“Azerbaijan Caspian Shipping” Closed Joint Stock Company

Consolidated financial statements

For the year ended 31 December 2018
with independent auditor’s report

Contents

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Independent auditor's report

To Management of "Azerbaijan Caspian Shipping" CJSC

Opinion

We have audited the consolidated financial statements of Azerbaijan Caspian Shipping CJSC and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2018 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (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 are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

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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 ISA 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.

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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.

Ernst & Young Holdings (CIS) B.V.

30 March 2019

Baku, Azerbaijan

A member firm of Ernst & Young Global Limited

Consolidated statement of financial position

As at 31 December 2018

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

	Notes	31 December 2018	31 December 2017
Assets			
Non-current assets			
Vessels, property, plant and equipment	13	766,508	669,846
Intangible assets		4,087	2,438
Long-term prepayments	9	120,295	94,050
Deferred tax assets	20	–	1,106
Total non-current assets		**890,890**	**767,440**
Current assets			
Inventories	10	82,614	74,949
Trade and other receivables	7	178,800	155,923
Taxes receivable	8	22,035	15,299
Short-term prepayments	9	11,406	9,443
Cash and cash equivalents	6	9,995	7,032
Restricted cash	6	302	65
Total current assets		**305,152**	**262,711**
Total assets		**1,196,042**	**1,030,151**
Equity			
Share capital	15	440,051	440,051
Additional paid-in capital	15	36,000	16,000
Retained earnings		514,937	467,489
Total equity		**990,988**	**923,540**
Liabilities			
Non-current liabilities			
Long-term loans	12	50,781	25,408
Non-current provisions	14	4,555	2,609
Deferred tax liabilities	20	14,148	3,984
Total non-current liabilities		**69,484**	**32,001**
Current liabilities			
Short-term loans	12	9,000	–
Current portion of long-term loans	12	16,322	4,864
Contract liabilities		17,035	–
Trade and other payables	11	79,117	60,494
Current provisions	14	9,630	7,968
Taxes payable	19	4,466	1,284
Total current liabilities		**135,570**	**74,610**
Total liabilities		**205,054**	**106,611**
Total equity and liabilities		**1,196,042**	**1,030,151**

Signed and authorized for release on behalf of the Group on 30 March 2019.

Mr. Rauf Valiyev
Chairman

Mr. Jalal Farajli
Deputy Chairman on Economic Issues

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2018

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

	Notes	2018	2017
Revenue	16	452,171	474,305
Cost of sales	17	(294,242)	(265,101)
Gross profit		**157,929**	**209,204**
General and administrative expenses	17	(52,461)	(52,120)
Social expenses	17	(12,132)	(5,103)
Other operating income	21	33,253	44,390
Other operating expenses	17	(48,114)	(52,105)
Loss on disposal of vessels, property, plant and equipment	13	(200)	(837)
Foreign exchange loss		(692)	(3,888)
Operating profit		**77,583**	**139,541**
Finance costs	22	(1,914)	(1,410)
Profit before income tax		**75,669**	**138,131**
Income tax expense	20	(23,207)	(38,000)
Profit for the year		**52,462**	**100,131**
Other comprehensive income for the year		–	–
Total comprehensive income for the year		**52,462**	**100,131**

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2018

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

	Share capital	Additional paid-in capital	Retained earnings	Total
Balance at 1 January 2017	**440,051**	**–**	**367,358**	**807,409**
Total comprehensive income for the year	–	–	100,131	**100,131**
Increase in additional paid-in capital (Note 15)	–	16,000	–	**16,000**
Balance at 31 December 2017	**440,051**	**16,000**	**467,489**	**923,540**
Impact of adopting IFRS 9 (Note 4)	–	–	(5,014)	**(5,014)**
Balance at 1 January 2018	**440,051**	**16,000**	**462,475**	**918,526**
Total comprehensive income for the year	–	–	52,462	**52,462**
Increase in additional paid-in capital (Note 15)	–	20,000	–	**20,000**
Balance at 31 December 2018	**440,051**	**36,000**	**514,937**	**990,988**

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2018

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

	Notes	2018	2017
Cash flows from operating activities			
Profit before income tax		75,669	138,131
Adjustments for:			
Depreciation of vessels, property, plant and equipment	13, 17	60,733	74,217
Amortisation of intangible assets	17	442	275
Impairment of trade and other receivables	17	1,099	5,185
Net foreign exchange differences		(995)	(1,082)
Loss on disposal of vessels, property, plant and equipment	13	200	837
Finance costs	22	1,914	1,410
Gain on release of provision and recovery of receivables written-off	21	(925)	(9,675)
Operating cash flows before working capital changes		**138,137**	**209,298**
Increase in trade and other receivables	7	(29,319)	(16,055)
Increase in inventories	10	(7,665)	(10,979)
Increase in prepayments	9	(1,963)	(3,322)
(Increase)/decrease in taxes receivable	8	(6,736)	7
Increase in restricted cash	6	(237)	(37)
Increase/(decrease) in trade and other payables	11	13,130	(178)
Increase in contract liabilities		17,035	–
Increase/(decrease) in provision	14	3,608	(365)
Increase in taxes payable	19	2,338	601
Cash generated from operations		**128,328**	**178,970**
Income taxes paid	18, 20	(9,839)	(21,564)
Interest paid		(1,914)	(1,410)
Net cash flows from operating activities		**116,575**	**155,996**
Cash flows from investing activities			
Purchase of vessels, property, plant and equipment	13	(178,346)	(165,097)
Purchase of intangible assets		(2,091)	(919)
Net cash flows used in investing activities		**(180,437)**	**(166,016)**
Cash flows from financing activities			
Proceeds from long-term loans	12	41,065	–
Proceeds from short-term loans	12	12,000	7,600
Repayment of long-term loans	12	(4,235)	(4,235)
Repayment of short-term loans	12	(3,000)	(7,600)
Increase in additional paid-in capital	15	20,000	16,000
Net cash flows from financing activities		**65,830**	**11,765**
Net increase in cash and cash equivalents		**1,968**	**1,745**
Net foreign exchange difference		995	1,082
Cash and cash equivalents at the beginning of the year	6	7,032	4,205
Cash and cash equivalents at the end of the year		**9,995**	**7,032**

The accompanying notes form an integral part of these consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

1. The Group and its operations

"Azerbaijan Caspian Shipping" Closed Joint Stock Company (the "Company") was established by merging the Azerbaijan State Caspian Sea Shipping Company ("ASCSC") and the Caspian Sea Oil Fleet ("CSOF") of the State Oil Company of Azerbaijan Republic ("SOCAR"), in accordance with the Decree No. 6 of the President of Azerbaijan Republic, dated 22 October 2013 on *Establishment of "Azerbaijan Caspian Shipping" Closed Joint-Stock Company* and Decree No. 213, dated 10 January 2014, on *Organization of Activity of "Azerbaijan Caspian Shipping" Closed Joint-Stock Company*. Two companies were merged in order to continue fundamental structural reforms in the economy, increase domestic and international transportation in maritime industry, enhance competitiveness and transit potential of Azerbaijan and get synergies from centralized management of the state owned shipping companies.

The Company and its subsidiaries are together referred to as "the Group" in these consolidated financial statements. The Group comprises the offshore support and merchant fleets, two shipyards, production support and social development business entities and entities providing logistics services, maritime education, implementation of repair, construction, installation and design works with near to 8,600 of full-time employees.

The ultimate controlling party of the Group as at 31 December 2018 and 2017 is the Government of the Republic of Azerbaijan (the "Government").

The registered address of the Group is M.A. Rasulzade str., 5, Baku, Azerbaijan.

2. Basis of preparation and significant accounting policies

Basis of preparation

The consolidated financial statements of the Company and its subsidiaries (collectively referred as the "Group") have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented. All amounts in these consolidated financial statements are presented in thousands Azerbaijani Manat ("AZN"), unless otherwise stated.

The consolidated financial statements have been prepared on a historical cost basis, except for investment properties, certain office properties (classified as property, plant and equipment), derivative financial instruments, available-for-sale financial assets, contingent consideration and non-cash distribution liability that have been measured at fair value. The consolidated financial statements provide comparative information in respect of the previous period.

Basis for consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December 2018.

Subsidiaries are all entities over which the Group has control, being the power to govern the financial and operating policies so as to obtain benefits from its activities, generally accompanying a shareholding of more than one half of the voting rights. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee;
- The ability to use its power over the investee to affect its returns.

The Group re-assesses whether or not it controls investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Basis for consolidation (continued)

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group’s accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

Current versus non-current classification

The Group presents assets and liabilities in the consolidated statement of financial position based on current/ non-current classification. An asset as current when it is:

- Expected to be realised or intended to sold or consumed in normal operating cycle;
- Held primarily for the purpose of trading;
- Expected to be realised within twelve months after the reporting period; or
- Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets are classified as non-current.

A liability is current when:

- It is expected to be settled in normal operating cycle;
- It is held primarily for the purpose of trading;
- It is due to be settled within twelve months after the reporting period; or
- There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

The Group classifies all other liabilities as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree’s identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer’s previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Business combinations with entities under common control

The Group applies acquisition method of accounting for business combinations with entities under the common control.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Foreign currency translation

The functional currency of the Company and its subsidiaries is Azerbaijan Manat as the majority of the Group's revenues, costs, inventory purchased, and trade liabilities are either priced, incurred, payable or otherwise measured in Azerbaijani Manat.

The operations in the Group entities of which currency differ from the functional currency of the Group and not already measured in the Group's functional currency are translated by following the below steps:

- Monetary assets and liabilities not already measured in the functional currency of respective Group entity are translated into the functional currency at the closing rate at the date of that statement of financial position;
- Income and expenses for each statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions).

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's entities are recognized in the consolidated statement of profit or loss or other comprehensive income.

At 31 December 2018 the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7000, EUR 1 = AZN 1.9468, RUB 1 = AZN 0.0245, TRY 1 = AZN 0.3212 (31 December 2017: USD 1 = AZN 1.7001, EUR 1 = AZN 2.0307, RUB 1 = AZN 0.0295, TRY 1 = AZN 0.4499).

Financial instruments − key measurement terms

Depending on their classification financial instruments are carried at fair value, or amortized cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 − quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 − valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 − valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial instruments − key measurement terms (continued)

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses ("ECL"). Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the consolidated statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the gross carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate. For assets that are purchased or originated credit impaired ("POCI") at initial recognition, the effective interest rate is adjusted for credit risk, i.e. it is calculated based on the expected cash flows on initial recognition instead of contractual payments.

Financial assets

Initial recognition and measurement

Financial assets are classified, at initial recognition, as subsequently measured at amortised cost, fair value through other comprehensive income (OCI), and fair value through profit or loss.

The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Group's business model for managing them. With the exception of trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient, the Group initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs. Trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient are measured at the transaction price determined under IFRS 15.

In order for a financial asset to be classified and measured at amortised cost or fair value through OCI, it needs to give rise to cash flows that are 'solely payments of principal and interest (SPPI)' on the principal amount outstanding. This assessment is referred to as the SPPI test and is performed at an instrument level.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

The Group's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

Subsequent measurement

For purposes of subsequent measurement, financial assets are classified in four categories:

- Financial assets at amortised cost (debt instruments);
- Financial assets at fair value through OCI with recycling of cumulative gains and losses (debt instruments);
- Financial assets designated at fair value through OCI with no recycling of cumulative gains and losses upon derecognition (equity instruments);
- Financial assets at fair value through profit or loss.

Financial assets at amortised cost (debt instruments)

This category is the most relevant to the Group. The Group measures financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at amortised cost are subsequently measured using the effective interest (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

The Group's financial assets at amortised cost includes trade receivables.

The Group measures debt instruments at fair value through OCI if both of the following conditions are met:

- The financial asset is held within a business model with the objective of both holding to collect contractual cash flows and selling; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For debt instruments at fair value through OCI, interest income, foreign exchange revaluation and impairment losses or reversals are recognised in the statement of profit or loss and computed in the same manner as for financial assets measured at amortised cost. The remaining fair value changes are recognised in OCI. Upon derecognition, the cumulative fair value change recognised in OCI is recycled to profit or loss.

The Group has no debt instruments at fair value through OCI.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

Financial assets designated at fair value through OCI (equity instruments)

Upon initial recognition, the Group can elect to classify irrevocably its equity investments as equity instruments designated at fair value through OCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. The classification is determined on an instrument-by-instrument basis.

Gains and losses on these financial assets are never recycled to profit or loss. Dividends are recognised as other income in the statement of profit or loss when the right of payment has been established, except when the Group benefits from such proceeds as a recovery of part of the cost of the financial asset, in which case, such gains are recorded in OCI. Equity instruments designated at fair value through OCI are not subject to impairment assessment.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets mandatorily required to be measured at fair value. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets with cash flows that are not solely payments of principal and interest are classified and measured at fair value through profit or loss, irrespective of the business model. Notwithstanding the criteria for debt instruments to be classified at amortised cost or at fair value through OCI, as described above, debt instruments may be designated at fair value through profit or loss on initial recognition if doing so eliminates, or significantly reduces, an accounting mismatch.

Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value recognised in the statement of profit or loss.

A derivative embedded in a hybrid contract, with a financial liability or non-financial host, is separated from the host and accounted for as a separate derivative if: the economic characteristics and risks are not closely related to the host; a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and the hybrid contract is not measured at fair value through profit or loss. Embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss. Reassessment only occurs if there is either a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required or a reclassification of a financial asset out of the fair value through profit or loss category.

A derivative embedded within a hybrid contract containing a financial asset host is not accounted for separately. The financial asset host together with the embedded derivative is required to be classified in its entirety as a financial asset at fair value through profit or loss.

Derecognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Group's consolidated statement of financial position) when:

- The rights to receive cash flows from the asset have expired; or
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of its continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Impairment of financial assets

The Group recognises an allowance for expected credit losses (ECLs) for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Group expects to receive, discounted at an approximation of the original effective interest rate.

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

For trade receivables and contract assets, the Group applies a simplified approach in calculating ECLs.

Therefore, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

For debt instruments at fair value through OCI, the Group applies the low credit risk simplification. At every reporting date, the Group evaluates whether the debt instrument is considered to have low credit risk using all reasonable and supportable information that is available without undue cost or effort. In making that evaluation, the Group reassesses the internal credit rating of the debt instrument. In addition, the Group considers that there has been a significant increase in credit risk when contractual payments are more than 30 days past due.

The Group considers a financial asset to be in default when internal or external information indicates that the Group is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the Group. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs. The Group's financial liabilities include trade and other payables, short-term and long-term loans.

Subsequent measurement

The measurement of financial liabilities depends on their classification, as described below:

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. This category also includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships as defined by IFRS 9. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

Gains or losses on liabilities held for trading are recognised in the statement of profit or loss.

Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IFRS 9 are satisfied. The Group has not designated any financial liability as at fair value through profit or loss.

Loans and borrowings

This is the category most relevant to the Group. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the statement of profit or loss. This category generally applies to interest-bearing loans and borrowings.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the statement of profit or loss.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A receivable represents the Group's right to an amount of consideration that is unconditional.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

Restricted cash

Restricted cash is presented separately from cash and cash equivalents. Restricted balances represent amount available on VAT deposit account and are excluded from cash and cash equivalents for the purposes of consolidated cash flow statement.

Trade payables

Trade payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognised initially at fair and subsequently measured at amortised cost using the effective interest rate method.

Loans

All loans are initially recognised at fair value of the proceeds received net of issue costs associated with the loan. Loans are carried at amortised cost using the effective interest rate method.

Interest costs on loans to finance the construction of vessels, property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Vessels, property, plant and equipment

Construction in progress, plant and equipment are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Such cost includes the cost of replacing part of the plant and equipment and borrowing costs for long-term construction projects if the recognition criteria are met. When significant parts of plant and equipment are required to be replaced at intervals, the Group depreciates them separately based on their specific useful lives. Likewise, when a major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognised in profit or loss as incurred.

Significant renovation and overhaul expenses over vessels arising at a later date are included in each asset's book value. They can be recognised as a separate asset only if it is likely that the future economic benefits associated with the item will be beneficial to the Group and if the acquisition cost of the asset can be reliably determined. Ordinary repair and maintenance expenses are recognised as expenses for the reporting period during which they were incurred.

Vessels are depreciated over their estimated useful lives. The estimated useful lives and the residual values of assets are revised at each end of the reporting period and, when necessary, adjusted to reflect changes that have taken place in the expected future economic benefits.

A revaluation surplus is recorded in other comprehensive income and credited to the asset revaluation surplus in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit or loss. A revaluation deficit is recognised in the statement of profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Vessels, property, plant and equipment (continued)

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation

Vessels, property, plant and equipment related to shipping industry are depreciated using a straight line depreciation method. Land is not depreciated. Assets under construction are not depreciated.

The estimated useful lives of the Group's vessels, property, plant and equipment are as follows:

Buildings and constructions	15 to 30 years
Machinery and equipment	3 to 25 years
Vessels and port facilities	3 to 30 years

The expected useful lives of vessels, property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life unless scrap value is significant. The assets' residual values are reviewed, and adjusted if appropriate, at each reporting date.

Leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

Group as a lessee

A lease is classified at the inception date as a finance lease or an operating lease. A lease that transfers substantially all the risks and rewards incidental to ownership to the Group is classified as a finance lease.

Finance leases are capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in finance costs in the statement of profit or loss.

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Operating lease payments are recognised as an operating expense in the statement of profit or loss on a straight-line basis over the lease term.

Group as a lessor

Leases in which the Group does not transfer substantially all the risks and rewards of ownership of an asset are classified as operating leases. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Internally generated intangibles, excluding capitalised development costs, are not capitalised and the related expenditure is reflected in profit or loss in the period in which the expenditure is incurred. Intangible assets include rights and computer software, patents, licences, customer relationships, trade name, water rights and development projects.

The useful lives of intangible assets are assessed as either finite or indefinite. Intangible assets with finite lives are amortised on a straight-line basis over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of profit or loss and other comprehensive income in the expense category consistent with the function of the intangible assets.

Intangible assets with indefinite useful lives are not amortised, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss when the asset is derecognised.

Inventories

Inventories are stated at the lower of cost and net realizable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs to sell.

Cost is assigned by the weighted average method. Cost comprises direct purchase costs of materials for vessels repair and maintenance and cost of production (based on normal operating capacity).

Distribution to the Government

Distribution to the Government represent cash distributions or financing which the Group may be required to make to the state budget, various government agencies and projects administered by the Government based on the particular decisions of the Government. Such distributions are recorded as a reduction of equity. Distributions in the form of transfers of non-monetary assets are recognised at the carrying value of transferred assets.

Contributions by the Government

Contributions by the Government are made in the form of cash contributions, transfer of other state-owned entities or transfer of all or part of the Government's share in other entities. Transfer of the state-owned entities to the Group is recognized as contribution through equity statement in the amount being the fair value of the transferred entity (in case of transfer by the Government of its share in other entities − the transferred share in the fair value of the respective entity).

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Value-added tax

The tax authorities permit the settlement of sales and purchases value-added tax ("VAT") on a net basis.

VAT payable

VAT payable represents VAT related to sales net of VAT on purchases which have been settled at the reporting date. VAT related to sales is payable to tax authorities either upon receipt of payment, if payment is received prior to or within 30 days from the date of sale, or at recognition of sales to customers, if payment is received after 30 days from the date of sale. VAT related to sales which have not been settled at the statement of financial position date is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT where applicable. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

VAT recoverable

VAT recoverable relates to purchases which have not been settled at the reporting date. VAT recoverable is reclaimable against VAT on sales upon payment for the purchases.

Revenue recognition

The Group's revenue is mainly generated through sales of offshore services (mainly, time-charters) and transportation of cargo and passengers (mainly, voyage charters). Revenue is recognised when control of the services or goods are transferred to the customer at an amount that reflects the consideration to which the Group expects to be entitled in exchange for those services or goods. The Group has generally concluded that it is the principal in its revenue arrangements, because it typically controls the goods or services before transferring them to the customer.

Revenue from voyage charters

Revenues from voyage charters are earned for the carriage of cargo on behalf of the charterer, in the spot market and on contracts of affreightment, from one or more locations of cargo loading to one or more locations of cargo discharge in return for payment of an agreed upon freight rate per ton of cargo. Freight contracts contain conditions regarding the amount of time available for loading and discharging of the vessel. If these conditions are breached the Group is compensated for the additional time incurred in the form of demurrage revenue. Demurrage is a variable consideration which is recognised, from the time it becomes probable, over the remaining time of the voyage. In applying its revenue recognition method, management believes that satisfaction of a performance obligation for a voyage charter begins when the vessel arrives at the loading port and ends at the time the discharge of cargo is completed at the discharge port (load to discharge, which is when the contract with the customer expires).The Group uses the output method for measuring the progress towards satisfaction of a performance obligation, i.e. voyage revenue is recognised pro-rata based on time elapsed from loading to the expected date of completion of the discharge.

Revenue from time charters

Revenues from time charters are earned for use of the services of the vessel and the crew by the charterer for an agreed period of time. The time-charter contracts continues to be accounted for as a service contract. The performance obligation is satisfied over time, given that the charterers simultaneously receive and consume the benefits provided by the Group.

Other revenues

Other revenues from non-core operating activities usually contain one distinct performance obligation, which is satisfied over time as the customer simultaneously receives and consumes the benefit from the Group's performance, using the output method. Whereas, there are also other revenues from contracts related to sales of goods and services of the Group not directly related to core business, which are satisfied at the point of time.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

2. Basis of preparation and significant accounting policies (continued)

Contract assets

A contract asset is the right to consideration in exchange for goods or services transferred to the customer. If the Group performs, by transferring goods or services to a customer, before the customer pays consideration or before payment is due, a contract asset is recognised for the earned consideration that is conditional.

Contract liabilities

A contract liability is the obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer. If a customer pays consideration before the Group transfers goods or services to the customer, a contract liability is recognised when the payment is made or the payment is due (whichever is earlier). Contract liabilities are recognised as revenue when the Group performs under the contract.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the respective asset. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Related parties

Related parties are disclosed in accordance with IAS 24 *Related Party Disclosures*.

Governmental economic and social policies affect the Group's financial position, results of operations and cash flows.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arms-length basis.

Corporate income taxes

Corporate income taxes have been provided for in the consolidated financial statements in accordance with the applicable legislation enacted or substantively enacted by the reporting date. The income tax charge comprises current tax and deferred tax and is recognised on the profit or loss unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than income, are recorded within operating expenses.

Employee benefits

Wages, salaries, contributions to the Social Protection Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (e.g. health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group.

Expenses

Expenses are presented by function in consolidated statement of comprehensive income. Categorization of the nature of expenses is based on operational functions of the Group's entities and subsidiaries.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

3. Critical accounting estimates and judgements

In the application of the Group’s accounting policies, which are described in Note 2, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Provision for expected credit losses of trade receivables and contract assets

The Group uses a provision matrix to calculate ECLs for trade receivables and contract assets. The provision rates are based on days past due for groupings of various customer segments that have similar loss patterns (i.e., by geography, product type, customer type and rating, and coverage by letters of credit and other forms of credit insurance).

The provision matrix is initially based on the Group’s historical observed default rates. The Group will calibrate the matrix to adjust the historical credit loss experience with forward-looking information. For instance, if forecast economic conditions (i.e., gross domestic product) are expected to deteriorate over the next year which can lead to an increased number of defaults in the sector, the historical default rates are adjusted. At every reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analysed.

The assessment of the correlation between historical observed default rates, forecast economic conditions and ECLs is a significant estimate. The amount of ECLs is sensitive to changes in circumstances and of forecast economic conditions. The Group’s historical credit loss experience and forecast of economic conditions may also not be representative of customer’s actual default in the future. The information about the ECLs on the Group’s trade receivables and contract assets is disclosed in Note 23.

Deferred tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for: all deductible temporary differences: the carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences. The carry forward of unused tax credits and unused tax losses can be utilised, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

3. Critical accounting estimates and judgements (continued)

Deferred tax (continued)

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is presented in the consolidated statement of profit or loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Impairment of non-financial assets

Management assesses whether there are any indicators of possible impairment of all non-financial assets at each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Such indicators include changes in the Group's business plans, changes in commodity prices leading to unprofitable performances, changes in product mixes. Goodwill and other indefinite life intangibles are tested for impairment annually and at other times when impairment indicators exist. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

The recoverable amount is the higher of the asset's fair value less costs to sell and value-in-use. Given the nature of the Group's activities, information on the fair value of an asset is usually difficult to obtain unless negotiations with potential purchasers are taking place. Consequently, unless indicated otherwise, the recoverable amount used in assessing the impairment charges described below is value-in-use. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

If the estimated weighted average cost of capital used in the calculation had been 1 per cent higher than management's estimate, no impairment loss on vessels, property, plant and equipment would be recognized.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

3. Critical accounting estimates and judgements (continued)

Useful lives of vessels, property, plant and equipment and intangible assets

Management determines the estimated useful lives and related depreciation and amortization charges for its vessels, property, plant and equipment and intangible assets. This estimate is based on projected period over which the Group expects to consume economic benefits from the asset. Management will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete assets that have been abandoned or sold. The useful lives are reviewed at least at each reporting date. Changes in any of the above conditions or estimates may result in adjustments to future depreciation rates.

Provision for unused vacation

The Group has a policy to settle total amount of payable to individual employee accrued for several years for unused vacations only when the vacation option is utilized by the employee and no reliable basis for estimation of timing of payment is available.

4. Changes in accounting policies

New and amended standards and interpretations

The accounting policies adopted in the preparation of these consolidated financial statements are consistent with those followed in the preparation of the consolidated financial statements as at and for the year ended 31 December 2017, except for the adoption of new standards effective as at 1 January 2018. The Group has not early adopted any standards, interpretations or amendments that have been issued, but are not yet effective.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 supersedes IAS 11 *Construction Contracts*, IAS 18 *Revenue* and related interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. IFRS 15 establishes a five step model to account for revenue arising from contracts with customers and requires that revenue be recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

IFRS 15 requires entities to exercise judgement, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

The Group adopted IFRS 15 using the modified retrospective method of adoption and therefore the comparative information has not been restated and continues to be reported under IAS 18. The Group assessed that there are no material differences arising from the adoption of IFRS 15, which require correction to the retained earnings as at 1 January 2018. The adoption of IFRS 15 also had no a material impact on the Group's operating, investing and financing cash flows.

Set out below, are the amounts by which each consolidated financial statement line item is affected as at and for the year ended 31 December 2018 as a result of the adoption of IFRS 15. The first column shows amounts prepared under IFRS 15 and the second column shows what the amounts would have been had IFRS 15 not been adopted.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

4. Changes in accounting policies (continued)

New and amended standards and interpretations (continued)

Consolidated statement of financial position as at 31 December 2018:

	Reference	Amounts prepared under IFRS 15	Amounts prepared under Previous IFRS	Increase/ (decrease)
Total assets		**1,196,042**	**1,196,042**	**–**
Total equity		**990,988**	**990,988**	**–**
Trade and other payables	(a)	79,117	96,152	(17,035)
Contract liabilities	(a)	17,035	–	17,035
Remaining current liabilities		39,418	39,418	–
Total current liabilities		**135,570**	**135,570**	**–**
Total liabilities		**205,054**	**205,054**	**–**
Total equity and liabilities		**1,196,042**	**1,196,042**	**–**

(a) The Group receives advances from its customers for provision of services. Respective amounts received in advance should be treated separately, as contract liabilities under IFRS 15.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The Company has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed below.

	Retained earnings
Closing balance of retained earnings under previous IFRS (31 December 2017)	**467,489**
Effect of recognition of expected credit loss provision under IFRS9 on retained earnings	(6,267)
Deferred tax effect of above adjustment on retained earnings	1,253
Restated opening balance under IFRS 9 (1 January 2018)	**462,475**

The effect of adopting IFRS 9 at initial application date of 01 January 2018 is, as follows:

	IAS 39 measurement 31 December 2017	Transition adjustment (ECL)	IFRS 9 measurement 1 January 2018
Trade and other receivables	155,923	(6,267)	149,656
Total	**155,923**	**(6,267)**	**149,656**

As indicated in above table, the adoption of IFRS 9 has fundamentally changed the Group's accounting for impairment losses for financial assets by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Group to recognize an allowance for ECLs for all financial assets held at amortized costs (including contract assets). Upon adoption of IFRS 9 the Group recognised additional impairment on the Group's trade and other receivables of AZN 6,267, which resulted in a respective decrease in Retained earnings as at 1 January 2018.

There are no changes in classification and measurement for the Group's financial liabilities.

Several other amendments and interpretations apply for the first time in 2018, but do not have an impact on the financial statements of the Group. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

5. New standards and amendments issued, but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group’s consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases − Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of ’low-value’ assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today’s accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Group plans to adopt IFRS 16 from effective date applying the modified retrospective transition method and will elect to apply the practical expedient that permits the entity not to reassess whether a contract is, or contains, a lease at the date of initial application. In addition, the Group will elect to use the exemptions applicable to the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. The Group has certain leases that are considered of low value.

The Group is in the process of making a preliminary impact assessment of IFRS 16. The Group expects that upon adoption of IFRS 16, its operating profit will improve, while its interest expense will increase. This is due to the change in the accounting for expenses of leases that were classified as operating leases under IAS 17.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates;
- How an entity considers changes in facts and circumstances.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

5. New standards and amendments issued, but not yet effective (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment (continued)

An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Group intends to adopt the interpretation on the effective date, and does not expect the impact of adoption of the interpretation to be material.

Amendments to IFRS 9 Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the consolidated financial statements of the Group.

Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

Annual improvements 2015-2017 cycle (issued in December 2017)

These improvements include:

IFRS 3 Business Combinations

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. These amendments will apply on future business combinations of the Group.

IFRS 11 Joint Arrangements

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.

An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. These amendments are currently not applicable to the Group but may apply to future transactions.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

5. New standards and amendments issued, but not yet effective (continued)

Annual improvements 2015-2017 cycle (issued in December 2017) (continued)

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.

An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. Since the Group's current practice is in line with these amendments, the Group does not expect any effect on its consolidated financial statements.

IAS 23 Borrowing Costs

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application permitted. Since the Group's current practice is in line with these amendments, the Group does not expect any effect on its consolidated financial statements.

6. Cash and cash equivalents and restricted cash

Cash and cash equivalents and restricted cash comprised the following as at:

	31 December 2018	**31 December 2017**
AZN denominated bank balances	3,759	4,374
USD denominated bank balances	5,728	2,401
EUR denominated bank balances	497	243
TRY denominated bank balances	3	14
Cash on hand	8	–
VAT deposit account, AZN	302	65
Total cash and cash equivalents and restricted cash	**10,297**	**7,097**

Effective 1 January 2008 the state tax authorities introduced VAT deposit accounts and enforced payments of input and output VAT via these accounts. In order to comply with new tax regulation, the Group has opened a VAT deposit account. In accordance with this regulation, the balance on VAT deposit account may only be withdrawn with a 45 days notice to the tax authorities.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

7. Trade and other receivables

Trade and other receivables comprised the following as at:

	31 December 2018	31 December 2017
Trade and other receivables	189,777	159,534
Less: impairment loss provision	(10,977)	(3,611)
Total trade and other receivables	**178,800**	**155,923**

Movements on the provision for impairment of trade receivables were as follows:

At 31 December 2017	**(3,611)**
Impact of adopting IFRS 9	(6,267)
Adjusted at 1 January 2018	**(9,878)**
Charge for the year	(1,099)
At 31 December 2018	**(10,977)**

8. Taxes receivable

Taxes receivable is recoverable by means of an offset against future tax liabilities or as a direct cash refund from the tax authorities.

Taxes receivable comprised the followings as at:

	31 December 2018	31 December 2017
Receivable from state budget	16,732	8,210
VAT recoverable	5,303	7,089
Total taxes receivable	**22,035**	**15,299**

Receivable from state budget is related to prepayments made for taxes throughout the year. VAT recoverable amount related to purchases which have not been settled at the end of the year, and thus not claimed in tax declarations and prepayment on construction works which can be claimed only after the vendor performs the associated services.

9. Prepayments

Prepayments comprised the following as at:

	31 December 2018	31 December 2017
Short-term prepayments for trade and services	11,406	9,443
Long-term prepayments for purchase of vessels	120,295	94,050
Total prepayments	**131,701**	**103,493**

Prepayments as at 31 December 2018 and 31 December 2017 are primarily represented by prepayments made to suppliers for construction of vessels, raw materials, spare parts and equipment and repair and maintenance services for vessels.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

10. Inventories

Inventories comprised the followings as at:

	31 December 2018	31 December 2017
Raw materials and spare parts	75,012	70,313
Fuel	4,937	4,420
Other	2,665	216
Total inventories	**82,614**	**74,949**

11. Trade and other payables

Trade and other payables as at 31 December 2018 and 31 December 2017 represent amounts due to suppliers for raw materials, spare parts and equipment and repair and maintenance services for vessels.

	31 December 2018	31 December 2017
Trade payables	70,444	49,687
Total financial payables	**70,444**	**49,687**
Advances received from customers	–	1,858
Payable to employees	8,673	8,949
Total trade and other payables	**79,117**	**60,494**

Financial payables in amount of AZN 50,123 (31 December 2017: AZN 36,167) are denominated in foreign currencies, mainly in USD and EUR.

12. Loans

At 31 December 2018 and 31 December 2017, short-term loans of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Balance as at 31 December 2018	Balance as at 31 December 2017
Short-term facilities in AZN	10%/12%	March 2019 / June 2019	9,000	–
Current portion of long-term borrowings			16,322	4,864
Total short-term loans and current portion of long-term loans			**25,322**	**4,864**

As at 31 December 2018 and 31 December 2017, long-term loans of the Group were represented by the following facilities:

			Balance as at 31 December 2018		Balance as at 31 December 2017	
Facilities	**Interest rate**	**Maturity date**	**Non-current portion**	**Current portion**	**Non-current portion**	**Current portion**
Azerbaijani Manat 42 million	3.65%	August 2024	21,174	4,864	25,408	4,864
USD 2 million	4.9%	October 2020	2,125	425	–	–
USD 10 million	4.9%	December 2020	16,449	–	–	–
USD 13 million	4.9%	June 2020	11,033	11,033	–	–
Total long-term loans			**50,781**	**16,322**	**25,408**	**4,864**

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

13. Vessels, property, plant and equipment

Movements in the carrying amount of vessels, property, plant and equipment ("PPE") were as follows:

	Buildings and constructions	Machinery and equipment	Vessels and port facilities	Vehicles, furniture and other	Construction in progress	Total
Cost						
At 1 January 2017	**97,129**	**21,295**	**1,069,948**	**21,216**	**34,055**	**1,243,643**
Additions	186	3,064	54,797	1,919	95,771	**155,737**
Disposals	(69)	(151)	(24,402)	(287)	–	**(24,909)**
Transfers	9,512	2,169	39,702	20	(51,403)	**–**
At 31 December 2017	**106,758**	**26,377**	**1,140,045**	**22,868**	**78,423**	**1,374,471**
Additions	256	4,408	15,889	2,084	134,958	**157,595**
Disposals	(138)	(456)	–	(441)	–	**(1,035)**
Transfers	1,080	–	65,634	70	(66,784)	**–**
At 31 December 2018	**107,956**	**30,329**	**1,221,568**	**24,581**	**146,597**	**1,531,031**
Depreciation						
At 1 January 2017	**(13,603)**	**(13,166)**	**(606,372)**	**(14,348)**	**(6,991)**	**(654,480)**
Depreciation charge for the year	(4,243)	(2,073)	(65,760)	(2,141)	–	**(74,217)**
Disposals	11	136	23,662	263	–	**24,072**
At 31 December 2017	**(17,835)**	**(15,103)**	**(648,470)**	**(16,226)**	**(6,991)**	**(704,625)**
Depreciation charge for the year	(4,551)	(2,530)	(51,307)	(2,345)	–	**(60,733)**
Disposals	19	456	–	360	–	**835**
At 31 December 2018	**(22,367)**	**(17,177)**	**(699,777)**	**(18,211)**	**(6,991)**	**(764,523)**
Net book value						
At 1 January 2017	**83,526**	**8,129**	**463,576**	**6,868**	**27,064**	**589,163**
At 31 December 2017	**88,923**	**11,274**	**491,575**	**6,642**	**71,432**	**669,846**
At 31 December 2018	**85,589**	**13,152**	**521,791**	**6,370**	**139,606**	**766,508**

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

14. Provisions

	Environ-mental obligations	Disability payments	Unused vacation	Total
Carrying amount at 1 January 2017	**(7,823)**	**(3,343)**	**(7,599)**	**(18,765)**
Utilization	–	925	22,050	**22,975**
Disposals	7,823	–	–	**7,823**
Charge	–	(925)	(21,685)	**(22,610)**
Carrying amount at 31 December 2017	**–**	**(3,343)**	**(7,234)**	**(10,577)**
Utilization	–	1,483	22,840	**24,323**
Disposals	–	–	–	**–**
Charge	–	(3,557)	(24,374)	**(27,931)**
Carrying amount at 31 December 2018	**–**	**(5,417)**	**(8,768)**	**(14,185)**
At 31 December 2017	**–**	**(3,343)**	**(7,234)**	**(10,577)**
Current	–	(734)	(7,234)	**(7,968)**
Non-current	–	(2,609)	–	**(2,609)**
At 31 December 2018	**–**	**(5,417)**	**(8,768)**	**(14,185)**
Current	–	(862)	(8,768)	**(9,630)**
Non-current	–	(4,555)	–	**(4,555)**

Provision for disability payments

The Group has an obligation to compensate its employees for the damage caused to their health during their employment, as well as to compensate the families of the employees died at work. The Group calculated the present value of the injury payments to employees using a discount rate of 8.93% and 8.15% as at 31 December 2018 and 31 December 2017, respectively. For the purpose of calculation of the lifetime payments to injured employees, the Group estimated a life expectancy as 73 and 78 for men and women, respectively.

15. Share capital and additional paid-in capital

Share capital

The Group includes fourteen separate legal entities each possessing their own share capital. As at 31 December 2018 the Company had authorized and issued 440,050,998 shares at par 1 Azerbaijani Manat to the Government of the Republic of Azerbaijan, which is the sole and ultimate shareholder of the Group.

Additional paid-in capital

In 2018 the Group's additional paid-in capital increased by AZN 20,000 (2017: AZN 16,000) of which full amount was contributed as cash.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

16. Analysis of revenue by categories

The Group's main services offered are freight and passenger transportation, offshore support services and logistics services. Revenue generated by business segments are:

	Note	2018	2017
Offshore support services		249,291	284,878
Freight and passenger transportation		170,779	179,597
Logistics services		23,317	1,127
Other revenue		8,784	8,703
Total revenue		**452,171**	**474,305**
Other operating income from contracts with customers	21	32,328	
Total revenue from contracts with customers		**484,499**	

17. Analysis of expenses by nature

For the year ended 31 December 2018 and 31 December 2017 cost of sales, social, general and administrative expenses and other operating expenses comprised the followings:

	2018	2017
Wages, salaries and social security costs	140,635	124,429
Depreciation of vessels, property, plant and equipment	60,733	74,217
Raw materials and consumables used	55,922	47,972
Repairs and maintenance expenses	24,977	27,305
Port charges	22,632	20,582
Logistics expenses	21,750	974
Food expenses	13,689	12,862
Daily travelling expenses of the crew of marine transports	10,483	9,491
Reimbursable expenses	8,497	10,090
Rent expenses	5,027	4,149
Taxes other than on income	4,599	9,557
Provision of social housing	4,466	–
Insurance expenses	4,101	3,566
Utilities expenses	3,999	3,823
Agency and brokerage costs	3,781	1,745
Sponsorship expenses	3,407	1,312
Vessels registration costs	3,092	2,674
Impairment of trade and other receivables	1,099	3,611
Business trip expenses	895	1,078
Amortisation of intangible assets	442	275
Written off trade receivables	285	1,574
Other	12,438	13,143
Total cost of sales, social, general, administrative and other operating expenses	**406,949**	**374,429**

In 2018 social expenses mainly consist of costs incurred on projects carried out within the framework of the Group's social and corporate responsibility, including costs for the construction of a residential building for seafarers who have been registered in the housing queue since Soviet times, and for sponsorship of a number of sports organizations as a result of increasing care for sport in the country.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

18. Balances and transactions with related parties

Key management compensation

Key management of the Group includes the Chairman of the Group and its five Deputy Chairman. All of the Group's key management are appointed by the President of the Azerbaijan Republic. Key management individuals are entitled to salaries and benefits of the Group in accordance with the approved payroll matrix. During 2018 compensation of key management personnel totalled to AZN 464 (2017: AZN 333).

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding are detailed below.

At 31 December 2018 and 31 December 2017, the outstanding balances with related parties were as follows:

	Government and entities under government control 31 December 2018	**Government and entities under government control 31 December 2017**
Trade and other receivables	181,172	141,137
Bad debt provision	(7,291)	(2,008)
Prepayments	7,466	3,657
Cash and cash equivalents and restricted cash	6,818	5,077
Long-term loans	(50,781)	(25,408)
Current portion of long-term loans	(16,322)	(4,864)
Short-term loans	(9,000)	–
Trade and other payables	(9,485)	(2,337)
Taxes payable	(4,466)	(1,284)

The transactions with related parties for the year ended 31 December 2018 and 31 December 2017 were as follows:

	Government and entities under government control 31 December 2018	**Government and entities under government control 31 December 2017**
Freight and passenger transportation services	61,632	57,119
Offshore support services	228,398	201,574
Other operating income	13,686	20,339
Property tax	(4,827)	(4,684)
Other taxes	(4,569)	(1,517)
Net VAT on free transferred fixed assets	(2)	(2,408)
Tax fines and claims	(30)	(800)
Repairs and maintenance expenses	(1,909)	(3,378)
Utilities expense	(2,761)	(2,919)
Bad debts written-off	–	(1,430)
Port expenses	(4,904)	(2,761)
Bank charges	(815)	(730)
Finance cost	(1,824)	(1,404)
Other expenses	(1,621)	(3,395)

Outstanding balances at the year-end are unsecured and settlement occurs in cash. There have been no guarantees provided for any related party receivables or payables.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

19. Taxes payable

Taxes payable comprises the following at:

	2018	2017
Current income tax payable	(844)	–
Social security contributions	(2,782)	(493)
Other	(840)	(791)
Total taxes payable	**(4,466)**	**(1,284)**

20. Income taxes

Income tax expense comprises the following:

	2018	2017
Current income tax expense	(10,683)	(21,456)
Deferred tax charge	(12,524)	(16,534)
Income tax expense for the year ended 31 December	**(23,207)**	**(38,000)**

The reconciliation between the expected and the actual taxation charge is provided below:

	2018	2017
Profit before tax	**75,669**	**138,131**
Theoretical tax charge at statutory rate of 20 per cent	**(15,134)**	**(27,626)**
Tax effect of non-deductible expenses	(5,666)	(9,014)
Unrecognised temporary differences	(1,146)	–
Other	(1,261)	(1,360)
Income tax expense for the year ended 31 December 2018	**(23,207)**	**(38,000)**

Non-deductible expenses are mainly comprised of the social and employee-related expenses as well as the depreciation expenses of non-revenue generating assets.

Differences between IFRS and applicable domestic tax regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below:

	31 December 2017	Effect of IFRS 9 adoption	Origination and reverse of temporary differences in the consolidated statement of profit or loss and other comprehensive income	31 December 2018
Tax effect of deductible/(taxable) temporary differences				
Vessels, property, plant and equipment	4	–	(4)	–
Trade and other receivables, net	775	–	(775)	–
Inventories	8	–	(8)	–
Trade payables and accrued liabilities	319	–	(319)	–
Deferred tax assets	**1,106**	**–**	**(1,106)**	**–**

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

20. Income taxes (continued)

	31 December 2017	Effect of IFRS 9 adoption	Origination and reverse of temporary differences in the consolidated statement of profit or loss and other comprehensive income	31 December 2018
Tax effect of deductible/(taxable) temporary differences				
Vessels, property, plant and equipment	(7,964)	–	(12,695)	(20,659)
Non-current and current provisions	2,115	–	803	2,918
Trade and other receivables, net	1,482	1,253	285	3,020
Inventories	338	–	(194)	144
Trade payables and accrued liabilities	45	–	384	429
Deferred tax liabilities	**(3,984)**	**1,253**	**(11,417)**	**(14,148)**

	31 December 2016	Origination and reverse of temporary differences in the consolidated statement of profit or loss and other comprehensive income	31 December 2017
Tax effect of deductible/(taxable) temporary differences			
Vessels, property, plant and equipment	10,384	(10,380)	4
Non-current and current provisions	3,753	(3,753)	–
Trade and other receivables, net	1,354	(579)	775
Inventories	441	(433)	8
Trade payables and accrued liabilities	370	(51)	319
Deferred tax assets	**16,302**	**(15,196)**	**1,106**

	31 December 2016	Origination and reverse of temporary differences in the consolidated statement of profit or loss and other comprehensive income	31 December 2017
Tax effect of deductible/(taxable) temporary differences			
Vessels, property, plant and equipment	(2,126)	(5,838)	(7,964)
Non-current and current provisions	–	2,115	2,115
Trade and other receivables, net	(108)	1,590	1,482
Inventories	–	338	338
Trade payables and accrued liabilities	(402)	447	45
Deferred tax liabilities	**(2,636)**	**(1,348)**	**(3,984)**

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

21. Other operating income

Other operating income comprised of the following:

	2018	2017
Sales of other goods and services rendered	12,215	12,317
Income from alliance agreement	10,484	11,124
Other	9,629	11,274
Other operating income from contracts with customers	**32,328**	**34,715**
Gain on release of provision and recovery of receivables written-off	925	9,675
Total other operating income	**33,253**	**44,390**

22. Finance costs

Finance costs comprised the following:

	2018	2017
Interest expense	1,914	1,410
Total finance costs	**1,914**	**1,410**

23. Risk management

Financial risk factors

The Group's management that have the appropriate skills, experience and supervision oversees the management of risks and monitors the Group's overall position on a regular basis. This process of risk management is critical to the Group and key individuals within the Group are accountable for the risk exposures relating to their responsibilities.

The Group's principal financial liabilities comprise trade payables, short-term and long-term loans. Cash and cash equivalents, term deposits, restricted cash, accrued revenues/incomes and trade and other receivables represent the Group's principal financial assets. Both principal financial liabilities and financial assets arise directly from the Group's operations.

In the ordinary course of business, the Group is exposed to credit, liquidity and market risks. Market risk arises from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial position. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position. Based on structured formal management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

Market risk

The Group takes on exposure to market risks. Market risks arise from open positions in (i) foreign currencies, (ii) interest bearing assets and liabilities, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a regular basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

23. Risk management (continued)

Market risk (continued)

(i) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to USD. Foreign exchange risk arises primarily from future commercial transactions, recognised assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The majority of the Group's payables and receivables from foreign vendors and customers are denominated in USD. There were two waves of devaluation of Azerbaijani Manat against USD (34% on 21 February 2015 and 48% on 21 December 2015) and other major foreign currencies in 2015. There has been no significant devaluation of AZN against USD and other major currencies during the year ended 31 December 2017 and 2018.

Management does not hedge the Group's foreign exchange risk.

The following table demonstrates the sensitivity to a reasonably possible change in the USD, EUR, TRY exchange rates, with all other variables held constant, of the Group's post-tax profit. There is no material impact on the Group's equity:

	Change in rates (+/-)	Effect on 2018 post-tax profit	Change in rates (+/-)	Effect on 2017 post-tax profit
USD/AZN	14.00%/-3.00%	(6,513)/1,396	13.50%/-13.50%	3,817/(3,817)
EUR/AZN	14.00%/-3.00%	(1,053)/226	11.30%/-11.30%	408/(408)
TRY/AZN	20.00%/-25.00%	(25)/31	14.00%/-20.00%	(19)/27

(ii) Interest rate risk

The Group is subject to interest rate risk on financial liabilities and assets with variable interest rates. To mitigate this risk, the Group's management performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In case where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favourable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable over the expected period until maturity.

As at 31 December 2017 and 31 December 2018 date the Group's interest bearing liabilities are not significantly affected by fluctuating interest rate.

Credit risk and concentration of credit risk

Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if counterparty defaults on its contractual obligations.

The Group's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and trade receivables.

The Group places its cash with reputable financial institutions in the Azerbaijan Republic. The Group's cash is mainly placed with the International Bank of Azerbaijan ("IBA") which is controlled by the Azerbaijani Government. The balance of cash and cash equivalents held with the IBA at 31 December 2018 was AZN 6,580 (2017: AZN 5,077). The Group continually monitors the status of the banks where its accounts are maintained.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

23. Risk management (continued)

Credit risk and concentration of credit risk (continued)

The Group's maximum exposure to credit risk is represented by carrying amounts of financial assets on the consolidated statement of financial position and is presented by class of assets as shown in the table below:

	31 December 2018	31 December 2017
Cash and cash equivalents (Note 6)	9,995	7,032
Trade and other receivables, net (Note 7)	178,800	155,923
Total maximum exposure to credit risk	**188,795**	**162,955**

Trade and other receivables in amount of AZN 31,418 (31 December 2017: AZN 58,628) are denominated in foreign currencies, mainly in USD and EUR.

Trade receivables

Customer credit risk is managed by each business unit subject to the Group's established policy, procedures and control relating to customer credit risk management. Credit quality of a customer is assessed based on an extensive credit rating scorecard and individual credit limits are defined in accordance with this assessment.

An impairment analysis is performed at each reporting date using a provision matrix to measure expected credit losses. The provision rates are based on days past due for groupings of various customer segments with similar loss patterns (i.e., by geographical region, product type, customer type and rating, and coverage by letters of credit or other forms of credit insurance). The calculation reflects the probability-weighted outcome, the time value of money and reasonable and supportable information that is available at the reporting date about past events, current conditions and forecasts of future economic conditions. The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in above table.

The expected loss allowance as at 31 December 2018 and 1 January 2018 (on adoption of IFRS 9) was determined as follows for trade receivables from customers:

31 December 2018	Less than 30 days past due	30-60 days past due	61-90 days past due	91-360 days past due	More than 360 days past due	Total
Gross carrying amount of trade receivables	36,664	40,104	26,799	85,498	712	**189,777**
Less impairment provision	(3,151)	(1,653)	(1,425)	(4,036)	(712)	**(10,977)**
Net trade receivables	**33,513**	**38,451**	**25,374**	**81,462**	**–**	**178,800**

1 January 2018	Less than 30 days past due	30-60 days past due	61-90 days past due	91-360 days past due	More than 360 days past due	Total
Gross carrying amount of trade receivables	32,443	31,372	27,868	65,490	2,361	**159,534**
Less impairment provision	(3,187)	(808)	(604)	(2,917)	(2,361)	**(9,877)**
Net trade receivables	**29,256**	**30,564**	**27,264**	**62,573**	**–**	**149,657**

The Group structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties. Such risks are subject to an annual or more frequent review. Limits on the level of credit risk by category are approved annually by management.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

23. Risk management (continued)

Trade receivables (continued)

In assessing the credit quality of financial assets the Group considers the nature of counterparty, historical information about counterparty, default rates and any other available information which can be used to assess credit quality.

Trade receivables consist mainly of receivables from offshore and transportation services rendered to top customers operating on the local market in oil and gas industry. The Group's credit risk arising from its trade receivables is further mitigated by continuous monitoring of the creditworthiness of customers.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows.

Prudent liquidity risk management includes maintaining sufficient working capital and the ability to close out market positions. Management monitors rolling forecasts of the Group's liquidity reserve on the basis of expected cash flows.

All of the Group's financial liabilities represent non-derivative financial instruments. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period from the consolidated statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months approximate their carrying values, as the impact of discounting is not significant.

The maturity analysis of financial liabilities as at 31 December 2018 and 31 December 2017 was as follows:

At 31 December 2018	Notes	Less than 3 months	3-12 months	1-5 years	More than 5 years	Total
Trade payables	11	70,444	–	–	–	**70,444**
Loans	12	3,898	25,625	48,931	2,706	**81,160**
Total undiscounted financial liabilities		**74,342**	**25,625**	**48,931**	**2,706**	**151,604**

At 31 December 2017	Notes	Less than 3 months	3-12 months	1-5 years	More than 5 years	Total
Trade payables	11	49,687	–	–	–	**49,687**
Loans	12	2,735	4,566	19,369	7,155	**33,825**
Total undiscounted financial liabilities		**52,422**	**4,566**	**19,369**	**7,155**	**83,512**

Fair value of financial instruments

The fair value of the financial assets and liabilities is included at the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

23. Risk management (continued)

Fair value of financial instruments (continued)

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements.

	31 December 2018	
	Carrying amounts	**Fair values**
Cash and cash equivalents (Note 6)	9,995	9,995
Trade receivables and other receivables (Note 7)	178,800	178,800
Total financial assets	**188,795**	**188,795**
Total financial payables (Note 11)	(70,444)	(70,444)
Short-term loans (Note 12)	(9,000)	(9,000)
Current portion of long-term loans (Note 12)	(16,322)	(16,322)
Long-term loans (Note 12)	(50,781)	(50,781)
Total financial liabilities	**(146,495)**	**(146,495)**

	31 December 2017	
	Carrying amounts	**Fair values**
Cash and cash equivalents (Note 6)	7,032	7,032
Trade receivables and other receivables (Note 7)	155,923	155,923
Total financial assets	**162,955**	**162,955**
Total financial payables (Note 11)	(49,687)	(49,687)
Current portion of long-term loans (Note 12)	(4,864)	(4,864)
Long-term loans (Note 12)	(25,408)	(25,408)
Total financial liabilities	**(79,959)**	**(79,959)**

The following methods and assumptions were used to estimate the fair values:

(i) Short-term financial assets and liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments;

(ii) Long-term fixed-rate and variable-rate receivables/loans are evaluated by the Group using Level 3 inputs based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

Capital management

The primary objective of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain shareholders and creditor confidence to support its business activities.

The Group is 100% owned by the Government and periodically receives funds in the form of the Government investments for purchase of new vessels.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

23. Risk management (continued)

Capital management (continued)

The Group considers total capital under management to be as follows:

	Notes	31 December 2018	31 December 2017
Short-term loans	12	9,000	–
Non-current portion of long-term loans	12	50,781	25,408
Current portion of long-term loans	12	16,322	4,864
Trade and other payables and accrued liabilities	11	79,117	58,636
Less: cash and cash equivalents	6	(9,995)	(7,032)
Net debt		**145,225**	**81,876**
Equity	15	990,988	923,540
Capital and net debt		**1,136,213**	**1,005,416**
Gearing ratio		13%	8%

24. Contingencies, commitments and operating risks

Operating environment

The Group's operations are mainly conducted in the Caspian Sea region. Besides this, the Group considers significant expansion in its foreign operations and as a result, 95% of dry cargo transportation during 2018 comprised of operations in Black Sea region. As an emerging market, at the present time the Republic of Azerbaijan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy.

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan economy is largely dependent upon these reforms and the effectiveness of economic, financial and monetary measures undertaken by the government as well as crude oil prices and stability of Azerbaijani Manat.

The Azerbaijan economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani Manat during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth.

In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support financial system. On 6 December 2016 President of the Republic of Azerbaijan approved *Strategic Road Maps for the National Economy and Main Economic Sectors of Azerbaijan*. The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond.

Furthermore, during 2018 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani Manat. This policy is expected to continue in 2019 with the aim of maintaining macroeconomic stability.

The Group's management is monitoring economic developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

While Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

The accompanying financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the period when they become known and estimable.

(Amounts presented are in thousands of Azerbaijani Manats unless otherwise stated)

24. Contingencies, commitments and operating risks (continued)

Legal proceedings

On the basis of its own estimates and both internal and external professional advice management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in these consolidated financial statements.

Tax legislation

Azerbaijan tax, currency and customs legislation is subject to varying interpretations, and changes, which may occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities.

The Group's management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained and potential tax liabilities of the Group will not exceed the amounts recorded in these consolidated financial statements.

Environmental matters

The enforcement of environmental regulation in the Azerbaijan Republic is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damages.

The Group is subject to numerous national and local environmental laws and regulations concerning its products, operations and other activities. These laws and regulations may require the Group to take future action to remediate the effects on the environment of the Group's operations. Such contingencies may exist for various waste disposal sites. In addition, the Group may have obligations relating to prior asset sales or closed facilities. The ultimate requirement for remediation and its cost are inherently difficult to estimate. While the amounts of future costs could be significant and could be material to the Group's results of operations in the period in which they are recognised, it is not practical to estimate the amounts involved. The Group does not expect these costs to have a material effect on the Group's financial position or liquidity.

25. Events after the reporting date

No subsequent events have occurred that would require recognition or disclosure in the consolidated financial statements.