initial recognition and reviews their classification at each reporting date.

Financial assets are derecognised when the contractual rights of the *Group* to receive cash flows from the financial assets expire or where the *Group* transfers the financial asset to another party, or transfers substantially all risks and rewards incidental to ownership. As part of the operating activity, acquisition and selling of financial assets are accounted for at the transaction date, i.e., at the date when the *Group* decides to buy or sell the asset.

All of the *Group's* financial assets are non-derivative financial assets not traded on an active market. They are presented under current assets, except for the assets with a maturity term longer than 12 months from the end of the reporting period. Whereas they are classified as long-term investments.

Available-for-sale investments

Available-for-sale investments are non-derivative financial instruments which cannot be classified into any other category. These investments are presented under Long-term assets unless the *Management* intends to sell them within 12 months from the reporting year date. Equity instruments that are not traded on the stock exchange and the fair value of which cannot be determined precisely, are measured at their original cost less the decrease in value. Dividends from investments are recognised in the consolidated profit or loss statement when the *Group* acquires legitimated rights to them.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market and are not held for trading. Loans and receivables consist of trade and other receivables. Short-term receivables are not discounted.

Receivables and loans are initially recognised at fair value and subsequently are measured at amortised cost, using the effective interest rate method, less provisions for impairment. Provisions for impairment are created when there is objective evidence that the *Group* will not be able to recover the receivables in full at the originally specified maturity dates. Significant financial difficulties of the debtor, the probability that bankruptcy proceedings or reorganization will be started, as well as defaulting of payments or violations are signs that the value of trade receivable has impaired. Provision for impairment is the difference between the book value of the asset and the estimated future cash flows, which has been determined by discounting at the original effective interest rate. A provision for impairment is accounted for in a separate provision account and losses are recognised in the consolidated profit or loss.

If in the period following the recognition of the impairment the loss amount decreases and the amount of such reduction can be objectively related to an event after the recognition of the impairment (for example, improving of the debtor's credit rating), the reversal of the previously recognised impairment losses is recognised in the consolidated 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 of 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 comprise borrowings, trade payables and other liabilities. Financial liabilities are derecognised when the obligation underlying the liability is revoked, cancelled or expires.

Liabilities

Liabilities are initially recognised at their fair value. In the future periods, liabilities are carried at amortised cost, using the effective interest rate. Liabilities are classified as current liabilities if the term to maturity is one year or less. If the payment period is longer than one year, liabilities are presented under non-current liabilities.

Borrowings

Borrowings are initially recognised at fair value, net of the costs related to the receiving of borrowings. Subsequently borrowings are measured at amortised cost using the effective interest rate method.

The difference between the amount of funds received, less borrowing related costs and loan amortization value is gradually charged to profit or loss using the effective interest rate on the loan. This difference is recognised under financial costs.

Borrowings are classified as current liabilities, except when the *Group* has irrevocable rights to defer settlement of the liability for at least 12 months after the balance sheet date.

Financial liabilities are derecognised when the obligation underlying the liability is revoked, cancelled or expires.

2.7. Inventories

Items are stated at the lower of cost or net realisable value. Net realisable value represents the selling price of inventories in the normal course of business, less cost to complete and sell. The acquisition cost is determined using the weighted average inventories measurement method for diesel and fuel, and the FIFO (first in, first out) method for other inventory items.

If necessary, provisions for impairment loss are created for obsolete, slow-moving or damaged inventories. The amount of provisions is charged to profit or loss.

2.8. Share capital and payments for the use of the State capital (dividends)

The share capital of the *Group's* parent company consists of common name shares. All of the *Group's* parent company's shares are dematerialised shares. The nominal value per share is one euro.

The dividends disbursable to the *Group's* parent company, i.e., payments for the use of the State capital are presented as liabilities in the *Group's* financial statements in the period where the *Group's* parent company approves the amount of the dividends.

2.9. Reserves

After the approval of each annual report, the shareholder's general meeting shall decide on the distribution of the profit for the year. Some part of the *Group's* parent after-tax profit, based on the decision of the *Group's* parent company's shareholder's meeting, may be credited to the reserve capital. For this purpose, equity comprises "Other reserves". The use and distribution of other reserves lies within the competence of the shareholder's meeting.

2.10. Unused annual leave accruals

Unused annual leave accruals are calculated by multiplying the number of unused leave days outstanding at the end of the year with the average daily wage for the last six months plus the employer's share of social insurance contributions.

2.11. Provisions

Provisions are recognised when the *Group* has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and the amount of liabilities may be reliably estimated.

When the *Group* expects some or all of the provision to be reversed, the reversal shall be recognised as a separate asset only when the reversal is virtually certain. Expenses related to the creation of provisions are charged to profit or loss, net of the recovered amounts.

2.12. Corporate income tax for the reporting year

Income tax is presented in the consolidated profit or loss.

Corporate income tax is calculated in accordance with tax legislation in force at the end of the reporting period. According to the effective law, the tax is charged at the rate of 20 percent of the estimated taxable base which has been adjusted prior to the application of the tax rate, and the is divided by the factor of 0.8.

Under the new Corporate Income Tax Law that came into force on 1 January 2018, the difference between financial and tax depreciation in the tax base as well as changes in provisions are not included in the tax base. Thus in 2017, the deferred tax was derecognised, and then included as income from corporate income tax in the consolidated profit or loss.

2.13. Income recognition

Revenue is the remuneration received in the course of carrying out the operating activities. Revenue is measured at the transaction price set forth in the agreement. The transaction price is the amount that the *Group* expects to receive after transferring the control over goods or services, other than the amounts collected on behalf of third-parties (e.g. value added tax). The transaction price is reduced by the received discounts or other bonuses granted to the buyer. Specific criteria for the recognition of the *Group's* revenue by type of revenue are listed below.

The *Group's* companies do not have such contracts with a customer, which would provide for the settlement period of more than one year, therefore the *Group* does not make adjustments to reflect changes in the value of money over time. In addition, the settlement terms and conditions do not provide for a variable remuneration.

Revenue from sales of goods is recognised upon transferring control, i.e., at the time when the *Group* transfers the goods to the customer and the latter accepts them, and it is probable that the receivable is recoverable.

Revenue from provision of services is recognised in the financial period when the services were provided, taking into consideration the total service provided and total contractual service, if applicable.

The *Group* provides the following services:

- *Cargo transportation services* – carriage 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 recognised based on the number of tonne/kilometres the cargo was transported during the relevant reporting period.
- *Public use railway infrastructure using services* – ensuring access to the railway infrastructure and is provided by the infrastructure manager without discrimination to all carriers. In 2018, revenue from use of railway infrastructure services was calculated pursuant to the actually run train-kilometres and recognised in the reporting period when the train traffic occurred, applying the fee for the use of the public use railway infrastructure carriage train kilometres determined by AS "LatRailNet", the manager of key functions of the public use railway infrastructure.
- *Ancillary services provided by the infrastructure manager* – handling of freight trains, including train bundling or not, technical maintenance and inspection of wagons. Revenue is recognised in the period when the services are provided.
- *Specific services related to the maintenance service and repairs of infrastructure* – construction and repairs of the rail tracks and bridges, replacement of switches, repairs and upgrading of railway machinery, tools and mechanisms and carriages, rail welding works and transportation of long rails, water installation and repairs of wastewaters, as well as preparation of the earth structure. Revenue is recognised when maintenance works are being provided, or when repair works have been completed.
- *International passenger transport services* – ensuring passenger transportation on international routes Riga-Moscow-Riga and Riga-St. Petersburg-Riga, Riga-Minsk-Riga. Revenue is recognized when revenue from ticket sales are received.
- *Expedition services* – development of cargo transportation routes, organization of railway traffic process, including preparation of transit documents, processing and customs clearance, shipment/receiving freights. Revenue is recognised when the services are provided.
- *Lease services* – the *Group* leases out buildings, constructions, land and other property, plant and equipment items that are not needed for its business activity, primarily to other carriers and other companies and organizations related to the operations of the railway infrastructure. Leasing of the unused space located in the railway infrastructure objects reduces the cost of the provision of principal services. As a result, the competitiveness of the principal services improves, as does the efficiency of the object usage. Revenue is recognised in the period when the services are provided.
- *Electricity distribution services* – electricity distribution and sales services to individuals and legal entities as well as the dependent subsidiaries, and purchasing 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 excluded from electricity distribution

services. *Latvijas dzelzceļš* provides general services to individuals fulfilling its obligations laid down by the Electricity Market Law, the Law on Regulators of Public Services and Rulings of the Cabinet No. 50 "Rules on Selling and Use of Electricity". *Latvijas dzelzceļš* acts as the principal provider of services, thus revenue and related costs are recognised on a gross basis. Revenue is calculated as a function of the rates and actual kilowatt hours used during the period when consumed.

- *Principal's services* include transit clearance in the border stations, transit declaration in the base stations, temporary storage. Revenue is recognised in the period when the services are provided.
- *Repairs and technical maintenance of the rolling stock.* Revenue is recognised when maintenance works are being provided, or when repair works have been completed.
- *Traction provision services* – provides locomotive crews services to other carriers that do not have locomotive crews for ensuring own transportation. Revenue is recognised when the actual service is being provided on the basis of the usage of crew in the respective reporting period.
- *Electronic communications services* – data and electronic message transmission services, leased line services, services of access points to the electronic infrastructure, public fixed electronic voice telephony services and interconnection services. Revenue is recognised based on the actual usage of network capacity during respective reporting period.
- *Information technology services* – include services that are related to the information systems of freight and passenger transport, train traffic, as well as business support, control and management information systems. Revenue is recognised in the period when the services are provided.
- *Other services* – these services include fuel storage and sale, crewing services, IT services, selling of self-produced heating, maintenance services and various other small-scale services for corporate clients and individuals. Revenue is recognised in the period when the services are provided.

Interest income

Interest income is recognised on an accruals basis, using the effective interest rate. Interest income from cash and cash equivalents is classified as financial income.

Income from fines

Under the prudence principle, contractual fines, including late payment duty for the liabilities past the due date are recognised in revenue only after the receipt thereof.

2.14. Lease agreements

Operating lease

Lease transactions where the lessor retains a significant portion of the risks and rewards incidental to ownership are classified as an operating lease.

The *Group* is the lessor

Assets that are leased under an operating lease, are presented under Property, plant and equipment at cost, less depreciation. Depreciation is calculated using the straight-line method.

Lease income from operating leases and prepayments received from customers is credited to consolidated profit or loss in the corresponding lease period on a straight-line basis.

The *Group* leases out its buildings, land and other property, plant and equipment not used in its business. An insignificant part of buildings and land is leased, therefore these fixed assets are not reclassified as investment property.

There are no significant non-cancellable operating lease payments or income arising from transactions where the *Group* is the lessor.

The *Group* as a lessee

Payments made under the operating lease agreement are presented in the consolidated profit or loss in the relevant lease agreement period on a straight-line basis.

Finance lease – the *Group* as a lessee

Finance leases, within which all the risks and rewards incidental to the ownership of the lease object are transferred to the *Group* and are recognised in the balance sheet as fixed assets at the amount at the inception of the lease corresponds to the fair value of the leased property, or, if it is less, the present value of minimum lease payments with presentation under current and non-current liabilities. Finance lease payments are divided between finance costs and reduction in liability so to achieve a constant rate of interest on the remaining balance of the liability. Financial costs are charged to the consolidated profit or loss.

If there are sufficient grounds to consider that the end of the lease period the lease object will transfer into the possession of the lessee, the useful life of the asset is assumed to be the anticipated time. In all other cases, the depreciation of capitalised leased assets is calculated using the straight-line method over the estimated useful life of the asset or the lease period, whichever of the following periods is shorter.

2.15. State budget co-financing and EU financing

State budget co-financing and EU financing are recognised at fair value when there is sufficient assurance that they will be received and it can be credibly claimed that the *Group* will be able to fulfil all the terms and conditions related to the receiving of these funds.

The State budget co-financing and EU financing attributable to the assets (property, plant and equipment) are presented under the balance sheet item "Deferred income" and periodically recognised in the consolidated profit or loss pro rata to the depreciation of the relevant assets (property, plant and equipment) over their useful life.

2.16. Related parties

Related parties are: the State, the members of the Board of the *Group* companies, their close relatives, and companies in which they exert significant influence or control.

2.17. Events after the balance sheet date

Such events after the end of the reporting year are presented in the financial statements, which provide additional information on the *Group's* financial position at the balance sheet date (adjusting events). If events after the balance sheet date are not adjusting events, they are disclosed in the notes to the consolidated financial statements, 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 law. 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 recognised as an expense on the accrual basis, and are included in the staff costs. Under the Cabinet Regulation No. 786 *"Regulation on the apportionment of the national social insurance contribution rate between the types of national social insurance"* of 19 December 2017, the defined level of social insurance contributions to be used for the state funded pension scheme was 71.87% (71.99% in 2017).

2.19. The principles of consolidation

The *Group's* subsidiary is such a subsidiary, the financial or operating activity of which is controlled by the *Group's* parent company. Control is deemed to exist if the *Group's* parent company owns more than 50% of the capital in the subsidiary, and it has the ability to control all operational decisions made by the relevant subsidiary.

Financial statements of the *Group's* subsidiaries are consolidated as soon as the parent company has gained control over the subsidiary, whereas consolidation is ceased when the said control no longer exists.

The financial statements of the companies are prepared, using uniform accounting and financial policies for similar transactions and other events in similar circumstances. If necessary, the accounting and measurement methods of the *Group's* subsidiaries may be changed to ensure compliance with those used by the *Group*. The consolidated financial statements include the financial statements of the parent company and its subsidiaries for 2018. The reporting year period of the *Group's* companies ar the same and coincide with the calendar year.

Transactions between the *Group's* companies, mutual balances and unrealised profit and loss on transactions between the *Group's* companies are eliminated.

Associated companies are such companies, in which the *Group* has a significant interest (directly or indirectly), but which are not controlled, the participation is usually 20-50 per cent of the shares carrying the voting right. Investments in associated companies are accounted for in the financial statements under the equity method and are initially recognised at acquisition cost. The carrying amount of the associated company includes the goodwill resulting at the acquisition. The carrying value of the associated company is reduced by the dividends received from that associated company. Other changes that have occurred in the net assets of the associated companies acquired by the *Group* are recognised as follows: (i) the *Group's* share of profit or loss of the associated company is recognised in the consolidated profit or loss as gain or loss from investment in associated companies, (ii) the *Group's* share of associated company other income is recognised under other income in a separate row. When the *Group's* share of loss in an associated company evens out or exceeds the share of its investment, including any unsecured receivables, the *Group* will no longer recognise further losses, unless it has undertaken or made payments on behalf of the associated company.

Unrealised profit from transactions between the *Group* and its associated companies is excluded to the extent it corresponds to the *Group's* share of investment in the associated company. Unrealised losses are also excluded unless the transaction provides evidence that the transferred asset has been impaired.

3. KEY ASSUMPTIONS AND JUDGMENTS

The preparation of the financial statements in accordance with IFRS requires making significant assumptions. It also requires the *Management* to make its assumptions and judgments, applying the accounting policies selected by the *Group*.

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 might differ from those estimates. The areas that are the most affected by assumptions are the *Management's* assumptions and calculations, used in determining the recoverable amount of the assets and the amount of provisions.

Useful life of property, plant and equipment

At the end date of each reporting period, the *Group* reviews the remaining useful life of the asset. Based on the most recent assessment carried out by the Financial Directorate of the *Group's* parent company, the current useful life of the *Group's* property, plant and equipment is appropriate to the actual life thereof.

Provisions

When assessing the provisions, the *Management* uses estimates on the likely liabilities as well as the term during which the liabilities might crystalise. If these events do not occur or occur in a different manner, the actual costs may differ from estimated costs. More detailed information on the assumptions regarding the provisions is provided in Note 19.

4. REVENUE

(EUR'000)

	2018	2017
Freight transport	221,060	188,558
The fee for the use of the public use of railway infrastructure	67,199	62,589
Expedition services	33,308	26,969
International passenger transport services	7,169	7,682
Infrastructure management services	8,040	7,656
Electricity sale services	5,574	5,621
Lease services	4,178	4,305
Repairs and technical maintenance of the rolling stock	3,305	3,791
Diesel and fuel sale revenue	2,923	2,368
Services of a principal	2,864	2,561
Specific services related to infrastructure maintenance and repairs	1,165	445
Information technology services	672	768
Security guard services	645	489
Electronic communications services	401	412
Traction ensuring services	290	1,315
Other services	6,251	3,109
Total	**365,044**	**318,638**

5. COST OF SALES

(EUR'000)

	2018	2017
Remuneration	117,117	111,912
National social insurance mandatory contributions	28,080	26,246
Diesel and fuel	41,234	31,857
Materials	14,466	13,801
Electricity	9,460	9,590
Depreciation of property, plant and equipment and amortisation of intangible assets	63,736	63,769
Other costs	69,019	63,396
Total	**343,112**	**320,571**

6. ADMINISTRATIVE COSTS

(EUR'000)

	2018	2017
Remuneration	18,020	17,043
National social insurance mandatory contributions	4,313	3,988
Materials, fuel and electricity	355	340
Depreciation of property, plant and equipment and amortisation of intangible assets	652	555
Other costs	2,328	2,690
Total	**25,668**	**24,616**
of which is the remuneration of the members of the *Group's* parent company board and council members	774	567
including remuneration	*624*	*459*
national social insurance mandatory contributions (employer's contribution)	*150*	*108*

7. OTHER OPERATING INCOME

(EUR'000)

	2018	2017
Deferred income (see Note 23)	19,867	20,377
Profit from scrap sales	2,724	2,934
Profit from sale of property, plant and equipment	3,317	337
Gain on foreign exchange rate fluctuations	-	848
Penalties and late charges	357	500
Reduction of other provisions	3,959	7,289
The budget allocation to compensate for damages	286	230
Other income	1,311	1,113
Total	**31,821**	**33,628**

8. OTHER OPERATING COSTS

(EUR'000)

	2018	2017
Costs of the disposal of property, plant and equipment and unfinished construction	1,266	1,844
The costs provided for in the collective agreement of *Latvijas dzelzceļš Group*, etc.	1,366	1,287
Losses on exchange rate fluctuations	80	-
Currency conversion	43	23
Penalties and late charges	36	24
Social infrastructure maintenance costs	24	22
An increase in provisions for doubtful debts	541	59
Provisions for materials that have not been used for more than a year	741	910
Impairment of property, plant and equipment	-	724
Annual leave accruals	1,315	123
Increases/decreases in other provisions, net	171	599
Corporate income tax on deemed profit distributions	97	-
Impairment of property, plant and equipment	4,650	-
Other costs	746	662
Total	**11,076**	**6,277**

9. FINANCE COSTS, NET

(EUR'000)

	2018	2017
Financial income	**3**	**2**
Bank interest	3	2
Financial costs	**(2,225)**	**(2,272)**
Bank interest, incl. long-term credit interest	(2,225)	(2,272)
Finance costs, net	**(2,222)**	**(2,270)**

10. CORPORATE INCOME TAX

The *Group* calculated corporate income tax in accordance with the legislation of the Republic of Latvia, which was effective at the end of the reporting period. According to the effective law, tax is applied at the rate of 20 percent of the estimated taxable base and divided by a factor of 0.8. Corporate income tax, calculated from the profit distributed in dividends is presented in the consolidated profit or loss, whereas in other cases it is presented under other operating costs.

The *Group's* deferred tax is calculated on the undistributed profit of the subsidiaries for 2018, which is expected to be paid in dividends to the parent company in the future years, on the basis of the amount of dividends due from state capital companies as provided for by the law.

Overpaid corporate income tax/corporate tax payable for the reporting year

(EUR'000)

	2018	**2017**
Overpaid at 1 January	446	1,875
(Payable) on 1 January	(2)	-
Calculated for the reporting year	(97)	(42)
Paid in the reporting year	88	471
Transferred from other taxes	(407)	(1,860)
Overpaid at 31 December	**28**	**446**
(Payable) at 31 December	**-**	**(2)**

Overpaid corporate income tax and corporate income tax liability relate to various *Group* subsidiaries. The *Group* does not have the legal rights to offset these amounts.

Current corporate income tax expense

(EUR'000)

	2018	**2017**
Calculated corporate income tax	-	42
Increase / decrease in deferred tax liability	745	(32,376)
Total	**745**	**(32,334)**

11. INTANGIBLE ASSETS

(EUR'000)

Licences and rights	**2018**	**2017**
Historical cost at the beginning of the year	**6,656**	**6,255**
Additions	697	406
Reclassified	2	-
Disposals	(61)	(5)
Historical cost at the end of the year	**7,294**	**6,656**
Accumulated depreciation at the beginning of year	**5,296**	**4,696**
Depreciation charge	592	605
Disposals	(61)	(5)
Accumulated depreciation at the end of the year	**5,827**	**5,296**
Net book value at the beginning of the year	**1,360**	**1,559**
Net book value at the end of the year	**1,467**	**1,360**

12. PROPERTY, PLANT AND EQUIPMENT

(EUR'000)

	Land plots	Buildings, structures and perennial plantations	Railway tracks	Long-term leasehold improvements	Plant and machinery	Wagons for the transport of goods	Computing equipment and fittings, communications equipment, copiers and equipment	Other property, plant and equipment	Unfinished construction site costs	Total
Historical cost/revalued at 01.01.2017	**1,340**	**143,186**	**595,160**	**2,671**	**370,985**	**201,917**	**27,829**	**26,877**	**18,068**	**1,388,033**
Acquisition and creation of plant, property and equipment	-	637	18,699	-	28,762	304	2,738	1,687	3,227	**56,054**
Reclassified	-	(234)	-	-	228	-	6	-	-	-
Disposals of property, plant and equipment	-	(165)	(3,723)	(26)	(4,655)	(61)	(577)	(684)	(1,917)	**(11,808)**
Historical cost/revalued at 31.12.2017	**1,340**	**143,424**	**610,136**	**2,645**	**395,320**	**202,160**	**29,996**	**27,880**	**19,378**	**1,432,279**
Accumulated depreciation at 01.01.2017	-	**41,307**	**185,567**	**645**	**131,642**	**86,557**	**17,465**	**16,784**	-	**479,967**
Depreciation charge	-	4,087	29,115	112	19,769	7,489	2,791	1,472	-	**64,835**
Reclassified	-	(11)	-	-	7	-	4	-	-	-
Disposals	-	(144)	(3,105)	(26)	(4,449)	(46)	(559)	(703)	-	**(9,032)**
Accumulated depreciation at 31.12.2017	-	**45,239**	**211,577**	**731**	**146,969**	**94,000**	**19,701**	**17,553**	-	**535,770**
Impairment at 01.01.2017	-	-	-	-	-	-	-	-	-	-
Recognition or (reversal) of impairment charge	-	-	-	-	(725)	-	-	-	-	**(725)**
Impairment at 31.12.2017	-	-	-	-	**(725)**	-	-	-	-	**(725)**
Net book value at 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 at 31.12.2017	**1,340**	**98,185**	**398,559**	**1,914**	**247,626**	**108,160**	**10,295**	**10,327**	**19,378**	**895,784**

(EUR'000)

	Land plots	Buildings, structures and perennial plantations	Railway tracks	Long-term leasehold improvements	Plant and machinery	Wagons for the transport of goods	Computing equipment and fittings, communications equipment, copiers and equipment	Other property, plant and equipment	Unfinished construction site costs	Total
Historical cost/ revalued at 01.01.2018	**1,340**	**143,424**	**610,136**	**2,645**	**395,320**	**202,160**	**29,996**	**27,880**	**19,378**	**1,432,279**
Acquisition and creation of plant, property and equipment	-	3,732	14,534	9	21,080	1,550	2,669	1,539	(7,601)	**37,512**
Reclassified	-	(1)	-	-	(10)	-	-	11	**(52)**	**(52)**
Disposals of property, plant and equipment	-	(245)	(3,681)	-	(7,817)	(6,566)	(1,070)	(963)	-	**(20,342)**
Historical cost/revalued at 31.12.2018	**1,340**	**146,910**	**620,989**	**2,654**	**408,573**	**197,144**	**31,595**	**28,467**	**11,725**	**1,449,397**
Accumulated depreciation at 01.01.2018	-	**45,239**	**211,577**	**731**	**146,969**	**94,000**	**19,701**	**17,553**	-	**535,770**
Depreciation charge	-	3,930	29,618	104	18,691	7,072	2,973	1,561	-	**63,949**
Reclassified	-	(1)		-	(10)	-	-	11	-	-
Disposals	-	(199)	(3,106)	-	(6,723)	(4,864)	(1,064)	(940)	-	**(16,896)**
Accumulated depreciation at 31.12.2018	-	**48,969**	**238,089**	**835**	**158,927**	**96,208**	**21,610**	**18,185**	-	**582,823**
Impairment at 01.01.2018	-	-	-	-	**(725)**	-	-	-	-	**(725)**
Recognition or (reversal) of impairment charge	-	-	-	-	(4,650)	-	-	-	-	(4,650)
Impairment at 31.12.2018	-	-	-	-	**(5,375)**	-	-	-	-	**(5,375)**
Net book value at 01.01.2018	**1,340**	**98,185**	**398,559**	**1,914**	**247,626**	**108,160**	**10,295**	**10,327**	**19,378**	**895,784**
Net book value at 31.12.2018.	**1,340**	**97,941**	**382,900**	**1,819**	**244,271**	**100,936**	**9,985**	**10,282**	**11,725**	**861,199**

During the reporting year, as well as in comparative periods, the land of 15,144 hectares registered on the name of the Ministry of Transport of the Republic of Latvia was transferred into use to the *Group* (mostly it is the railway land partition area that forms a part of the public-use railway infrastructure and is intended for the deployment of rail infrastructure objects to ensure the development of the railway infrastructure and a safe operation thereof).

The capitalised part of salaries is included in the cost of property, plant and equipment EUR 1,059 thousand (2017 - EUR 3,915 thousand). In 2018, EUR 42,353 thousand were spent in the renovation of property, plant and equipment, intangible investments as well as the construction of new objects (in 2017: EUR 55,608 thousand).

In 2018, the impairment was recognised for the property, plant and equipment, rail track machinery and service wagons on the balance sheet of SIA “LDZ infrastruktūra”, which was due to significant reduction in the volume of work, and the fact that these items are not used in business, with book value of EUR 4,650 thousand. In 2018, net turnover of SIA “LDZ infrastruktūra” fell by 64.4%, because neither in 2018, nor in subsequent years, the company will carry out the track reconstruction works for the parent company. Significant changes that have taken place in the economic environment have impacted the impairment of technological equipment, track machinery and technological wagons.

13. LONG-TERM FINANCIAL INVESTMENTS

(EUR’000)

Name of the company	Shareholding%	NBV	
		31.12.2018	**31.12.2017**
Belarusian-Latvian joint venture MIRIGO	3.0	10*1)	420
SIA STREK	5.84	74	74
Total		**84**	**494**

*1) Because the company's performance indicators have deteriorated in recent years, and positive development trends are not anticipated, the fair value of financial investments was determined, and the value of investment in Belarusian-Latvian joint venture “MIRIGO” was reduced accordingly by EUR 410 thousand. There have been no other changes during the year.

SIA “STREK” has been measured at cost. According to the *Management's* estimates the fair value of these investments do not significantly differ from the carrying amounts.

In the reporting year, the dividends calculated by other companies totalled to EUR 776 thousand. Dividend income is recognised when the rights to receive dividends arise.

14. INVENTORIES

(EUR'000)

	31.12.2018	31.12.2017
Road materials	7,213	6,276
Spare parts	5,515	12,246
Other materials	4,846	4,498
Diesel and fuel	3,023	2,351
Other inventories and work in progress	719	907
Gross book value	**21,316**	**26,278**
Provisions for material that have not been used for more than a year	(2,775)	(2,034)
Book value	**18,541**	**24,244**

15. TRADE AND OTHER RECEIVABLES

(EUR'000)

	31.12.2018	31.12.2017
Trade receivables	11,684	10,733
Overpaid VAT	5,744	2,351
Doubtful receivables	1,411	1,336
Other receivables	2,458	1,695
Gross book value	**21,297**	**16,115**
Provisions for doubtful receivables	(1,411)	(1,336)
Book value	**19,886**	**14,779**

Movement table of provisions for doubtful receivables:

(EUR'000)

	2018	2017
Provisions for doubtful debts at the beginning of the year	1,336	1,294
Decrease in provisions due to the recovery of debts	(87)	(55)
Decrease in provisions due to the write off of debts	(466)	(17)
Additional provisions created	628	114
Provisions for doubtful debts at the end of the year	**1,411**	**1,336**

Estimate of the expected value of the impairment of receivables by their risk group and days outstanding was made (detailed information is provided in Note 24). The expected loss rates are based on historical repayment indicators, which were specified as the bad debts/relevant revenue ratio over the past 36 months (counting from either 31 December 2018 or 1 January 2018). The historical loss ratios were adjusted to disclose the current and anticipated information on macroeconomic factors that affect the ability of customers to make settlements with the *Group*. The GDP forecasts are considered to be the most significant factor because it has the most direct effect on the changes in bad debts.

According to the calculations, at 31 December 2018 and at 1 January 2018, the provisions created for such trade receivables that have not delayed payment terms or have been outstanding for less than 6 months were immaterial, therefore their value in the financial statements is zero.

Similar calculations were also made for related party receivables, loans issued to related parties, other receivables, as well as for cash and cash equivalents, however, these calculations were based not on a historical experience but rather on the default rates of external credit rating agencies for similar borrowers or borrower groups. Such an approach was chosen because the *Group* has no historical data regarding losses for these financial asset groups. The results of the calculations suggest that the credit quality of the said assets is good, therefore the expected credit losses at 31 December 2018 and 1 January 2018 are not significant, therefore their value in the financial statements is zero.

Under the *Group's* accounting policies, usually provisions of 100% for expected credit losses are made for trade receivables that have been outstanding for more than 6 months, making adjustments only to present the potential recovery of such debts.

16. CASH AND CASH EQUIVALENTS

(EUR'000)

	31.12.2018	31.12.2017
Cash in bank	89,901	72,882
Cash in hand	2	1
Cash in transit	1	-
Total	**89,904**	**72,883**

17. SHARE CAPITAL

The registered and paid up capital of the *Group's* parent company

The share capital of *Latvijas dzelzceļš* is EUR 256,720,375, consisting of two hundred and fifty-six million seven hundred and twenty thousand three hundred and seventy-five shares, with a nominal value per share of EUR 1 (one euro).

The shareholder of all shares is the Republic of Latvia and the shares are fully paid-up. The Ministry of Transport is the sole holder of the state capital shares. All of the *Group's* parent company's shares carry the same rights to dividends, liquidation quota and voting rights in the shareholders' meeting.

Payments for the State capital (dividends)

Under Section 28, Paragraphs one and two of the Law on Governance of Capital Shares of a Public Person and Capital, the foreseeable share of profit to be disbursed in dividends and the profit share to be disbursed in dividends shall be determined based on the medium-term operational strategy of the capital company. Based on the medium-term business strategy, the board of the capital company shall draw up a proposal for the expected profit distributable in dividends, and submit the proposal to the shareholders.

The medium-term operational strategy for 2017-2022 of VAS "Latvijas dzelzceļš", which was approved by the Council of *Latvijas dzelzceļš* under the Council decision No. PA 1.2./11-1, section 17 of 8 November 2018, determines for the period of the operation of the strategy, the share of dividends payable to the State from *Latvijas dzelzceļš* net profit, as retaining the profit at the disposal of *Latvijas dzelzceļš* and using it for the development and restoration of the public-use railway infrastructure, including the setting up of a reserve, which can be used to maintain the sustainability of the *Latvijas dzelzceļš* and to implement the budgeted public-use railway infrastructure projects.

The application of a different profit share to determine the distributable share of profit was supported in the opinion provided in the letter No. 1.2-5.1/159-IP of *Pārresoru koordinācijas centrs* of 30 November 2017 on the medium-term business strategy of *VAS Latvijas dzelzceļš* for 2017-2022.

Under Cabinet Order No. 588 of 6 November 2018 "Indicative railway infrastructure development plan for 2018-2022" was approved, whereas on 9 November 2018, the Ministry of Transport and *Latvijas dzelzceļš* entered into the Multi-annual agreement for the maintenance of the existing public use railway infrastructure managed by *Latvijas dzelzceļš* and the planning of development, and ensuring the financial leverage for the period form 9 November 2018 to 31 December 2022.

The mechanism of ensuring the financial stability of the operator of the public use railway infrastructure specified in the Plan may function, and such investment projects may be implemented if the Cabinet's conceptual decision that the share of the profit payable by *Latvijas dzelzceļš* to the State in dividends is 0% of the net profit of *Latvijas dzelzceļš* in the years 2018-2021 (the Cabinet Order No. 212 "On variable share of profit of state joint stock company for the 2018-2021 reporting year"), is incorporated in the annual bill on the State Budget and in the bill On the Medium-Term Budgetary Framework for the relevant periods.

On 7 February 2019, the Law on the Budget and Financial Management was amended, under paragraph 82 of the Transitional provisions, in 2019, the Bill on the Medium-Term Budgetary Framework Bill is required only for 2020, 2021, and 2022, and the Cabinet shall submit it to the Parliament (*Saeima*) concurrently with the Bill for the 2020 State Budget. Thus, the decision on a different share of the profit of *Latvijas dzelzceļš* to be disbursed in dividends for 2018 shall be made, when making decision regarding the 2019 budget.

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

From 1 July 2013, wagons for freight transport that make up the rail rolling stock are measured at the revaluation method by the *Group*. In 2013, this property, plant and equipment was revalued, and the increase in their value was credited to the long-term revaluation reserve (net of the tax effect). In 2018, SIA "LDZ CARGO" measured the freight wagons owned by it using the market method. The commission passed the decision to consider the book value of property, plant and equipment as fair value and not to carry out the revaluation of fixed assets, because the current market value of freight wagons does not significantly differ from the existing carrying value. The determined market value would only be by about 0.41% higher than the current book value.

Under the Cabinet order No. 376 “On the share of profits payable in dividends by the State joint stock company Latvijas dzelzceļš to the State for 2017” of 8 August 2018, the amount of dividends payable was set at EUR 614,875 (approx. 2.65%) of the net profit for 2017, and the net profit EUR 22,569,492 for 2017 was redirected to the implementation of the budgeted public-use railway infrastructure projects of the State joint stock company *Latvijas dzelzceļš* in accordance with the Company’s medium-term operational strategy for 2017 - 2022.

Reserves consist of the prior period retained earnings, which by the decision of the owner were redirected to the ensuring of the *Group’s* development. Therefore reserves and prior period retained earnings by their substance are no different and are consolidated into a single balance sheet item. The procedure for using the *Group’s* parent company’s reserves and the prior retained earnings is determined by the *Group’s* parent company's shareholders' meeting.

19. PROVISIONS

(EUR’000)

	31.12.2018	31.12.2017
Other provisions	162	177
Total non-current portion	**162**	**177**
Provisions for public railway infrastructure services	3,461	6,922
Provisions for benefits until the time of the arising of pension rights	570	487
Other provisions	490	1,077
Total current portion	**4,521**	**8,486**
Total	**4,683**	**8,663**

Provisions movement table by type of provision in 2018

(EUR’000)

	01.01.2018	Increase in provisions	Decrease in provisions	31.12.2018
Provisions for public railway infrastructure services	**6,922**	-	(3,461)	**3,461**
Provisions for potential losses from litigation	**195**	12	(192)	**15**
Provisions for benefits until the retirement age	**487**	83	-	**570**
Other provisions	**1,059**	76	(498)	**637**
Total	**8,663**	**171**	**(4,151)**	**4,683**

Provisions movement table by type of provision in 2017

(EUR'000)

	01.01.2017	Increase in provisions	Decrease in provisions	31.12.2017
Provisions for public railway infrastructure services	**13,843**	-	(6,921)	**6,922**
Provisions for potential losses from litigation	**15**	192	(12)	**195**
Provisions for benefits until the retirement age	**634**	-	(147)	**487**
Other provisions	**873**	407	(221)	**1,059**
Total	**15,365**	**599**	**(7,301)**	**8,663**

In 2018, the provisions created for the financing of the public use railway infrastructure were reduced to EUR 3,461 thousand. Reduction in provisions was made due to the amendments to the Railway Law that became effective on 10 March 2016, and the amendments of the regulatory documents related to them, based on which the provisions of the EU Parliament and the Council Directive 2012/34/EU of 21 November 2012 were transposed in the national law.

In 2018, provisions for contingent losses from court proceedings of EUR 12 thousand were made, whereas at 31 December 2018, the *Group's* total provisions for contingent liabilities amounted to EUR 15 thousand.

Accruals for severance benefits until the arising of the right to pension are created in accordance with the provisions of the Collective agreement entered into between the *Group's* companies on the payment of benefits to employees, the employment relationship with which is terminated five years before them reaching the pension age. The provision has been recognised in accordance with the best estimate of the benefits to be paid, i.e., EUR 570 thousand.

Other provisions for contingent liabilities created by the *Group* at 31 December 2018 included contingent liabilities for production injuries of EUR 162 thousand, losses of freight transport and freight wagon damage of EUR 407 thousand and provisions for guarantee repairs of EUR 68 thousand.

Increases/decreases in provisions are presented under other operating income or other operating expenses at net value.

20. BORROWINGS FROM CREDIT INSTITUTIONS

(EUR'000)

	31.12.2018	31.12.2017
Non-current borrowings from credit institutions	165,409	176,527
Current loans from credit institutions	36,110	35,114
Total borrowings from credit institutions	**201,519**	**211,641**

Borrowings were raised from Swedbank AS, Nordea Bank AB, Luminor Bank AS Latvian branch, SEB banka AS, North Investment Bank, OP Corporate Bank plc and OP Corporate Bank branch in Latvia. During the reporting period, the total borrowings were EUR 24,966 thousand and EUR 35,127 thousand were repaid. The loan agreements entered into with banks provide for that financial indicators that the *Group's* companies must adhere to within the term of the agreement; if the said indicators are not met, then, before the year end, letters are requested from banks to provide evidence that the lender will not demand an early repayment of the loan.

In 2009-2010, SIA "LDZ Cargo" has entered into the credit agreements for the renewal and replenishment of the rolling stock, which are secured by a pledge. The freight wagons of SIA "LDZ CARGO" with the value EUR 8,012 thousand were pledged to secure the loans from Swedbank AS and Luminor Bank AS Latvian branch for crediting.

One of the principal activities of SIA "LDZ ritošā sastāva serviss" is selling of diesel fuel. Under Section 31, Paragraph 1 of the Excise Tax Law, to engage in transactions with excisable goods and use the deferred tax payment, the taxpayer must provide a security. In 2018, SIA "LDZ ritošā sastāva serviss" extended the guarantee by EUR 4,000 thousand in AS SEB Banka for the general security of the excise tax until 1 June 2019.

Outstanding borrowings and interest rates at 31 December 2018:

Currency of the borrowing	Borrowing, EUR'000	Interest rate
EUR	22,132	1M EURIBOR + 1.33%
	124,022	3M EURIBOR + 0.69% to 1.61%
	53,951	6M EURIBOR + 1.05% to 1.8%
	842	6M EUR LIBOR + 1.65%
USD	572	6 M USD LIBOR + 1.65%
Total	**201,519**	

Outstanding borrowings and interest rates at 31 December 2017:

Currency of the borrowing	Borrowing, 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	6 M USD LIBOR + 1.65%
Total	**211,641**	

Outstanding borrowings movement table

(EUR'000)

	2018	2017
Borrowings outstanding at the start of the reporting period	**211,641**	**210,733**
Received during the reporting period	24,966	34,704
Repaid during the reporting period	(35,127)	(33,337)
Gain/loss on currency exchange rate fluctuations	39	(459)
Borrowings outstanding at the end of the reporting period	**201,519**	**211,641**

Effect of the exchange rate fluctuations on borrowings denominated in foreign currencies

(EUR'000)

Currency of the borrowing: USD	2018	2017
Borrowings outstanding at the start of the reporting period	**2,874**	**5,920**
Repaid during the reporting period	(2,341)	(2,587)
Gains/losses on exchange rate fluctuations	39	(459)
Borrowings outstanding at the end of the reporting period	**572**	**2,874**

21. OTHER BORROWINGS

(EUR'000)

	31.12.2018	31.12.2017
Settlement for the property title under the contract for the construction of the optical telecommunications networks (expansion) in sections Liepaja-Jelgava-Riga-Valka railway * 1) incl.: non-current portion	2,204	2,321
Including, liabilities payable after more than five years after the end of the reporting period	*1,736*	*1,853*
liabilities maturing in more than one year, however, not later than five years after the end of the reporting period	*468*	*468*
current portion	117	117
Total	**2,321**	**2,438**

*1) The Contract was entered into in 2013 for the total amount of EUR 2,925 thousand until 2038.

22. TAXES AND NATIONAL SOCIAL INSURANCE MANDATORY CONTRIBUTIONS

Movement table of taxes and mandatory national social insurance contributions during the reporting year

(EUR'000)

Type of tax	Overpaid taxes (-) liabilities (+) at 31.12.2017	Calculated for 2018	Paid in 2018	Transferred from other taxes	Tax refund	Overpaid taxes (-) liabilities (+) at 31.12.2018
Corporate income tax	(444)	97	(88)	407	-	(28)
Corporate income tax from non-residents	-	3	(3)	-	-	-
Mandatory national social insurance contributions	5,434	49,539	(48,750)	(400)	-	5,823
Personal income tax	3,036	23,135	(23,272)	-	-	2,899
incl. in Belarus	-	*8*	*(7)*	-	-	*1*
Real estate tax	-	650	(650)	-	-	-
Excise tax	1,423	17,273	(17,040)	-	-	1,656
Natural resources tax	15	43	(43)	-	-	15
Import duty	-	5	(5)	-	-	-
Value added tax	2,511	8,762	(43,407)	(7)	31,896	(245)
Company vehicle tax	-	51	(46)	-	-	5
Vehicle operation tax	1	65	(65)	-	-	1
Stamp duty on storing the security reserves	33	461	(448)	-	-	46
Business risk stamp duty	4	45	(45)	-	-	4
Total, incl.	**12,013**	**100,129**	**(133,862)**	**-**	**31,896**	**10,176**
overpaid taxes	(2,795)					(5,772)
tax liability	14,808					15,948

The tax liability arose in December 2018. At 31.12.2018, the *Group* does not have tax debts.

23. DEFERRED INCOME

(EUR'000)

	31.12.2018	31.12.2017
Non-current portion of deferred income (EU and State budget financing)	290,238	307,639
Other deferred income	116	-
Total non-current portion	**290,354**	**307,639**
Current portion of deferred income (EU and State budget financing)	19,394	19,860
Other deferred income	112	528
Total current portion	**19,506**	**20,388**
Total deferred revenue	**309,860**	**328,027**

The majority of deferred revenue are the EU funds and State budget funds received for the development of the railway infrastructure.

EU project financing movement table for 2018 (property, plant and equipment created with EU fund financing)

(EUR'000)

Deferred income	At 01.01.2018	Reclassified (transferred)	State budget financing received	Decrease in depreciation of property, plant and equipment	At 31.12.2018
Non-current portion	**307,639**	(19,401)	2,000	-	**290,238**
Current portion	**19,860**	19,401	-	(19,867)	**19,394**
Total	**327,499**	-	**2,000**	**(19,867)**	**309,632**

In 2018, financing was received from the priority measure of the State budget – the national public-use railway infrastructure object – the construction of the pedestrian tunnel at the Ogre station aimed at improving the level of security in railway stations in the vicinity of intensive pedestrian and train traffic.

EU project financing movement table for 2017 (property, plant and equipment created with EU fund financing)

(EUR'000)

Deferred income	At 01.01.2017	Reclassified (transferred)	Adjustments	Decrease in the depreciation charge of property plant and equipment	At 31.12.2017
Non-current portion	**329,671**	(21,029)	(1,003)	-	**307,639**
Current portion	**19,208**	21,029	-	(20,377)	**19,860**
Total	**348,879**	-	**(1,003)**	**(20,377)**	**327,499**

24. FINANCIAL RISK MANAGEMENT

The *Group's* most significant financial instruments are borrowings from banks, other borrowings, cash and deposits with banks as well as receivables and payables. The key purpose of these financial instruments is to ensure financing to the *Group's* business activities. The *Group* has several other financial assets and liabilities, such as receivables and payables to suppliers and contractors arising directly from business activity.

The *Group* is exposed to market, credit and liquidity risks in connection with its financial instruments.

Financial risks are managed by the Finance Directorate of *VAS Latvijas dzelzceļš* and the *Group's* Finance Committee.

The *Group's* financial instruments are categorised into the following categories:

(EUR'000)

	31.12.2018
Financial assets at amortised cost	
Trade and other receivables, except advances	11,684
Cash and cash equivalents	89,904
Financial assets at fair value through profit or loss	
Long-term financial investments	84
Total financial assets	**101,672**
Financial liabilities at amortised cost	
Borrowings from credit institutions	201,519
Other borrowings	2,321
Trade payables, payables to contractors and other payables, except advances (including non-current portion)	36,250
Total financial liabilities	**240,090**

(EUR'000)

	31.12.2017
Loans and receivables	
Trade and other receivables, except advances	10,733
Cash and cash equivalents	72,883
Available-for-sale investments	
Long-term financial investments	494
Total financial assets	**84,110**
Other financial liabilities at amortised cost	
Borrowings from credit institutions	211,641
Other borrowings	2,438
Trade payables, payables to contractors and other payables, except advances (including non-current portion)	36,940
Total financial liabilities	**251,019**

Market risk

Market risk is a risk that changes in market risk factors, e.g. changes in foreign currency rates, interest rates and goods prices will affect the *Group's* revenue or the value of financial instruments owned by it. Market risk includes currency risk and interest rate risk.

Interest rate risk

Interest rate risk is the risk of incurring losses related to the changes in the interest rates applicable to the *Group's* assets and liabilities. The *Group* is exposed to changes in market interest rates in relation to its non-current liabilities, to which a variable interest rate was applied.

All of the *Group's* borrowings have variable interest rates. For a detailed description of the interest rates on the borrowings, see Note 20. The *Group* manages the risk of changes in interest rates through regular monitoring of the available market borrowing rates. If lower than existing interest rates are available, the *Group* shall assess the financial benefit of recrediting.

The *Group's* companies do not use derivative financial instruments for interest rate risk management purposes.

Sensitivity of interest rates

In the table below, the *Group's* sensitivity of profit before tax to reasonably possible changes in interest rates at the end of each specified reported period is shown, if all other variables remain unchanged. The *Group's* equity, other than the performance for the reporting year, would not be affected.

	2018		**2017**	
	Increase/decrease in the base rate (basis points)	**The impact on profit before taxes (in thousand EUR)**	**Increase/decrease in the base rate (basis points)**	**The impact on profit before taxes (in thousand EUR)**
EURIBOR	(+100)	(2,009)	(+100)	(2,088)
	(-100)	2,009	(-100)	2,088
LIBOR	(+50)	(3)	(+50)	(14)
	(-50)	3	(-50)	14

Currency risk

Currency risk is the risk of incurring losses due to adverse exchange rate changes related to assets and liabilities denominated in foreign currencies. Currency risk to which the *Group* is exposed, mainly arises from its business activity, revenue and costs are denominated in different currencies from borrowing in foreign currencies. The *Group's* trade receivables are mainly denominated in euro while borrowings from banks are denominated in USD. A detailed breakdown of financial instruments by currency given in Note 27.

The main foreign currency (FX) risk management instrument used by the *Group* is the monitoring of the assets held in FX by the *Group's* companies and use thereof within the scope of the *Group*, for meeting the *Group's* liabilities in foreign currencies.

The Group's companies do not use derivative financial instruments for interest rate risk management purposes.

Sensitivity of currencies

In the table below, the *Group's* sensitivity of profit before tax to reasonably possible changes in currency rates as compared to the monetary position, if all other variables remain unchanged. The *Group's* equity, other than the performance for the reporting year, would not be affected.

	2018		2017	
	Changes to currency exchange rates	**The impact on profit before taxes (in thousand EUR)**	**Changes to currency exchange rates**	**The impact on profit before taxes (in thousand EUR)**
USD	(+5%)	41	(+5%)	124
	(-5%)	(41)	(-5%)	(124)

Credit risk

Credit risk is the risk that the counterparty might not meet their obligations owed to the *Group*, resulting in significant financial losses. The *Group* is exposed to credit risk arising directly from its operating activities – mostly trade receivables, and credit risk in connection with the *Group's* financing activities – mainly cash deposits with banks.

Trade receivables

Each *Group's* company manages the credit risk of trade receivables in accordance with the *Group's* policies. The solvency of customers is ascertained before entering into contracts. Several companies of the *Group* manage credit risk through prepayments from its customers.

The *Group* continuously monitors the balances of receivables to reduce the likelihood of bad debts arising. The potential impairment of trade receivables is continuously monitored.

The *Group* has not received any pledges as a security against trade receivables.

The *Group* considers that its trade receivables credit risk concentration is medium. At 31 December 2018, the *Group* had three customers (in 2017: three customers), and each of them owed the *Group* more than EUR 700 thousand, amounted to approx. 51.6% (2017: 55.7 %) of the total receivables.

The *Group* has not developed an internal credit rating system for the assessment of trade receivables.

During 2018, there have been no significant changes in the expected credit losses with regard to trade receivables.

Receivables are written off only when recovering of them is not expected. The indicators, which show the impossibility of recovering the debt include, among other things, inability to agree with the customer on the repayment schedule, which is complemented by the debtor's insolvency, bankruptcy or liquidation.

Cash deposits

Credit risk arising from the *Group's* cash deposits with banks is managed by the *Group's* Finance Committee in accordance with the *Group's* Financial management policy. Under the said policy the free resources of the *Group* may be invested only in deposits or money market funds. Before deploying funds in banks (current or deposit accounts), the *Group's* Finance Committee assesses the bank's credit rating and offered interest rates.

The *Group's* cash balances in banks according to the agency Moody's assigned banks' credit ratings:

(EUR'000)

Credit rating	**31.12.2018**	**31.12.2017**
Aa2	22,606	-
Aa3	23	67,867
A1	-	5,015
Baa1	65,272	-
No rating*	2,000	-
Total	**89,901**	**72,882**

*The ratings are not assigned to the State Treasury and VAS Latvijas Pasts (a State-owned company).

The *Group* is exposed to credit risk as presented in the table below:

(EUR'000)

	31.12.2018	**31.12.2017**
Cash and cash equivalents	89,904	72,883
Trade and other receivables (gross amount), except advances and prepayments	13,095	12,069
Total	**102,999**	**84,952**

In addition, information is disclosed regarding the credit risk:

(EUR'000)

	31.12.2018	31.12.2017
Financial assets, which have not been defaulted and for which no provisions for impairment have been made		
Current receivables, including	100,160	82,608
Cash and cash equivalents	*89,904*	*72,883*
Trade receivables	*10,256*	*9,725*
Age structure analysis of financial assets that are overdue, but for which no provisions for impairment have been made		
Up to 3 months	1,149	580
From 3 to 12 months	66	223
From 1 to 5 years	213	205
Total financial assets for which no provisions for impairment have been made	**101,588**	**83,616**
Financial assets, for which provisions for impairment (in full) have been created	1,411	1,336
Total	**102,999**	**84,952**

Liquidity risk

Liquidity risk is the risk that the *Group* will not be able to meet its financial liabilities as they fall due.

The *Group's* Financial Committee manages liquidity risk by maintaining sufficient cash reserves and providing sufficient financing, using the assigned loans, lines of credit, finance lease, etc., as well as constantly monitoring forecast and actual cash flows and matching the age structure of financial assets and liabilities.

The *Group* prepares a long-term cash flow forecast for the year and operating cash flow forecast for one week, to ensure that the *Group* has sufficient cash to finance the expected operating costs, meet financial obligations and make the necessary investments.

The *Group's* current liabilities include deferred revenue related to investments financed by EU projects in the railway public infrastructure, which has affected the liquidity ratio. It should be noted that an outflow of financial resources to pay these liabilities will not be necessary, so the *Group* will be able to cover its current payments and maintain financial stability.

In the tables below, the *Group's* financial liabilities are presented broken down by their maturity date, based on the amounts of undiscounted financial obligations provided for in agreements, including interest payments:

(EUR'000)

At 31 December 2018	Up to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Borrowings from credit institutions	9,229	29,221	112,946	57,716	**209,112**
Other liabilities (including other loans, trade payables and other payables)	25,602	10,279	954	1,736	**38,571**
Total	**34,831**	**39,500**	**113,900**	**59,452**	**247,683**

(EUR'000)

At 31 December 2017	Up to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Borrowings from credit institutions	9,036	28,311	128,972	54,996	**221,315**
Other liabilities (including other loans, trade payables and other payables)	27,279	9,292	954	1,853	**39,378**
Total	**36,315**	**37,603**	**129,926**	**56,849**	**260,693**

25. FAIR VALUE CONSIDERATIONS

IFRS 13 lays down the value measurement technique hierarchy, based on whether the measurement technique uses observable market data or market data are not observable. Observable market data are obtained from independent sources. If market data are not observable, the value measurement technique reflects the *Group's* assumptions about the market situation.

The said hierarchy requires that observable market data must be used, if they are available. In carrying out revaluation, the *Group* takes into consideration the relevant observable market prices, if possible.

The purpose of the fair value measurement, even in inactive markets, is to arrive at the price at which market participants would be willing to sell the asset or assume the liability at the measurement date under current market conditions.

To determine the fair value of a financial instrument, several methods are used: quoted prices or a valuation technique that includes observable market data and is based on internal models. Based on the fair value hierarchy, all measurement techniques are subdivided in to Level 1, Level 2, and Level 3.

The fair value hierarchy level of a financial instrument level must be determined as the lowest level, if a substantial part of the value is made up of lower level data.

In the fair value hierarchy, financial instruments are grouped into two stages:

1. Group the data of each level to determine the fair value hierarchy;

2. Assets are grouped at the lowest level, based on proportion of observable data used in determination of the fair value.

Quoted market prices – Level 1

For the measurement technique of Level 1, the quotation prices for identical assets or liabilities on an active market are used when the quotation prices are readily available and the relevant price represents the actual market situation for fair business competition. The *Group* does not have any financial instruments measured at Level 1.

Value measurement technique when market data are used – Level 2

In the models used for the measurement technique of Level 2, all essential data are used which are directly or indirectly observable on part of the assets or liabilities. The model uses market data other than the quoted prices of Level 1, but which can be observed directly (i.e., the price), or indirectly (i.e., are derived from the price). The *Group* does not have Level 2 financial instruments.

Value measurement technique when such market data are used which are not based on observable market data - Level 3

For the measurement technique when the market data not based on observable market data are used (not observable market data) are classified as Level 3. Not observable market data are deemed to be such data that are not readily available in an active market due to an illiquid market or the complexity of the financial instrument. Level 3 data are primarily determined on the basis of similar observable market data, historical observations or using an analytical approach.

These financial assets and liabilities are included in Level 3:

(EUR'000)

Assets:	**31.12.2018**	**31.12.2017**
Cash and cash equivalents	89,904	72,883
Trade receivables, net	11,683	10,733
Long-term financial investments	84	494
Total	**101,671**	**84,110**

(EUR'000)

Liabilities:	**31.12.2018**	**31.12.2017**
Borrowings from credit institutions	201,519	211,641
Trade payables	36,250	36,940
Other liabilities	2,321	2,438
Total	**240,090**	**251,019**

Assets and liabilities for which fair value is disclosed

The carrying amount of liquid and short-term financial instruments (with maturity of up to 3 months), for example, cash and cash equivalents, short-term deposits, short-term trade payables and trade receivables, approximates their fair value.

The fair value of bank loans, finance lease liabilities and other long-term liabilities is measured by discounting future cash flows and applying market interest rates. As interest rates applied on loans from credit institutions, finance lease liabilities and other long-term liabilities are variable and do not significantly differ from market rates, and as 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 and subject to the International financial reporting standard Nr. 13 "Fair value measurement". The carriages were measured in 2018, using two methods – price comparison method, because a sufficiently active and liquid secondary market was identified for most of the measured plant and property, and market prices were used to carry out the assessment. The fair value that was determined using the market method changed only by 0.41% as compared to their book value, which makes up an insignificant part of the total value of property, plant and equipment. It is therefore considered that the carrying value of cargo carriages fleet corresponds to Level 3 measurement technique.

26. CAPITAL MANAGEMENT

The Republic of Latvia owns 100% of VAS *Latvijas dzelzceļš.*

The *Group's* objectives in relation to capital management is to ensure the *Group's* ability to continue its business and earn the return on capital as determined by the shareholder meetings of the relevant companies. As the only shareholder of the *Group*, the Latvian Government has the right to take decisions related to the increase or reduction of the share capital of the *Group*, the payment of dividends or using them for the development of the *Group*.

In the context of the capital management the *Group* assesses the debt-capital ratio. The risk management policy of the *Group* does not define the level of this ratio. However, one of the financial terms of the agreements signed between the *Group* and the banks is keeping the borrowed capital and total capital ratio within specified boundaries, which was met at 31 December 2017 as well as at 31 December 2018. Preparing long-term and short-term financial plans and budgets, the *Group* takes into consideration the financial terms required by banks with regard to debt-capital ratio.

(EUR'000)

	31.12.2018	31.12.2017
Borrowings from credit institutions and other borrowings	203,840	214,079
Liabilities (including taxes)	66,002	67,392
Other liabilities	315,288	336,690
Total liabilities	**585,130**	**618,161**
Equity	406,366	392,574
Total liabilities and equity	**991,496**	**1,010,735**
Debt/capital ratio	59%	61%
Equity and total liabilities ratio	69%	64%

27. BREAKDWON OF FINANCIAL ASSETS AND LIABILITIES BY CURRENCY

In the table below, the *Group's* financial instruments are broken down by currency at 31 December 2018:

	EUR	USD	Other currencies	Total
	EUR'000	**EUR'000**	**EUR'000**	**EUR'000**
Trade and other receivables, except advances	10,432	581	671	11,684
Cash and cash equivalents	89,429	200	275	89,904
Total financial assets	**99,861**	**781**	**946**	**101,588**
Borrowings from credit institutions	200,947	572	-	201,519
Other borrowings	2,321	-	-	2,321
Trade payables, payables to contractors and other payables, except advances	32,072	365	3,813	36,250
Total financial liabilities	**235,340**	**937**	**3,813**	**240,090**

In the table below, the *Group's* financial instruments are broken down by currency at 31 December 2017:

	EUR	USD	Other currencies	Total
	EUR'000	**EUR'000**	**EUR'000**	**EUR'000**
Trade and other receivables, except 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**
Borrowings from credit institutions	208,767	2,874	-	211,641
Other borrowings	2,438	-	-	2,438
Trade payables, payables to contractors and other payables, except advances	34,027	92	2,821	36,940
Total financial liabilities	**245,232**	**2,966**	**2,821**	**251,019**

28. CAPITAL INVESTMENT COMMITMENTS

Over the next reporting year, the *Group* expects to make capital investments in property, plant and equipment and intangible assets, of which:

- the largest contracts entered into but not yet completed are:

Name of the counterparty Subject of the contract	Contract date	Contract performance due date	Contract amount EUR'000
SIA KleinTech Services Expansion of the Automated Cargo Wagon and Train Commercial inspection, the wagon number recording and recognition system.	02.05.2018	31.12.2019	1,150
AS Baltic marine group MTU diesel engine spare parts supply for the 2M62UM series diesel locomotives	19.12.2018	31.12.2019	584
SIA LDZ infrastruktūra Construction on the elevated platform at the Skrīveri station	18.08.2017	28.02.2019	451
SIA Katiss The reconstruction of the contact network at the Ogre and Šķirotava stations.	31.10.2017	29.06.2018	275
SIA "Belam – Rīga" Designing of optical networks for the railway station "Glūda-Reņģe- national border"	18.12.2018	18.08.2019	135

➢ major transactions approved, but not yet entered into in the reporting year:

Name of the counterparty Subject of the contract	Type of procurement procedure, date	Contract performance due date	Offer amount EUR'000
General partnership "BMGS – Viadukts" Construction of the pedestrian tunnel at the Ogre station	Open tender on 19.09.2018	20.11.2020	1,490

29. CONTINGENT TAX LIABILITIES

The tax authorities may, at any time, carry out the audit of accounting records within a period of three years from the end of the tax year and charge additional tax liabilities and fines. The *Group's Management* is not aware of any such circumstances that might lead to possible significant future obligations.

30. FUTURE LEASE PAYMENTS

In 2018, the *Group's* costs related to the concluded operating lease agreements were EUR 3,196 thousand in 2017, EUR 3,175 thousand.

At 31 December 2018, non-cancellable operating lease agreements for cars were entered into. Non-cancellable future lease payments totalled EUR 1,455 thousand (at 31.12.2017: EUR 2,081 thousand).

Early termination of other operating lease agreements may not have a considerable impact on the *Group's* financial position and the performance thereof.

31. STAFF COSTS

(EUR'000)

	2018	2017
Salary	138,131	131,553
(Employer's) mandatory national social insurance contributions	33,114	30,845

The average number of employees employed by the *Group* in 2018 was 10,400 (in 2017: 11,189).

32. RELATED PARTY TRANSACTIONS

The *Group* engages in transactions with the Ministry of Transport (100% shareholder of *Latvijas dzelzceļš*) and other commercial companies owned by the State. The largest transactions are carried out with AS "Pasažieru vilciens" (fees for the public use of the railway infrastructure for domestic passenger services, electricity distribution and sales, leasing of premises, subscribers' tickets) for EUR 54,405 thousand (in 2017: EUR 51,466 thousand) and VAS "Latvenergo" (purchasing of electricity) for EUR 8,538 thousand (in 2017: EUR 11,904 thous). The mutual transactions are related to the principal activities of the relevant parties.

33. EVENTS AFTER THE END OF THE REPORTING YEAR

In the period since the last day of the reporting year have been no such events, which would significantly affect the *Group's* financial position at 31 December 2018.

Riga, 21 March 2019

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 annual report was prepared by the Financial Directorate of *VAS Latvijas dzelzceļš:*

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