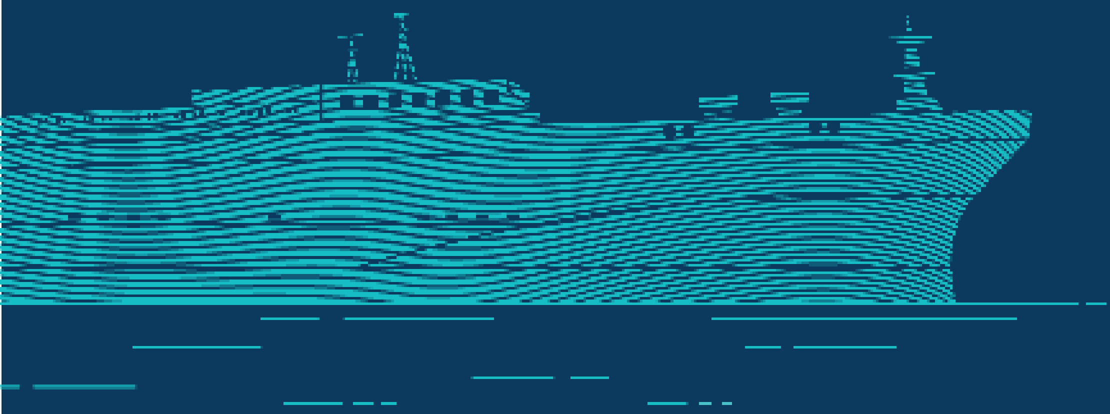

FIVE YEARS REPORT
2014-2018

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INTRODUCTION

THE NATIONWIDE LEADER AND THE PRESIDENT OF THE COUNTRY ABOUT SHIPPING

‘Our Caspian Shipping Company’s fleet is a huge wealth of Azerbaijan. They do great works and will continue in the future as well. It is pleasing that works in this field are developing in a positive direction’

Heydar Aliyev

Nationwide Leader of Azerbaijani People

It is very good that vessels of the Caspian Shipping also operate on the Black Sea. The shipping has a bright future. The reforms under way, structural reforms and steps taken in relation to the shipping operations are yielding excellent results. There will be even better results... I am sure that the Caspian Shipping Company will grow into a great and modern global company... Our shipping industry has always played a major role in the Caspian Sea. By creating a modern company today, we will strengthen our economic potential and at the same time, the Caspian Shipping Company will assert itself globally as a modern, well-managed and transparent company.

Ilham Aliyev

President of the Azerbaijan Republic

CHAIRMAN'S FOREWORD

One of the main directions of the socio-economic development strategy established by the Nationwide Leader Heydar Aliyev and successfully continued by President Ilham Aliyev is comprehensive development of the transport sector. Special attention and care has always been paid by the government to the shipping industry, which is one of the priority areas of the transport sector bearing international importance. Major reforms have been implemented in this direction and complex measures are continuously taken for the development of the shipping industry.

In order to increase international and domestic transportation, to increase the quality of the services provided, to strengthen the competitiveness and the transit potential of the country, in accordance with the Decree of the President of the Republic of Azerbaijan, dated October 22, 2013 about merging the country's two largest existing fleets - Azerbaijan State Caspian Shipping Company and Caspian Sea Oil Fleet of the State Oil Company of the Republic of Azerbaijan, Azerbaijan Caspian Shipping Closed Joint Stock Company (ASCO) was established.

Based on Mr. President's assignments on establishing a highly profitable and efficiently operating commercial organization having the potential to face modern challenges in the new economic conjuncture, shipping industry's development targets were set and Strategic Development Program was prepared to achieve these targets. The Company's operations are organized based on this approved Program, as well as, "the State Program on the Development of Shipping in the Republic of Azerbaijan for the period of 2016-2020" approved by the Decree of the President of the Republic of Azerbaijan, dated November 7, 2016.

Main objectives standing in front of the new management have been the renewal of our fleet with affordable and competitive modern vessels meeting international requirements, retention and further strengthening of the leading position of Azerbaijan shipping in the Caspian Sea, increasing service export potential of our country by vessels floating under the flag of Azerbaijan in waters beyond the Caspian Sea, focusing on main activity by handing over non-profile subdivisions which do not belong to core operations of the Company to relevant authorities, raising interest to shipping industry among younger generation and preparing young talent that can be successful followers of Azerbaijani seafarers who earned fame in international waters, implementing corporate governance system, as well as leading programs, procedures and systems that proved themselves in international practice for more effective and efficient management of vessels and shipping in general, performing operations in a safe manner and without harming the environment.

During last 5 years of our activities, ASCO has implemented a number of projects and achieved major positive results in health and occupational safety, environmental protection, human resource management, corporate governance, social and economic spheres. So that, International Financial Reporting Standards have been implemented in ASCO since 2014 and financial statements based on these standards are compiled each year. Additionally, as a continuation of ensuring transparency in the shipping field, preparation of Sustainable development reports covering a period of two years has been started in the Company since 2014. Financial statements for the years of 2014, 2015, 2016, 2017 and 2018, as well as Sustainable development reports of the Company for the years of 2014-2015 and 2016-2017 have been audited by international audit firm "EY", positive opinion was presented and the reports were openly published on the official web-site of the Company. In 2016, ASCO's business model has been analyzed by international rating agency "Fitch" and a credit rating was provided to the Company for the first time in its history. For the purpose of improvement of the corporate governance system, a roadmap was developed for ASCO by an international consulting company, and during after coming years projects outlined in the roadmap were implemented. In 2016, a performance based remuneration system (KPI system) was designed and prepared and implemented in the Company since 1 January 2017. As a result of regular international audits of ISO and ISM certifications presented to the Company, the compliance of the Company's Effective Safety Management System with the international standards was confirmed.

After the inception of ASCO, our fleet was improved with the purchase and commissioning of 20 new modern vessels. Based on ASCO's order, 6 vessels are currently being built at Baku Shipyard: 2 new generation Ro-Pax/Ferry type vessels for transporting railway wagons, trucks and passengers, and 4 tankers with loading capacity of 8,000 tons each. Besides, negotiations are conducted on placing an order in the same ship yard for the construction of additional 2-6 vessels in near future.

At the same time, according to Mr. President's recommendations and assignments on decreasing the dependence of the shipping industry on one market and diversifying the operations, in 2014 ASCO resumed its operations in international waters beyond the Caspian Sea. Currently, ASCO participates in international cargo shipping market and operates 14 vessels under the flag of Azerbaijan in Black and Mediterranean Sea basins. In 2017 ASCO founded two new companies named "Caspdry" and Casptankers" in Turkey. New companies serve for more effective exploitation of vessels floating under the flag of Azerbaijan in basins beyond the Caspian Sea. "Caspdry" realizes the operations of dry cargo vessels, and "Casptankers" of liquid cargo transporting tankers beyond the Caspian Sea. At the same time, ASCO's offices were established in Greece and Russia to expand international operations of the Company.

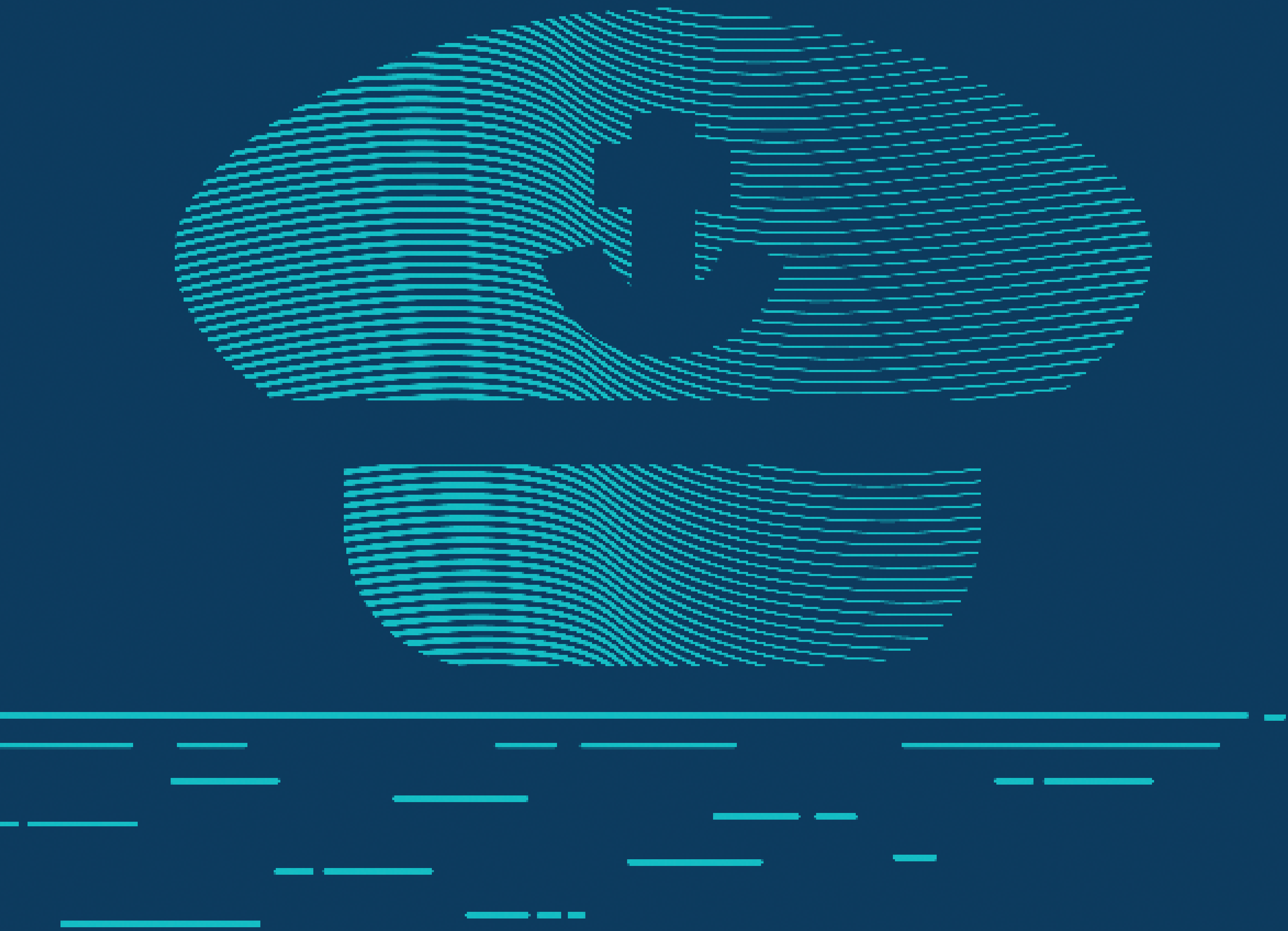
Today, as the leading shipping company of the region, ASCO's operations are focused on transformation of Azerbaijan into the regional transport logistics hub, realizing favorable geographical location of our country and its transit potential, as well as developing Trans-Caspian corridor. To this end, ASCO closely cooperates with relevant bodies participating in cargo transportation of our country, as well as other countries.

The Five Years' Report that further you will get familiar with, outlines in more details the objectives set for and achievements of ASCO since its inception, envisioned plans for the coming years, history of shipping, ASCO's structure, subsidiaries and joint ventures, international representative offices, core business areas and routes of our fleet, our mission, strategic targets and goals, business model and priorities, corporate governance system, environmental management, personnel management, health and occupational safety, social activities, financial indicators and a number of other significant data.

Finally, I would like to note that, the Azerbaijan Caspian Shipping celebrates its 160th anniversary, as well as 5 years of operating as a closed joint-stock company. The shipping industry, which has a rich history of 160 years, has passed a glorious way during this period and fostered many heroic seafarers who have earned fame in international waters and far oceans. Today ASCO works hard to continue this glorious history, to protect the values and via taking the advantage of experience over the years to continue its development as a modern shipping company.

Rauf Valiyev

The Chairman of ASCO



OUR COMPANY

OUR COMPANY

ABOUT ASCO

Azerbaijan Caspian Shipping was founded in 1858 via the establishment of “The Caucasus and Mercury” shipping company. ASCO has 160 years of rich history and today Azerbaijan shipping embodies years of experience, as well as corporate governance system built in accordance with the requirements of modern age.

Azerbaijan Caspian Shipping was re-established as a closed joint-stock company and stepped on the new phase of its development by Decree No. 6 of the President of the Republic of Azerbaijan dated October 22, 2013, On the establishment of Azerbaijan Caspian Shipping Closed Joint-Stock Company, and Decree No. 213 dated January 10, 2014, On the organization of activities of Azerbaijan Caspian Shipping Closed Joint-Stock Company. So that, based on these decrees, Azerbaijan Caspian Shipping Closed Joint-Stock Company (ASCO) was established through merger of the country’s two major fleets – Azerbaijan State Caspian Sea Shipping Company and Caspian Sea Oil Fleet of the State Oil Company of Azerbaijan Republic, with the aim to continue wide-scale structural reforms in the economy, to increase domestic and international marine transportation, and to improve the competitiveness and transit potential of the country.

ASCO, being the connecting link for the Transport Corridor Europe-

Caucasus-Asia (TRACECA), provides cargo and passengers transportation services along the Trans-Caspian corridor, as well as, relevant specialized offshore services for offshore petroleum operations.

Besides the transportation fleet, a specialized fleet and ship repair yards are also included in ASCO. ASCO is the largest and oldest shipping company operating in the Caspian Sea basin. Currently, ASCO's vessels are operating both in the Caspian Sea and in the waters beyond the Caspian Sea under the flag of Azerbaijan.

OUR HISTORY

Caspian shipping was founded with establishment of "The Caucasus and Mercury" Joint-Stock Company on May 21, 1858. As the volume of freight transported by sea increased, the number of ports on shores of the Caspian Sea grew, new bridges were constructed, storage facilities were built, and cranes were installed. The expansion of the fleet necessitated the establishment of a ship repair base and thus, the mechanical plant of "The Caucasus and Mercury" Joint-Stock Company was founded in Baku in 1866. Baku Seamen classes were organized in 1881 to meet the staffing requirements of the emerging fleet.

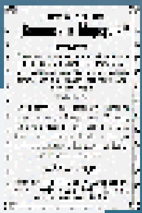
The development of shipping in Azerbaijan is tightly tied with establishment and progress of the oil industry. Rapid growth of oil production in Baku in XIX century triggered the development of shipping in the Caspian Sea. It goes without saying that in that period a need emerged to new floating facilities for the transportation of oil and oil products. And it's no coincidence that the world's first oil barge, "Alexander", began its operations in the Caspian Sea in 1873. The first tanker in the world, "Zoroaster" (built in 1878), was also voyaging in the Caspian Sea. Caspian seafarers were destined to sail on the first vessel with an internal combustion engine, named Vandal (1903), and the first vessel with two reversible engines, named Delo (1908).

In subsequent years, the shipping fleet was enriched by new types of vessels constructed in the country and abroad. River-sea type tankers and ships carrying cotton, timber and etc. were placed at the disposal of Caspian seafarers. the largest ferry crossing in Europe at that time, Baku-Turkmenbashi, designed by specialists of the Caspian Sea Transport Project Research and Scientific Investigation Institute, was put into operation in 1962.

Since 1960, vessels of Azerbaijan Caspian Shipping started to sail in the world waters via the Volga-Baltic Waterway.

The history of Caspian Sea Oil Fleet, covering a period of more than 60 years, is full of glorious pages. "Azerneft" Union was established by decree of the USSR Cabinet of Ministers dated October 31, 1949, "On Development of Offshore Oil Production in the Caspian Sea", while the "Floating Crafts" division was established as a component of "Azerneft" Union by order of the USSR Ministry of Oil Industry dated November 4, 1949. The development of the Caspian Sea Oil Fleet began since that date. At that time, the floating crafts of "Stalinneft" and "Artyomneft" offshore drilling trusts were transferred to ownership of the newly established organisation. These mainly were "Transportnik", "Gabala", "BMK-90" type small boats, 20 tons floating cranes and barges. By the Order of the USSR Ministry of Oil Industry dated January 22, 1953, the "Floating Crafts" Division was remade into the Caspian Sea Oil Fleet.

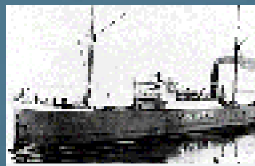
Today, by combining the maritime transport fleets into a single entity, ASCO is committed to fulfilling its objectives efficiently and to a high standard.



Caspian Shipping Company was founded by establishment of "Caucasus and Mercury" CSJC

Mechanical Plant of "Caucasus and Mercury" founded in Baku

The world's first oil barge named "Alexander" was put into operation on the Caspian Sea

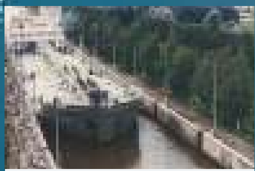


The world's first tanker named "Zoroaster" was put into operation on the Caspian Sea

Baku Maritime Classes launched to educate and elevate seafarers

The first vessel with internal combustion engine named "Vandal" was put into operation on the Caspian Sea

The first vessel with two reversible-engine drivers named "Delo" was put into operation on the Caspian Sea



Caspian Shipping Company vessels started sailing to international waters via the Volga-Baltic Channel

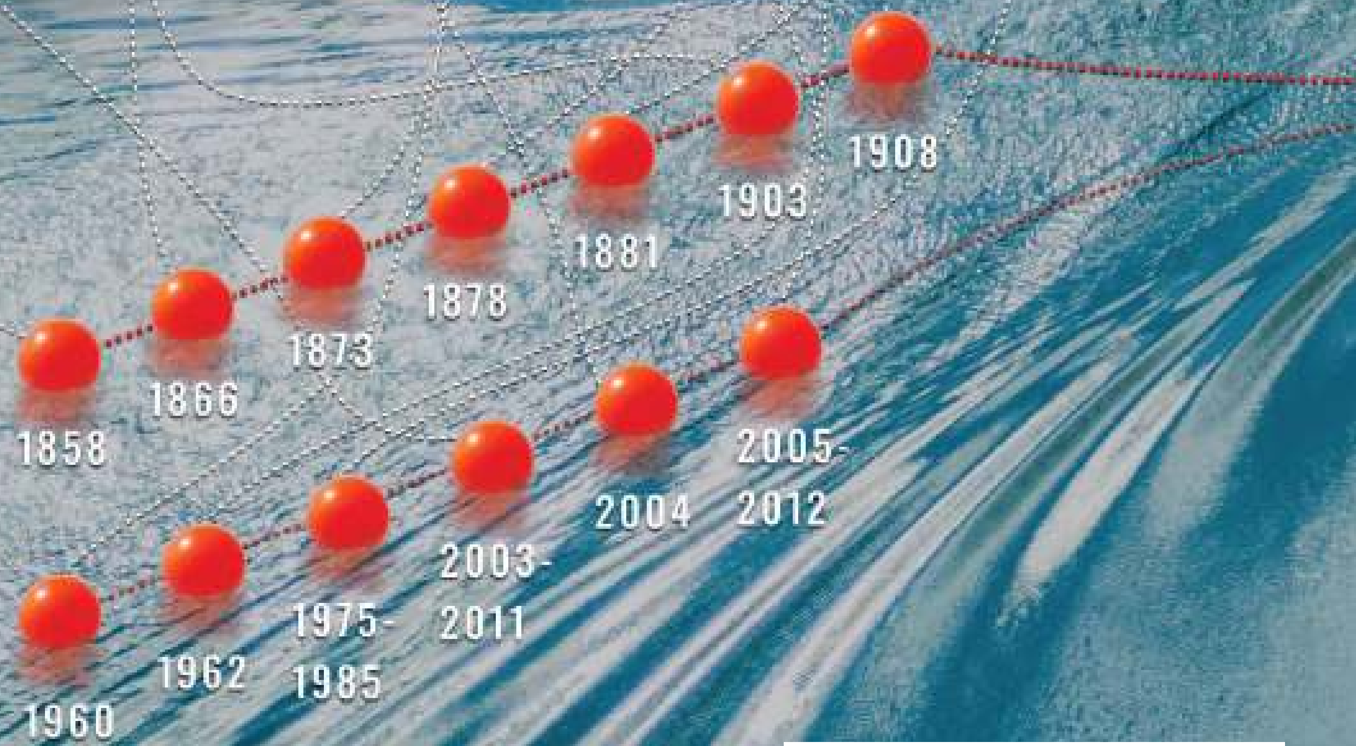
Construction of the first major ferry crossing on the Caspian Sea (Turkmenbashi) and the launch of ferries operating along it

Purchase and construction of new tankers, universal dry-cargo vessels and ferries for the merchant fleet

Launch of a major tanker named "President Heydar Aliyev" with 13,000 tons deadweight on the Caspian Sea

Renewal of the tanker fleet

Renewal of the ferry fleet



- Azerbaijan State Caspian Shipping Company
- Caspian Sea Oil Fleet
- ASCO

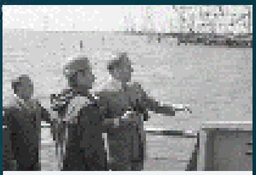
1949

Foundation of the Caspian Sea Oil Fleet by establishing the Floating Vehicles Division serving the Azerneft Union

1966

The world’s first huge crane-catamaran named “Koroglu” was put into operation on the Caspian Sea

1970-1980



Construction of over 300 specialized offshore ships, at a rate of 20-30 ships per year, rapid development stage of the specialized oil fleet

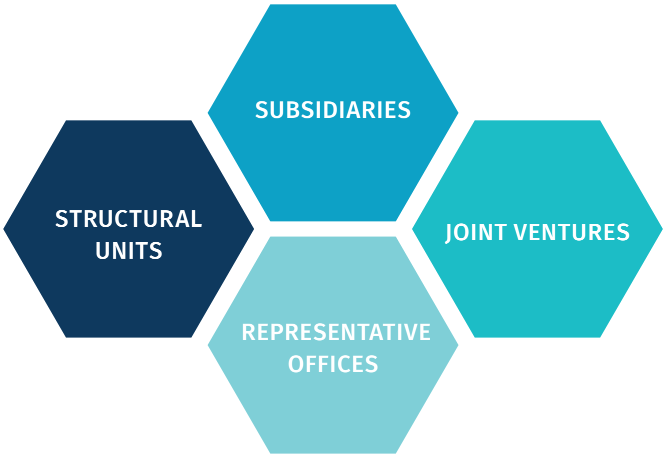
2013

Establishment of the Azerbaijan Caspian Shipping Closed Joint-Stock Company by merging Azerbaijan State Caspian Shipping Company and the Caspian Sea Oil Fleet of the State Oil Company of Azerbaijan Republic

STRUCTURAL UNITS, SUBSIDIARIES, JOINT VENTURES AND REPRESENTATIVE OFFICES

ASCO pays special attention to organizing and constantly improving a management structure that enables taking prompt business decisions and effective management. Thus, in order to ensure the most optimal management structure, the Company has taken several optimization measures on the recommendation of international advisory companies and non-core structural units which are not directly related to main business were handed over to relevant authorities. Since 2014, ASCO has handed over housing and utilities, event center for the seafarers, the "Danizchi" auxiliary agricultural enterprise, land used for agriculture, and the Central Seamen Hospital to relevant authorities. Such initiatives are further ongoing.

Currently, ASCO's structural units, subsidiaries, joint ventures and representative offices are as follows:



STRUCTURAL UNITS:

ASCO Headquarters
Caspian Sea Oil Fleet
Sea Transport Fleet
Bibiheybat Ship Repair Yard
Zygh Ship Repair and Construction Yard
Production Services Department
Zygh Dry Cargo Port

SUBSIDIARIES:

Caspdry Ship Management Inc. (The Republic of Turkey)
Casptankers Ship Management Inc. (The Republic of Turkey)
Azerbaijan State Marine Academy
ACSC Logistics LLC
Caspian Sea Transport Project Research and Scientific Investigation Institute
Danizchi Housing Cooperative
Danizchi Repair-Construction LLC
Seamen Polyclinic LLC
Azerbaijan Caspian Shipping Limited (The Republic of Malta)
Yacht Club LLC
"ASCO Trasportation" LLC
"ASCO Security" LLC

JOINT VENTURES:

Caspian Sea Shipping LLC
Caspian Marine Engineering Bureau LLC

Representative offices are operating in the following countries:

- The Republic of Turkey
- The Republic of Kazakhstan
- The Republic of Turkmenistan
- The Islamic Republic of Iran
- Greece

In January 2017, ASCO established Caspdry Ship Management Inc. and Casptankers Ship Management Inc. as legal entities in Turkey to organize the effective management of vessels operating in the Black and Mediterranean Sea basins. The main objectives of these companies are to organize more efficient operations of ASCO's vessels sailing under the flag of Azerbaijan beyond the Caspian Sea and to assist in settling issues arising during cargo transportation in an efficient and timely manner. Caspdry Ship Management Inc. is engaged in the management of dry cargo vessels, while Casptankers Ship Management Inc. manages tankers operating beyond the Caspian Sea.

Caspian Sea Shipping LLC, a joint venture in which ASCO is a partner, started operations in Astrakhan, the Russian Federation, at the end of 2015. This Company serves to ease the access of ASCO's vessels to foreign markets through the Volga-Don Canal. The key reason for the establishment of the Company was to increase cargo transportation between the ports of Azerbaijan and Russia, as well as to provide timely resolution of issues arising during these cargo transportations.

Caspian Sea Transport Project Research and Scientific Investigation Institute, operating within the ASCO structure, provides engineering, design and construction services for the shipping industry. To expand this business line, the Caspian Marine Engineering Bureau LLC joint venture was established in December 2016 by ASCO and Odessa Marine Engineering Bureau, a prominent global provider of ship design and construction services. This joint venture has created an opportunity for the Caspian Sea Transport Project Research and Scientific Investigation Institute and Odessa Marine Engineering Bureau to share experience and run joint projects. The main purpose in establishing the joint venture was to provide engineering and construction services for maritime and river transport, to carry out design and construction operations, to build, reequip and modernize ships and floating facilities, to conduct other scientific research activities and to train skilled personnel in this field.

The personnel of the Caspian Sea Transport Project Research and Scientific Investigation Institute have made a worthy contribution to the development of ferry connection. The Institute has prepared the designs of ferry complexes at the Baku, Turkmenbashi and Bekdash ports. The Vanino-Kholmsk ferry crossing connecting Sakhalin Island with the mainland, Ilichevsk-Varna (Ukraine-Bulgaria) and Klaipėda-Mukran (Lithuania-Germany) ferry crossings were also constructed using the institute's designs. Works conducted by this institute also include designs for the construction of hydro technical devices of the Baku Deep Water Jacket Factory located in the Garadagh district of Baku, the reconstruction of ship repair yards and vessel navigation canals, the construction of public and residential buildings and other various installations. In addition, some research and design activities have been carried out in Syria, Libya, Iran, Bulgaria and Afghanistan.

In April 2016, ASCO established Danizchi Housing Cooperative to meet the housing needs of the Company's former and current employees who have been queuing for apartments for many years. The primary responsibility of this cooperative is to accelerate the process of providing employees with housing and improving their living conditions upon agreement with relevant state authorities. Moreover, in November 2017, ASCO established Danizchi Repair-Construction LLC, which is engaged in the construction of a residential complex in accordance with urban planning and construction legislation.

The main objective of Seamen Polyclinic operating within the ASCO structure is to deliver high-quality diagnostics, outpatient and inpatient care to all company employees and their family members, as well as to third parties.

Detailed information about Azerbaijan State Marine Academy and ACSC Logistics LLC is provided in the "Our fleet and main business operations" section of the report. Representative offices of ASCO in the Republic of Turkey, the Republic of Kazakhstan, the Republic of Turkmenistan, the Islamic Republic of Iran and Greece assist in the efficient and timely addressing of issues arising at the ports of these countries or other relevant locations.

MUBARIZ JABBAROV – FIRST DEPUTY CHAIRMAN / COO

Since its establishment in 2013, ASCO has faced and overcome numerous challenges while maintaining the leading position in Offshore and Marine industry in the Caspian Sea region. Today ASCO stands as a full-fledged marine services and offshore shipping company with different business divisions. We have transport fleet, offshore fleet, ship building and ship repairing divisions/ yards.

ASCO plays connecting role in the Transport Corridor Europe-Caucasus-Asia (TRACECA), provides marine transportation of goods and passengers, as well as offshore support services for oil and gas operations.

The 21st century requires a new vision. Global markets are opening and boundless competition characterizes this new century. We are greeting this new century with high expectations for maintaining the leadership position in our core business fields in the Caspian Sea region and trying to expand our shipping business in areas beyond the Caspian Sea. New representation offices or subsidiaries were opened in the last couple of years in Astrakhan (Russia), Istanbul (Turkey) and Athens (Greece) where our company is active. At the same time studies are being carried out for expansion into different regions.

To this end, we will continue to improve the technology and quality of our mainstream products. Therefore, we have set a target to do the followings in the coming years:

- To renew our tanker fleet with new modern tankers, currently the building of one of the new sea–river type modern tankers is expected to finish in 2019 and the second one in the first half of 2020.

- To build new modern Ro-Pax vessels, currently two units are being built at Baku Shipyard and the building is expected to finish in 2020.

- To renew offshore fleet with preferably modern DP 1 and DP 2 AHTSVs, PSVs, DSVs and etc.

In 2018 we bought 4 modern DP 1 PSVs and we keep renewing the offshore fleet.

- We keep maintaining our fleet units to meet the Caspian oil and gas majors’ requirements.

We continue providing increasingly innovative training schemes including DP trainings which is helping our office and sea staff to improve their knowledge and safety records of the fleet. The future will be delivered by our combination of assets – including our dedicated people, the size and quality of our fleet, our stronghold position in the Caspian Sea and Black Sea regions, ASCO’s commitment to innovation and digitization and finally by our expanding offering of logistics services.

Today, ASCO is the leading Marine and Offshore services company in the Caspian Sea region. We highly value the mutual trust and understanding forged with our business partners and clients throughout the Caspian Sea and the world. We will continue to cherish these precious relationships and do our utmost to offer our customers the best products and services available.

OUR FLEET AND MAIN BUSINESS ACTIVITIES

ASCO's core activities comprise:

- Cargo transportation
- Specialized offshore services for the oil industry
- Ship repair and construction
- Education and training
- Other supporting activities

Cargo transportation:

ASCO provides cargo transportation services in the Caspian Sea and waters beyond the Caspian Sea, mainly in the Black and Mediterranean Sea basins. Cargo is transported by the ASCO's transport fleet. Transport fleet comprises tankers, universal dry cargo vessels, ferries and Ro-Ro type vessels. Currently, 52 vessels, including 22 tankers, 15 dry cargo vessels, 13 ferries and 2 Ro-Ro type vessels are operated in the transport fleet of ASCO.

Transport fleet composition

Type of vessel	Number
Tanker	22
Dry cargo	15
Ro-Ro	2
Ferry	13
Total	**52**

ASCO's tanker fleet transports oil and oil products and is used to transport most of the liquid cargo through the Caspian Sea. In accordance with its strategy to diversify business lines and reduce dependence on a single market, ASCO has offered transportation services by tankers beyond the Caspian Sea since 2017. At present, ASCO operates two tanker vessels in the Black and Mediterranean Sea basins.

Universal dry cargo vessels of ASCO operate both in the Caspian Sea and in the Black and Mediterranean Sea basins. ASCO's dry cargo vessels in the Caspian Sea serve to maintain Azerbaijan's position in dry cargo market in the Caspian Sea, and to meet demand for transit container volumes which is predicted to increase.

In total, ASCO operates 14 vessels beyond the Caspian Sea – in the Black and Mediterranean Sea basins, including 12 dry cargo vessels and 2 tanker vessels and these vessels are floating in international waters under the flag of Azerbaijan.

Today, ASCO is the only shipping company that operates ferries in the Caspian Sea. ASCO's ferries transport wagons, trucks, and container cargo along the Trans-Caspian corridor, linking railways on the Eastern and Western shores of the Caspian Sea.

ASCO's Ro-Ro vessels "Composer Fikrat Amirov" and "Composer Gara Garayev" transport various wheeled vehicles, including large cargo vehicles, along the Kazakhstan-Azerbaijan and Turkmenistan-Azerbaijan routes.

Specialized offshore services for the oil industry

ASCO's specialized oil fleet consists of 212 vessels and serves many important oil and gas projects in the Caspian Sea region. Its operations include oil and gas production processes, the construction of marine platforms, geological exploration, laying oil and gas pipelines and their repair during operations, firefighting at oil facilities, delivering oil workers to their workplace, and other activities involving the exploration and extraction of mineral resources at the bottom of the sea. This fleet is also involved in the development of the Shah Deniz, Bahar-Gum-Deniz and Azeri-Chirag-Gunashli fields in the Caspian region.

Specialized oil fleet composition, number

Type of vessel	Gəmi sayı
Crane vessels	22
Passenger ships	25
Anchor handling tug supply vessels	19
Platform support vessels	7
Tug boats	3
Port tug boats	8
Diving support vessels	11
Firefighting vessels	6
Barges	6
Liquid cargo vessels (tankers)	8
Engineering-geological vessels	5
Underwater pipelaying vessels	2
Surface cleaner and sewage water collector vessels	12
Support boats	68
Ship repair workshops	3
Floating workshop	1
Dredger ships and convoys	6
Total	**212**

Ship repair and construction:

The Zygh Ship Repair and Construction Yard (Zygh SRCY) and the Bibiheybat Ship Repair Yard (Bibiheybat SRY) repair the vessels and technical equipment of both ASCO and other shipping companies, prepare spare parts, special paint and technical tools according to orders. At the same time, Zygh yard has started providing shipbuilding services by passing relevant certification since 2017. Other services carried out in these yards include the installation and tuning of ship systems and equipment, electric and radio-navigation equipment, engines, and devices; diving and underwater hydro-technical works; the inspection, cleaning and painting of underwater hulls, steering wheels and screws by lifting ships on to the dock; the inspection and repair of hydrostatic separating devices and individual rescue vehicles, and the maintenance of ASV type isolating breathing apparatuses.

Three berths, a new administration building, a new warehouse complex, a canteen building, a social building and a changing room were built and commissioned at Zygh ship repair yard to improve the quality of repair works and speed up the repair processes. In addition, a mechanical workshop, repair shop, compressor building, blacksmith workshop, boiler house, potable water pumping station, transformer substation, heating network, and new crossing points were built and commissioned; power and potable water supply networks were set up and the blacksmith workshops and boiler house were connected to the gas system.

Infrastructure expansion works, including the overhaul of the coastal bridge and the construction of substations for dockyard berths, were carried out at Bibiheybat ship repair yard. It is planned to extend the berths and cranial roads, overhaul current cranial roads, and to renew the yard's equipment at the next stage.

Education:

Azerbaijan State Marine Academy (ASMA), that is part of the ASCO structure, has 130 years of experience in marine education and prepares seafarers for shipping companies in Azerbaijan, as well as in other countries of the region. Currently, the Academy serves students with three faculties and 16 departments. ASMA is recognized by the International Maritime Organization (IMO). Considerable reforms have been carried out at the Academy starting from 2014, while graduation standards and specializations of students have been aligned with ASCO's requirements, with preference given to quality, but not to quantity, in education and graduation standards.

Moreover, the Academy operates a Training and Education Center (TEC) to increase the professional degree and qualification level of seafarers, and to provide their certification. The Center is equipped with training facilities and simulators, and special courses are organized for the certification of seafarers. Educational programs held at the Center are totally in line with IMO standards. A Dynamic Positioning Simulator (DP2) used on the latest modern vessels was commissioned at the TEC in 2016. The dynamic positioning system allows total automatic monitoring of the position and course of the vessel. DP2 plays a great role in training ship drivers engaged in marine operations. Moreover, TEC has obtained relevant certificates to enhance the quality of its training. So that, Bureau Veritas and American Bureau of Shipping (ABS) have certified 40 training courses held at TEC. At the same time, The Nautical Institute, has certified its DP Induction and DP Simulator training courses, as a result of which TEC has become one of 95 training centers around the world and the only one in the Caspian region with the authority to deliver these courses.

Azerbaijan Marine College, which also provides education within the ASCO structure, was established in 2016. By the decision of the Cabinet of Ministers of the Republic of Azerbaijan, Azerbaijan Marine Fisheries College was subordinated to ASCO and served as the basis for the Azerbaijan Marine College established under ASMA. This college trains specialists in the fields of operating power devices, energy equipment and automatic machines, ship steering, ship repair, and installation of ship equipment.

Supporting business operations:

Apart from the above core operations, ASCO carries out the below supporting operations:

- Logistics services
- Dry cargo port and agency services

Logistics services:

ACSC Logistics LLC, operating within the ASCO structure, provides a full range of logistics services. ACSC Logistics transports cargo from the starting point to the destination in a safe, timely and effective manner via a number of transport modes. Moreover, ACSC Logistics provides advisory services to consignors to select the optimal route and transport mode, as well as providing documentation, convoy, customs clearance and insurance services required during cargo transportation.

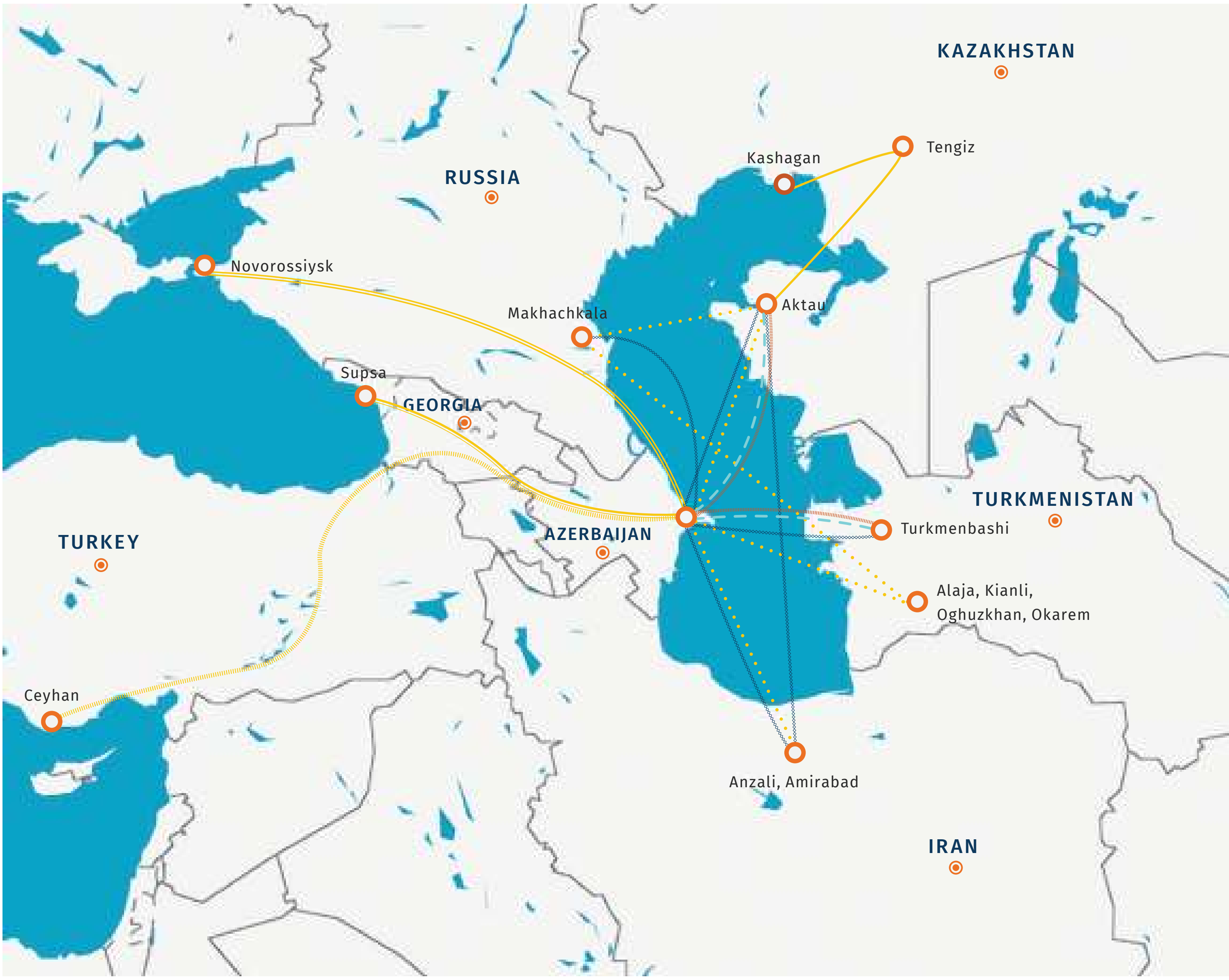
Dry cargo port and agency services:

The Zygh dry cargo port facility operates within the ASCO structure with its main purpose being to organize, operate and manage dry cargo port activities by applying advanced techniques and technologies, providing high-level port services to local and foreign shipping companies, carrying out cargo operations, serving vessels and passengers, as well as other relevant port services. The dry cargo port also provides agency services. The port provides clearance services on arrival, during the stay and on departure of vessels at sea ports of Azerbaijan. It also provides legal representation of vessel owners, freighters or any other individual operating vessels to the relevant authorities, as well as organizing and carrying out financial operations on their behalf.

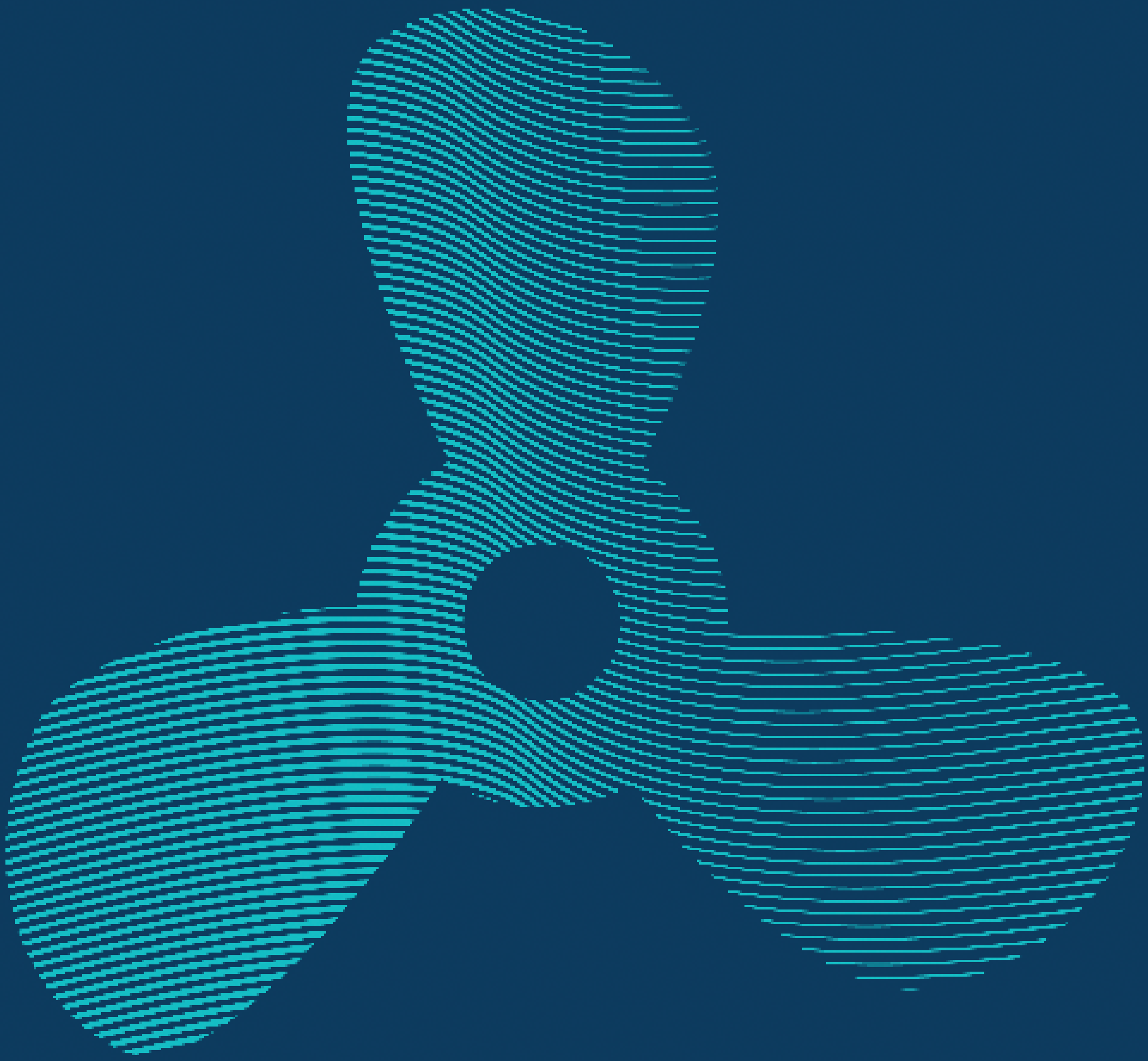
OPERATION ROUTES

ASCO operates both in the Caspian Sea and beyond, in particular, in the Black and Mediterranean sea basins. ASCO has 160 years of wide experience in shipping. ASCO re-established its operations in the basins beyond the Caspian Sea in 2014. Currently, 14 vessels operate under the Azerbaijani flag on basins beyond the Caspian Sea: 12 dry cargo vessels and 2 tankers.

Routes beyond the Caspian Sea:



- Tanker routes in the Caspian Sea
- Routes of dry cargo vessels in the Caspian Sea
- Ferry routes
- Routes of Ro-Ro type vessels



STRATEGY

STRATEGY

VALUES

People - Experienced sailing personnel and professional team are our major assets.

Safety - We continually focus on establishing a safe working environment, providing high-quality services and mitigating risks.

Environment - Our aim is to minimize impact on the environment in all aspects of our operations.

Quality Service - As ASCO, we guarantee high-quality cargo transportation and diverse specialized offshore services based on our rich experience.

Continuous Improvement - As a shipping company with effective management, we pursue continuous improvement in all aspects of our business to provide value-added services to our clients.

MISSION

To support the harmonious and continuous flow of international cargo and contribute to Azerbaijan's regional transportation hub strategy.

VISION

To secure the leading position in the Caspian Sea and expand operations beyond the Caspian Sea.

MOTTO

Your shortest bridge between Europe and Asia.

STRATEGIC TARGETS

Target 1: Building a modern shipping company that operates efficiently and maintains sustainable development.

Target 2: Conducting operations in a safe manner and without environmental damage.

Target 3: Preparing strong local personnel.

Target 4: Expansion and diversification of activities.

- To maintain the leading position in cargo transportation in the Caspian Sea
- To restore and expand operations beyond the Caspian Sea
- To extend the geography of offshore support services
- To increase ship repair services to external enterprises
- To expand and increase the profitability of other activities

PURPOSE OF SUSTAINABLE DEVELOPMENT

We strive to adhere to sustainable development principles throughout the value chain. We recognize the importance of nature and human capital for our activities and minimizing potential negative impact in this regard is our long-term goal.

JALAL FARAJLI – DEPUTY CHAIRMAN / CFO

As ASCO, we propose wide specter of services in trade and offshore shipping fields in Caspian, Black and Mediterranean seas. Our main values are Azerbaijan marine experience inherited over 160 years; diversified fleet consisting of various types of modern vessels; our sensitivity to the subject of health, safety and environmental protection.

As a result of effective and efficient management through the past 5 years after its establishment, ASCO has finished each financial year with satisfactory economic results. During this period, the net profit of ASCO has accumulated to 364 million AZN and EBITDA to 833 million AZN.

ASCO's management pay a special attention to the longevity of the company and put efforts to become one of significant participants in global business. That is why one of the main tasks we currently face is to direct the obtained economic value to the renewal of our fleet. During the past 5 years, the revenue of our Company from main operations aggregated 1,976 million AZN, whereas the amount of investment on vessels and other fixed assets totaled 659 million AZN. Our goal is not only the physical renewal of the vessels, but also ensuring efficient and profitable operations through diversification by type of vessels considering the market demand and regional diversification. Another task we face is to ensure profitable operations of the companies in ASCO's composition not relating to its main activity which emerged as a result of structural improvement.

We may have a further look to certain numbers in order to gain a wider idea on ASCO's activity. As a measurement of liquidity, ASCO's current ratio is way above the world shipping industry average. Additionally, EBITDA margin for the reported 5 years' period is above several shipping industry giants' indicators and clearly shows the effectiveness of the Company's activity.

Our Company is keen to take the opportunities waiting for us ahead to maintain the leadership position in the Caspian Sea region and increasing the market share in international waters. ASCO enters 2019 with enthusiasm and all our attention will be directed to effective management and growth in the upcoming years.

BUSINESS MODEL – KEY POINTS

ASCO is a 100% state-owned shipping company. ASCO agrees the shipping budget for upcoming years with “Commission on review and approval of budget of large government companies” and relevantly reports performance versus budget. ASCO closely cooperates with other relevant government agencies involved in cargo transportation to expand domestic and international shipping, to strengthen the competitiveness and to improve the transit potential of the country and these agencies are also stakeholders in the Company’s operations. Furthermore, as shipping is an international activity, the Company cooperates with international organizations and institutions, and joins relevant international conventions.

ASCO owns the largest and most diversified fleet in the Caspian Sea. Currently, there are a transportation fleet providing freight forwarding services and an oil fleet providing various specialized services to oil and gas industry within ASCO. In general, our fleet consists of more than 20 different type and wide profile ships, with a total number of more than 250. ASCO is considered a unique shipping company in the world for variety and diversity of the ships in its fleet. Transportation fleet providing freight forwarding services consists of tankers, universal dry cargo vessels, ferries and Ro-Ro type vessels. Oil fleet providing specialized offshore services to oil industry is comprised of crane vessels, passenger ships, anchor handling tug supply vessels, platform supply vessels, tug boats, diving vessels, firefighting vessels, barges, geological engineering vessels, underwater pipe-laying vessels, dredger ships and others.

ASCO serves many local and foreign customers in transportation of various cargo, including oil and oil products, containers, dry cargo, wagons and trucks along the Trans-Caspian corridor. Our commercial vessels operating in the Caspian Sea realize cargo transportation among the ports of Caspian Sea countries. At the same time, ASCO re-established its operations in international waters beyond the Caspian Sea in 2014, to reduce dependence on a single market and diversify its business. Currently, ASCO operates 14 vessels under the flag of Azerbaijan, including 12 dry cargo vessels and 2 tankers, in the Black and Mediterranean Sea basins. In this regard, our commercial vessels sailing in the Black and Mediterranean seas are moored in ports of countries like Turkey, Italy, France, Greece, Bulgaria, Romania, Russia, Ukraine, Israel, Algeria, Morocco and Egypt. For more on this topic, see the Our Fleet and Major Operations and Operation Routes sections of this report.

In specialized services to oil and gas industry, main customers of our Company are Azneft Production Association of State Oil Company of the Azerbaijan Republic (Azneft PU), SOCAR Logistics DMCC, SOCAR AQS LLC, Bahar Energy Operation Company, BP, Total, Saipem and other foreign subcontractors of these companies, other legal persons and individuals. ASCO is the only shipping company in the Caspian Sea with a fleet that totally satisfies the requirements of Azneft PU, our largest customer. At the same time, participates in several projects realized in other sectors of Caspian Sea, in

Russia, Kazakhstan and Turkmenistan sectors, cooperates with Prime Exerter, Lukoil, Jan De Nul, Maersk and other large customers.

The main challenges facing our Company in terms of maintaining the existing customer base, deepening business relationships with them and attracting new customers consist of the timely upgrade of our fleet with modern ships and the development of our people.

To upgrade our fleet, 20 new and modern vessels were purchased by ASCO in last 5 years, including 8 dry cargo vessels and 1 tanker for transportation fleet; 1 tug supply vessel, the largest in the Caspian Sea, 6 supply and tug boats, one port tug boat and three passenger ships for our specialized oil fleet.

As another step towards the modernization of our fleet, one of our main partners, Baku Shipyard LLC, following an order from our Company, is currently building four tankers and two Ro-Pax ferry-boats. By order of the President of the Republic of Azerbaijan, 30% of financing of two tankers and two ferries out of these vessels', and 50% of two tankers' construction is done at the expense of funds allocated for public investments. The remaining part is financed by our Company's internal resources. In near future, within the plan of modernization of our fleet, it is planned to place an order for constructing additional 2-6 vessels in Baku Shipyard. Let us note that, to keep the fleet in line with requirements of cargo owners and regional oil and gas projects realized or planned in perspective, the fleet renewal plan till 2025 is prepared by ASCO and proposed for discussion with relevant government bodies. Zygh Shipbuilding and Construction Yard, one of the Company's structural divisions, has started construction of a number of vessels for the Caspian Sea Oil Fleet under the fleet renewal plan for the coming years. A noteworthy detail is that these vessels are designed by professionals from another structural division of the Company, Caspian Sea Transport Project Research and Scientific Investigation Institute.

One of the structural divisions of ASCO, Azerbaijan State Marine Academy (ASMA) ensures development of young seafarers in Azerbaijan and provides bachelors and masters education on Navigation and Shipboards mechanics faculties. Training, industrial and cruising practice on vessels is provided to the students of Academy. Additionally, Marine College is also operated within the structure of Academy. ASMA is recognized by the International Maritime Organization (IMO) and is included in the global higher marine education system. At the same time, the Academy has become a member of the International Association of Marine Universities and the diplomas and certificates issued by the Academy are internationally recognized. Two graduates of ASMA have done masters on "Shipping management and logistics" and "Maritime management" specialties in World Maritime University located in Malmo, Sweden and this education has been sponsored by ASCO within the 2017 Scholarship Program. Opportunities are created to undertake internship both in

ASCO ships and world's leading and reputable shipping companies to the students and graduates distinguishing in education and personal qualities and showing higher academic results. That said, our two employees who are ASMA graduates are undertaking internship in Columbia Shipmanagement Ltd and other three employees who are ASMA graduates are also expected to participate in the same program. It is worth noting that the Chairman of ASCO issues a letter of guarantee for employment and scholarship to students who have excelled in their education in ASMA.

Training and Education Center (TEC) serving to increase the professionalism and qualification level of seafarers and providing their certification, operates within ASMA. TEC's main goal is to organize training and certification for seafarers of both the Sea Transport Fleet and Caspian Sea Oil Fleet. At the same time, TEC provides training and certification for the employees of other shipping companies. In 2016 a new dynamic positioning system (DP) simulator was launched in TEC. Dynamic positioning systems allow to fully control the position and course of the vessel automatically, using its own propellers and thrusters. Bureau Veritas Center and the American Bureau of Shipping have issued relevant certificates for 40 training courses held at the Center. In 2017 The Nautical Institute, UK, audited the TEC and certified its DP Induction and DP Simulator training courses. Thus, TEC has become one of 95 centers in the world and the only training center in the Caspian Sea authorized to deliver these training courses.

ASCO's wide range of activities necessitates cooperation with both local and foreign companies in supply chain. The supply chain comprises domestic and international suppliers of goods and services. Suppliers are selected based on the Company's procurement guidelines with the significant focus on aspects such as business ethics, anti-corruption, transparency, etc. Let us note that, the procurement regulations of the Company, as well as, the information about tenders for purchase of materials and services within the Company, are transparently issued in the official internet site of ASCO. The evaluation of suppliers is carried out collectively by the Procurement Committee of ASCO. The organization and management of the procurement process with suppliers are regulated by legislation of the Republic of Azerbaijan, as well as ASCO's Procurement Committee Regulations, ASCO's Rules on Organizing and Management of Procurement, bid invitation documents, the procurement agreement template and the final protocol on tender results. ASCO's supply chain of domestic and foreign firms comprises of companies offering shipbuilding and repair, construction, supply of materials, engineering, communication, port, insurance and other services.
ASCO strives to achieve mutually beneficial cooperation with suppliers and mainly prefers local suppliers. Local suppliers are companies registered in the Republic of Azerbaijan and bearing tax liability in accordance with the laws of Azerbaijan. In 2016 and 2017 the amount spent on domestic suppliers averaged 67% of total supply costs.

BUSINESS MODEL OF ASCO

Main stakeholders
- Suppliers
- Ports
- Yards
- Railways
- Agencies and brokers
- Customers
- Other

Main operations
- Transportation
- Offshore support services
- Ship repair and building
- Education and training
- Other

Values
- Personnel
- Security
- Environment
- High-quality services
- Sustainable development

Customer relations
- Quality
- Reliable partner
- Trust
- Profitability
- Productivity
- Fairness
- Transparency

Main resources
- Personnel
- Experience
- Ships
- Yards
- Other

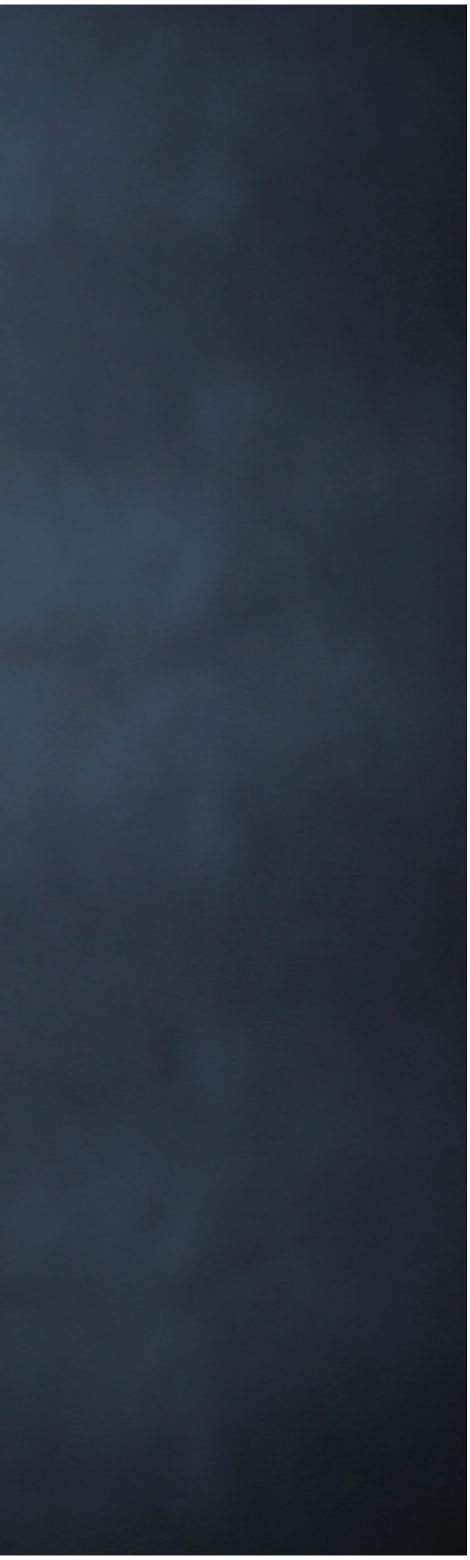
Communication channels
- Office
- Web-site
- Social networks
- Hotline

Customer segments
- Trading companies
- Transportation companies
- Cargo owners
- Oil & Gas industry
- Logistics companies
- Expeditors
- Other

Structure of expenses
- Petrol
- Port expenses
- Repair expenses
- Depreciation
- Salaries
- Taxes
- Other

Sources of profit
- Transportation services
- Offshore support services
- Ship repair services
- Logistics services
- Other

SEVDA MAMMADOVA – HEAD OF HR



The success of business activities directly depends on preparation of highly qualified specialists in management and operations, and improvement of staff potential. That is why putting human potential to the core of development, directing this process to human, addressing existing problems, also clearing the way to spiritual revival are main aims in the world today.

The issue of staff preparation for sustainable development is a priority in our Company, supported both by the government and the Company. Continuous high and occupational education system for the development of shipping industry is created and continiously improved in the country. So that, attention is given to high qualification of staff and their productivity levels, as shipping is a human capital oriented field and requires a great deal of labor work. Currently, actions on preparation, re-qualification and improving professionalism levels of staff working in management and operations, are taken continiously.

Let us take a short look at main achievements in HR sphere during the 5 years since ASCO's inception:

- Organizational structure and HR system of the Company is set;
- HR strategy and short, medium and long-term targets are established;
- HR policy, regulations, procedures, instructions and internal rules are written;
- HR functions like recruitment, planning, training and development, performance evaluation, working with talented youth and etc. are organized;
- Significant work is done towards automatization and application of processes and HR reporting system.


Mərdəkan

RELATIONSHIP WITH PERSONNEL

We believe that employees who are aligned with the values of ASCO and serve our mission and goal, should develop together with the Company in the long term. We have created working conditions that motivate employees and promote diversity. Career development planning is used in our Company to provide employees with both material and intellectual motivation. The emphasis is on working conditions that promote equality and safety, maintain a balance between the personal and professional lives of employees. Employee-employer relations in our Company are based on mutual trust and respect.

The Company has created a working environment that creates equal opportunities for each employee to raise their professional level and develop their careers. Necessary processes have been set up in the Company and further work is being done for the recruitment of the best and development of future leaders. One of the most important factors in the future success of the Company is the retention and appointment of the best employees to managerial positions.

That is why our Company attaches great importance to the professional development of our employees. Our key priorities are the preparation of strong Azerbaijani seafarers, promotion of the maritime profession in the country, improving the quality of education at our academy, continuous professional development of staff, identifying high-potential young people and appointing them to leading positions. For this purpose, internationally recognized seafarers are regularly invited to train our staff at the expense of ASCO, and special projects are implemented to encourage young employees to gain practice with international marine companies or on our ships in international waters. Under the ASCO Scholarship Program, graduates of ASMA are sent to prestigious universities around the world every year to receive a master's degree. In addition, a career center has been established at our academy, which provides information about students and alumni, and through which ASCO is closely involved in their future professional lives. Students who are distinguished in education at our academy are provided with individual scholarships and jobs after their graduation. This is a clear example of how the Company prioritizes educated young sailors in shaping human resources.

Keeping employees highly motivated is one of the key priorities of the management. Employees are regularly evaluated on an individual basis. As a result, the development needs of employees are identified and measures are taken in this area. Moreover, employees receive bonuses and material rewards. Specialists distinguished in their fields are also awarded with certificate of honor.

In addition to the above factors, our Company attaches great importance to providing employees with effective and healthy leisure time and establishing friendly relations in social life outside the workplace. So that, ASCO regularly organizes sports events, including swimming, football and other sports competitions, as well as team trips. These activities help to increase sincerity and confidence, along with professional relationships among employees.

CREATING VALUE AND TRANSPARENCY IN ACTIVITIES

After ASCO was formed, the process of merging state shipping entities was smoothly done and unified synergy in the maritime industry was obtained. The Company's Strategic Development Program is prepared, covering works towards transparency, optimization and diversification, taking the principle of fairness as a basis.

We pay a lot of attention to the application of software in all aspects of our business to ensure the effective management of the Company. With that in mind, we established a central corporate network with fiber optic channels in 2014 and installed SAP ERP system the same year. Now, we use SAP ERP system modules including finance, human resources, material resources management, sales, cost controlling and treasury. We began freight transportation programs and established a central dispatch service. We have developed a unified electronic HR database for the management of human resources. Electronic ticket sales, electronic procurement system and electronic document management systems were introduced. We have developed the Company's new website and internal portal.

In order to optimize operations and direct the focus towards key development prospects, the Company has spun off structural divisions beyond its core business to the relevant authorities. Since 2014, ASCO has delivered to the relevant authorities

- housing and public utilities comprising 168 housing units,
- the seafarers' cultural center,
- the Danizchi auxiliary agricultural enterprise with an area of 1,638 hectares of agricultural land and an administrative building with a total area of 1,027 square meters, and
- the Central Seamen Hospital.

The Company maintains its accounting records in accordance with International Financial Reporting Standards (IFRS). Company's financial statements prepared in accordance with IFRS are audited by EY each year. In addition, ASCO has prepared sustainable development reports covering its economic, social and environmental performance. These reports are also audited by EY. In order to make these statements available to public, they are published on our website, which is constantly updated.

Since July 2014, international company American Bureau of Shipping (ABS) was invited and ASCO was audited in order to assess its internal management system and to verify compliance of its activities with the SMS (Safety Management System) and international ISO standards. GAP analysis was carried out by ABS and a new Quality Safety Management

System was applied as a result of this analysis. The new system was jointly developed by the QHSE Department and ABS Consulting. This system incorporates the requirements and recommendations of international management standards such as ISM-2010, SOLAS, MARPOL, ISO-14001, ISO-18001, ISO-9001 and ISO-50001. Compliance of internal Quality Safety Management System with international standards was approved and ISO certificates have been obtained following the audit conducted in September 2015.

In 2016, Fitch Ratings analyzed the financial and business models of the Company, determined the liquidity of the Company and sustainable ability to meet its credit obligations, and provided a positive credit rating.

The Company performs attestation of its floating staff on a regular basis and provides special international training to increase the capabilities of managers and supervisors. In that respect, ASCO closely cooperates with well-known international companies – ABS, the Azerbaijan Professional Finance Managers Association, EY and BIMCO Business Academies.

Since its establishment, the Company has regularly revised salaries of employees, and the wages of floating and coastal staff have increased multiple times. In October 2017, the Company started and internally financed construction of a 472-apartment residential complex to provide housing to those seafarers and their families who have queued for accommodation since the 1980s. In parallel with this, in order to improve the working conditions of employees, a new administrative building for our Company has been under construction since 2017 near Flag Square – one of the most picturesque parts of Baku.

The steps taken by ASCO since its inception have helped the Company to take and maintain a leading position in the domestic market and open up to international markets. Using new technologies, modernizing our fleet and increasing the skills and knowledge of our employees, we provide our customers with quality and reliable services. Thanks to flexible and timely management solutions, we have increased our profitability since inception and succeeded in becoming a renowned modern international shipping company.

The Six Capital model you see below is one of the tools used to demonstrate how the Company has used its key resources for production. Six Capital is divided into financial, industrial, intellectual, human, social and natural categories, and descriptions of each of these capitals, the main available resources, and what the Company has achieved from available resources are given below.

ASCO – SIX CAPITAL MODEL

	Capitals	Description	Resources	Outcomes
Economic	Financial	Economic resources financing business	• Equity share • Debt financing • Undistributed earnings	• Income • Project financing • Profit for shareholders
	Manufactured	Profitable infrastructure	• Transportation fleet • Offshore support fleet • Yards	• Transportation services • Technological fleet services • Ship repair and construction
Social	Intellectual	Knowledge and intellectual property used to enhance the competitive advantage of individuals and develop the business	• A world-famous brand • Robust knowledge base • Qualified skills • Approved systems and structures	• Innovative and special offers to customers • Proper business management
	Human	Knowledge, skills, experience, and judgment of people who help to achieve the organization's goals	• Qualified workers • Training in knowledge and skills development	• Employee safety and well-being • Personal and professional development • Indirect protection of workers' family members
	Social	Relationships for raising individual and collective well-being among stakeholders. This capital includes: • Distributed norms, common values and principles • Significant stakeholders, as well as the strength the Company has used to maintain trust with customers, suppliers, businesses partners and other stakeholders	• Stakeholder engagement • Strategic relationships	• Mutual benefit for stakeholders • Job opportunities • Increased community sustainability • Customer health and safety • Anti-discrimination measures and other human rights support measures
Environmental	Natural	Renewable and non-renewable environmental resources used to supply services and goods that support the current and future development of the organization. These include: • Air, water, soil, minerals and forests • Biodiversity and ecosystem health	Natural resources	Mitigating negative environmental impact (emissions, waste)

ALEKBER AZIZLI – HEAD OF QHSE

The concepts of quality, health, safety and environment have been centralized under one management system and operated as the QHSE department since the establishment of ASCO. During these 5 years serious reforms were made and useful results were achieved in each direction. The followings may be noted as an example to the achievements:

- Certification of operations of the fleet's main type vessels based on international ISO standards;
- Provision of personal protection equipment for working in production to office and sea staff;
- Renewal of procedures and instructions in modern format in the offices;
- Taking urgent preventive measures based on the lessons learnt from timely investigation of incidents and potential dangers;
- Identifying and improving environments that may harm human organism;
- Providing trainings on and propagating special policies in all offices of ASCO for the sake of safety and environmental protection;
- Utilization, recycling and recording based on sorting of 90% of the waste from vessels and shore objects and etc.

QHSE policy values the following principles in the offices of ASCO:

- Ensuring healthy and safe working environment via benefiting from healthy and safe working experiences;
- Preventing pollution in the sea and ports;
- Taking detective and preventive measures against all identified risks;
- Evaluating the results of audit and inspections;
- Analyzing the reasons of non-compliances and assessing the effectiveness of adjustments made.

BUSINESS GOALS

After the establishment of ASCO, based on Mr. President’s instructions on the development of shipping industry, the Company’s development targets were set and a Strategic Development Program was prepared to reach these targets. The Strategic Development Program of the Company was approved in 2014. Afterwards, strategic development priorities of the Azerbaijan Caspian Shipping were identified through the decree of the Cabinet of Ministers of the Republic of Azerbaijan dated 11 September 2015. The State Program for the Development of Shipping in the Republic of Azerbaijan was approved by decree of the President of the Republic of Azerbaijan in November 2016.

The documents mentioned above comprise the basis of the strategic plan and strategic targets of ASCO. The following short, medium and long-term targets and objectives are identified by ASCO:

Target 1: Building a modern shipping company that operates efficiently and maintains sustainable development

- Objective 1.1: Continious improvement of the centralized corporate governance system
- Objective 1.2: Application of software necessary for efficient management
- Objective 1.3: Continuing international certification in shipping operations and application of leading international experince
- Objective 1.4: Optimization of costs, structure and operations and ensuring efficiency
- Objective 1.5: Transformation of the Company into an efficiently operating commercial organization which brings dividends to the shareholders
- Objective 1.6: Ensuring transparency in the operations

Target 2: Conducting operations in a safe manner and without environmental damage

- Objective 2.1: Improvement of QHSE service
- Objective 2.2: Training of personnel on the requirements of QHSE standards, educating them on this field
- Objective 2.3: Ensuring environmental protection complies with International Environmental Management Standards in order to prevent onshore and offshore pollution


AXOG

BUSINESS GOALS

Target 3: Preparing strong local personnel

- Objective 3.1: Preparing strong local nautical personnel and promotion of the seafarer profession in the country
- Objective 3.2: Continious development of professionalism of the personnel and improving their prosperity

Target 4: Expansion and diversification of activities

- Objective 4.1: To maintain the leading position in cargo transportation in the Caspian Sea
- Objective 4.2: To restore and expand operations beyond the Caspian Sea
- Objective 4.3: To expand the geography of offshore support services
- Objective 4.4: To increase ship repair services for outside companies
- Objective 4.5: To extend other business areas and increase profitability

SOCIAL ACTIVITIES

ASCO acknowledges its corporate responsibility to the public. ASCO's social activities mainly cover the following directions:

- Financial support and charity;
- Welfare of personnel and health support;
- Support to foster children and veterans;
- Youth support;
- Promotion of the sailor profession in the country and support to sailors' education.

Based on ASCO's Statue on Providing Financial Support approved in 2014, financial support is provided to orphan children, families in difficult financial conditions, war veterans and disabled persons. During the 5 years period since ASCO's inception till the end of 2018, 2,191,000 AZN financial support is provided in accordance with the mentioned Statue.

Providing food support 5 times a year on holidays to families consisting of 3,350 internally displaced persons located in Goranboy region, financial support 4 times a year to ASCO's families whose members were killed in war, blood donation actions among employees, release of "Gizil gul" park for use, providing housing to those seafarers and their families who have queued for accommodation (see "Creating value and transparency in activities" section of this report for more details), support to the development of sport in the country, including sponsorship to "Sabail" football club and Sailing Federation and etc. social activities can be provided as examples of other work done by ASCO in social sphere.

Please refer to the Company's Sustainable Development Report for more details on ASCO's social activities.

ASCO AT A GLANCE

ASCO AT A GLANCE

OPERATING INDICATORS

Cargo transportation volume (thousand tons)					
Type of vessel	**2018**	**2017**	**2016**	**2015**	**2014**
Liquid cargo	4,513.8	4,064.4	2,411.6	4,298.6	5,573.2
Dry cargo	961.9	1,025	853.1	475.5	618.3
Ro-Ro/Ferry	2,760.4	3,257.9	2,537	1,851.7	3,745.1
Total	**8,236.1**	**8,347.3**	**5,801.7**	**6,625.8**	**9,936.6**

Specialized offshore fleet indicators (hours)					
Type of vessel	**2018**	**2017**	**2016**	**2015**	**2014**
Crane vessels	74,733	73,405	66,117	60,757	52,714
Passenger ships	89,145	89,903	89,505	85,746	89,979
Anchor handling tug supply vessels (AHTSV)	45,164	39,622	48,651	55,405	52,814
Platform supply vessels (PSV)	7,661	7,358	3,881	4,654	4,663
Tug boats	6,264	7,368	5,628	12,392	6,117
Port-tug boats	1,620	1,272	996	3,841	7,433
Diving vessels	34,048	36,949	39,649	27,420	27,993
Firefighting vessels	17,680	20,875	20,181	24,133	27,218
Barges	9,648	16,976	19,194	19,558	13,318
Liquid cargo vessels (tankers)	11,937	13,153	12,883	13,450	10,714
Geological survey vessels	17,094	14,633	16,970	12,513	9,562
Underwater pipe layer vessels	3,333	3,773	7,029	4,149	4,181
Cable layer supply vessel	0	4,641	2,821	2,746	3,056
Surface cleaner and fecal water collector ships	15,103	13,200	12,936	4,656	1,080
Supporting boats	169,862	176,525	185,272	178,391	182,725
Total hours worked	**503,292**	**519,653**	**531,713**	**509,811**	**493,567**
Dredger vessel and convoys, m3 of soil	87,450	352,750	154,720	208,860	265,600

FINANCIAL INDICATORS

5-year outlook (for more information, please refer to the audited financial statements that are an integral part of this report)

Profit and loss (in thousands of Azerbaijani Manats)					
	2018	**2017**	**2016**	**2015**	**2014**
Revenue	452,171	474,305	454,925	331,642	262,480
Cost of sales	(294,242)	(265,101)	(266,762)	(224,459)	(241,981)
Gross profit	**157,929**	**209,204**	**188,163**	**107,183**	**20,499**
General and administrative expenses	(52,461)	(52,120)	(60,945)	(36,471)	(34,737)
Social expenses	(12,132)	(5,103)	(4,031)	(2,975)	(1,961)
Other operating income	33,253	44,390	45,480	30,192	39,159
Other operating expenses	(48,114)	(52,105)	(18,288)	(9,307)	(6,079)
Loss on disposal of vessels, property, plant and equipment	(200)	(837)	(1,245)	(575)	(2,620)
Foreign exchange (loss)/ gain	(692)	(3,888)	886	4,864	-
Operating profit	**77,583**	**139,541**	**150,020**	**92,911**	**14,261**
Finance costs	(1,914)	(1,410)	(1,596)	(2,145)	(1,216)
Profit before income tax	**75,669**	**138,131**	**148,424**	**90,766**	**13,045**
Income tax (expense)/benefit	(23,207)	(38,000)	(40,158)	(21,769)	20,971
Net profit	**52,462**	**100,131**	**108,266**	**68,997**	**34,016**

Balance sheet (in thousands of Azerbaijani Manats)					
	2018	**2017**	**2016**	**2015**	**2014**
Non-current assets	890,890	767,440	668,835	621,948	643,953
Current assets	305,152	262,711	232,831	181,895	190,857
Total assets	**1,196,042**	**1,030,151**	**901,666**	**803,843**	**834,810**
Non-current liabilities	69,484	32,001	34,768	40,317	46,897
Current liabilities	135,570	74,610	59,489	70,156	173,574
Total liabilities	**205,054**	**106,611**	**94,257**	**110,473**	**220,471**
Total equity	**990,988**	**923,540**	**807,409**	**693,370**	**614,339**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CORPORATE GOVERNANCE

CORPORATE GOVERNANCE

CORPORATE GOVERNANCE SYSTEM

In order to ensure transparency and efficiency of operations, application of international corporate governance practice and organizing its operations in compliance with international standards have been the focus of attention since the establishment of ASCO. In that context, strategic development priorities of our Company were identified and approved by the Decree of the Cabinet of Ministers of the Republic of Azerbaijan. In line with strategic development priorities, short-term targets covering a 1-3 years period, medium-term targets covering a 3-6 years period and long-term targets covering a 6-10 years period have been identified, and the Company's Strategic Development Program has been prepared. The Strategic Development Program is regularly reviewed, targets and objectives are constantly updated. Furthermore, the State Program for the Development of Shipping in the Republic of Azerbaijan in 2016-2020 was approved by the Decree of the President of the Republic of Azerbaijan in November 2016. Execution of the State Program ensures timely renewal of the fleet with the required ships and step-by-step implementation of work on ASCO's strategic development priorities.

We drafted and adopted regulatory documents to meet the requirements of the international corporate governance system:

- Board of Directors Regulations
- Company's Strategic Plan
- Code of Corporate Governance
- Internal discipline rules
- Code of Business Ethics
- Anti-Corruption Guidelines
- Regulations on Hotline Communication Center Activities and Internal Investigations
- Policy on Disclosure of Financial and Operating Results
- Disclosure Guidelines
- Statute of the Public Consultations Board
- QHSE and HR documents
- Internal Audit documents
- Risk Management documents

ASCO is committed to ensuring transparency and considering the views of stakeholders when making important decisions. Based on leading international corporate governance principles, the Company has established the following relevant committees to ensure collective decision-making in its operations:

- Procurement Committee
- Risk Management Committee
- Remuneration Committee

Transparent and sustainable development

- International Financial Reporting Standards are implemented at ASCO. Financial statements prepared in accordance with these standards and audited by international audit firm EY are published on the Company's website in accordance with transparency principles and presented to relevant stakeholders on an annual basis.
- The American Bureau of Shipping (ABS) has audited ASCO's internal QHSE management system and certified its compliance with international governance standards. 5-year ISO and ISM compliance certificates were issued to the Company, Azerbaijan State Marine Academy and Training and Education Center.
- Fitch Ratings agency analyzed ASCO's business model, determined its liquidity and sustainable ability to meet its credit obligations, and assigned a credit rating to the Company.
- In order to enable personnel to master the principles of international corporate governance system and to improve the level of their proficiency, ASCO regularly organizes trainings in cooperation with internationally recognized companies.
- Sustainable Development Reports covering a period of two years are prepared in our Company and openly issued in the official internet page of ASCO. Please refer to "Sustainable development" section fo this report for more details on Sustainable Development Reports.

- **Work performed on Information Technologies:**
- establishment of a unified central computer network via fiber optic channels covering all departments of the Company;
- implementation of the SAP ERP system;
- establishment of a central electronic dispatch system;
- application of a fleet positioning program which allows the Company to determine the location of ships on an electronic map at any time;
- application of electronic document management system;
- continuous communication of ships with coastal units;
- replacement of old paper-based maps used in ships with electronic maps;
- establishment of an electronic ticket sale system.

Information Disclosure Regulations approved in 2016 are designed to ensure the transparency and publicity of the Company's operations, the availability of relevant information to all stakeholders, and everyone's equal right to obtain such relevant information, as well as to exclude inaccurate information about the Company and enhance the Company's reputation. Information is disclosed

through the official ASCO website and other online resources, press agencies, television and radio channels. **Pursuant to Information Disclosure Regulations, the Company discloses the below information:**

- financial indicators for the period;
- borrowed finances;
- significant agreements with relevant parties;
- the Company's management bodies and officials;
- shareholders;
- dividends;
- the acquisition or alienation of a significant share;
- conclusions on the Company's activities;
- Sustainable development results.

Furthermore, in 2016 the Company approved the policy on disclosure of financial and operating results. The main objectives of this policy are:

- ensuring a unified approach to the disclosure of financial and operating results and related procedures;
- ensuring transparency and the removal of inaccurate information that may damage the Company's image;
- ensuring that all stakeholders, including the public, have full access to information on the financial state of the Company and have a complete and accurate view of the Company;
- more accurate formation of economic policy, financial and economic activities of the Company and precise definition of future priorities;
- attracting potential investors and partners to develop specific projects.

To improve the existing corporate governance system, in 2016 we engaged international auditor and consultant firm EY to assess the current state of the corporate governance system and develop a roadmap containing improvement measures. All steps envisaged in the roadmap were successfully implemented in 2016-2018. Business process maps were compiled for all major business processes and sub-processes in the Company, and the internal control matrix was improved taking into account potential risks. Further, the Promotion and Remuneration Policy was approved in 2016, key performance indicators (KPIs) were established, and a performance-based remuneration system was applied from January 1, 2017.

In continuation of large-scale corporate governance related projects, we initiated a procedure for obtaining a corporate governance rating for the Company. To this end, international audit company Deloitte reviewed our corporate governance system, existing documents and their level of operation, strategic and other important decision-making processes, risk management, internal control and audit, and the level of transparency in the Company as of the end of 2017, taking into account both internal and external factors. As a result, the Company's performance was positively evaluated.

REMUNERATION SYSTEM

ASCO places special emphasis on staff development and motivation. As part of the ongoing work to improve its corporate governance system, ASCO has implemented a bonus system based on employees' annual performance, as widely accepted in international practice. The main goal of implementing this system is to achieve continuous efficiency and increase productivity.

Initially, the Motivation and Remuneration Policy was approved in September 2016. Subsequently, we developed a balanced key performance indicators (KPI) system and KPI scorecards to achieve the strategic goals and objectives of the Company in accordance with this Policy.

Three levels of KPIs have been developed, corporate, functional and individual.

ASCO applies the KPI system to:

- encourage the Company's management to develop and improve, and to increase the effectiveness and efficiency of operations;
- ensure the attraction and retention of high-quality staff in the Company;
- align shareholders' interests with those of management of the Company;
- ensure the long-term and sustainable development of the Company.

The KPI system must:

- correspond and be linked to the Company's development strategy;
- be aimed at achieving strategic goals and objectives;
- be transparent;
- be consistent with current market conditions and the best international practice.

The Company established the Remuneration Committee to ensure the implementation of measures stipulated in the Motivation and Remuneration Policy and to manage the process. The Remuneration Committee updates the Motivation and Remuneration Policy to reflect the current situation, makes suggestions on budgeting and performs other regulatory functions. The performance based remuneration system (the KPI system) has been applied since January 1, 2017.

We also highlight that the Cabinet of Ministers of the Republic of Azerbaijan was entrusted by the Decree of the President of the Republic of Azerbaijan dated September 5, 2016, On Additional Measures to Increase Efficiency in the Activities of Legal Entities with a State Controlling Stake, to develop a remuneration system based on performance and the corresponding regulatory act for managing bodies of legal entities. The Motivation and Remuneration Policy prepared by the Company and the KPI system applied ensure the implementation of these measures.

INTERNAL CONTROL AND RISK MANAGEMENT

The Internal Audit Department of ASCO reports directly to the Board of Directors. Internal auditors of the Company are involved in the audit of various fields as well as providing advisory services. These services are approved by the Board of Directors and are subject to the Company's annual internal audit plan. The audit plan is prepared for the next year at the end of each year. Recommendations are made to eliminate inconsistencies discovered during the audit, and regular monitoring of actions taken with regard to discrepancies is conducted. Internal Audit Policy and compliance of internal audit reports with International Standards for the Professional Practice of Internal Auditing are verified by international audit company PwC.

All major business processes, their subprocesses and process owners are identified, and maps of all identified business processes are drawn up. Risks have been identified in the business processes, and the Risks and Control Mechanisms Matrix has been designed by identifying appropriate control mechanisms for these risks. The Internal Audit Department checks the compliance of activities with business processes, monitors the compliance with control mechanisms in the processes, and regularly evaluates internal control mechanisms.

The Risk Committee has also been established along with the Risk Management and Insurance Division to form the Risk Management System (RIS) at ASCO and also to effectively manage the risks inherent to the Company. The composition of the Committee shall be determined by the Chairman of the Company. At quarterly meetings of the Committee, issues related to the risk management process are discussed, and risk management measures are assessed. At the same time, the Corporate Risks Map of ASCO is reviewed by the Committee and submitted to the Chairman of the Company for approval.

The Risk Committee collects and analyzes information and explanations for the risks that have occurred during a certain period of time. In order to prevent the recurrence of the same risk, this risk is reviewed and updated on the basis of the scorecard data. Much attention is paid to the development and regular update of the Corporate Risks Map. In addition, several training courses have been organized to improve the Company's management's, as well as personnel's knowledge of risk management.

The Company's Risk Management System is based on the Enterprise Risk Management (ERM) methodology of COSO (the Committee of Sponsoring Organizations of the Treadway Commission). This system is integrated into the Company's performance and strategy and its purpose is to ensure that the Company achieves its goals.

SUSTAINABLE DEVELOPMENT

SUSTAINABLE DEVELOPMENT

RESULTS IN SUSTAINABLE DEVELOPMENT

Our Company pays special attention to sustainable development and work in this area is a key focus of attention. Starting from 2014, the Company decided to prepare and publish sustainability reports covering a 2-year period reflecting achievements in sustainable development, and to gain external assurance for such reports. In previous reports, for 2014-2015 and 2016-2017, achieving efficiency in environmental, social, economic, health and human resources management has been identified as one of the main goals. The Company's business is managed in a way to achieve positive results in the listed areas, and to expand business activities by providing high-quality services.

ASCO works towards maintaining sustainable development in all major operations and business lines. The regular renewal of our fleets that provide freight and specialized services, fuel savings as a result of more efficient use of ships, the collection of waste from ships, plants and other production facilities and its transfer to the relevant agencies, continuous development of personnel and other similar work, are all examples of the integration of sustainable development principles into ASCO's daily operations. At the same time, the Company's Strategic

Plan focuses on its sustainable development. The Strategic Plan has set targets for sustainable development too, and the Company's management has set activities in line with these targets.

Personnel are the main value of ASCO. Strong, professional and competent staff are the foundation of sustainable development. ASCO recognizes its responsibility for its employees and protects the rights of employees in accordance with relevant local legislation and international corporate governance standards, as well as ensures their social and material wellbeing.

	2018	2017	2016	2015	2014
Workforce, people	8,613	8,921	8,621	8,790	9,123

ASCO's Regulation on Financial Aid was approved in 2014 to provide financial support to people in need within the framework of the Company's corporate social responsibility. In accordance with this Regulation, material assistance is provided to homeless children, financially disadvantaged families, war veterans, and persons with disabilities. The following is a summary of the number of people who have been financially assisted by ASCO:

	2018	2017	2016	2015	2014
Sea Transport Fleet	142	120	110	120	76
Caspian Sea Oil Fleet	240	196	104	67	28
Coastline entities	408	440	271	179	53
Ex-Workers	50	62	48	40	11
Outsiders	7	7	18	4	5
Total	**847**	**825**	**551**	**410**	**173**

ASCO attaches special importance to the safety of all work carried out in the course of its business so that it does not cause injuries to employees, or any other health threat or accident. Management in this area is conducted in line with the laws of the Republic of Azerbaijan, international conventions and ASCO's internal documents. With the introduction of the QHSE Security Quality Management System, adherence to conventions of SOLAS, MARPOL, STCW and the ILO is ensured. In order to ensure the safety of the operations, procedures are being implemented in accordance with the requirements of the Security Quality Management System to continuously identify hazards of specific operations, to conduct risk assessments, to ensure regular monitoring and take measurements, and to ensure proper oversight. Precautionary measures are taken to prevent hazards triggered by employee behavior or other factors that may adversely affect the safety of our employees.

The protection of the environment is important not only for the achievement of sustainable development goals, but also for the preservation of the biological environment we live and operate in, so that we can bequeath it to future generations and build a healthy future. Minimizing the environmental impact, including waste and emissions, of our fleet and coastline entities, compliance with ecological requirements during the retirement of vessels and other fixed assets, as well as using water and energy resources efficiently, are our main priorities. The table below illustrates our energy intensity ratio (using one thousand kWh of electricity per worker):

	2018	2017	2016	2015	2014
Electricity usage per employee (thousands of kWh)	2.91	2.81	2.94	3.28	2.96

You can read more about sustainable development in our Sustainable Development Reports published on ASCO's official website and audited by international audit firm EY.

TARIYEL MIRZAYEV – HEAD OF STRATEGIC DEVELOPMENT AND INVESTMENT PROJECTS DEPARTMENT

After ASCO was established at the end of 2013, based on Mr. President's recommendations and assignments, short, medium and long-term targets were set and Strategic Development Program was prepared and approved. Besides, ASCO's strategic development targets were approved by the decree of the Cabinet of Ministers in 2015 and "the State Program on the Development of Shipping in the Republic of Azerbaijan for the period of 2016-2020" was approved by the Decree of the President of the Republic of Azerbaijan in 2016. During last 5 years, the Company has established its activity in accordance with the mentioned documents and towards execution of the allocated targets and tasks. The Company continues the work in this direction.

According to the strategy, the Company's sustainable development, profitability and transparency in all aspects of its activities are ensured. A strong team is formed, and it is ensured that operations are done in a safe manner and without harming the environment.

Capital repair of vessels and renewal of the fleet take a significant place in ASCO's Strategic Development Program. During last 5 years 20 new vessels were bought and put in operations by ASCO and currently 6 more vessels are built in Baku Shipyard. Additionally, fleet renewal plan is prepared and according to this plan more than 70 various type new vessels are expected to be built in next 10 years.

According to the Company's target of diversifying the activities and decreasing the dependence on one market, ASCO has reestablished its operations in waters beyond the Caspian Sea in 2014 and currently operates 14 vessels under the flag of Azerbaijan in Black and Mediterranean Sea.

Since 2014, an international corporate governance system is applied in ASCO and this system is based on transparency, fairness and reliable partner principles. Each year ASCO's financial statements are prepared based on international standards, audited by international audit company and issued to the public on the official internet page of the Company. At the same time, sustainable development reports covering two-years' period are prepared and placed in our official internet page after an international audit. Various electronic systems are applied in the Company, increasing efficiency of the operations and assisting in making prompt business decisions. In 2015 the Company's international certification works were finished and 5-years ISO and ISM compliance certificates were issued to ASCO by The American Bureau of Shipping. In 2016 the Company received a credit rating for the first time in its history. Since 2017 a renumeration system based on performance results (KPI system) is successfully applied in ASCO. In 2018 ASCO's corporate governance system was analyzed by an international advisory company and the Company was presented a positive corporate governance rating.

ASCO closely cooperates with relevant bodies participating in cargo transportation of our country, as well as other countries and realizes various cooperative projects in order to realize Azerbaijan's transit potential. At the same time, within the frames of the Strategic Roadmap on the Development of Logistics and Trade in the Republic of Azerbaijan approved by the decree of Mr. President, ASCO is realizing projects with relevant bodies of Azerbaijan in order to increase the transit cargo volumes passing through Azerbaijan.

MANAGEMENT DISCUSSION ON THE ACTIVITIES OF THE COMPANY

MANAGEMENT DISCUSSION ON THE ACTIVITIES OF THE COMPANY

With this report, we, as the management of ASCO, intend to highlight how our Company has been creating value so far and how we continue to do so. We are proud to demonstrate that we have been able to manage our resources effectively towards achieving our strategic objectives.

Azerbaijan's shipping industry has undergone huge modernization following the decree of the President of the Republic of Azerbaijan dated October 22, 2013. 100% state owned ASCO was created. Although the restructuring process overlapped with economic challenges in the world caused by the significant drop in global oil prices, the management of the Company achieved better efficiency and effectiveness by turning the challenges into opportunities. By optimally managing allocated government subsidies, which have been decreasing compared to previous years, we have justified the confidence placed in us by the government. Nowadays, the Company is proud to have the biggest flotilla in the Caspian Sea, with 264 vessels.

As the biggest flotilla in the Caspian Sea region, the Company is constantly renewing its fleet, raising its technical capabilities and strengthening its talent pool to overcome new challenges and improve its competitive edge as it expands beyond the Caspian basin. Within the next 10 years, our ambition is to establish a modern, world-class shipping company by rejuvenating our fleet, diversifying and expanding our international operations. As a part of our growth strategy, 14 vessels have been commissioned in the Black Sea and Mediterranean regions. We are planning to invest more than USD 1 billion in expanding our fleet within the next ten years. We are planning to finance this project mostly with our own resources.

We continuously focus on maintaining our fleet in accordance with internationally accepted standards by effective management and significant financial investments. Substantial reforms and structural changes have been achieved since the re-establishment of the Company. The Company introduced SAP system modules in accordance with international standards for the reporting of financial statements, and established a Central Dispatch System, Electronic Supply System, and a unified corporate computer network. At the same time, the Company has carried out measures to optimize the communication of ships with coastal units. Electronic maps have been installed on ships. Moreover, based on the audit conducted by the Nautical Institute on July 6-7, 2017, a certificate was issued for the dynamic positioning (DP) simulator, which is a computer-controlled system for maintaining the position and course of ships, which belongs to the Training Center of the Azerbaijan State Maritime Academy of ASCO. This certificate allows the center to conduct DP Induction and DP Simulator training.

Additionally, since the Company's re-establishment our financial statements are issued and externally audited by international audit firm EY. In light of our acknowledgement that the achievement of not only economic but also safety, social and environmental objectives are the main criteria critical for the Company's success, we issue a biannual Sustainable Development Report. Our Company is one of the sustainable development pioneers in the country, demonstrating support for the government's policy and strategy to implement the global sustainability agenda. Reliable financial and sustainability reports will further contribute to ensuring transparency in the Company's operations.

Detailed information about our operations is given in the Our fleet and main business activities section of this report.

OUR COMPETITIVE ADVANTAGE

The Caspian region has been an important global energy basin since the early 19th century and benefits from comparatively low extraction costs, significant reserves and growing production levels.

We have an experience of 160 years in the shipping industry. During this period, we have continuously developed in every aspect of the business. Our main assets are our teams dedicated to their work and highly qualified sailors. Our fleet consisting of various type modern vessels meeting the requirements of customers is the most diversified and rich fleet in the Caspian Sea. With the government support added to the mentioned points, ASCO is currently one of the leading shipping companies. Mentioned points are the foundation of our competitive advantage.


BƏSTƏKAR QARA QARAYEV

OUTLOOK ON BUSINESS RISKS

We have laid out here the main risks that are significant for our operations. Acknowledging these risks, we closely track all the trends, risks and uncertainties to be able to assess them in a timely fashion and to prevent or mitigate them in a proactive manner. The level of our exposure to risks is effectively controlled by our risk management system. We also assess some risks not only just as threats but also as our drivers for change and areas for improvement. We have attracted tangible investment to turn those risks into opportunities.

Reputation risk

Due to reasons such as an inability to build professional relationships, to provide lower service levels, not to meet contractual obligations and others, our Company may lose value in front of stakeholders. In order to avoid this risk, we must provide customers with a high level of service, as well as ensure that transportation is safe and secure, without causing any damage to the environment and cargo, and without our passengers' dissatisfaction. Moreover, it is important to review a potential partner's business history before engaging in a relationship, maintaining long-term cooperation principles and business ethics.

Competition risk

We can lose market share and profits as a result of our failure to exploit our competitive advantage, weak research, the non-renewal of fleet and lack of competitiveness. For this reason, ASCO carries out a regular review of both the Caspian and beyond Caspian markets, studying customers' needs and competitors in the markets, investigating the strengths and weaknesses of our Company, and identifying and maintaining our competitive advantage.

Political and economic risks

Any failure to carry out transportation or provide offshore support services due to the political and economic situation in our region of activity, may jeopardize business continuity. To be prepared, it is important to monitor the political and economic dynamics in the region of activity and increase our independence from these political and economic influences.

Failure to prepare strong local personnel

The main source of the success of our shipping business is the professionalism of the Azerbaijani sailors. Inadequate staffing, lack of training and an inability to retain talent may result in an additional financial burden, the need for external professionals, and shortcomings in common business processes. For this reason, the promotion of the sailor profession in the country is one of our main goals. Determining training needs and courses for each area of our business, training our students in international waters and on our Company's ships sailing abroad, strengthening the education infrastructure of our academy, and improving the wellbeing of our staff are the most important steps we have undertaken to prevent this risk.

Loss of customers due to outdated ships

The high service age of ships and equipment and the possibility that they don’t meet the modern requirements can lead to loss of customers. In order to avoid this, old ships must be operated in accordance with their technical condition, the marine quality of the vessels should be kept under constant watch and the ships should be repaired in accordance with the repair plan, and the modernization of ships should be carried out on time, taking into account the technical and construction indicators.

The risk to life and health of employees

Damage to life and health as a result of a breach of safety rules and reduced control may result in the delay in the implementation of common business processes and harm the reputation of the Company. At ASCO, we monitor the use of personal protective equipment and its regular use. Relevant measures are taken to ensure that the working conditions of employees meet the requirements of existing standards, and staff are provided with timely instructions and training. It is crucial to comply with the rules of safe conduct during the use and transportation of toxic chemical substances in the workplace. Moreover, staff participation in first medical aid courses is ensured.

Damage that may arise from the extension of repair periods

Due to mistakes in the repair process, any prolongation of repair periods may result in the loss of profits and a delay in overall business processes. In order to avoid this risk, we pay special attention to the timely preparation of repair estimate documentation and the elimination of delays in purchasing spare parts and materials. Other important factors include the maintenance of equipment and lifting equipment installed on lateral bridges for repair, and the knowledge and skills of the repair workers.

Damage to the environment

Violation of maritime industry safety rules may result in pollution of the sea or groundwater with oil or petroleum products, household waste or chemical products. In order to avoid this risk, we attach special importance to the cleaning of oil-fuel tanks of vessels under repair, to the preparation of emergency action plans, to enhancing the skills and habits of employees through training, and to complying with production process rules when collecting, transporting and handling household wastewater.

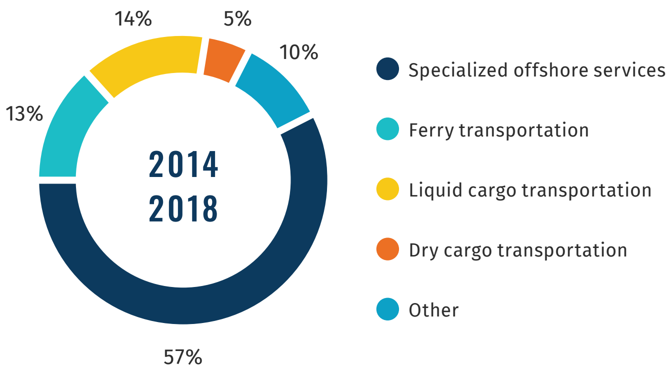
The technical specifications of our vessels sailing in international waters are consistent with those required by IMO. We have to timely incur certain maintenance costs to keep standards high. Sulphur emission limit tightened by IMO is not yet applied in the Caspian Sea. If this regulatory

requirement is adopted in the Caspian Sea in the future, that could lead to the use of more expensive and low-sulphur blends and the need for capital to make necessary modifications to vessels. In the long-run, however, we embrace these risks as an opportunity for us to shift to a more energy-efficient technology and further modernize our fleet.

OUR BUSINESS AND INDUSTRY

Our business comprises of specialized offshore support services, transportation services (ferry, liquid and dry cargo) and other services. As we mostly earn revenues from offshore and transportation services, our discussions are mainly focused on these services. The breakdown of our revenues from services provided for the 5 years starting the establishment of our Company is given below.

Revenue breakdown by services provided during the period of 2014-2018 (%)



Oil fleet

Global energy demand is the fundamental driver of all oil and gas related activities. While crude oil remains the key energy source in the market, natural gas is gaining importance globally as the demand for a relatively clean fuel source becomes more important. According to ExxonMobil's 2018 Outlook for Energy, natural gas will grow at the fastest rate of all energy sources, reaching a quarter of all demand by 2040. Oil will continue to play a key role in the world's energy mix, with growing demand driven by commercial transportation needs and feedstock requirements for the chemicals industry.

Trends in exploration and production expenditure on oil and gas fields have a direct impact on our operations. According to the Westwood Global Energy Group, Eastern Europe and CIS countries are expected to see growth of 28% in aggregate exploration and production costs of oil and gas fields (compared with the last five-year period). The bulk of Azerbaijan's gas is sourced from the Shah Deniz field. Production is expected to increase sharply after the commencement of the second phase of the Shah Deniz project in 2019.

Utilization rates of our oil fleet vessels were on a steadily high level. Utilization rates through last five years varied between 85% and 88%. The utilization rate is one of our key performance indicators, illustrating how we have been taking the fullest advantage of our fleet by efficiently exploiting the broad vessel spectrum.

Demand for offshore support services in Caspian region is forecasted to grow. In the long run, according to Douglas-Westwood, there will be a positive shift in the offshore vessel market with the demand for all offshore vessel types increasing globally by 3.7% per year on average between 2014 and 2025, driven by growing offshore oil and gas supply in the coming years, notably in deep offshore fields.

We expect steady future growth in revenue generation from our offshore support vessels due to the rise in demand for offshore vessels caused by accelerated offshore activities, given that the Company is continuously investing to maintain its competitiveness in this market.

Transportation fleet

Over the past decade, the shipping industry has seen a general trend of increase in total trade volume. The United Nations Conference on Trade and Development (UNCTAD) forecasts world seaborne trade volumes to grow at an estimated compound annual growth rate of 3.2 percent between 2017 and 2022. According to Clarksons Research, world seaborne tanker trade – crude oil, refined petroleum products and gas – continued to grow in 2016, with an increase in oil market supply and low oil prices, and will continue to grow. The Food and Agriculture Organization (FAO) predicts that global demand for agricultural products will continue to rise at a pace of 1.4% a year for 2015 to 2030. In the longer term, the fact that shipping is the most fuel efficient and carbon friendly type of commercial transport should lead to a greater proportion of world trade being carried by sea, according to the International Chamber of Shipping.

Within our transportation service line, we offer liquid cargo (tanker), dry cargo and ferry transportation services. Our liquid cargo is mainly crude oil, fuel oil and diesel fuel, as well as other petroleum products. Our liquid cargo transportation revenue experienced an increase of 23% in 2018 in comparison to the previous year. Generally, we expect positive trends in the energy sector to continue, with a notable increase in oil consumption. Demand for consumer-led oil products should boost our liquid cargo transportation service line.

Dry cargo transportation includes the transportation of a variety of agricultural commodities, construction materials and metals. Revenues generated from this service have been growing over recent years. There was a 16% increase in dry cargo transportation revenue in 2018 in comparison to the previous year. Most of our dry cargo transportation revenue come from agricultural commodities shipping, mainly wheat and corn. Our continual revenue growth generated from dry cargo transportation is explained not only by the rise in vessel numbers, but also by our operational efficiency and the quality of our services. As the world's population is rising and the demand for agricultural products is predicted to grow, we expect to increase our revenues from dry cargo transportation, given that ASCO will further modernize its fleet in terms of quality, number and type of vessels to efficiently meet our clients' demands.

DISCUSSIONS ON FINANCIAL POSITION

The preparation of consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. A summary of the Company's significant accounting policies, estimates and assumptions, including accounting pronouncements that will be adopted in future periods, can be found in notes 2 to 5 of the audited consolidated financial statements for the year ended December 31, 2018, which are an integral part of this report.

Non-current assets of the Company mainly consist of vessels, plant and equipment. Current assets mainly contain such accounts as inventories and trade and other receivables. Non-current liabilities mainly consist of long-term loans. Current liabilities are mainly trade and other payables and the current portion of long-term loans.

	2018	2017	2016
Specialized offshore fleet	249,290,442	284,878,007	285,428,957
Ferry transportation	68,761,101	84,496,596	71,773,956
Liquid cargo transportation	60,692,007	56,502,497	64,867,942
Dry cargo transportation	39,348,277	38,938,797	23,454,173
Other	34,079,173	9,489,103	9,399,972
Total revenue, AZN	**452,171,000**	**474,305,000**	**454,925,000**

As can be seen from the table above, we earn most of our revenues from offshore services, ferry transportation, liquid and dry cargo transportations.

Financial risks – we are exposed to financial risks, including liquidity risk, credit risk, currency risk, market risk, interest rate risk and price risk. That is why we constantly monitor fluctuations and take necessary actions to mitigate risks. We are careful when dealing with foreign currency transactions and we give preference to providing pre-paid services.

	2018	2017	2016	2015	2014
Gross margin	**35%**	**44%**	**41%**	**32%**	**8%**

We have a consistent increase in the gross margin with a slight decrease in 2018, which proves that investments made by the government have been successfully utilized in terms of improving the overall profitability of our Company and contributing to the prosperity of the local economy.

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed capital conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

	2018	2017	2016	2015	2014
Current ratio	2.25	3.52	3.91	2.59	1.10
Acid test	1.64	2.52	2.84	1.74	0.71

According to the liquidity analysis, the Company has high ratios, demonstrating its ability to cover its short-term debt with assets that can be easily converted into cash and cash equivalents.

For more information on ASCO's financial results, please refer to the audited financial statements for the year ended December 31, 2018, which are an integral part of this report. This and audited financial statements for the years ended 31 December 2014, 2015, 2016 and 2017 can be easily found on our Company's official website.

FINANCIAL REPORTS

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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.

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

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)

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.

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 govern-ment control 31 December 2018	**Government and entities under govern-ment 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.

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