

Aeroflot Group

Aeroflot Group 12M 2017 IFRS Financial Results

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Speakers:

- Andrey Napolnov, Head of IR
- Giorgio Callegari, Deputy CEO for Strategy and Alliances
- Shamil Kurmashov, Deputy CEO for Commerce and Finance

Participants asking questions:

- Alexander Prutkin, VTB Capital
- Michael Ganelin, Aton
- Kerem Tezcan, Citi
- Mitch Mitchell, BCS
- Osman Memisoglu, Bank of America
- Artem Yamschikov, Renaissance Capital
- Denis Vorchik, Bank Uralsib

Operator: Good day, everyone, and welcome to the Aeroflot Group 12M 2017 IFRS Financial Results conference call. Just as a reminder, today's call is being recorded. At this time, I would like to turn the call over to your host for today, Mr Andrey Napolnov. Please go ahead, sir.

Andrey Napolnov: Good afternoon, ladies and gentlemen. Thank you for joining the call to discuss our 12M and Q4 2017 financial results. Today, we have two speakers, as usual, Deputy CEO for Strategy and Alliances, Giorgio Callegari, and Deputy CEO for Commerce and Finance, Shamil Kurmashov. I would like to remind you that the press release and IFRS statements are available at our website, as well as our updated databook. The presentation will be available after the conference call. Before we start, I would like to draw your attention to the fact that some information on the call may contain forward-looking statements regarding future events and performance, and actual results may differ materially from those expressed or implied in these statements. For more information, please refer to the disclaimer statement on the second slide of the presentation. Now, I would like to pass the floor to Giorgio Callegari, who will run you through the Company's operational achievements.

Giorgio Callegari: Thank you so much, Andrey. Good morning and good afternoon to everybody on the line. I will be happy to walk you through the initial part of the presentation, where we highlight our results and the key drivers of those results.

In particular, as a summary, in 2017, Aeroflot carried more than 50 mn PAX, 50.1 mn PAX to be precise. That is 6.7 mn PAX above last year, i.e. 15.4% in terms of growth. We also increased passenger load factor by 1.4 p.p. to 82.8% at the Group level. Financial part of our results. Total revenue is close to RUB 533 bn, which equates a 7.5% increase y-o-y. EBITDAR and EBITDA margins are 22.9% and 10.5%, respectively, with strong operating and free cash flow generation. That resulted in net income of RUB 23.1 bn and a further reduction of our Net Debt / EBITDA level, which went from 1.4x as at the end of 2016 to 0.9x as at the end of 2017. That happened on the background of the Russian market, consistent with what we saw at the end of

2016, continuing to grow at an accelerated pace of 20.3% y-o-y overall. Gained growth showed different rates, in particular, higher on international destinations because of the strength of the rouble compared to foreign currencies and reopening of Turkey as a leisure destination. That translated in a 31.7% increase in international traffic and a 10.9% increase in domestic traffic. So, while certain international traffic is booming, it is important to underline that the improving economic conditions of the country have led to a continued increase in domestic traffic. What is also important to outline at the beginning is that we are seeing a rational behaviour of all players in the market as a result of, we believe, a less fragmented market and a more rational approach to opportunities, with load factor increases for most operators in the market.

Let us look at the market dynamics in more detail. Aeroflot performance, as I have said, was up 6.7 mn PAX to reach a total of 50.1 mn PAX. Not surprisingly, for the reasons I will explain, this resulted in the market share decreasing from 42.3% to 40.5%. That is the result of our strategic decision to continue to focus on scheduled traffic and to accept to give up some share of leisure traffic, as well as not to follow additional capacities aggressively when some foreign carriers come back to the market. The second operator in the market remains S7 Airlines, with a significantly lower market share. They also saw a reduction from 12.8% to 11.5%. The summary is that the market is clearly showing a significant difference in behaviours between scheduled carriers with a more conservative approach to the market and charter carriers that are more focused on taking opportunities.

In terms of the overall market size, the market grew from close to 103 mn PAX to 124 mn PAX, with a distribution of traffic of almost 50/50 between domestic and international – a balanced segmentation, which we as a carrier with competitive offers in both segments stand to benefit from more than others. In terms of capacity (because we think it is important to indicate what has been the industrial behaviour of the market players, so that we can eventually adjust or confirm our strategy), the capacity added by foreign carriers was aggressively high in Q3 2017 but slowed down in Q4 2017. Again, the capacity was very high, compared with the low base, and became significantly less, in comparison terms, compared with the growth started in Q4 2016. On the other hand, the average load factor of Russian carriers increased y-o-y both on domestic and international routes, showing a considerate and rational approach to market opportunities.

If we look at the performance of the Group brands, we will see that the Aeroflot brand continues growing in line with what we believe is the scheduled market segment, with a growth of 13.3%. Rossiya, with a presence in the charter market, showed a much more significant growth of 26.7% from 8.8 mn PAX to 11.2 mn PAX. We take this as an indication, even though there obviously were question marks and there still are a number of question marks and we hold discussions around it, that our decision to retain our presence in the mid-price segment, regional segment is paying off and the selective approach to charter opportunities is paying off. I will leave comments on Pobeda for later slides, while I would like to focus on Aurora.

Aurora, being such a small part of the Group, is overlooked most of the time. Even though the growth is 12.5%, it is only 1.5 mn PAX, which is easily discounted as irrelevant, while, on the other hand, we believe it is an important component of our strategy. Let me explain why. Aurora is flying 57 mainline scheduled routes and also 28 regional routes, which are vital to the mobility of the region. They have been able to secure additional traffic rights to feed those subsidised regional routes with international traffic, and they have been able to improve their performance in terms of yields and load factor. We think that all the four pillars of our strategy are equally important and equally moving in the right direction.

The Aeroflot Group network. We said a number of times that we focused on developing the quality of points being served, and that is still paying off handsomely. In 2017, the Group operated 153 unique destinations in 52 countries. We added a relatively small number of destinations in 2017 – Lisbon and Kostanay

internationally and Belgorod, Khanty-Mansiysk and Salekhard as three domestic destinations. In 2018, we have already announced expansion in Europe with points in Italy, and we will be adding routes over the summer, once the World Cup focus is over. Once again, balancing frequency increases with a conservative approach to new destinations has led to a continuing increase of average frequencies per destination. In this respect, London is a very interesting example, because we started with three misaligned flights per day, and now we have five flights operated by Aeroflot to Heathrow. We have become the largest operator from and to Russia for this destination. And Rossiya will start operations from St Petersburg to Gatwick, preserving the market development that we have created with Aeroflot.

Where does that leave us in terms of transfer traffic? As we have said a number of times, for Aeroflot, transfer is an important and interesting opportunity, but not the focus of our efforts. That means that, for instance, the percentage of International–International traffic increased in 2017 compared to 2016 from 13.1% to 13.6%, but it still remains a very, very minor part of our total number of passengers. Nevertheless, we are in the Top 5 operators connecting markets between Asia and Europe. By combining a focused development in terms of points with increasing frequencies, we offer connectivity that is significantly appreciated by our customers and see that it is reflected in the continuously growing connectivity index of Aeroflot.

In terms of infrastructure, because again, it is a focus of Aeroflot's development, a legitimate question is, can we sustain the growth pace that we delivered in the past few years? The answer is yes. We have been able to squeeze more passengers in the Sheremetyevo airport, which was a constraint, by working effectively with all the subjects to improve the efficiency of the infrastructure. Now, in 2018, the new Terminal B will be opened, the Interterminal tunnel under the runways will be opened, and that will significantly increase the theoretical annual capacity of the airport up to 66 mn PAX. The plan for the Sheremetyevo development as described by the Chairman of Sheremetyevo in his interview to *Vedomosti* in February confirms that by 2026, the airport will be capable of catering for 80 mn PAX. Not only this one is an important number, but also the number of flights per hour is crucial. That will grow up to 90 because that means improved opportunities for connectivity without depending on that business model.

Talking about carriers that certainly do not depend on connectivity, we have Pobeda. Pobeda kept growing, even though at a slower pace than in 2016 compared to 2015, with the reason being limitations in fleet. We added four aircraft, but those came at the end of the year and therefore were not really meaningful in terms of growth opportunities. All the growth, as we can see in the presentation, comes from the improved load factor. On the yearly average, the Pobeda load factor was above 94%, and we believe that it is a truly impressive result, which, combined with the recognition of Pobeda as the most effective Boeing 737-800 operator worldwide, explains the success of that company. In the article that was published in *Vedomosti* in February there is also an indication of what we anticipated regarding the market at our Capital Markets Day, i.e. the continued focus on increasing regional flying to stimulate the additional segment.

In terms of the World Cup, we have a chart dedicated to that. The chart clearly shows what the plan is, not only in terms of different services, but also in terms of preparations that we put in place to properly serve both Russian fans and fans that we expect from abroad. It is a number of actions that we put in place in close coordination with the Organising Committee and that cover all the aspects. We expect that the positive experience that we had with the Sochi Olympics will be repeated with the World Cup.

In terms of operating performance, I think, I have already mentioned more than enough the figures about passengers. What I would like to point out is that for the third year in a row, and this is extremely important in light of the comments I will make later on the yield, we have increased our load factor. Not only do we

believe that we are properly focusing on the most topical part of the market, but we are doing so by effectively combining the pricing and capacity management strategies.

Pricing. The Q4 results represent, if you allow me, a vindication of what we were saying throughout the year: that we felt confident about our revenue management policies inasmuch as we were coping with the currency fluctuations, with sudden changes in the market, however, we were of the opinion that we were moving in the right direction. Russia remains the largest product in our network, the largest point of sale, while we see a continuously increasing percentage of online sales, which represent an opportunity to build loyalty in our customers and at the same time to reduce the cost of distribution. That said, in terms of yields, we saw the domestic yields continuing their move in a positive territory more and more each month, with 4.1% y-o-y in December. We also saw the international yield grow close to being at the level it was last year. Why is it yet not in the positive territory? For a number of factors. In particular, as I have said, a) our desire to give up some market share, but only to a certain point; and b) the effect of the US dollar devaluation, which meant lower revenue level from markets like China (which is obviously very important, with the renminbi linked to the US dollar) and the US. Overall, in Q4, we saw a yield improvement of 1%, RASK improvement of 2.8%. Again, the combination of effective pricing policy and effective capacity management are delivering positive results.

Having said that, I would like to hand over the floor to my colleague Shamil Kurmashov. Thank you for your attention.

Shamil Kurmashov: Good afternoon, ladies and gentlemen. Let us begin with slide 21 of the presentation. As of the end of the previous year, the Group had 331 aircraft in the fleet. We still think that our fleet is well balanced in terms of composition: 68% of the fleet are narrow-bodies, which are used on medium-haul flights; wide-bodies represent 16% of the total fleet amount. 69% of the Group's fleet is exploited by Aeroflot, and we are still No. 1 in the world by the fleet age (slightly more than four years). The majority of our share of the Group's fleet, 86%, is under operating lease contracts. It is evident that it is more flexible, therefore, it is more actively used in our operations. In 2018, we plan to phase out 13 aircraft in finance lease and 1 aircraft in operating lease. Among other factors is a change in the fleet mix by ownership, attributed to the fact that the two finance lease A321 were disposed of in 2017. No other significant changes happened with the fleet structure in the previous year.

Next slide. Let me say a few words about the fleet expansion strategy. In 12M 2017, the Group was actively expanding its capacity with 54 aircraft joining the fleet and 14 aircraft being phased out. We are talking about the net increase of 40 aircraft, so our net add is 40 aircraft. The key changes in additions and phase-outs of aircraft in 2018 are additional 6 wide-bodies, 36 narrow-bodies (and phase-out of 25 narrow-bodies) and 15 narrow-bodies for regional aircraft, like regional jets. Despite the significant additions to the aircraft in 2017, the average utilisation rate of the Group was not materially affected, only less by 2.7% y-o-y in 12M. Going forward, the Group plans to expand its fleet with the number of aircraft reaching 409 in 2022. It is in line with our strategy, which was previously approved and announced. The additions will be front-line, loaded with 31 aircraft expected to join the fleet in 2018, and then more balanced in 2019–2022, namely 49 aircraft are expected to join Aeroflot on a net basis, 29 aircraft are expected to join Pobeda, and 1 aircraft is expected to join Rossiya Airlines. The fleet of Aurora is expected to remain relatively stable by 2022.

The key slides about our financial performance for 12M and Q4 2017. In 12M 2017, we continued our operational expansion, reaching a milestone of 50 mn PAX and generating more than RUB 500 bn in revenue, which represents a 7.5% growth that we think is significant and material in the current conditions. After a record high in 2016, we saw margin normalisation in 2017. We discussed the reasons in detail during our

previous calls – competition, exchange rate, fuel price. By the way, it is not just foreign exchange rate and oil price that affected our results negatively, but the change in the correlation pattern between these metrics. What is really important is that, despite all these headwinds, the EBITDA margin posted for the year did not decrease below 10%, the psychological level, like a support line. We are proud that we did not go below this threshold, which, we believe, is a normalised level over the cycle at the current stage.

We would also like to compare the record high results of 2016 with those of last year. If we deduct the one-off effect of the foreign exchange difference on PDP paid for aircraft, RUB 13 bn, from the consolidated net income for 2016 of RUB 38 bn, we would come to the amount of RUB 25 bn. This year, we expect more than RUB 23 bn, so we are almost in line with the record high of the previous year, if we deduct one-off factors from the results of 2016. In Q4 2017, we earned positive EBITDA of RUB 2.7 bn in comparison with RUB 0.8 bn in Q4 2016. Net loss decreased to RUB 4.1 bn. If we look at Q4 2016, Aeroflot was able to improve its y-o-y results. Traffic revenue was growing slightly above traffic, up 13.5%, and EBITDAR also improved. We look very positively at our results, and we think that they are in line and comparable with the outstanding results of 2016.

The next slide shows revenue growth decomposition, as usual. The Group's revenue grew by 7.5% and amounted to RUB 533 bn, mainly driven by passenger traffic revenue. This could be explained by two factors: expansion of scheduled operations mainly due to the growth of Aeroflot and Pobeda, generated RUB 24 bn, and also opportunities provided by the rebounding leisure segment that supported growth by Rossiya airline's charter segment, which allowed us to generate additional RUB 13 bn of extra revenues. The revenue growth in 2017 showed clear signs of acceleration because we could clearly see this pace in 6M 2017 (+4.9%), 9M 2017 (+7.9%) and Q4 2017 (+11.9%). So, we clearly see the acceleration of the pace of our revenue growth.

The key factors of the revenue growth in 2017. First of all, it was the growing traffic volume, up RUB 67 bn on the back of more than 15% growth in PAX and 16.2% growth in RPK (revenue passenger kilometre), the growth opportunities provided by the market. The second important factor was the rouble appreciation, approximately 13% up vs US dollar and 11% up vs euro, which resulted in negative effects in revenues of RUB 39 bn, because more than half of our revenue is denominated in euro and the appreciation of the rouble results in certain weakening of revenues. However, the pace of the rouble appreciation slowed down in Q4 to 7% from 14% in 9M 2017 (RUB vs USD), the magnitude of the currency effect also decreased. Only RUB 2.2 bn out of RUB 38 bn are attributable to Q4. Rouble yields for FY 2017 are down by 4.9%, with those for the domestic segment down 1.1% and those for the international segment down by 7.7%. If we speak about Q4 specifically, the rouble yield was up by 1.0%. This is the blended ratio. If we decompose it between the domestic segment and the international one, there would be +4.4% and -1.2%, respectively. We think we clearly see two different trends in the dynamics of our yields. We would also like to draw your attention to the positive pricing effect of RUB 7.7 bn, including RUB 4.0 bn in Q4 2017. We were able to benefit from the strong demand. We may particularly highlight the CIS, Asia and European regions, where we realised the most of the pricing effect, while the least of the pricing effect relates to the US region, as we have opened the third flight to JFK and it takes some time to ramp up the new frequencies. So, the positive yield dynamics in Q4 is attributable to the fact that airlines started passing over the growing fuel costs to the customer. It usually happens if there is an increase in fuel prices, which account for a significant part of our cost base. Certain fuel surcharges are passed on to the shoulders of passengers.

Operating costs analysis, slide 26. In 12M 2017, operating expenses grew by 13.8%. It was significantly influenced by FX. If not for the rouble appreciation, it would have grown by almost 21%. So, the influence was really positive. Volume growth was the key factor for the OPEX growth, and some lines of expenses require

more attention. First of all, fuel costs were up by 21%. The dynamics of the fuel costs were driven by the increase in rouble fuel prices only by 8% and the remainder was due to the growing scale of operations. I remind you that there was an increase in our ASKs by more than 14% that was significantly based on the capacity that was infused to the market.

The second line is SG&A, which is up by almost 20%. This increase is explained by the commercial and marketing expenses growth, as Aeroflot was promoting its flights in the key markets. Extra spending on marketing amounted to almost RUB 3 bn on an annual basis. We continue to promote our services abroad, but the scope of the programme has been reduced, and in the current year we plan the marketing expenses to be lower, amounting to the level of 1–1.2% of the revenue. The third factor is staff costs, which grew by 28%, first of all due to the wage indexation of 5%, which is mandatory and required by the legislation. The second largest factor was recruitment linked to the growing volumes. Total increase of the headcount was 6.3%. I will speak about it later. I would like to mention one correction, an accounting treatment related to unused holiday reserve in the amount of RUB 3 bn, which is like an arithmetical correction. Going forward, changes in reserves will be considered recurring items. Bonus for pilots is an additional motivation payment, in the staff cost line. There is also a certain accounting treatment effect that happened in Q4 2017. First of all, introduction of a special RI charge. This charge, together with some other charges, was compensated by a special revenue line, therefore this introduction was not reflected in the P&L. However, we see a certain increase in the cost line. Maintenance expenses were lower by 9.1% in Q4 2017 due to changes in accounting treatment regarding accrual and release of reserves between certain accounting lines, maintenance and other operating expenses. In general, we do not see any material influence of this correction.

Further, we analyse the Group unit costs. On a per unit basis, cost per ASK in rouble terms decreased by 0.3% to RUB 3.13. Non-fuel CASK stood at RUB 2.35, declining by 2.2%. Fuel CASK increased by approximately 6% driven by an 8% increase in the fuel price, which I have already mentioned. Other factors are explained by the same reasons as described on the previous slide.

Fuel cost management. We work on increasing our efficiency in fuel consumption despite the fact that the base is already very low and has been gradually decreasing, or improving, our coefficients over a period of five or six years. Any further improvement is only marginal. Nevertheless, fuel consumption per ASK decreased by 0.6 y-o-y. The fuel price increased on average by 7.6% y-o-y and amounted to RUB 33,500/tonne. But during the high season, from May to August, as you can see from the chart, jet fuel price was supportive for our results (during the high season, on the extended base of carriages), and it really contributed to our positive result. So, the three key indicators – flight hours, fuel consumption per ASK and fuel consumption per RTK – demonstrate improvement, they are in the green zone.

Headcount overview, slide 29. Our headcount amounted to more than 38,000 employees. We again increased our labour productivity measured by PAX traffic and traffic revenue divided by average headcount. They are also in the green zone. Headcount grew by 6.3%, most of the growth coming from operations: cabin crews, technical personnel and airport services, as you can see in the table above. It is important to speed up the recruitment of employees, first of all pilots and flight attendants, as we have planned deliveries of new aircraft and evidently we need new personnel. We expect the opening of a new terminal in Sheremetyevo, in the north of our premises. That will increase our airport headcount by 10%, because our operations will be geographically more expanded, therefore we will need more personnel to support this growth.

EBITDA evolution, slide 30. EBITDA amounted to RUB 56 bn. Fundamental reason is that OpEx growth outpaced revenue growth, but let us look at why exactly that happened. EBITDA for 12M was significantly affected by foreign exchange movements and other macroeconomic factors. Nevertheless, if we look at the

combined effect of the FX drag on revenue and FX benefit on costs, we see only RUB 5.5 bn negative influence, because they offset each other. Negative influence on the revenue side is more than RUB 38 bn, and positive impact on our cost side is more than RUB 33 bn. Staff costs were up by RUB 18 bn: RUB 4 bn due to increasing headcount, RUB 2 bn due to wage indexation, and RUB 12 bn due to other factors, first of which is RUB 3 bn of unused vacation accruals, which is an accounting treatment, and the second one is extra costs related to the increased variable remuneration due to our long-term motivational programme. SG&A costs were up by RUB 6 bn, which was mostly driven by more aggressive marketing reaching out to key priority markets (up to RUB 3 bn on an annual basis). Euro/USD was quite favourable for Aeroflot: in Q4 2017, the rate reached 1.18 compared to 1.08 for the respective period of the previous year. Net FX effect amounted to RUB 5.5 bn, as I have already shown, implying RUB 2.0 bn positive currency effect, which, together with our selling initiatives that we plan to roll out into 2018, supported our margin and helped to earn positive EBITDA of RUB 3 bn in Q4 2017.

Reported and adjusted operating and net income analysis. Our operating income for 12M 2017 was affected by a number of one-off factors, altogether having a limited impact on our performance. First of all, release of legal reserve (RUB 2.5 bn) connected to a number of legal cases, for which the probability of cash outflows for the Group has significantly diminished and is currently close to zero. That is why we eliminated this reserve. The increase of reserve for social payments (RUB 3 bn), which is required by the Russian law and is triggered by Donavia and Orenair initiating bankruptcy procedures. This is not a new fact, it was in the financial statements for the previous reporting period. The increase in unused vacation reserve: we have also reviewed the methodology to reflect the true amount of future obligations. It was reviewed by the auditor and reflected in our financials. Net income was additionally affected by the following factors: FX gain on pre-delivery payments (RUB 2.5 bn), which is related to return payments from the manufacturers that were paid by Aeroflot under aircraft purchase agreements. Adjusted net income amounted to RUB 24 bn. As we see, it does not differ radically from the reported net income, RUB 23.060 bn.

Now a few words about Pobeda financial results. I think Giorgio can comment on that.

Giorgio Callegari: Thank you so much, Shamil. Well, a number of you asked in the past to present the performance of the Group's companies, and we said that it was not meaningful for Rossiya and Aurora because of the centralised revenue management, network planning, fleet acquisition, etc., but that it could make sense for Pobeda. So, in line with what was described at the Capital Markets Day, here we have an overview of the performance of Pobeda. Let me focus on the net income right away. You see that it is lower in 2017 compared to 2016. The reason is very simple. It has to do with the fact that after two years of using constant fleet, Pobeda added four aircraft at the end of 2017. In 2018, we will be adding eight aircraft: one per month, from February to October. Obviously, in order to have these new aircraft operating at high utilization rate from the very beginning we need to hire personnel, pilots, flight attendants, supporting staff, well ahead of time, and that results in additional cost compensated by revenue that is delayed. On the other hand, if you look at the more commercial indicators, you will see that, notwithstanding these factors, CASK is basically in line with what it was in 2015 (RUB 2.07). Cost control remains the focus of the management team of Pobeda. The RASK dynamics are also in line with what they were in 2016, even slightly lower because of additional capacity due to the opening of new routes in the regions at the end of 2017. Thank you, Shamil.

Shamil Kurmashov: Thank you, Giorgio. Coming back to the financial profile. We are going to report leverage and liquidity. Total debt as at the end of the previous year decreased by 27% on the back of two factors – decrease in borrowings and lower finance lease liabilities. Finance lease liabilities decreased due to the revaluation in the environment of the appreciating rouble, and we also had the repayment of borrowings. The total amount of repaid credit lines was up to RUB 17.2 bn, and Aeroflot Group is currently left with one

major loan outstanding. As a result of lower debt, we saved RUB 2.5 bn on interest expenses, so we did not pay extra interest expenses, and had RUB 2.7 bn of FX effect for finance lease payments recognised in P&L. On liquidity, despite significant repayments, the Group secures a very stable cash position – almost RUB 55 bn. On top of that, we secured RUB 103 bn of undrawn credit lines, so we have a significant cushion for drawdowns if we need any. Amid a significant decrease in borrowings and finance lease liabilities, Aeroflot Group secured a very comfortable Net Debt / EBITDA ratio, which stands at 0.9x as at the end of last year. Of course, we understand that beginning from 1 January 2019 the capitalised operating leases will be incorporated into the debt structure, but we are ready to report this matter as well. Now we are at the very comfortable level of 0.9x in terms of Net Debt / EBITDA ratio.

Now I would like to speak about operating and free cash flows, slide 35. Cash flows remained in a good shape, with the free cash flow of more than RUB 60 bn, RUB 61.8 bn to be exact, a y-o-y decline due to cash flow from operating activities dynamics. In 12M 2017, the working capital increased by RUB 5.5 bn, which can be explained by usual factors: accounts receivable, accounts payable, etc. But I would like to speak about more important factors. Other adjustments before working capital changes include RUB 5.6 bn of loss reclassified from hedge reserve to P&L (there was certain reserve which was reflected in the capital and was reclassified and came to the P&L level). RUB 10.9 bn are changes in provisions, and main contributors to these changes are maintenance reserve (RUB 11.5 bn) and legal reserve. Part of our free cash flow was used to pay out finance lease (RUB 15.5 bn), also for loan repayments (RUB 17.4 bn). As a result, net change in cash amounted to RUB 14.5 bn (a liquidity cushion ahead of the low season). As a conclusion for this slide and this chart, we feel confident that we have a very strong liquidity profile and liquidity position. We are two times better than in 2015 and slightly worse than in the previous year.

And now, after we have discussed the highlights for 12M 2017, it is time to set our guidance for the coming years. Market results in 12M 2017 were quite strong, attributable to the low-base effect of the previous two years, as well as higher demand and appreciating rouble, and improving macro indicators. In the current year, we expect double-digit growth in total market in PAX terms: double-digit growth internationally and single-digit growth domestically. The key driver of the growth will be the international segment, and the domestic segment will be secondary, because, as we have seen, there is certain deceleration in the domestic market development. Aeroflot showed healthy numbers in 12M 2017, and we are planning to continue operational growth on the back of stabilised macro environment, which will help us generate additional volumes as well. The figures are as follows: passenger metric (PAX) growth of 11–12%, ASK growth of less than 10%, load factor of 82%, acceleration in revenue growth to double-digit figures, positive pricing effect, pressure on cost coming from fuel prices, cockpit wage indexation, because there is very tough competition in the market for pilots. There is also growth of headcount by single-digit figures on the back of business expansion. But this is a healthy growth, as this is not administrative personnel, but operations and maintenance personnel.

Basically, that is all that we wanted to tell you about the results of our operations for the previous year. Now it is time I propose that we should come to the Q&A session. Thank you.

Alexander Prutkin: Hi, thank you for the report. I have two question on the problems that you had at the beginning of February. The first question is about damage to plane engines at the beginning of February. It was reported in the news that 19 aircraft had been settled down. My question is whether this amount is correct, and what additional expenses you expect to have in 2018.

Giorgio Callegari: Thanks a lot for the question. Yes, press reports were correct. Unfortunately, as they say, there is a chicken average issue: on average there is one chicken for everybody, but if somebody eats two chickens, another one eats no chickens – that leaves one hungry and another one fat. This is an unfortunate

concentration of events, but still let us not forget that the overall fleet size of the Group is above 300 aircraft. Even if temporarily we have a number of aircraft affected by what we call on-ground damages, we have put them back into service again, and we will not expect any significant impact on our operating results. Thank you.

Alexander Prutkin: OK, thank you for the answer. The last question is about the flight cancellations you had at the beginning of February. Do you expect any additional expenses connected to this?

Giorgio Callegari: Flight cancellations due to bad weather always generate a portion of additional costs and also in terms of customer service. On the other hand, there are no direct costs associated with it, because there is no fuel consumed, no airport taxes paid, etc. So yes, we expect costs coming from catering for the passengers that could not take the cancelled services, but it is a normal course of operations. Our regularity is perfectly in line with what it was last year and with our target for 2018. Thank you.

Alexander Prutkin: OK, thank you.

Michael Ganelin: Good day, gentlemen. Thank you for the results. I have two questions. The first is on your growth guidance for this year. You said that you expect double-digit growth, especially on international flights, but at the same time, we saw quite unimpressive January results, with some deceleration in the growth rate. I understand that it is just the first month of the year. Still, why do you expect that there will be some pickup in the coming months? Thank you.

Giorgio Callegari: Thank you for your question. Yes, in January, we grew 7.7%, but the performance is better than last year as the Group delivered a better load factor. Once again, as I said during my part of the presentation, we are trying to balance improved efficiency and increased load factor with the pricing policy that continues driving our yields up. We understand that it means slower growth rates, but it is entirely acceptable. Let us not forget that the 7.7% growth rate (close to 8%) is twice the rate of growth of our European neighbours. So, if you allow me, I would call it impressive, maybe not as much as it was in the past, but certainly very remarkable results in line with the target that we have – balanced growth in all operating and financial indicators. Thank you.

Michael Ganelin: Thank you. My second question is about yields again. Do you think it is possible that you will be able to pass costs on yields? Fuel costs are higher this year, and staff costs also increase because you increase payrolls. Will you be able to pass these costs inflation on yields? This is one part of my question. The second part is that you have a strong debate with the Federal Antimonopoly Service, which also pressures you regarding this yield management. How do you expect this tension to develop? Thank you.

Shamil Kurmashov: Thank you for your question. In aviation once there is an increase in fuel prices (taking into account that it consumes a significant part of our cost base, up to 30%, and in different other companies – more than 30%), we do not absorb this growth, because otherwise we would not have any margins. Therefore, it is certain that the majority of airlines pass this through, in the form of fuel surcharge, onto the shoulders of passengers, so that they see that these are not the profits of the company but something that is compensating their cost base. Would the market be able to adsorb that growth or not? You know that historically this increase in the fuel surcharge was up to 70% in certain periods. Now we think that it would not be so dramatic, but would be limited to 30%, and it would be incorporated into tickets and absorbed by passengers. We think that demand would absorb this growth. If we speak about the monopoly watchdog and our debates with them and the pricing models, each time they question the algorithm which is embedded into our calculating machines and in our Sabre revenue management system, each time we meet with them, we manage to show them that it happens automatically. There are a lot of factors which are taken into account, and it is not

something which is changed or done by hand, manually by our employees. And each time they see that it is an automatic process and is calibrated based upon historic statistics, the fewer claims they have against us. This work is constant, it goes on each day, and we allocate significant resources to persuade them and to make them understand how it works. I think that we do not have any significant problems outstanding with them, because there was only one issue raised: about whether we change the algorithm that is used in computer models and systems which we use as our management software. When we clearly demonstrated them how it works, they were satisfied, as far as we understood. So we do not think that there would be any tension in the near future.

Michael Ganelin: All right, thank you very much.

Kerem Tezcan: Thank you for the presentation. I have two questions. The first is about forward booking – what does it look like? After January, you have been pretty much in line with your double-digit growth target. You have explained it in part, but can you elaborate more on forward booking? The second question is about the jet fuel price used in your budget. What have you budgeted for jet fuel per tonne? Thank you.

Shamil Kurmashov: Hello, I will begin with the second question. Our budgeted fuel price is RUB 33,500/tonne. 35 airports are on formula-linked pricing, 32 airports use fixed quoted pricing published by the airports, and the remaining ones use fixed pricing. The average RUB-denominated fuel price is RUB 33,500/tonne. The first question was about forward bookings.

Giorgio Callegari: Yes, thanks for your question. Forward bookings are supporting the guidance that we gave. I will repeat, because I think it is important, that in terms of overall expectations, the market will grow by 10–12%, and we expect the Group to grow by 11–12%, i.e. in line with the market growth, possibly better in some areas. We expect Pobeda to obviously grow faster, and Rossiya to grow a bit slower from the high base that we achieved last year, while Aeroflot continues to perform in line with the market. I underline again that we do expect the international segment to be the driver of growth, also because Egypt will finally be back as a leisure destination for Russian passengers. But we also see a good opportunity for the continued growth of the domestic market. In general, we believe (also based on advance bookings) that we will be able to deliver on the expectations and guidance that we shared with you.

Kerem Tezcan: Thank you.

Operator: And the next question is from Mitch Mitchell, BCS. Please, go ahead. Your line is open.

Mitch Mitchell: Hello and thank you for taking my questions. The first question I wanted to ask is about the fleet structure and the way you acquire your planes, thinking a few years out in the future. Every quarter we meet, I look at the breakdown of your ownership: the percentage of the fleet that is used by operating lease goes up all the way. Will we continue to see that ratio get higher three or four years out? Or is there some target structure where you expect to set? You have talked about the advantages of operating leases in terms of always having new planes and flexibility. Are you making a sacrifice in terms of costs by operating leases? How do you see the pricing of planes changing in the future as you bring new planes into the fleet? Thank you.

Shamil Kurmashov: Thank you for your question. We do not have a certain ratio of operating and finance lease. But previously there was a compromise between the cost of aircraft ownership and operating lease – and the comfort and flexibility. Now they coincide. In the past, operating lease was an evidently more expensive means of financing than finance lease because within a short period of time, six to eight years, we had to pay back the total cost of the aircraft and then return the aircraft to the owner. In finance lease, it was

cheaper because you keep the ownership of the aircraft and ultimately you can sell it in the market. And its market value was higher than the book value.

The situation changed five years ago when the export credit agencies which guaranteed Airbus and Boeing deliveries abroad re-thought their aircraft sector understanding and introduced a 3-fold increase in the commission for allocating funds to carriers – for all customers abroad, including Aeroflot. First, they found out that European and American carriers did not enjoy this new environment (because of the issues of location outside the US and Europe). Companies like Aeroflot or Turkish Airlines and many other carriers were in more favourable conditions. Secondly, they changed their mind and decided not to invest any more in promoting this means of financing.

If before then the effective cost of a ten-year finance lease was 1–2% p.a., after that it tripled or simply became much more expensive. At the same time, operating lease started a downward trend in pricing. First, there were a lot of deliveries of aircraft, up to 300–400 aircraft bought by international leasing companies like GECAS, BOC or ILFC. They, therefore, had significant discounts on these aircraft, which in turn allowed them to offer favourable pricing conditions to ultimate users, i.e. airlines. Therefore, along with the evident flexibility, the prices also went down. We still see the downward trend in operating lease contracts. At the same time, the finance lease contracts remain too expensive for us. Therefore, we do not see any proportion. Before that, the proportion was 70 to 30% – 70 for operating lease and 30 for finance lease. Now we do not think it is feasible anymore, and I think that the cheaper operating lease gets, the greater its proportion will be in our portfolio. It might be up to 90% because the cost of ownership of operating lease aircraft is significantly lower than finance lease aircraft, and the impact on P&L is better. So it is a purely economic effect, it is a straightforward effect, and there are no other implications behind that. I hope that answers your question. Thank you.

Mitch Mitchell: Yes, thank you very much. One more question on free cash flow. Your free cash flow is very strong and your leverage, at least under current accounting standards, is going down. What are you planning to do with your free cash flow? Thank you.

Shamil Kurmashov: There are significant fluctuations in the financials of the aviation industry, and we see our competitors very easily go from the green zone to negative figures. I think we manage our free cash flow and liquidity effectively, i.e. funds and short-term instruments on our balance sheet. We gain significant finance interest from them. We place them in banks or try to prepay the deliveries of aircraft in exchange for additional discounts, which is much more productive for us because it is easier to prepay more and get significant discounts than repay finance debt. Also, there is a certain cushion for us, maybe 30–40%, and I am very conservative here. The remainder is an instrument to make our deliveries cheaper and, at the same time, we gain proceeds from the effective management of these funds.

Mitch Mitchell: Thank you.

Osman Memisoglu: Hello. Thank you very much for the presentation. I have a couple of questions on the cost side. I apologise if I missed it in the presentation. Can you give us guidance on the overall cost increase you expect for 2018? Specifically, on the staff side. And in terms of operating leases, I am curious if you could give us some sensitivity on interest rates. Again, I am assuming it is mostly related to your operating leases now because there is way more function in it. Thank you.

Shamil Kurmashov: As for guidance for the cost side for 2018, I do not think there will be any extraordinary factors to influence our operations. Some of the facts described on the cost side were staff, maintenance, and fuel costs. These are recurring items, and they will be similar in the current year. Therefore, we expect the same trends in our cost development as we outlined in our cost slide.

In terms of sensitivity analysis, we would also share this data with you: LIBOR rate continued to grow in 2017, the increase amounted to approximately 50 bps. We have agreements with 3-month LIBOR and 6-month LIBOR and the payment will be linked to changes in the applicable rate. So, a 50 bps change in LIBOR, for example, for a mid-range aircraft leads to a change in payment of about USD 12,000–17,000. The calculation for floating-rate payments often takes into account the reduction in the influence of LIBOR and the size of payments over time.

Osman Memisoglu: Thank you.

Artem Yamschikov: Hello. Thank you for the presentation. I have several questions. First, could you please provide your view on the competition in the international segment coming from foreign carriers? You expect positive pricing, so apparently you do not anticipate competition from foreign carriers to rise significantly. Could the situation change during the year? Second, regarding PDPs. You have positive net inflows in PDPs in 2016 and 2017. What net inflow do you expect in 2018? Thank you.

Giorgio Callegari: Thank you for your question. As for competition, we have seen, as I said in the presentation, a slowdown in the growth of new capacity both in frequencies and points served, and we do not expect that to change significantly. If you compare the trends in our international yields with the competition, you will see that we have been able to increase our yields even in the face of increasing competition. Why is that? One thing is when a competitor enters the market when we serve a point, e.g. London, two times per day, other thing is when we serve it five times a day. This means that if we serve that same point five times a day, whatever a competitor shows in the market, we believe that we have the flexibility and the range of products that will enable us to retain premium pricing and cope with promotional actions a competitor might choose to put into the market. It is not that we are ignoring the competition, we are monitoring it very carefully, but we also believe that the quality of our network, quality of the services we offer to our passengers justify our confidence in the yield evolution.

Shamil Kurmashov: In terms of net amount of PDPs, you know that they return to the company by the date of each aircraft delivery. According to the currency legislation of the Russian Federation, the PDPs that have been paid to a producer, for example, Airbus or Boeing, should be given back, and then financing from the lessor or a bank institution partially compensates the value of aircraft. Therefore, taking into account that we are expecting net delivery of 31 new aircraft, we expect the PDPs which had been paid for them under the current direct contracts coming back. As for their value, are expecting at least RUB 15 bn in our cash flow.

Artem Yamschikov: Thank you.

Denis Vorchik: Hello. Thank you for taking my question. May I ask about your fleet policy. The management recently announced a huge contract with Irkut, which will deliver newly-built locally produced MC-21. How will you address the risk of replacing Boeings and Airbuses with new locally produced aircraft (if you see any risk at all)?

Shamil Kurmashov: The contract is being discussed now and we have extended negotiations with Aviacapital-Service, a daughter company of Rostec. The delivery date of the first aircraft has not been clarified now because there has not been even a board of directors meeting to consider this transaction. Now we are in pricing negotiations with them. But the first aircraft will not be joining our fleet earlier than end of 2019 or 2020. By then we will clearly see the “diseases” of this aircraft as a launch customer. We will have time to look into its operation and flight characteristics. We do not see any negative influence because the proportion of MC-21 in our fleet will be under 10%. Only by 2023 will there be a significant number of them enough to dilute the foreign aircraft. I think that it is only by 2023, taking into account the organic growth of our fleet, that the percentage of MC-21 will exceed 10%. By then a lot of issues will be dealt with and we will find

solutions to any problems that might arise from the use of this aircraft. I think that will be in a five-year horizon. Therefore, we do not see it as a threat, which is what is implied in your question. I think that by that moment in time, we will be very well prepared to introduce the new type of aircraft into our fleet.

Denis Vorchik: Thank you. As I understand it, domestically-produced fleet currently amounts to about 10% in total due to Sukhoi Superjet. What is your impression from utilising this aircraft? Are there any considerations you will take into account when it is time to sign the MC-21 contract with Irkut based on the experience with Sukhoi Superjet?

Shamil Kurmashov: When we entered into the contract with Sukhoi Superjet, we also incorporated very strong guarantees and the producer's responsibility in that contract. Thus, if there are any problems, malfunctions or deficiencies, we are covered by the producer's responsibility. And we will use the same principles in the MC-21 contract. In certain cases, the degree of responsibility under the contract is higher than in our similar contracts with Boeing and Airbus. So, with domestic contracts, we are more protected than with the international ones.

Sukhoi Superjet now represents more than 10% of our fleet, and we know how to work with it. The utilisation of this aircraft may be slightly lower vs competitive benchmarks. But each year it becomes more and more relevant. Also, MC-21 differs radically from Sukhoi Superjet from a technical point of view. They are not similar. The fact that they both are made locally does not mean they would have the same problems. Should any problems arise with MC-21, we will address them adequately.

Denis Vorchik: Thank you. Could you also comment on the dividends for last year? What proportion of net profit would the Board recommend paying as dividends to shareholders? And what payout ratio would you expect for the coming years of 2018 and 2019? Thank you.

Shamil Kurmashov: This question is on the agenda of the forthcoming Board meeting on 16 March 2018. Usually the management does not provide any prior information. It is the Board of Directors that decides what dividend payout to approve. It is not prudent for the management to propose anything on that matter: all the financials are on the table and they are audited. The Board members and the shareholders understand the potential of the company and how much we are in a position to pay out. This matter will be included on the agenda of the Board of Directors meeting and the decision will be made on 16 March 2018.

Denis Vorchik: Thank you very much.

Andrey Napolnov: Thank you very much for participating in the call. We would like to make another announcement. I am passing the floor again to Giorgio Callegari.

Giorgio Callegari: Thank you so much, Andrey. I would like to personally thank all of you for the amazing work that we have done together. As we communicated this morning, I am stepping down from my position. That was the result of a purely personal and difficult decision because it is very difficult to leave such an amazing company where we have achieved such impressive results. Still, I consider a true privilege to have been a part of it for six and a half years. I wish all my colleagues bright future, building on what we have achieved, because one, and perhaps the main, feature of Aeroflot is that we never look back – we always look forward. So looking forward, I wish all the best to my colleagues and all the best to you. Thank you so much.