m2 Commercial Assets LLC

Carve-out financial statements

For the year ended 31 December 2017
with independent auditor's report

Contents

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Independent auditor's report

To the Participant and Management of m2 Commercial Assets LLC

Opinion

We have audited the carve-out financial statements of m2 Commercial Assets LLC (the Company), which comprise the carve-out statement of financial position as at 31 December 2017, and the carve-out statement of comprehensive income, carve-out statement of changes in invested capital and carve-out statement of cash flows for the year then ended, and notes to the carve-out financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying carve-out financial statements present fairly, in all material respects, the carve-out financial position of the Company as at 31 December 2017 and its carve-out financial performance and its carve-out 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 carve-out financial statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the carve-out financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and 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 Supervisory Board of JSC m2 Real Estate for the carve-out financial statements

Management is responsible for the preparation and fair presentation of the carve-out financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of carve-out financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the carve-out financial statements, management is responsible for assessing the Company'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 Company or to cease operations, or has no realistic alternative but to do so.

Supervisory Board of JSC m2 Real Estate are responsible for overseeing the Company's financial reporting process.

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Auditor's responsibilities for the audit of the carve-out financial statements

Our objectives are to obtain reasonable assurance about whether the carve-out financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these carve-out 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 carve-out 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 Company'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 Company'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 carve-out 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 Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the carve-out financial statements, including the disclosures, and whether the carve-out financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Building a better working world

We communicate with Supervisory Board of JSC m2 Real Estate 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.

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

4 December 2018

Carve-out statement of comprehensive income

For the year ended 31 December

(Thousands of Georgian Lari)

	Notes	2017	2016
Rental income	5	3,628	2,758
Property operating expense	6	(615)	(531)
Net rental income		3,013	2,227
Net gain from revaluation of investment property	10	805	2,121
Net gain from revaluation of investment property under construction	11	21,380	–
Net gain from revaluation		22,185	2,121
Employee benefits expense		(268)	(165)
Other general and administrative expenses		(274)	(64)
Profit before income tax		24,656	4,119
Income tax benefit	7	–	851
Profit for the year		24,656	4,970
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Exchange difference on translation of operations to presentation currency		1,617	5,579
Total comprehensive income for the year		26,273	10,549

Signed and authorised for release on behalf of the management of the Company.

Chief Executive Officer Giorgi Natroshvili

4 December 2018

The accompanying notes on pages 5-17 are an integral part of these carve-out financial statements.

Carve-out statement of financial position

As at 31 December

(Thousands of Georgian Lari)

	Notes	2017	2016	1 January 2016
Assets				
Non-current assets				
Investment property	8	41,172	40,713	30,409
Investment property under construction	9	33,428	1,390	–
		74,600	42,103	30,409
Current assets				
Prepayments and other assets	10	910	231	–
Trade and other receivables	10	342	304	336
		1,252	535	336
Total assets		75,852	42,638	30,745
Invested capital		75,605	41,442	29,083
Non-current liabilities				
Deferred income tax liabilities	7	–	–	1,469
		–	–	1,469
Current liabilities				
Current income tax liabilities	7	–	431	193
Trade and other payables		126	478	–
Other liabilities		121	287	–
		247	1,196	193
Total liabilities		247	1,196	1,662
Total invested capital and liabilities		75,852	42,638	30,745

The accompanying notes on pages 5-17 are an integral part of these carve-out financial statements.

Carve-out statement of changes in invested capital

For the year ended 31 December

(Thousands of Georgian Lari)

	Invested capital
At 1 January 2016	29,083
Net profit	4,970
Other comprehensive income	5,579
Total comprehensive income for the year	10,549
Net capital distribution from Parent (Note 11)	3,808
Deemed profit distribution (Note 11)	(2,092)
Share based payments	94
At 31 December 2016	41,442
Net profit	24,656
Other comprehensive income	1,617
Total comprehensive income for the year	26,273
Net capital contribution from Parent (Note 11)	10,361
Deemed profit distribution (Note 11)	(2,608)
Share based payments	137
At 31 December 2017	75,605

The accompanying notes on pages 5-17 are an integral part of these carve-out financial statements.

Carve-out statement of cash flows

For the year ended 31 December

(Thousands of Georgian Lari)

	Notes	2017	2016
Operating activities			
Profit before income tax		24,656	4,119
Gain from valuation of investment property and investment property under construction	10, 11	(22,185)	(2,121)
Share based payments		137	94
Operating gain before changes in working capital		2,608	2,092
Working capital adjustments			
Increase in prepayments and other assets		(679)	(231)
Decrease/(increase) trade and other receivables		(38)	32
(Decrease)/increase in trade and other payables		(352)	478
Decrease/(increase) in other current liabilities		(166)	287
Cash flows from operating activities		1,373	2,658
Income tax paid		–	(62)
Net cash flows from operating activities		1,373	2,596
Investing activities			
Purchase of investment property	8	–	(2,281)
Capital expenditure on investment property		(70)	(1,076)
Capital expenditure on investment property under construction		(8,759)	(1,253)
Net cash flows used in investing activities		(8,829)	(4,610)
Cash flows from financing activities			
Deemed profit distribution	11	(2,608)	(2,092)
Net contribution from the Parent	11	10,064	4,106
Net cash flows from financing activities		7,456	2,014
Net increase in cash and cash equivalents		–	–
Cash and cash equivalents at 1 January		–	–
Cash and cash equivalents at 31 December		–	–

The accompanying notes on pages 5-17 are an integral part of these carve-out financial statements.

(Thousands of Georgian Lari)

1. Background

JSC m2 Real Estate (the "Parent") is a joint stock company incorporated on 27 September 2006. The legal address of the Parent is 29, I. Chavchavadze Ave, 0179, Tbilisi, Georgia. The Parent, together with subsidiaries, is referred to as the "Group". The Group's principal activities included development and sales of mainly residential apartments and investment property management. The Group's ultimate parent as at 31 December 2017, 31 December 2016 and 1 January 2016 was BGEO Group plc ("BGEO"), a UK-incorporated entity listed on London Stock Exchange. Following BGEO's demerger of its investment business in May 2018, the Group's ultimate parent became Georgia Capital plc, a UK-incorporated entity listed on London Stock Exchange.

In 2018, the Group initiated a corporate reorganization in order to legally separate its yield-generating segment with view of issuance of local bonds secured by the Group's portfolio of yield-generating properties. In April 2018, the Parent established a 100% owned subsidiary m2 Commercial Assets LLC ("the Company") and initiated a plan (expected to be completed in December 2018) to transfer properties of the Group's yield-generating segment from various Group's subsidiaries to the Company. The Company will then aim at the issuance of the local bonds and their listing on Georgian Stock Exchange. The legal address of the Company is 29, I. Chavchavadze Ave, 0179, Tbilisi, Georgia.

In the view of the bonds listing and in order to reflect the effects of reorganization through the separation of its yield-generating business segment and establishment of the Company, the management of the Parent prepared these carve-out financial statements of the Company for the year ended 31 December 2017.

2. Basis of preparation

Basis of carve-out

The Company has historically operated as part of the Parent and not as a standalone company. Therefore these carve-out financial statements have been prepared by separating yield-generating segment out of the Group's consolidated financial statements prepared in accordance with IFRS based on the criteria and assumptions further discussed in this note below assuming that the Company's date of transition to IFRS is the initial date of transition to IFRS of the Parent.

The Company applied consistent criteria and assumptions to allocate the assets and liabilities, income and expenses and cash flows and as at 31 December 2017 and 2016 and for the years then ended. All significant transactions between the Company and the Parent have been included in these carve-out financial statements.

Carve-out assumptions

Those investment properties, investment properties under construction have been included in these carve-out financial statements that are due to be transferred to m2 Commercial Assets LLC, together with respective rental income, property operating expense, valuation gains and losses, as well as trade receivables and payables, prepayments and other assets and liabilities directly attributable to operations of those properties (for example rent receivables, utilities and other costs payable or prepaid).

Employee benefits expense were recognized in these carve-out financial statements to the extend attributable to specific employees responsible for operations of the yield-generating segment, and a portion of other employee benefits (e.g. those of the Group's head office employees) recognized in the consolidated financial statements of the Group pro rata to yield-generating segment's share in total revenue of the Group.

General and administrative expenses were included to these carve out financial statements pro rata to yield-generating segment's share in total revenue of the Group.

Income tax was estimated based on statutory tax rate, adjusted as appropriate for the effects of known non-taxable and non-deductible items reported in the carve-out income statement as described above.

Cash flows directly attributable to acquisition, construction and operating of the properties reported in the carve-out statement of financial position (including respective capital expenditures incurred reported under investing cash flows) are reported in the carve-out statement of cash flows, with balancing movement "Net cash contribution by the Parent" reported under financing cash flows.

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

Carve-out assumptions (continued)

The difference between yield-generating segment's assets and liabilities is presented as "Invested capital" in the carve-out statement of financial position. The Company discloses movements in invested capital in carve-out statement of changes in invested capital, showing separately capital investments (e.g. acquisitions of properties due to be transferred to the Company, and capital expenditures incurred on their construction) and invested capital withdrawals (e.g. reallocation of net cash generated by the properties to the Parent company).

Amounts recognized by the Company are not necessarily representative of the amounts that would have been reflected in the financial statements had the Company operated independently of the Parent. Accordingly, none of the Parent's cash, cash equivalents or borrowings at the corporate level have been assigned to the Company in these carve-out financial statements.

Statement of compliance

These carve-out financial statements have been prepared in accordance with International Financial reporting standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

General

These carve-out financial statements have been prepared on a going concern basis and under the historical cost convention except for valuation of investment property, investment property under construction which are carried at fair value.

These carve-out financial statements have been presented in thousands of Georgian Lari (GEL), except otherwise stated.

These carve-out financial statements have not yet been approved by the Parent. The Parent has the power and authority to amend the carve-out financial statements after the issuance.

3.1. Summary of significant accounting policies

Adoption of new or revised standards and interpretations

The Company early adopted IFRS 15 Revenue from Contracts with Customers starting from 1 January 2017 using modified retrospective approach. Early adoption of IFRS 15 did not have any impact on the Company as all of its revenue (rental income) is outside the scope of the new standard. No other new or revised IFRS that became effective in 2017 had any impact on the Company's financial position, performance or disclosure.

Revenue recognition

Rental income

The Company is the lessor in operating leases. Rental income arising from operating leases on investment property is accounted for on a straight-line basis over the lease term. 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..

Functional, presentation currencies and foreign currency translation

The carve-out financial statements are presented in Georgian Lari, which is the Company's presentation currency. The Company's functional currency is US Dollar, which is the currency of denomination of vast majority Company's rental agreements and currency in which investment properties are priced in the Georgian real estate market. The Company uses presentation currency different from its functional currency as the Company considers it provides more relevant and appropriate information to the users of the carve-out financial statements, as using Georgian Lari as presentation currency is common practice for Georgian reporters.

(Thousands of Georgian Lari)

3.1. Summary of significant accounting policies (continued)

Functional, presentation currencies and foreign currency translation (continued)

Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into functional currency at functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of comprehensive income as net foreign exchange gain/(loss). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. When a gain or loss on a non-monetary item is recognized in other comprehensive income, any exchange component of that gain or loss is recognized in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognized in profit or loss, any exchange component of that gain or loss is recognized in profit or loss.

Differences between the contractual exchange rate of a certain transaction and the National Bank of Georgia (“NBG”) exchange rate on the date of the transaction are included in Net foreign exchange gain/(loss).

The official NBG exchange rate at 31 December 2017, 31 December 2016 and 1 January 2016 were 2.5922, 2.6468 and 2.3949 GEL to 1 USD respectively.

Taxation

The annual profit earned by entities other than banks, insurance companies and microfinance organizations is not taxed in Georgia starting from 1 January 2017 (Note 7). Corporate income tax is paid on dividends is levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia at the rate of 15/85 of net distribution. The corporate income tax arising from the payment of dividends is accounted for as a liability and expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid. In certain circumstances, deductions from income tax charge payable are available that are accounted as reduction of income tax expense related to respective distribution. Due to the nature of the Georgian taxation system, no deferred tax assets and liabilities arise for the entities registered in Georgia.

Georgian tax legislation also provides for charging corporate income tax on certain transactions that are considered deemed profit distributions (for example, transactions at non-market prices, non-business related expenses or supply of goods and services free of charge). Taxation of such transactions is accounted similar to operating taxes.

Georgia also has various operating taxes that are assessed on the Company’s activities. These taxes are included as a component of general and administrative expenses.

Investment property

Investment property includes buildings held for earning rental income and land plots held for a currently undetermined future use or with a view of future redevelopment for future use as investment property.

Investment property is measured initially at cost including transaction costs. Transaction costs include transfer taxes, professional fees for legal services and initial leasing commissions to bring the property to the condition necessary for it to be capable of operating. The carrying amount also includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met, and borrowing costs.

Subsequent to initial recognition, investment property is stated at fair value. Gains or losses arising from changes in the fair values are charged to profit or loss in the year in which they arise.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by commencement of an operating lease. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of development with a view to sale.

Investment property under construction

Investment property under construction is accounted in the same way as the completed investment property, unless its fair value cannot be determined reliably. In that case, investment property under construction is accounted at cost until the construction is complete or fair value becomes reliably measurable.

(Thousands of Georgian Lari)

3.1. Summary of significant accounting policies (continued)

Operating leases

Where the Company is a lessor in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Company, the total lease payments are charged to profit or loss on a straight-line basis over the lease term.

Financial assets

Initial recognition

All Company's financial assets in the scope of IAS 39 are classified as loans and receivables. When financial assets are recognized initially, they are measured at fair value, plus directly attributable transaction costs. The Company determines the classification of its financial assets upon initial recognition.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate (EIR) method, less impairment. Amortized 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 amortization is included in finance income in the statement of profit or loss.

Rent and other receivables are recognized at their original invoiced value. Where the time value of money is material, receivables are carried at amortized cost.

Fair value measurements

The Company measures certain non-financial assets such as investment property, at fair value at the end of each reporting period.

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 Company is able to access the principal or the most advantageous market at the measurement date.

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 Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs 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.

Fair value of assets included in Level 3 of the fair value hierarchy may be subject to change once and if observable relevant transactions are available.

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

(Thousands of Georgian Lari)

3.1. Summary of significant accounting policies (continued)

Financial liabilities

Financial liabilities (including trade and other payables) are initially recognized at fair value plus directly attributable transaction costs.

After initial recognition, these are 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.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Company has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Company.

Segment reporting

As at 31 December 2017, the chief operating decision maker evaluates the whole Company as a single operating segment, yield-generating business. All of Company’s assets and liabilities are concentrated in Georgia and revenue from external customers is received from the operations in Georgia. No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Company’s total revenue in 2017 or 2016.

Borrowing costs

Borrowing costs comprise interest expense calculated using the effective interest method and exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period in which they occur.

(Thousands of Georgian Lari)

3.1. Summary of significant accounting policies (continued)

Borrowing costs (continued)

As the Company borrows funds specifically for the purpose of each development project, amount of borrowing costs eligible for capitalisation is determined as the actual borrowing costs incurred on that borrowing during the period of property development phase.

3.2. Significant accounting judgements, estimates and assumptions

The preparation of the Company's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Estimates

Measurement of fair value of investment properties and investment properties under construction

The fair value of investment properties and investment properties under construction is determined by independent professionally qualified appraisers. Fair value is determined using a combination of the internal capitalization method (also known as discounted future cash flow method) and the sales comparison method.

The Company performs valuation of its investment properties and investment properties under construction with a sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Results of this valuation, as well as valuation inputs and techniques are presented in Note 8 and 9. While the secondary market in Georgia provides adequate market information for fair value measurements for small and medium sized properties, valuation of large and unique properties involves application of various observable and unobservable inputs to determine adjustments to the available comparable sale prices. These estimates and assumptions are based on the best available information, however, actual results could be different.

4. Standards issued but not yet effective

Up to the date of approval of the financial statements, certain new standards, interpretations and amendments to existing standards have been published that are not yet effective for the current reporting period and which the Company has not early adopted. Such standards that are expected to have an impact on the Company, or the impacts of which are currently being assessed are as follows:

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Company adopted the new standard on the required effective date without restatement of the comparative information Adoption of IFRS 9 did not have any significant impact on the Company's statement of financial position and equity.

(Thousands of Georgian Lari)

4. Standards issued but not yet effective (continued)

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's 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 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

The Company is currently assessing the impact of IFRS 16 on its carve-out financial statements.

Transfers of Investment Property – Amendments to IAS 40

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. Early application of the amendments is permitted and must be disclosed. The Company will apply amendments when they become effective. However, since Company's current practice is in line with the clarifications issued, the Company does not expect any effect on its carve-out financial statements.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the transaction date for each payment or receipt of advance consideration. Entities may apply the amendments on a fully retrospective basis. Alternatively, an entity may apply the Interpretation prospectively to all assets, expenses and income in its scope that are initially recognised on or after:

(i) The beginning of the reporting period in which the entity first applies the interpretation; or

(ii) The beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

The Interpretation is effective for annual periods beginning on or after 1 January 2018. Early application of interpretation is permitted and must be disclosed. However, since the Company's current practice is in line with the Interpretation, the Company does not expect any effect on its carve-out financial statements.

(Thousands of Georgian Lari)

4. Standards issued but not yet effective (continued)

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.

An entity must 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 Company will apply interpretation from its effective date and is currently assessing its impact.

Other standards and interpretations issued but not yet effective are not expected to have an impact on the Company.

5. Rental Income

	2017	2016
Rental income		
Retail	1,282	804
Office	1,656	1,236
Warehouse	690	718
	3,628	2,758

The Company's future minimum lease payments receivable under non-cancellable operating leases amounted to:

	2017	2016	1 January 2016
Not later than 1 year	4,616	4,029	1,769
Later than 1 year but not later than 5 years	10,368	9,562	3,783
Later than 5 years	3,869	3,411	–
Total	18,853	17,002	5,552

Most of the Company's leases are priced in USD and have lease term varying from 3 months to 10 years (average term: 4 years).

6. Property operating expense

	2017	2016
Property tax	360	307
Insurance	88	64
Security	79	84
Utilities	53	40
Maintenance	35	36
Total property operating expense	615	531
Of which related to properties that did not generate rental income	174	7

(Thousands of Georgian Lari)

7. Income tax

In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments became effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date is 1 January 2019. Under the new regulation, corporate income tax is levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia, rather than on profit earned. The amount of tax payable on a dividend distribution is calculated as 15/85 of the amount of net distribution. The companies are able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation. Dividends distributions between Georgian resident companies is not subject to corporate income tax.

Following the enactment of the amendments, as at 31 December 2016 the Company reversed in full its deferred tax assets and liabilities based on IAS 12 Income Taxes requirement to measure deferred taxes at 0% tax rate applicable for undistributed profits starting from 1 January 2017, recognising GEL 1,151 as income tax benefit for the period.

The corporate income tax charge comprises:

	2017	2016
Current income tax charge	–	(300)
Deferred tax benefit relating to origination and reversal of temporary differences	–	1,151
Total income tax benefit	–	851

Income tax liabilities comprised nil as at 31 December 2017 (2016 – 431, 1 January 2016 – 193).

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2017	2016
Net dividends (2017) / profit before tax (2016)	–	4,119
Statutory tax rate	15/85	15%
Theoretical income tax expense at the statutory rate	–	(618)
Effect from change in tax legislation	–	1,151
Non-deductible expenditures less non-taxable income	–	318
Income tax benefit	–	851

Applicable tax regulations are often unclear and not large number of precedents have been established. This creates tax risks in Georgia, substantially more significant than typically found in countries with more developed tax systems. Management believes that the Company is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard to interpretative issues.

(Thousands of Georgian Lari)

8. Investment property

The table below shows movements in investment property:

Investment property	Amount, GEL
At 1 January 2016	30,409
Acquisitions	2,281
Net gain from revaluation	2,121
Capital expenditure	1,076
Currency translation effect	4,826
At 31 December 2016	40,713
Net gain from revaluation	805
Capital expenditure	70
Contributions from Parent	706
Currency translation effect	(1,122)
At 31 December 2017	41,172

Retail properties represent office buildings rented out. Included into other investment properties are the buildings not rented out but held for capital appreciation purposes. Most of Company's investment properties are located in Tbilisi, Georgia as at 31 December 2017, 2016 and 1 January 2016.

Fair value measurement of investment property

Investment properties are stated at fair value. The fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The date of latest valuation performed by independent appraiser for investment property and investment property under construction are 30 September 2017 and 31 December 2017, respectively. The valuation was performed by an accredited independent valuator with a recognized and relevant professional qualification and with recent experience in the locations and categories of the investment property being valued. The valuation models in accordance with those recommended by the International Valuation Standards Committee have been applied and are consistent with the principles in IFRS 13. Investment property valuation belongs to Level 3 of fair value hierarchy.

Market comparison and income approaches were used to value the investment properties.

Market approach

This method is based on the direct comparison of the subject property to another property object, which has been sold or has been entered on the sale registry. Adjustments to value are determined based on the following considerations in the order of priority: 1) funding conditions; 2) sale conditions; 3) market conditions; 4) location; and 5) physical indices.

Income approach

Income approach is a valuation method that appraisers and real estate investors use to estimate the value of income producing real estate. It is based upon the premise of anticipation i.e., the expectation of future benefits. Under the income approach, the value of property is estimated based on the income that the property can be expected to generate. Income capitalization converts anticipated cash flows into present value by "capitalizing" net operating income by a market derived "capitalization rate". A capitalization rate is a rate of return on investment. It is used by real estate investors as a benchmark for determining how much they should pay for a property.

(Thousands of Georgian Lari)

8. Investment property (continued)

Fair value measurement of investment property (continued)

For the purpose of fair value disclosures, the Company identified three classes of investment properties – retail properties, land and other properties. The following table shows descriptions of significant unobservable inputs to valuation as well as sensitivity of the inputs as at 31 December 2017, 2016 and 1 January 2016:

Class of investment properties	Fair value 2017	Valuation technique	Significant unobservable inputs	Range (weighted average)	Type	Total area, square meters
Retail properties	11,315	Market approach / income approach	Price per square meter, GEL	1.60-7.15 (3.33)	Building	2,333
			Capitalization rate	8.50%-9.50% (8.90%)		
	1,006	Income approach	Capitalization rate	9.50%-9.50% (9.50%)	Building	689
					Land	1,158
Office	1,387	Market approach	Price per square meter, GEL	2.14-3.19 (2.81)	Building	493
	20,595	Market approach / income approach	Price per square meter, GEL	1.18-3.81 (2.03)	Building	8,996
			Capitalization rate	8.50%-9.00% (8.88%)	Land	4,464
Warehouse	6,869	Market approach / income approach	Price per square meter, GEL	0.07-0.28 (0.15)	Building	12,346
			Capitalization rate	8.00%-10.50% (9.67%)	Land	37,110
	41,172					67,589

Class of investment properties	Fair value 2016	Valuation technique	Significant unobservable inputs	Range (weighted average)	Type	Total area, square meters
Retail properties	1,636	Market approach	Price per square meter, GEL	0.16-2.67 (1.09)	Building	1,232
					Land	1,158
	10.402	Market approach / income approach	Price per square meter, GEL	2.18-2.18 (2.18)	Building	1,893
			Capitalization rate	9.00%-10.00% (9.50%)		
Office	16,455	Market approach	Price per square meter, GEL	1.36-3.41 (2.07)	Building	5,955
					Land	4,464
	4,661	Market approach / income approach	Price per square meter, GEL	1.53-1.53 (1.53)	Building	3,040
			Capitalization rate	9.00%-9.00% (9.00%)		
Warehouse	7,559	Market approach	Price per square meter, GEL	0.07-0.32 (0.17)	Building	11,574
					Land	37,110
	40,713					66,426

Class of investment properties	Fair value 1 January 2016	Valuation technique	Significant unobservable inputs	Range (weighted average)	Type	Total area, square meters
Retail properties	1,900	Market approach	Price per square meter, GEL	0.33-2.34 (1.13)	Building	1,817
					Land	1,158
	7,449	Market approach / income approach	Price per square meter, GEL	6.05-6.05 (6.05)	Building	1,231
			Capitalization rate	8.50%-8.50% (8.50%)		
Office	14,466	Income approach	Capitalization rate	11.20%-13.50% (12.73%)	Building	5,955
Warehouse	6,594	Market approach	Price per square meter, GEL	0.06-0.27 (0.15)	Building	12,346
					Land	37,110
	30,409					59,617

Increase in the price per square meter and decrease in capitalization rate would result in increase in fair values of the investment properties.

(Thousands of Georgian Lari)

9. Investment property under construction

A summary of movement in investment property under construction:

	Retail	Office	Kindergarten	Total
At 1 January 2016	–	–	–	–
Capital expenditure	1,253	–	–	1,253
Currency translation effect	137	–	–	137
At 31 December 2016	1,390	–	–	1,390
Net gain from revaluation	16,880	4,343	157	21,380
Capital expenditure	2,693	4,355	1,238	8,286
Borrowing costs capitalized	171	233	69	473
Currency translation effect	1,360	481	58	1,899
At 31 December 2017	22,494	9,412	1,522	33,428

The Company determined that fair values of investment properties under construction became reliably measurable as at 31 December 2017 (2016 – fair values were not reliably determinable and thus investment properties under construction were measured at cost). The following table shows descriptions of significant unobservable inputs to valuation as well as sensitivity of the inputs for 2017:

Class of investment properties under construction	Fair value 2017	Valuation technique	Significant unobservable inputs	Range (weighted average)	Type	Total area, square meters
Retail	22,494	Market approach	Rent price per square meter, GEL	3.59-8.86 (6.29)	Building	3,979
					Building	–
Office	9,412	Market approach	Rent price per square meter, GEL	1.97-1.97 (1.97)	Building	4,778
					Building	–
Kindergarten	1,522	Market approach	Rent price per square meter, GEL	0.99-1.36 (1.18)	Building	1,314
					Building	–
					Building	–
Total	33,428					10,071

Increase in the rent price per square meter would result in increase in fair value of investment properties under construction.

10. Prepayments, other assets and trade receivables

At 31 December prepayments and other assets comprised of the following:

	2017	2016	1 January 2016
VAT prepayments	895	224	–
Prepayments for properties' maintenance	15	7	–
Prepayments and other assets, current	910	231	–
Total prepayments and other assets	910	231	–
Trade and other receivables, current	342	304	336

VAT prepayments are expected to be recovered on a monthly basis due to changes in Georgian tax legislation effective from 1 January 2017. According the changes VAT liability must be recognized on advances received from customers.

Trade and other receivables of the Company are mostly comprised of receivables from rental. These receivables are mostly denominated in USD and are due from 1 to 3 months from the reporting date. No significant trade and other receivable are either past due or impaired as at 31 December 2017, 31 December 2016 and 1 January 2016.

(Thousands of Georgian Lari)

11. Invested capital

Capital management

The Company's objectives when managing capital (which it defines as reported net assets in its IFRS carve-out financial statements) are:

- To safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To maintain sufficient size to make the operation of the Company cost-efficient.

To achieve these goals the Company performs a detailed analysis of each potential project setting an individual minimal requirement for internal rate of return considering the cost of borrowed funds and level of own capital available.

Transactions with the Parent

Contributions from and distribution to the Parent recognized as increase or decrease in invested capital mostly include costs acquisition and construction of investment property incurred by the Parent on behalf of the Company and transfers of completed properties to other business segments of the Parent, respectively. Deemed profit distribution comprises the amount of cash generated by the Company's investment properties (net of respective property operating expense), which was retained by the Parent.

12. Related party transactions

The volumes of related party transactions, outstanding balances at the year end, and related expenses and income for the year are as follows:

	2017			2016		
	Parent[1]	Entities under common control[2]	Key management personnel	Parent	Entities under common control	Key management personnel
Balances as at 31 December						
Accounts receivable	15	51	–	15	75	–
Accounts payable	–	17	–	–	17	–
Transactions for the year ended 31 December						
Employee benefits expense	–	–	163	–	–	118
Rental income	29	1,187	–	12	708	–
Rental expense	–	29	–	–	14	–
Insurance expense	–	7	–	–	2	–
Other general and administrative expense	–	4	–	–	3	–

[1] As at 31 December 2017, 31 December 2016 and 1 January 2016 and in the years then ended Parent includes balances and transactions with m2 Real Estate JSC.

[2] Entities under common control include BGEO Group PLC subsidiaries, except those included in Parent category.

There were no outstanding balances on transactions with related parties as at 1 January 2016.

Transactions with the Parent also include costs of acquisition and construction of investment property incurred by the Parent on behalf of the Company (Note 8, 9).

Key management personnel of the Company is that of its Parent. Company's share of the compensation of key management personnel recognized in these carve-out financial statements comprised:

	2017	2016
Share-based compensation	128	92
Salary	23	17
Cash bonus	12	9
	163	118