

Aeroflot Group

Aeroflot Group 6M 2017 IFRS Financial Results Transcript (edited)

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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:

- Robert Bonte-Friedheim, BlueCrest Capital Management
- Daniil Fedorov, Goldman Sachs
- Mikhail Ganelin, Aton
- Olga Boltrukevich, VTB Capital
- Denis Vorchik, Uralsib
- Mitch Mitchell, BCS

Operator: Good day and welcome to the Aeroflot Group 6M 2017 IFRS Financial Results call. Today's conference is being recorded. At this time, I would like to turn the conference over to Andrey Napolnov. Please go ahead.

Andrey Napolnov: Good morning and good afternoon, ladies and gentlemen. Thank you for joining the call to discuss Aeroflot 6M 2017 IFRS Financial Results. Today we have two speakers, 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 have been available in the Investor Relations section of our website since yesterday. You can access the presentation in our IR section as well. Before we start, I would like to draw your attention to the fact that some information on the call may contain forward-looking statements, and actual results may differ materially from those expressed or implied in the statements made during the conference call due to known and unknown risks and uncertainties. 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 take you through the Company's operational achievements. Giorgio?

Giorgio Callegari: Thanks a lot, Andrey, and good afternoon to everybody, thanks for being on the call. We understand that there are a number of incoming calls, and that has led to a marginal delay required to give everybody an opportunity to take part in our call. Let me go straight to the key messages, the highlights of our 6M 2017 results. First of all, number of passengers. We carried 23 mn PAX in the first six months, which means an increase of 3.3 mn PAX at the group level, or a 16.6% growth compared to the same period of 2016. That was achieved thanks also to improved efficiency, as the load factor of the Group grew by 2 p.p. to 80.6%. In terms of the financial results, we had a total revenue of close to RUB 235 bn (up almost 5% y-o-y). The EBITDAR and EBITDA margins were 19.6% and 6.6% respectively. There was a decrease compared to the same period of the previous year, and we will explain why that happened and why that should be of no concern, as we believe that we are fully on track with the implementation of our

strategy. An obvious evidence of why we are on track is that we had a very strong operating and free cash flow generation with a net income close to RUB 3 bn – better if compared to the same period of the last year. On the back of this financial strength, we were able to reduce our debt level from the Net Debt/EBITDA ratio of 3.4x at the end of December 2015 to 1.4x at the end of 2016 and 0.7x as at 30 June 2017, impressive progress in terms of financial solidity. That happened in the Russian market, which continued to show its resilience. We have talked many times about debt performance and highlighted during our Q4 2016 results call that we had begun to see trend inversion, which fully manifested itself in 6M 2017 with a market growth close to 23%. This is an amazing performance in terms of any market, and in particular, the market of the size of the Russian one. The growth of 23% comes as a combination of still an impressive growth in domestic traffic close to 13% and an absolutely astounding growth of 35% in international traffic. Obviously, with a market so buoyant, a number of carriers have come back, and that resulted in an increased level of competition. Let me just draw an initial conclusion from these highlights. Buoyant market, which confirms our vision and assessment of the opportunities that this market presents, also requires a number of strategic choices on our side. Our choice has been to continue to grow at a significant pace. Look what is happening around us – others are growing at a pace much lower than ours. The second factor is allocating financial means to what we believe is the right focus: reducing debt, focusing on profitable growth opportunities while increasing the distribution of our market focus. I will explain more of that in the following slides.

Let us look at slide 5 that shows competitive dynamics. I think I have already somewhat highlighted the key messages, so we can focus on some additional information, in particular our market share. Here you can see that our market share has gone down from 44.6% to 42.4%, so even though we have increased our number of passengers by 3.3 mn PAX, which is an amazing increase, our market share has gone down as a result of being selective in the kind of passenger segments that we focus on.

Where is the market growth coming from? If we compare 6M 2017 to 6M 2016, we will see an increase from 44 mn PAX to 54 mn PAX. One source of growth is obviously the reopening of Turkey, which provided some interesting opportunities for Rossiya, our middle segment and leisure operator. At the same time, as a group we have seen our share being reduced, because we did not want to start aggressively serving the international leisure market. Another interesting thing is that the domestic market is still growing at a very fast pace. That, we believe, is also the result of the continuously improved performance of Pobeda. Stimulation of the lower end of the market brings additional passengers, though not of all of those passengers are interesting from the economic perspective for Aeroflot.

On slide 6, there is more information about what is happening in the market. You can see that particularly in Q2 2017 the capacity coming online in the Russian market is 33.4% higher than in the previous year (international segment) and 9.3% higher (domestic segment). Certainly, part of that capacity are the wide-bodies that we added for Rossiya to deploy to the Far East. I mentioned several times during our calls and meetings with investors that the lower base effect in 1H 2016 was due to be obvious in 1H 2017 when the capacity, which we deployed to the Far East, in particular, would have been operational throughout the six months and not only at the end of Q2 2016. Obviously, increased capacity became available not only from Aeroflot Group, but also from our competitors. But we believe that this capacity is still being deployed in a sensible way, because the load factors, overall, are improving for everybody. You can see in the bottom right-hand part of the slide that the load factor has increased for everybody. The message here is that we are having an amazingly performing market with some significant capacities coming online that are so far in line with the demand.

As we move to slide 8, you will see our performance on that buoyant market and the distribution of growth between Aeroflot, Rossiya, Aurora and Pobeda. I am very pleased to highlight that Aeroflot still has and will continue to have the largest portion of the market in terms of the Group statistics with over 15 mn PAX carried, which is an increase of almost 2 mn PAX, a significant increase in the premium segment. As far as Rossiya is concerned, as a result of the additional capacity deployed in 6M 2017, including both scheduled and charter operations, it has seen the largest percentage increase with the number of passengers growing from 3.7 mn PAX to almost 5 mn PAX equivalent to an increase of 35%. They represent 21% of the total Group slice. Aurora showed a significant growth, the more so as it happens in a very challenging region, combining commercial and subsidised operations with an increase of 13%. This is a remarkable increase in that region, and Aurora now accounts for 3% of the total Group. There will be a special slide on Pobeda, but I want to highlight the fact that its growth happened with the constant fleet, which is a very sound performance from the industrial perspective.

Let us look at the network on the following slide. This is one of the crucial aspects that enables us to say that we are perfectly on track with our strategy. Why is that? The approach that we have in our network development even in the face of such impressive market performance is to focus on selective opportunities. We have increased frequencies to Erevan from 28 to 42, to New York – from 14 to 21, to Hamburg – from 7 to 14. We have also become the player of reference on the London market with improved schedules, increased number of services to Heathrow and the opening of Gatwick. All these activities balance improvement in network quality with growth opportunities. This is compounded by additional destinations on the domestic market. Not every domestic market around the world can show a growth of 13%, and that is why we believe that opening destinations like Belgorod, Khanty-Mansiysk and Salekhard from Moscow, in addition to Sochi-Simferopol, is a proof of the wise and balanced approach. On the other hand, Rossiya continues its restructuring through the combination and integration of three daughter companies such as Donavia, Orenair and Rossiya itself. This enabled us to start scheduled services from Vnukovo to Barcelona, Kaliningrad and Kazan. This is another example of being selective in approaching market opportunities and focusing on continuing our strategy of balanced growth.

That balanced growth is very visible on slide 10 devoted to Aeroflot itself and the development of this premium brand. We continue to see, as it has been the case throughout the years, an increasing number of frequencies per destination, as you can see at the top left-hand part of the slide, as well as an interesting increase in connectivity. In absolute terms, the percentage of connecting passengers grew from 41.1% to 42.2%. But the growth happened in particular leveraging the contribution of the domestic market, because a significant part of the growth in percentage terms is domestic-to-domestic or domestic-to-international and vice versa. In terms of international-to-international, it is an important component of our traffic, because it accounts for 2 mn PAX in total out of 23 mn (which is almost 10%). Still a percentage of that traffic has gone down, notwithstanding the comfort and the competitiveness of Moscow as a transit point, which was clearly demonstrated and further improved by the quality of our connectivity. The message here is that we are focused on serving domestic market even with the premium brands, even when that means possibly giving up a market share. That enables us to protect our company position while expanding our international footprint, but only as much as it makes economic sense for us. That is why the connecting traffic has grown in 6M 2017 compared to 6M 2016 by only 12.4% compared to the overall growth of over 13% for Aeroflot.

Pobeda, once again, is a remarkable success story. Its load factor of 94.4% over six months is absolutely unheard of, particularly considering that we have non-refundable fares that generate an incentive to fly once you bought the ticket, but we also do not have an overbooking, as every other low cost carrier has in the world. This amazing performance led to an increase of traffic of 5.2% with constant fleet. This is all

about incremental efficiency. That efficiency has come also as the result of constantly adjusting our network in a way to increase international routes and an adjustment of domestic routes with less flying from Moscow and more developing the regions. Overall, that means a better industrial performance even if that brings a temporary reduction in yields, because international yield with the rouble effect means lower overall yields. Exploiting point-to-point opportunities outside of Moscow also means accepting temporary lower yields.

In terms of operating data, I think I have already hinted at what it is, but we can look at slide 13 for comprehensive figures. 23 mn PAX, load factor increased by 2 p.p. International routes have seen growth at the group level, which is higher than that for Aeroflot because of both the combination of Rossiya growth in the charter segment and Pobeda. There is still a remarkable increase in domestic passengers, if you look at the 6M and Q2 2017 results. Obviously, more international routes launched by Rossiya and Pobeda generated a decrease in yields. We will talk about it in a while.

If you look at our operating results on slide 14, you will see that our load factor in total at the group level has always increased y-o-y. Better performance has come mostly as a result of better performance of our international flights, as I have explained a couple of times. But towards the end of 1H 2017, the domestic load factor has also exceeded its last year performance.

In terms of revenue and yield management, slide 16 shows another proof of the fact that our strategy is implemented in a most effective way. Our share of international passengers continued to grow and reached 29.1% in terms of revenue by POS. Obviously, considering rouble devaluation and comparing apples to apples, these 29.1% would be even higher without the currency effect. It is important to note that Russia is still very strong, and we want to make sure that we do not give up significant competitive positions on the Russian market. Europe is the second market for us with the growth of revenue of 5%. Asia continues to grow by close to 5% with additional capacity deployed to the area. The CIS decreased in weight because of the rouble effect showing less interesting traffic generation from those areas. The decrease in North and Central America is entirely attributable to a combination of currency effect and the decrease in demand to Cuba as a result of an increasing traffic to closer leisure destinations. As for the Middle East – the revenue grew as result of increased capacity to Tel Aviv, as well as to other destinations in the area, due to deploying larger aircraft rather than increasing destinations.

That is translated in terms of yield and revenue in what we see on slide 17. What I would like to highlight here is the fact that the rouble appreciated by 17.5% compared to the US dollar and by 20% compared to the euro. The fact that the rouble-denominated yield has declined by only 8.1%, with a more pronounced decrease of 12.0% in international flights and a decrease of 2.8% in domestic flights, means that we have been able to pass a large portion of that rouble strengthening to our customers. Once again, we believe that we have found the right balancing act between preserving our competitive strength, our growth opportunities and the need to protect our economic performance. It also includes the effect of Rossiya, which we see on slide 18, with the growing weight of Rossiya, up 35% y-o-y, as mentioned, and the growing weight of Pobeda in terms of lower yield overall, and the mathematical effect. All in all, we can say that we remain confident in our growth, which is selective, above the market when the market is decreasing, and below the market when the market shows sudden growth. We focus on continuing to deliver a balanced distribution of revenue by regions and channels because again we have seen a significant growth in terms of direct sales and balance in terms of distribution of point-to-point passengers, connecting passengers, both from and to the Russian market and international to international. I will now hand the floor over to Shamil Kurmashov who will get into more details on the economic side of our performance. Thank you so much.

Shamil Kurmashov: Thank you very much, Giorgio. Dear colleagues, we will begin with the fleet structure on slide 20. At the end of June 2017, as you can see, we had a total fleet of 303 aircraft. Our fleet is well-balanced in terms of composition. 66% of the fleet are narrow-bodies for medium-haul flights. Wide-bodies amount to 17% of the fleet and narrow-bodies for regional operations – to 17% as well. Also, 66% of the Group's fleet is exploited by Aeroflot itself and the majority of the Group's fleet is under operating lease contracts. We think that this is the most efficient way of acquiring our fleet in comparison to finance lease. The breakdowns by company and aircraft type are provided at the bottom of the slide.

On the next slide, you see our fleet expansion strategy. In 1H 2017, the Group has been expanding its capacities with 20 aircraft joining the fleet and 8 aircraft being phased out resulting in the net increase of 12 aircraft. What are the changes? They are three additional wide-bodies including two ex-Transaero aircraft (B747) added to Rossiya Airlines. You know that their fleet is accommodated in this legal entity. The second factor is the addition of 16 narrow-bodies and a phase-out of 8 narrow-bodies, and the addition of one narrow-body (regional aircraft) for Aurora Airlines. Our order book is mostly consistent with our strategy, and there are no new developments there. As of now, we do not expect any significant corrections. The main focus of our fleet management team is arranging financing for existing sale and leaseback contracts for the A320 family scheduled for delivery in 2018. We are also preparing to introduce a new type of aircraft, A350. We plan to have 28 A350 family aircraft by 2025. This is our current plan but we can modify it if we see any delays in deliveries from the manufacturer.

Slide 23, Financial Highlights. In 1H 2017, our revenue growth was 4.9% y-o-y as a result of expanding passenger traffic and currency impact on traffic and other revenue. Albeit supported by positive foreign exchange movement, OPEX grew ahead of revenue, 13% vs 5%. The key factors behind that is that in the previous year, EBITDAR and EBITDA margins increased to 26.1 and 13.4%, respectively, the highest base in the historical trend. As you see in the upper right-hand chart, even 19.6% for 6M 2017, though lower than the corresponding level of 26.1% for 6M 2016, is still the second highest metric over the period of five years. That is why although this figure is lower than the previous one, it is on the highest level if you analyse the trend over the period of five years. The main thing relates to EBITDA margin, now at 6.6%, just in the trend and within the figures of the previous years. Despite the key P&L profitability lines being a little weaker compared with the corresponding period of the previous year that contrasts with strong absolute profitability, which I have already explained, with EBITDAR 1.6 times higher than the five-year average and the highest net income for the last five years despite a very tough low season in Q1. You all know this seasonal trough and traditionally we as an airline company look weaker in that season than in other seasons.

Let us discuss this trend in detail on the next slide, Revenue Growth Decomposition. The Group's revenue grew by almost 5% and amounted to an absolute figure of RUB 235 bn. It was mainly driven by passenger traffic revenue gaining RUB 7 bn from scheduled flights and RUB 5 bn from charter flights. The key factors are growing traffic volume, up RUB 37 bn, on the back of increases in PAX and RPK by 16.6% and 18.8% respectively. If you compare these figures with the certain guidelines which we gave you last time, we are slightly beyond our forecast in terms of PAX and RPK. As a result of rouble appreciation of plus 17.5% against the US dollar and plus 20% against the euro, yields in the rouble terms were in the negative territory, but despite the international yields being down by 12%, in euro terms they have increased by 9.9%, which proves effectiveness of our approach to revenue management. The positive pricing factor amounting to RUB 4 bn, as described on the left-hand chart, underpins our revenue management efforts. The key pricing effect is positive standing at over RUB 4 bn in a very tight environment. Speaking of revenue by business segments, we predominantly grow in the scheduled passenger flights segment. The second

largest segment is charter passenger flights. You know that this segment is being supported and exploited by Rossiya Airlines.

The cost side is described on slide 25. In 6M 2017, OPEX was significantly influenced by foreign exchange but in the way opposite to what we have seen in the previous years. The rouble appreciation has offset growth related to volume, pricing and other factors. Most of the lines increased on the back of volume growth. The only two lines, which deserve extra attention, are fuel and staff costs. Fuel costs are 25.5% up and such dynamics is driven by a 10% increase in the rouble fuel price, because we had historically low levels in the previous years, and a growing scale of operations in ASK terms of almost plus 16%.

Staff Costs. The nominal change is 23.5% due to wage indexation of around 5% according to the Russian legislation. This is also what we are required to do in line with inflation expectations each year according to collective bargaining agreements. Growing recruitment-linked volumes are in line with the volume of our operating activities. The total increase in headcount is almost 4%. The increase in the variable compensation of employees is linked to corporate KPIs under the long-term motivation programme. I think that these two items describe the majority of changes in our operating cost base as well as in CASK dynamics, which is described on the next slide.

On a per unit basis, cost per ASK (CASK) decreased by 2.3% to slightly above RUB 3 as a result of declining operating lease, maintenance costs and other expenses, including Global Distribution System (GDS) expenses, which represent almost the entire CASK decrease. These three factors describe the change of this metric. The decline in these costs was driven mainly by the FX factor. The rouble appreciation saved the Group RUB 0.3 per ASK as clearly described in the lower part of the slide. The only CASK items that increased are fuel and staff costs, which I have already explained on the previous slide. Once again, these are wage indexation and strong 2016 results, to which our KPIs are linked, leading to higher variable remuneration that is arithmetically linked to good dynamics. On the fuel cost management side, which is traditionally shown on slide 27, flight hours, fuel consumption per ASK and fuel consumption per RTK demonstrate significant improvements. We can explain it by a lot of factors, first of all, by the ones which are described on the slide. They include efficient fuel procurement as we have one-year supply contracts in airports across Russia. The majority of fuel purchased in Russia and almost all fuel purchased at international airports is supplied at formula-linked prices not affected by any imbalance between the supply and demand on certain markets (with potentially a very significant increase in price due the shortage of supply). We have an opportunity to get fuel at the preliminary agreed price, which is described by the formula you can also extract from this slide. We also paid increased average fuel prices (especially in the beginning of 2017), but by the end of June 2017 our price got to the normal level of the previous year as you can judge by the slide.

Headcount Overview, slide 28. The total headcount in all the categories was very stable. The total headcount is 37,974 people in all the Group's companies. This is predominantly core personnel, who contributes to our traditional operating activity. Traffic revenue per average airlines' headcount demonstrates a 4.1% improvement and PAX traffic per average airlines' headcount – a 5.4% improvement. This is really something we would like to draw your attention to. So headcount grew only by 3.9%, with most of the growth coming from cabin crews and airport operations, as we needed pilots and technicians to be hired to support our operations. 9.2% growth in other non-airline subsidiaries' personnel category is mainly attributed to the expansion of Aeromar subsidiary. The company provides catering services to the airlines of the Aeroflot Group and has subsidiaries operating in a number of Russian regions apart from the headquarters in Moscow, and is truly expanding its operations. For example, it has recently opened a new subsidiary in the Ufa airport, and is one of the business lines with a good potential.

A very important slide is number 29, EBITDA Evolution. Here we can see the FX effect on revenue and costs appearing in green and red colours. Our EBITDA amounted to RUB 15.4 bn. The primary reason for that is that operating expenses growth outpaced the revenue growth. EBITDA in 6M 2017 was significantly affected by the FX movements and the following factors. Our Group's other revenue was down as it is mostly nominated in hard currencies. You know that commercial agreements of airlines are denominated in US dollars or euros and we had a RUB 3.6 bn negative effect. As large portion of other revenue is not associated with costs, decline in it directly affects EBITDA. Fuel costs were up by RUB 11.4 bn, with RUB 19 bn driven by volume and price, which was offset by saving RUB 7.7 bn due to FX because any rouble strengthening on the cost side usually produces a positive effect on our financials. In addition, staff CASK increased by 6.6% with an additional cost of RUB 2.4 bn compared to the result we could have delivered with flat staff CASK levels. Although FX benefit on cost is less than FX drag on revenue, we managed to partially neutralise it by stronger pricing, plus RUB 4 bn effect, as was described in the revenue decomposition slide. As we stated earlier during the call, we see softer fuel cost environment right now. Brent costs and, therefore, fuel prices are in line with the last year, coming very close to the last year. It is particularly important as Q3 is a high season and therefore we consume the maximum of fuel and hope that the environment as well as our efficient revenue management approach will help us deliver strong results in 2H 2017.

On slide 30, we address the questions asked about the one-off effects. We showed reported operating income and adjusted operating income. Both at the operating and net income level you can see which are the one-off effects and how they have influenced our reported income. And you can see here they are not significant, and adjusted net income does not differ radically from reported net income. It almost coincides with the reported net income.

Operating and net income in 1H 2017 were influenced by a number of one-off factors: release of legal reserves RUB +1.3 bn, which was connected to a number of legal cases, where the probability of cash-out for the Group has significantly diminished and is currently close to zero. The second effect was the increase of reserves for social payments, it is our regular reserve, which is required by the Russian law and is triggered by Donavia and Orenair initiating bankruptcy proceedings. This is the result of the restructuring process when two legal entities – Donavia and Orenair – finished their operations and became part of Rossiya Airlines. This reserve is not expected to grow as the bankruptcy of the subsidiaries progresses. After insolvency proceedings are completed and companies are closed down additional charges may be reflected in Group's accounts related to subsidiaries deconsolidation. The magnitude of these charges can be assessed further on as insolvency unwinds (but not earlier than in 2018).

Net income was additionally affected by the following factors: FX gain on the pre-delivery payment refund RUB +1.7 bn, which is related to returned payments from airplane manufacturers, which were paid by Aeroflot at a certain time under aircraft purchase agreements. Surely, the exchange rate is in favour of Aeroflot.

And as I already mentioned, adjusted operating income in 1H 2017 amounted to c. RUB 9 bn, and adjusted net income – RUB 2.4 bn.

Next slide: capital structure and liquidity. Total debt as of the end of 1H 2017 decreased by 9.1% on the back of decreasing borrowings. The y-o-y change was -14% on credit lines, and finance lease liabilities lowered -8.4%. Finance lease liabilities decreased due to revaluation in the environment of appreciating rouble. Decrease in borrowings amounted to almost RUB 3 bn. After the reporting date, 30 June 2017, Aeroflot also paid off almost USD 160 m in advance leaving the Group with only two outstanding loans. So, we repaid all the expensive credit lines leaving only very cheap debt in our books. As a result of lower debt, we saved RUB 1 bn on interest expense, because the body was narrower, and we paid lower interest, and RUB 2 bn FX effect from finance lease payments recognised in P&L.

Despite the significant repayments, the Group secured very stable cash position – RUB 88 bn, up more than 2.3x. Our net debt to annualised EBITDA amounted to 0.7x. Amid a significant decrease in borrowings and finance lease liabilities, we managed to lower this ratio. With our business well capitalized there is no near-term funding needs. As to our finance lease portfolio in terms of maturity you can see it in the lower right-hand chart. So, the majority of payments are postponed beyond 2021. We have a solid liquidity position with almost RUB 181 bn available in cash on balance sheet, short-term investments and undrawn credit lines.

Operating and free cash flows, slide 33. In H1 2017, cash flow remained in a good shape almost at the level of the previous year, it was driven by a strong operational performance, first of all. H1 2017 was marked by a significant impact from working capital change, which can be described by three factors: increase in accounts payable by almost RUB 50 bn due to increase in transaction volumes on the back of business expansion, increase in unearned revenues, i.e. prepayments which we receive from our customers, and we are expanding very intensively. The second factor – accounts receivable – increased by RUB 17 bn ahead of the high season, and changes in inventories, a minor factor.

Key other adjustments before working capital changes include RUB 2.7 bn effect from revenue hedging from hedge reserves to P&L and almost RUB 5 bn of changes in provisions (maintenance reserves, legal reserves and bad debt reserves).

Part of our free cash flow was used to pay our finance lease of RUB 5.6 bn and for loan repayments – slightly above RUB 3 bn. As a result, net change in cash amounted to RUB +49.6 bn, with a certain liquidity cushion ahead of high season.

At this point, we are ready to start the Q&A session as usual, and answer your questions. Thank you very much for your attention.

Operator: We will take your first question from Robert Bonte-Friedheim, BlueCrest Capital Management. Your line is open.

Robert Bonte-Friedheim: Good afternoon and thank you for taking my question. I am just wondering if you could give us a little bit of colour on what you see now in Q3 in terms of traffic, yields and costs. I think it was the strongest quarter last year. I think it is the strongest quarter every year. Can you give us anything in terms of how it is going?

Giorgio Callegari: Thanks for your question, Robert. First of all, let me say that we see more of the same in terms of the market performance. We had given a guidance of single-digit growth in terms of total market. The market has grown by more than 20% in the first six months, and so we expect the overall market to grow more than double-digit for the whole year. That will see more than double-digit growth in the international market as well as single-digit growth in the domestic market as we see it somewhat lower. As you have seen in our fleet slide, we will add some additional aircraft at the end of the year. In particular, four aircraft will go to Pobeda. Therefore, we expect the results of Pobeda to continue to be significantly positive even though that might happen at the end of the year and at the lower end of the price curve and lower yield. As far as Rossiya is concerned, we see a better performance than the one last year because it would have been operating at the full fleet with a better understanding of the market for one year and not only for six months. Overall, I would say it is reasonable to expect that our passenger traffic will continue to be in line with what we have seen so far. There is a slight improvement on the guidance that we gave at the beginning of the year. There is also a slight improvement in RPKs, while in terms of guidance we maintained some capacity growth that we spoke of, in particular 13–15%. That means that we expect a slight improvement in terms of load factor. In terms of performance, from what we have seen so far across the board, all of our companies confirm that expectation. Thank you.

Robert Bonte-Friedheim: Is it an improvement versus 1H 2017 or an improvement y-o-y? Because my second question, I want to understand – with the cost growth and the revenue growth looking quite good – will we have positive operative growth with revenue growing faster than costs in 2H 2017 or what you are thinking right now?

Giorgio Callegari: We think that obviously as the rouble keeps strengthening, the FX will continue to affect the yield performance. Still as both Shamil Kurmashov and myself have highlighted, we believe that our revenue management approach is very effective and, therefore, the figures I gave you are compared with those for the last year, the guidance I shared is compared with the one for the last year, and this is possibly slightly better than 1H 2017.

Robert Bonte-Friedheim: Thank you very much for taking my question.

Robert Bonte-Friedheim: I have a follow-up. The operating costs growth in 1H 2017 was 13% y-o-y, and my model suggests the growth of 7% for 2H 2017. This means the costs growth below double digits – 9% – for FY 2017, is that roughly in the ballpark? Does it sound roughly reasonable?

Shamil Kurmashov: Yes, you are right. It is roughly as you have explained (but FX movements may result in differences).

Robert Bonte-Friedheim: OK, thank you.

Operator: Our next question comes from Daniil Fedorov from Goldman Sachs. Your line is open.

Daniil Fedorov: Hello Shamil and Giorgio, thank you for the presentation. I have two questions, if I may.

Can you provide any details on subsidiary performance? Is it possible for you to share any data on EBITDA or net income, specifically how Rossiya or Pobeda performed?

Second, can you please give us any idea on the fleet allocation and traffic growth you expect in 2H 2017? You have already shared some data on the overall growth, but I am interested if you have any colour on some regions, international and domestic, and especially if you want to allocate more capacity to Asian routes, because we definitely see a better environment with the Europe–Asia traffic this year.

Finally, are there any plans from your side on hedging (in terms of currency and fuel hedging)? We definitely see that volatility of these numbers affects your financials and in your P&L performance.

Giorgio Callegari: Thank you for your question. Let me try to address the things that we can disclose. First of all, as for performance of the Group, you can see it on page 8, which shows the different growth rates of the various operators of the Group. These growth rates will somewhat change: as I have said, Rossiya has a comparable base, and therefore the growth rate will be slower; Aurora has an absolutely comparable base, and therefore we expect the same kind of growth; while Pobeda will be adding four aircraft, which on top of twelve is a significant increase, so at the end of the year we will see more growth on the Pobeda side.

As for Aeroflot, we continue to maintain a stable growth pace. Having said that, we do not see a significant change in the growth approach of Aurora or Rossiya compared to what we saw in 1H 2017. I am talking specifically in terms of the approach to growth, not in terms of the percentage, because I have spoken about that. As far as Aeroflot is concerned, in 2H 2017 we see an opportunity to add frequencies to markets that we believe demonstrate significant potential, in particular Italy, where, as a result of the recently renegotiated service agreement, we have increased frequencies to the points that we serve. On the other end, Pobeda continues to see an interesting combination of international and domestic, which is where we will continue to focus its growth.

Overall – more of the same, with more international opportunities for Aeroflot in 2H 2017, and more domestic opportunities for the rest of the Group. As far as the results are concerned, Shamil will address what we can share, as well as the hedging part of the question.

Shamil Kurmashov: I will start from the last question on hedging. There is no news about hedging, and the Board of Directors has not taken any decisions. We make virtual hedging for internal use only. Having in mind the structure of the business, currencies and the contribution of each currency to our revenues and costs, we still think that it is not reasonable to have any instruments in place, because, besides the costs, they will not result in any positive effects for us. We do not expect to put any hedging procedures in place.

As for the results, we usually do not give guidance in terms of financial figures, but we do give operational guidance for 2017. Our updated targets are double-digit growth in PAX terms. I will cite some figures: in PAX terms, our previous guidance was +12–14%, while our actual performance in 1H 2017 was almost 17%, and now our updated guidance is up to 15%, so we stay in line. In RPK terms, our previous guidance was 11–13%, and our actual performance is 18.8%, and we update this metrics and forecast 12–14% in RPK growth. Next, PLF – the previous guidance was 80%, and our actual result is 80.6%. Our updated guidance is up to 81%. We think that in financial terms 1H 2017 saw a number of adverse effects from macro indicators, such as jet fuel price increase, as we have explained, and FX fluctuations, which we see normalising in 2H 2017, and we believe that macro will be supportive for the 2H 2017 results. The jet fuel price in Q3 2017 is expected to be comparable with the previous year, and the USD rate supports the decline in CASK, and EUR appreciation vs USD and RUB supports revenue.

We think that all these positive factors will support our net income for FY 2017. Thank you.

Daniil Fedorov: Thank you very much. Can I follow up on subsidiaries? This colour on growth plans is very helpful. Is it possible to get any financial data for Pobeda or Rossiya? I think you had quite a lot of capacity investments on the Rossiya side, which, I believe, diluted a bit the result of the entire Group. At the same time, Pobeda, given its impressive 9 p.p. improvement in the load factor, should have quite a good result. I am curious if we can get any information on the EBIT or net income side of this, as you used to disclose earlier?

As a separate question, do you plan to at some point start reporting on Pobeda on a bit more granular basis, providing a bit more analysis?

Shamil Kurmashov: Thank you for your question. For a period of five years, we do not disclose legal entity results, because they do not mean anything. For example, 89% of the entire Rossiya Airlines network is part of the Aeroflot network as flights of Rossiya are under 100% code-sharing agreements and this entity acts as a capacity provider to Aeroflot. Therefore, it does not make any sense to assess our legal entity results on a separate basis.

The only entity that we disclose separately, as it is a point-to-point carrier that does not have any synergy with our network and is not a part of it, is Pobeda Airline. We think that this legal entity coincides with the business unit terminology in this meaning of this word. Therefore, they are going to carry c5 mn PAX by the end of this year, and they are going to be profitable for the second consecutive year. The profit will exceed RUB 3 bn. The load factor is now at 93%, having increased by 9 p.p. y-o-y. Its fleet is currently at the level of 12, and additional 4 aircraft will make it 16 by the end of the year. If we see any other destinations that are compatible with the Pobeda resources, we may increase the number of aircraft up to 40 in the forthcoming years. We are ahead of our business plan, and we are quite happy with the development of Pobeda Airlines.

Therefore, the strategy for Pobeda Airline is to fly domestically and to make not more than 20% of flights abroad. This is not a permanent limit, but this is our vision for now. Therefore, it is going to work in the low-cost segment, but its average ticket is more than RUB 4,000 (average price per ticket), although there are tickets below RUB 1,000. The business model of any low-cost carrier is to earn not on core tickets, but on additional services. It is a classical story that is being replicated by Pobeda right now. Therefore, this year we expect the growth to over 5 mn PAX, profits above RUB 3 bn, and very solid seat load factors of approximately 90–93%. Thank you.

Daniil Fedorov: Thank you very much, that is very helpful.

Operator: Your next question comes from Mikhail Ganelin from Aton. Your line is open.

Mikhail Ganelin: Good day, gentlemen. I have one question about your cash flow. I just want to understand how it will look like this year. Could you give me any expectations regarding CAPEX for this year and regarding prepayments for aircraft. As I see, there were some returns of prepayments in 1H 2017 in the amount of almost RUB 12 bn. Do you expect more returns, or do you plan to make prepayments? Thank you.

Shamil Kurmashov: First of all, regarding PDPs. In 2017, we continued to prepay and receive prepayments back, which is reflected in the cash flow statements. In P&L, we account FX difference associated with the prepayments of the previous years, significantly influenced by the exchange rate. We do not expect a material PDP refund or foreign exchange effect from this refund on P&L. In 2016, the FX effect was RUB 12.7 bn. If there are prepayments, and if the transaction for six Boeing 777 aircraft this year is approved by the Board, I think that the prepayment would not exceed couple of billion RUB this year. This is all we expect this year, because the rest of our contracts are old, and we have already paid significant amounts for them in the previous years.

In terms of CAPEX, you know that we only have maintenance CAPEX: we do not construct anything, we do not invest in material assets. We incur certain expenses, which are further capitalised and reflected in our balance sheet as CAPEX. I do not expect them to exceed RUB 5–6 bn. This level can be observed over the period of five years. Therefore, it will not make any significant impact on our cash flow statement.

Mikhail Ganelin: OK, thank you very much.

Operator: Our next question comes from Olga Boltrukevich. Your line is open.

Olga Boltrukevich: Yes, good day, this is Olga Boltrukevich from VTB Capital. I have four questions, and I will start with the first two.

First, yield performance. From what we can see in your presentation, the yield performance on the domestic routes was actually quite weak and was down 2.8% in rouble terms during 1H 2017. I understand why the yield performance was quite weak on international routes, but why was it down on domestic routes? Could you provide more colour on this?

Second, to continue the question from our colleague: what was the yield performance during the first two months of Q3 2017, i.e. in July and August? If you could you provide the average yield performance separately for international and domestic routes during these two months, it would be helpful.

Giorgio Callegari: Olga, thanks for your question. I think I have explained the fact that the yield performance is a combination of a number of factors. First of all, we should not forget that Rossiya is 100% under Aeroflot's commercial management, which means that the yield of the Rossiya routes is an integral part of

Aeroflot's yield. Wide-body aircraft flights, as we show in the chart, under Rossiya colours, but with SU tickets to the Far East for 1H 2017, compared to the absence of those flights or their limited presence in 1H 2016, significantly and purely arithmetically affected the evolution of the yield. That is the explanation for the domestic yields.

On top of that, there is growth in Pobeda's size, which comes at the cost of lower yields for Aeroflot. Last but not least, the domestic yields are affected by the percentage of connecting traffic that we carry. If you look at page 10, where we show the connecting traffic, the domestic to international traffic and vice versa, has grown from 16.2% of the total connecting traffic to 17.3%. That is reflected in the lower yield portion of the domestic traffic. This is the explanation for the evolution of the domestic yields. Thank you.

Shamil Kurmashov: If we speak about the international routes in July, i.e. beginning of Q3 2017, we expected a certain decline in yields in rouble terms (-9%), also attributable to the rouble effect. As for domestic flights, we saw a slight increase of 1%. Thank you.

Olga Boltrukevich: OK, thank you. My two next questions are on your cost side and on the operating lease, which are reflected as off balance sheet.

First, operating costs. What do you expect in terms of the average salaries increase during FY 2017 vs 2016 on the level of the Group? In particular, can you discuss it in light of the recently launched motivation programme for your pilots?

The last question concerns your operating lease obligations, which are reflected off balance sheet. Even accounting for quite sizeable fleet expansion in rouble terms as of the end of 1H 2017, they look quite significant. Could you please provide more colour on that? The rouble was actually appreciating, so I would expect them to be lower compared to the level that you reported.

Shamil Kurmashov: Thank you for your question. I will start with the operating lease, as it is one of the three key factors contributing to the growth of our expenses, with the pace overcoming the pace of our revenues. There are three key factors: first of all, we have 29 incoming aircraft, which is an increase of almost 14%. They are not coming in pace with the operating development, because it cannot always happen simultaneously. Therefore, 29 aircraft are coming, and this is one of the key contributors.

Then, LIBOR rate, which is embedded in the lease rates under the contract conditions. The 3M LIBOR rate increased by 0.51 p.p. up to 1.14%, which resulted in a certain growth of our lease expenses. Other factors contributed only 2%.

Thus, the key drivers of the growth of our lease rate are the increase of the 3M LIBOR rate and the physical number of aircraft that are coming into our fleet. We think that this is quite normal, because we are consolidating our fleet positions. Now is the right moment to add the fleet, as 737NGs are going to go away from the market, and the new model – MAX – will be the extension of this aircraft. That is why we are trying to contract as many aircraft as we can, because the slots are in deficit now.

In terms of our rouble salaries and wages of our pilots, the only figure that is going to increase our expenses is the following: in June 2017, we introduced sign-on bonuses for pilots joining the Company. As you know, they are RUB 650,000 for captains and RUB 350,000 for second pilots. Therefore, 2H 2017 will see the effect of that.

We have also introduced quarterly bonuses of up to RUB 240,000 for captains. It was a mandatory measure, as we are competing with other airlines. If we do not do things like that, at some point we will face a pilot deficit. Other categories of the quarterly bonuses are RUB 75,000 for those with 1–2 years of experience,

RUB 150,000 for those with 2–3 years of experience, and RUB 240,000 for those with 3 years of experience. It is a seniority system, which Aeroflot used to have some time ago. At a certain point, we gave it up, but now we have to go back to using it again.

These are the key factors that are not yet reflected in our financials and that are going to produce the effect. The effect will not exceed RUB 1 bn of additional expenses in 2H 2017. The rest of the salaries and wages of our personnel remain unchanged, and we are not going to see any changes in 2H 2017.

Olga Boltrukevich: OK, thank you very much.

Operator: Our next question comes from Denis Vorchik from Uralsib. Your line is open.

Denis Vorchik: Good afternoon, I have a question regarding your capacity at Sheremetyevo. Given your double-digit plans for growth, are you comfortable with the available Sheremetyevo capacities? Could you also comment on the works that are currently underway at Sheremetyevo aimed at increasing the capacity?

Giorgio Callegari: Thank you for your question. Let me give a very clear answer: we are comfortable with the growth opportunities that Sheremetyevo is providing so far, and we are comfortable with the opportunities that we will have from 2018 onwards. As you may have noticed in our fleet development plan, we are very conservative in terms of aircraft that we are adding in 2018, as only a limited portion of those will go to Aeroflot and therefore to Sheremetyevo. At this stage, we have been able to increase the capacity by increasing frequencies on a limited number of destinations and by optimising the hub structure of Sheremetyevo. Thanks to our opportunities of flying to every destination, we are distributing flights throughout the day without decreasing the quality of our connectivity. Sheremetyevo is on track in terms of opening the new North Terminal Complex and connecting it to the South Terminal Complex via an underground tunnel.

Yes, we are confident in our ability to deliver additional growth opportunities, which we are already doing as we speak. As you have seen, there has been substantial growth in Sheremetyevo and not only for Aeroflot, other carriers have also expanded presence there and we expect the airport to be on time in delivering additional capacities in terms of terminals and the third runway from 2018 onwards. Thank you.

Denis Vorchik: OK, thank you.

Operator: Our next question comes from Mitch Mitchell from BCS. Your line is open.

Mitch Mitchell: Hi, thanks for taking my question. I have two somewhat longer-term questions.

First, we are about a year away from the 2018 FIFA World Cup here in Russia. Can you give us some colour on what the Group's plans are in terms of additional capacity and additional routes, anything around that event. How important do you think it will be for the business next year?

Second, as you have mentioned, you currently have a labour contract that, as far as I understand, expires at the beginning of December. You will probably be heading into the negotiations regarding that soon, or perhaps you have already started them. Can you give us any colour on when these negotiations will happen and what you are targeting? Could it be an extension to the existing contract, or will it be a new contract? What can we be looking forward to? Thank you.

Giorgio Callegari: Thank you for your question. Let me address the World Cup part, and then Shamil will address the collective labour agreement.

As far as the World Cup is concerned, there has been a lot of planning done together with the organising committee. We believe that the experience gained from being part of managing large events such as the Universiade (the university games in Kazan) in 2013, the Sochi Olympics in 2014 and other similar events give us the right amount of experience in coping with the demands of the World Cup. At this stage, we plan to have about 30 aircraft focused on serving that traffic, and we feel confident with the level of demand that we expect. Most of that additional capacity will be achieved by retaining in our fleet some of the aircraft that are expected to be phased out in 2018, therefore eliminating the need to commit additional new capacity to that. We believe that it is a very efficient use of what we have that maximises the operational reliability and commercial opportunities.

As for the collective labour agreement, Mr Kurmashov will take the question.

Shamil Kurmashov: There are no changes in the collective labour agreement, which has several days ago been extended for three years. There have not been even minor changes.

Mitch Mitchell: Great, thank you very much.

Andrey Napolnov: Thanks a lot for joining our call today. If you have follow-up questions, you can always contact us. This concludes our call.

Giorgio Callegari: Thank you everybody.

Shamil Kurmashov: Thank you.