

Aeroflot Group

Aeroflot Group 12M 2016 IFRS Financial Results

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Edited transcript

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 Kazbegi, Renaissance Capital
- Daniil Fedorov, Goldman Sachs
- Osman Memisoglu, Bank of America Merrill Lynch
- Mitch Mitchell, BCS
- Elena Sakhnova, VTB Capital

Dear ladies and gentlemen! Welcome to the Aeroflot Group 12 Month 2016 IFRS Financial Results Conference Call. The conference is being recorded. Now, I would like to turn the conference over to Andrey Napolnov. Please go ahead, sir.

Andrey Napolnov: Good afternoon ladies and gentlemen. Thank you for joining us on the call. We will discuss Aeroflot Group 12M 2016 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 are available on our website, Investor Relations section. Webcast presentation will be also available at our IR section during the 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 or performance 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 Andrey, and good afternoon everybody. Ladies and gentlemen, let me walk you through the initial part of the presentation. Most of you are familiar with the approach that we adopted in describing our results, in the past presentations, and therefore you will note that there is an update in the way that we try to walk you through the major implications of the operational and strategic decisions that we have taken during these years.

Let me start by highlighting the key achievements of Aeroflot Group in 2016. First of all, the number of passengers. We carried over 43 mn PAX, and that means an increase of 4 mn PAX, equivalent to more than 10% growth at the group level. That was achieved obviously by adding capacity, but also by improving the efficiency of our capacity utilisation through an increase of load factor by 3.2 p.p. up to 81.5%. More

efficiency and a better performance translated into a strong set of financial results: sales are up by almost 20%, close to RUB 500 bn; EBITDAR and EBITDA margins are of 27.7% and 15.7%, respectively; a strong cash flow as Shamil Kurmashov will highlight later in the presentation; net income of close to RUB 40 bn; and a significant improvement of our financial position with deleveraging from 3.4x Net Debt/EBITDA to 1.4x as at 31 December 2016.

What is the environment in which we achieved these results? The Russian aviation market in 2016 continued its decrease at least for the first nine month showing some indications of reversing trends in the last quarter. That negative performance was, as in the previous years, a combination of growth in the domestic market (+7.3%) and decrease in the international traffic (-15.1%). Carriers, both domestic and international, adapted to this market by continuing to decrease capacity for the first nine month and then putting it back in Q4 of 2016.

What was the market evolution in 2016, and not only 2016, but in the last 3 years in detail? The reason we are highlighting three years is that we reiterated that the traditional cycle in the aviation from growth to slowdown, and then to a new growth lasts around three years. This is exactly what is happening. We saw a peak of the market in 2014 with over 110 mn PAX, and we saw the lowest numbers in 2016 with 102–103 mn passengers. As I said, the trend reversed in Q4 2016. That trend has been, as I said, the change of a rapid to a moderate growth in domestic traffic and a decrease in international traffic, which is slowing down. The capacity evolution in the market has been mostly consistent with the trends related to its size and again is picking up in the Q4 2016. We call that the new norm in the sense that market is very volatile, it is not something that is surprising us, it is something that we carefully take into account in the way we plan our development strategy. When we look at the competitive environment, (and you see it for the first time) we show the market share which we call *clean*. What does it mean – *clean*? It reflects only passengers who travel with the Group, except “international–international” flights which cannot be included, in our opinion, in the determination of Russia’s market share. In that case you will see that our market share went up from 34.5% to 40.0%. It is a significant market share, but far from the threshold that could arouse the regulator’s concerns and worries. This was a good performance, we believe, but also the performance that still has room for additional growth. You can see in more detail what is happening in terms of growth in domestic versus international [transportation] in Q4 versus the full year, and in terms of performance of different airlines. In this respect, we would like to highlight the fact that we are looking at 12 months with Aeroflot up 4 mn, S7 up 2.5 mn, UTair down 0.6 mn. However, again, those numbers are not indicative of what could be the scenario in 2017, because growth rates that Russian carriers are showing in 2017 are significantly different. Therefore, let us look in more detail at Q4 2016, where we clearly identify the first signs of market revival. Obviously, we monitor that very closely and will further elaborate on the implications of that growth when we discuss the year performance. We do not see, as I think I hinted very clearly, a reason to significantly change our strategy. We were able to grow our market share, to do it at profit by combining what is certainly a careful analysis of market opportunities with the conservative approach to fleet and [network] development. We plan to do the same without giving up market opportunities and leveraging our multi-brand approach.

Speaking about multi-brands, I think that the term is very effective in describing how we improved and evolved the multi-brand approach which we first described in detail in 2014 in the last two years by streamlining the brand portfolio and by clearly identifying what the specific market positioning is for each individual airline.

On slide 9 of the presentation, you can see that there is a role for all the companies. There is a role not only in terms of past performance with significant growth in 2016 for all the carriers with the exception of

Rossiya (due to the fact that most of the wide-body fleet of Rossiya came in 2H 2016). There is also a role in terms of the future, because based on our internal analysis of market opportunities up to 2021 (it is a medium- to long-term horizon) we see the market segment relevant for Aeroflot showing potential CAGR of 6%, and the leisure and regional segment, which is the focus of Rossiya, showing an interesting CAGR of 3%. Obviously, the market which is more responsive to stimulation by Pobeda shows a much higher CAGR of close to 10%. The efficiency and effectiveness of the multi-brand strategy looking backwards is reflected by the results that we are discussing today, and we expect to continue along this path in terms of future opportunities for all the brands of the companies operating within the Group.

Even though the slide is very full, I would like to draw your attention to one final point, which is the clear identification of what the airports of relevance are for each of the carriers. Aeroflot remains focused on operating mostly out of Sheremetyevo, Rossiya consistent with its role of a regional carrier is operating from Vnukovo, Pulkovo in St Petersburg and from some regional airports, Aurora obviously is based in the Far East, and Pobeda is combining operations in Vnukovo with aggressive development in the regions.

Slide 10, Network Strategy. We have always talked about the network strategy and we thought it was useful to show it in a different way. On slide 10, we show that the number of destinations over the last three years grew, we keep on expanding the Company and each of the companies, but it grew at a very conservative pace, much slower pace than the pace that we have seen in the average flight frequency by the destination (the central part of the slide). What is also very important to highlight in this slide is the very small difference in terms of destinations operated in summer and in winter. The difference in 2016 is only nine. It suggests a focus on less seasonal destinations, which also implies a better opportunity to maximise aircraft utilisation and leverage on the commercial positioning of the Company.

Potential constraints. Having chosen to focus Aeroflot only on Sheremetyevo gives rise to a risk of lacking additional capacity for Aeroflot's growth. It is a rather technical slide, but we thought it was interesting to show that we have a high-quality network based on hub and spokes with high connectivity and we are showing additional opportunities and areas for growth (green lines on the slide). In 2016 in particular, we added what is called in technical terms a new connecting wave, bringing Aeroflot to operating with six connecting waves, which is in line with best-in-class operations. That is why we saw a very good performance in terms of connecting traffic, which we still consider an opportunity rather than a focus.

On the following slide we wanted to share with you what we believe are the main achievements in terms of commercial policy. In particular, in the top part of the slide you will see that there was an increase in sales abroad, which went up from 27% of the total to 30% of the total. There was a significant increase in internet sales (from 22% to 30%) and the amount of sales of Aeroflot in 2016 via internet was over USD 1 bn, making Aeroflot the first e-retailer in Russia. That was accompanied by a significant increase of corporate contracts, which is consistent with the fact that Aeroflot as a premium brand is engaging in long-term commercial agreements with major corporate customers in Russia and abroad. As you can see, we were flexible in pursuing the connecting traffic. It was hovering around 19%, but we are adapting it depending on market opportunities. In terms of scheduled traffic, we also see a very satisfactory growth in yields with CAGR close to 11% in the recent three years.

On the revenue side, all of that would not be this meaningful, if we had not invested significant efforts into making sure that our costs structure would be competitive. Obviously, the starting point of an efficient cost structure is the fleet strategy that has been successfully pursued with a great simplification in terms of types of aircraft. From 18 types of the aircraft that we added to the fleet in 2011 we slimmed down to seven

major types in 2016. We were doing that while bringing in new types, which enables Aeroflot to position itself as the airline with the youngest fleet in the world again.

All that resulted in significant customer satisfaction, which is a crucial component of our strategy. You can see that on slide 14. At the core of it is the very important recognition that we achieved in 2016 in terms of rating the Aeroflot services as a four-star Skytrax airline. You see it reflects the strength of the brand. In terms of valuation of the brand, Aeroflot is still No. 26 in the world, but in terms of strength we are No. 1 among airline brands. And the customer loyalty is reflecting the positive trend of our NPS.

The operating performance, which results from having acted on those lines is the one that you see on slide 16. I think that I have already highlighted throughout the initial part of the presentation the key elements – 43.4 mn PAX, 10.3% y-o-y the growth of the Group, 11% growth for Aeroflot, which means that the premium part of the Group's offering grows faster than the Group in general. Balance, particularly in Aeroflot, between domestic and international, growth in terms of passengers, which is higher than growth in the flight-hours, with an improvement in the load factor – all the indicators point to a positive development.

I promised that I would deal with the yields, so let us look at slide 18 where we see that the trend for 12M 2016 is extremely positive, while the trend for Q4 2016 shows some negative indicators. Obviously, negative indicators always deserve particular attention, but we believe that they are a result of sound commercial policies, in particular, the fact that the base in 2015 was high due to the demise and disappearance of Transaero over a short period of time causing a reduction in the offer. In particular, domestic yields in Q4 2015 were 3.36, which is very high. Speaking about the currency effects, the appreciation of the rouble had the effect of around 6%. There is also a mathematic effect, which is a combination of the growth of Pobeda (in Q4, Pobeda launched a number of international routes, which in the development phase bring low yields) and the fact that Rossiya received most of its wide bodies, which carry lower CASK, but also lower yield due to the higher stage length in 2H 2016. As we know, flying wide body aircraft to the Far East in the lower months of November and beginning of December translates into lower yields. We regard lower yields not as a result of uncontrolled fare war happening in the market but as a result of a very considerate commercial approach. Thank you for your attention. It is now my pleasure to give the floor to Shamil Kurmashov.

Shamil Kurmashov: Good evening, colleagues. Let us begin with a traditional slide devoted to fleet evolution. At the end of 2016, we had 291 aircraft in the fleet as a Group. Net increase in the fleet was 33 aircraft. Mainly these were financed by operating lease and it resulted in the gradual increase of operating lease share up to 81% at the end of 2016, in comparison with 78% share for 2015.

Slide 22. In 2016, the Group expanded its capacity with 56 aircraft joining the fleet and 23 aircraft being phased out, resulting in the net increase of 33 aircraft. In the local segment, out of 14 wide-body aircraft, we had twelve ex-Transaero aircraft, seven Jumbo aircraft (B747), five B777, and we phased out two B777 (from Orenair and from Rossiya Airlines). In the segment of single-aisle aircraft, the addition was 31 aircraft and we phased out 20, net addition was 11. In the short-haul segment, the addition was eleven narrow-body aircraft for regional transportation. These results are mainly attributable to Aurora, our Far East regional company.

Financial performance. Today we published our financial results, you are familiar with them, and we directly demonstrated the numbers. These are the best figures over the last 20 years. Revenue growth was up to 20%, that was the result of expending passenger traffic and currency impact, but predominantly that was due to passenger traffic increase. The cost base was mostly influenced by expanding operations and some

FX factors. As revenue was growing ahead of operating expenditure, we saw improvement in margins. In 12M 2016 EBITDAR and EBITDA margin increased to 27.7% and 15.7%. We will discuss it in more detail during the call. Despite very strong financials for 9M 2016, in Q4 we saw a slowdown of revenue and decline in profitability due to seasonal weakness, which is traditional for Q4. We saw an extraordinary imbalance of supply and demand after Transaero ceased operations, because we compare ourselves with Q4 2015 and in that quarter we can clearly see the effect of Transaero. This factor provided additional support to better-than-usual results of that quarter and less favourable compared to the current quarter. In Q4 2016, we saw declining RASK by 4.3% and yield by 7.6%. It can be explained by increased capacity. There is a very interesting fact: till September 2016 there was less capacity in the market in comparison with the corresponding period of 2015, due to the effect of Transaero, but after September 2016 the capacities exceeded the numbers of 2015. Many people say that Aeroflot is the main beneficiary of Transaero's exit from the market, but I would like to cite as an example our competitors' capacity growth figures – there was a 20% increase in S7 Group, 15% in Aeroflot, 45% in UTAir Group's business, and 9% in Ural Airlines. That is why the significant headroom for capacity was filled by our competitors rather than by ourselves. It can be explained by the fact that the Transaero's passengers are mainly the passengers of our competitors due to their budget and expenditure constraints. Therefore, the beneficiaries are all the market players. But we had a strong improvement in 12M compared to the previous year. Let us discuss it in details on the next slide.

We will begin with key revenue factors. The growth was almost 20%, or RUB 80 bn in absolute terms. This increase was driven by accelerating growth of revenue from scheduled passenger flights. We still declare ourselves as a scheduled carrier. Sizable contributions from the charter business operated by Rossiya are at the level of 1 mn PAX. The influence of that is that Rossiya Airlines currently specialise in the charter segment, because they should accommodate the excessive capacity of the local fleet which is partly the fleet of Transaero. In terms of the key factors, growing traffic volume is RUB 47.2 bn on the back of 10.3% PAX increase, and currency effect is RUB 32.3 bn due to significant portion of revenue from international sales and codeshare and other agreements with other airlines denominated in foreign currencies. Contribution of currency to revenue growth was at the level of 7.8% out of 19.4%. Revenue from international charter operations of Rossiya Airlines for the whole year was RUB 6.5 bn, so if you want to feel the impact of charter operations on the overall Group operations, it is less than RUB 7 bn.

Operating costs analysis, slide 26. As all cost items are usually negatively impacted by FX rate fluctuations, adjusted operating expenditure increased by 12% vs actual growth of 16.6%. We can divide our operating expenses into two groups: operating costs that increased more than revenue and less than revenue. In the first group, we should first speak about operating lease expenses (+34%). First of all it is due to FX rate change, because 100% of our operating lease payments are denominated in US dollars. Net of that effect, the growth amounts to 24.2%, which is significantly lower than the nominal growth rate. The second factor that justifies the growth of operating lease expenses is the expansion of fleet – additional 37 aircraft in operating lease that correspond to a 18% increase. The second component is 3-month LIBOR rate increase (+60%). At the end of 2016, it was 1.0 and for 2015 it was 0.61, so the significant increase of LIBOR rate also contributed to this growth. Other expenses were up by 26%, most growth comes from GDS, one of the key lines in other expenses. It was up by RUB 2 bn. Also, we saw additional growth in costs of catering and goods sold on board. In the second group of expenses, which are below the revenue growth rate, are maintenance expenses (+19.3%), which were also significantly driven by rouble depreciation and fuel cost (+7.6%). Fuel costs growth was driven by the decrease in rouble fuel price by 1.8% and growing scale of operations. The third item is aircraft traffic and passenger sales growth. In Q4 2016, the trend reversed, and

rouble appreciated. We saw a 20.2% increase in operating expenditure and 23.1% is a theoretical increase that we could have seen, if the FX rate stayed flat in Q4.

Next slide, Group unit costs. Per unit-based analysis, the cost per ASK in rouble terms increased by almost 6%, up to RUB 3.14 as a result of an increase in operating lease and all those factors which have been explained in the previous slide. In 2016, fuel CASK was down by 2.5% which is a very important information, but up by almost 3% in Q4, which reflects fuel price trends. We will discuss it on further slides.

Key factors for CASK inflation are also FX differences as it can be clearly seen on the slide.

Fuel cost management, slide 28. You can see a drive to higher fuel efficiency and lower fuel consumption ratios as a result of replacement of old aircraft with new fuel-efficient fleet. For example, in the previous year we replaced nine aircraft from finance lease with brand-new deliveries. Fuel consumption per ASK, which is a key metrics for us, decreased by 0.7% during the last year. We also have seen better fuel price. Jet fuel price is down by almost 2% to RUB 31,054 per tonne. If you look at the end of 2016 and compare it with the beginning of the year, jet fuel price was up by 9% as Brent price was rising, while rouble appreciation was lagging behind the oil price. The overall picture is very favourable, and only in Q4 fuel price was higher than in Q4 2015 due to the rouble dynamics, but the remaining part of the year was very favourable for us.

Headcount overview. By the end of the previous year, the overall headcount of the Group was at the level of 36,556 people, which is up by 7.4% y-o-y. The distribution of headcount by function is shown in the upper right corner of the slide. The key metrics like traffic revenue per airline headcount and PAX traffic per headcount both demonstrate very good improvement. Efficiency was achieved despite the execution of massive ex-Transaero employees recruitment programme. I would like to remind you that 4.3 thousand new employees joined the Group from the former Transaero. Predominantly, they were pilots and engineers; this is line personnel which is in demand in our operations. Optimisations of workforce took place in our airline subsidiaries uniting three regional brands under Rossiya umbrella brand – Donavia, Rossiya and Orenair. 13.6% growth in technical maintenance and repair categories is mainly attributable to the creation of new MRO subsidiary – A-Technics, which has 550 employees and is going to be specialised in and focused on light forms of checks, and in further years expanding its operations to heavy checks like D and C checks.

EBITDA evolution. We combined the currency effect and tried to extract it from the financial analysis in order not to mislead you into making the net impact of all the currency effects in one rectangular chart. The positive impact was RUB 32.3 bn on the revenue side and the negative impact was RUB 17.9 bn. The positive net effect was almost RUB 14.4 bn. The key driver of EBITDA increase (in absolute terms it was RUB 19.3 bn) was revenue growth (RUB 80.7 bn) outpacing cost inflation (RUB 61.4 bn). Thus, we earned net margin in our organic operations. Key drivers of EBITDA increase were revenue growth, as I have already explained. Net volume and price effect on revenue (almost RUB 49 bn) exceeded net volume and price effect on the costs side (RUB 43.5 bn). That enabled us to achieve the positive EBITDA contribution of RUB 78 bn for the whole year.

On the net income level (slide 31), we also see the same factors, traffic revenue growth also exceeded operational expenditure. Other revenue growth (almost RUB 6 bn) was to a large extent driven by FX and other factors resulting in a substantial net income improvement. We would like to draw your attention to the fact that no one-off effects in the amount comparable with non-recurring expenses of 12M 2015 were incurred. Many analysts asked us whether there would be significant one-offs in Q4. We have just announced that as we had promised, there were no one-offs materially affecting our bottom line, and we will demonstrate it on the next slide on the pro forma basis.

Slide 32. If we compare 12M adjusted net income build-up with the reported one, we can see that out of RUB 38.8 bn reported net income we come to RUB 37.3 bn. No one-offs considerably influenced the results. You can see that the results are close, and the pro forma net income is very close to the reported one.

Capital structure, slide 34. Total debt as of the end of the year decreased by 38% on the back of decrease in borrowings. We paid down more expensive credit lines and we also decreased finance lease liabilities, because a lot of fleet was retired from finance lease and replaced by operating lease. If we speak about the repayment of borrowings, decrease in borrowings amounted to RUB 48 bn (-70%). During the reporting period, the Group repaid RUB 73 bn of borrowings. All in all, we repaid USD 550 mn in advance, in addition to scheduled repayment. This is a positive fact, as we tried to get rid of expensive debt.

Operating and free cash flows. We generated free cash flow in the amount of RUB 83.9 bn for the whole year. The structure is shown on slide 35. I will not comment on that. If you have any questions, I would answer all of them later.

I would like to explain the fact that 12M contribution from the working capital was literally negligible (RUB 3.7 bn) due to the following reasons. Accounts receivable increased by almost RUB 7 bn due to the change in pre-delivery payments (PDPs) and growth of the business. Accounts payable increased by RUB 13.4 bn. It is justified by the increase in transaction volumes and increased unearned revenue due to the growth of the business (by unearned revenue, I mean paid tickets but not yet utilised by the passengers) and change in inventories which increased by RUB 2.8 bn.

As usual, we stop at the last slide which might be of interest to the financial and investment community. It is like a check-list of 2016 and guidance for 2017. There are key metrics that we usually discuss – total market, international segment growth, domestic segment growth and corresponding figures of Aeroflot Group. I would like, maybe, to pass the floor on to Giorgio who would comment on that.

Giorgio Callegari: Thank you, Shamil. I think that we have suggested that we see 2017 as the year of growth in terms of market potential. We see the growth in the single-digit size both domestic and international, with possibly more growth on the international side due to the strengthening of the rouble and the possibility of renewed confidence in destinations like Turkey and Egypt. However, the overall market size will certainly not reach the peak that we saw in 2014. On that background, we believe that there are regions for the Group to retain its development strategy, so the passenger growth target is in line with the capacity growth, and is in the lower tens between 10–13% both in terms of capacity, turnover and passenger numbers [as presented on the slide], which means that we expect the load factor to be basically in line. Obviously, there is a negative impact of the fact that the additional wide bodies that Rossiya received in 2H 2016 would be operating the full twelve months, and it will be challenging to achieve the high load factors seen in 2016 in the first weak months of the year, but there will be nothing really significant.

With that, I would say that we have finished the presentation. I give the floor again to Andrey and to the call manager for the Q&A session. Thank you.

Operator: Thank you. Your first question comes from, Alexander Kazbegi from Renaissance Capital. Please go ahead.

Alexander Kazbegi: Good afternoon. Maybe you could give us your expectation on the yields and how you see them in rouble terms spanning out for 2016 domestically and internationally. Do you see any impact on the yields possibly from changing passenger composition, both from the point of view of less transit, maybe more O&D. Any kind of assessment of where you see the yield domestically and internationally from the rouble perspective would be very much appreciated.

Second question is about the 40 airplanes which you scheduled to receive in 2017. Is there a flexibility that you postpone some of them? What is the rough [estimate] on that side?

Lastly, the obvious question about the dividend decision-making process. When do we expect the management to propose to the Board the dividend payment? Maybe you can give us your view about what the dividend should be. Thank you very much.

Giorgio Callegari: Thanks a lot, Alex. Let me address the first two questions – on yields and fleet flexibility and then Shamil will address the dividend policy.

As far as yields are concerned, if I succeeded in explaining our approach to market evolution, you would easily understand that it is a combination of a number of factors which have different influences on the yield evolution. As you know, we have announced that Pobeda will add capacity. Capacity of Pobeda obviously comes at a lower yield. That capacity will come at the end of the year. For the first nine months, Pobeda will see mostly growth and possibly consolidation of yields, which is mostly on the domestic side, because 80% of its capacity is domestic.

On the other hand, we will have twelve months of Rossiya. Out of those twelve months, Rossiya will be operating, as you know, a total of 14 wide bodies with a focus on the combination of leisure and Far East destinations which, as I have shown on the slide, come at a lower yield. Thus, we have two factors which will have an implication of lower yields, which does not necessarily translate into lower profitability. On the other hand, we have Aeroflot, which, as we have announced, started the year with a very good performance in terms of passenger growth and obviously in terms of market positioning and balance between domestic and international flights. I would reiterate that it is fair to look at stable yields with the ability of leveraging our multi-brand strategy and the combination of connecting vs point-to-point market in order to protect the profitability of the Company.

In terms of fleet flexibility, as I am sure you know very well, fleet flexibility is very limited over a short period of time. It should not be expected that we can reject an aircraft and terminate the contract for free. On the other hand, in 2016 and 2015 in the challenging market conditions we proved that we could act very quickly in terms of identifying remarketing opportunities and we are also pursuing some of those in 2017.

All in all, we see no reasons to have to face critical decisions, but we have the tools to adapt to the changes in the market performance, that is why I started the presentation by highlighting that this is what we call “the new normal”.

Shamil, will you take the last one?

Shamil Kurmashov: We have announced that we are ready for this year and we are in a position to pay out the dividend in the amount of 50% of IFRS-based consolidated net income. Depending on the decision of the government as the majority shareholder, we can pay out more than 50%. Of course, we will comply with that decision.

Alexander Kazbegi: But you do not expect less than 50%?

Shamil Kurmashov: Yes, 50%. According to our vision, no decision of less than 50% will be made for sure. A decision of more than 50% can be made, but we are not aware of that, as the management usually takes it as an order from the government. We will successfully meet that target.

Alexander Kazbegi: Understood, very clear. Thank you very much.

Operator: Thank you. We will take the next question from Daniil Fedorov from Goldman Sachs. Please go ahead.

Daniil Fedorov: Good afternoon, everybody. Congratulations on good results. A few questions if I may. First one: looking at fleet expansion, could you please give some colour on the timing within the year, when you expect the most growth to come? It would be very helpful if you could identify the subsidiaries which will receive the majority of the aircraft in 2017. Looking at your fleet expansion plan for the next few years, could you give us any idea on whether we should see PDP inflow or outflow in 2017. Thank you.

Shamil Kurmashov: The net increase of our fleet will be 41 aircraft for the Group. The majority will be represented by single-aisle aircraft. Aeroflot as a company (not the Group) will account for the vast majority of this figure. I mean, 90% of the aircraft will join the parent company. In the long-haul segment, there will be only one B777 for Aeroflot and up to four wide-body aircraft for Rossiya Airlines. That is it.

In terms of Sukhoi Superjet, we expect twelve aircraft to come. As you know, we had a contract for 50 aircraft (30 have been signed and 20 are going to be signed). That is the initial plan which has been in place for several years. We are strictly in line with that plan. Out of the 20 additional aircraft, twelve are going to come in 2017, but we do not expect this amount to be achieved. We believe that only half will arrive this year to the fleet. I hope that answers your question.

Daniil Fedorov: What about pre-delivery payments? I think this year there was net inflow, because you had some pre-delivery payments back. Would you expect a similar cash inflow or outflow from pre-delivery payments in 2017?

Shamil Kurmashov: This year, we do not expect significant changes in PDPs, because a significant amount had been paid several years ago and it came back last year, but for 2017 we do not expect significant amounts which would materially influence our financials.

Daniil Fedorov: Thank you.

Operator: Thank you. Our next question today comes from the line of Osman Memisoglu from Bank of America Merrill Lynch.

Osman Memisoglu: Hello. Thank you very much for the presentation. Following up on the fleet side, could you guide us, whether you are going to use operating leases again in 2017 or there will be some financial leases. That is my first question. If you could reiterate or confirm that you are staying put with the hedging strategy, that would be helpful. Then the final question is on the airport capacity developments, if you could give us the latest update on the expansion at Sheremetyevo, I would appreciate it. Thank you.

Shamil Kurmashov: Thank you for your questions. The proportion of operating and finance leases will be the same, maybe slightly less than the current level, – operating lease at 80% and finance lease at 20%. In terms of hedging, no changes from the latest statement that we have all the methodology and procedures in place, which have been approved by the Board of Directors. However, we do not have clearance from the Board to launch any transactions. Should it change, we will inform you about that. In terms of capacity, Giorgio, could you please reply.

Giorgio Callegari: In terms of capacity, we believe, the situation is consistent with the growth targets that we have. In particular, Vnukovo is capable of accommodating the growth of both Pobeda and Rossiya, and Sheremetyevo, based on the chart that we included into the presentation, is also capable of accommodating the capacity that we have in mind for 2017, by continuing improvements in operations, including number of movements per hour, throughput in the terminals, amount of luggage handled by the infrastructure, number of passengers checked in (also as a result of more self-check-ins and electronic check-ins). Recently, we had an extensive visit to Sheremetyevo. We believe that the airport is on track to deliver the expansion plan expected for 2018. The northern part of the airport, in particular, in Terminal B, will be connected to the southern terminal by an underground tunnel and in due time by a new larger road, which goes around the airport, and by a ramification of Aeroexpress. We can say that, by working together with the airport, we have been able to evolve and improve the efficiency of operations and prepare for the new expansion that will come online in 2018. Thank you.

Osman Memisoglu: Thank you.

Operator: Our next question comes from Mitch Mitchell from BCS – Investment Bank.

Mitch Mitchell: Good afternoon, gentlemen, and congratulations on the results. Three very quick questions from me. I just want to ask if you could reiterate what you said on dividends. It was not very clear. It sounded like you said you were ready to pay 50% of net income and you would pay more if the government asks. Is that what you said? That is the first question. The second question is about your guidance for this year and your view of the market. There has been a lot of speculation on when we will see flights to Egypt reopening. I am just wondering when you internally expect that will happen and how the date of that would affect your passenger growth guidance. The last question is on whether there is any chance that Aeroflot will start publishing consolidated IFRS results for Q1 2017. You have a rather strange reporting structure and reporting habits right now. I think it would be welcomed by the investment community if we could see your consolidated results every three months. Thank you.

Giorgio Callegari: Mitch, thanks a lot for your questions. Let me address the market part and then Shamil Kurmashov will address all the finance side. As far as our guidance for 2017 [is concerned], I think we gave it at the end. We see the market as rebounding and we see it as rebounding in the mid-teens in terms of growth rate. Sorry, say between 6 and 8%. Let us be more specific on that.

As far as Egypt is concerned, as you know, Aeroflot, with its own brand, flew only to Cairo. That is certainly not a big portion of our capacity or our passenger operations. Rossiya would be flying to Egypt based on the demand from tour operator customers. If the customers [the tour operators] at this stage have identified different destinations and then decide that Egypt is more convenient, they will negotiate a different operational pattern with Rossiya. However, it will not have a big impact on our growth in terms of numbers. Once again, we do not depend on one market segment or one destination. We are ready to exploit opportunities when they arrive as we have done in the past and as we will do in the future. Shamil, please.

Shamil Kurmashov: Thank you, Giorgio. In terms of dividends, yes, your understanding is right, 50% at least. If any decision is taken above this level, you clearly see from the financials that we are able to pay out more.

The third question was about Q1 2017. Yes, we have identified this interest from the investment community. We think it is reasonable but in order to correspond to this request we can begin from Q1 2018, not from this year, because we should have audited financials for Q1 now almost at the end of this quarter. We will disclose our financials, make all the auditing procedures for that and the feasible date will be Q1 2018.

Mitch Mitchell: Thank you.

Operator: Thank you. Our next question comes from the line of Elena Sakhnova from VTB Capital.

Elena Sakhnova: Good evening, gentlemen. I have two questions. The first is the following. In Q4 2016, you outperformed the industry operationally. Simultaneously, your yields are falling quite dramatically, 10% y-o-y and 16% q-o-q. So it is clear that you preferred to invest into traffic in Q4 2016 at the expense of the yields. Could you please explain why? The second question is that I have never heard of government insisting on any company, including Aeroflot, making an above 50% dividend payout. To tell you the truth, I am a little bit confused as Shamil continued to repeat that if the government insists on the above 50% payment, the Company is ready to do it. Could you please explain this thing to me as well.

Shamil Kurmashov: Thank you. Let us begin with the dividends. I do not see any game about that. In our dividend policy, we have 25%. That is all. That is something we should comply with. This is all we can say about the dividends. We make a yearly forecast saying that we think it is reasonable for this year to pay 50% dividends taking into account our results. The remainder of my wording relates to the position of the shareholders. If they want to distribute 100% of dividends, the whole net income, we would do that. That is the only thing. I think that there is a very positive message to the market that instead of 25% fixed in our dividend policy, we are ready to pay out 50%. We expect the decision to be taken. All I wanted to stress is that our financial position is strong enough in order to give us a possibility to react to a more aggressive position of the shareholders. That is all.

Giorgio Callegari: So, Elena, thanks a lot for your question about yields. If you look at slide 18 in our presentation, you will see what is happening in more detail, in particular, on slide 19, with a mechanical arithmetic effect of some things that happened in 2016. Certainly, we do want to defend our market position and, in the face of aggressive growth in Q4 2016, we reacted as any sound commercial operator would do by putting forward interesting and appealing commercial offers for the customers. However, the focus is always on protecting the economic performance of the Group. I would disagree that we traded one for the other. What we did was, obviously, that, compared to 2015, we had Pobeda playing a much bigger role because the load factor of Pobeda was higher in Q4 2016 than in 2015, that weighs on the Group's overall arithmetic yield. The same applies to Rossiya. In case of Rossiya, again, there is an average stage length, which is longer, as well as a focus on Asia because of opportunities that customers saw in flying charter operations to Asia. These again reduced the yield not because we wanted to chase the market opportunities, I mean competitors, but because we wanted to focus on and exploit market opportunities. It is always a combination of a number of decisions, including the fact that, as you see, we have been performing very well in terms of connecting traffic without aggressively growing there. Yes, there has been a decrease. About 6–7% of that decrease is the result of the currency effect, rouble appreciation compared to US dollar and euro, which is an important part of our revenue streams. Therefore, I would not characterise the result of this policy as trading market share for profitability but rather as a successful combination of market focus, opportunity exploitation and dynamics within the brands of the Group. Thank you.

Elena Sakhnova: Okay, thank you.

Operator: Thank you. We have a follow-up question from Osman Memisoglu from Bank of America Merrill Lynch.

Osman Memisoglu: Hi, thank you for taking my question once again. On the load factor side, is this 80% a part of your long-term strategy? What is driving the decline from the strategical perspective? Also, could you make a quick update on the regulatory side? Sometimes I see headlines on the outlook for the routes

you gained from Transaero. If you could comment on your view regarding that, I would appreciate it. Thank you.

Giorgio Callegari: Osman, there must be some misunderstanding because you talk about a decline in load factor, while actually on the first slide of our presentation we talk about a 3.2 pp increase in load factor. So I do not know what [you mean].

Osman Memisoglu: For 2017. Sorry if I have not specified.

Giorgio Callegari: Okay.

Osman Memisoglu: You are guiding for a slight decline, and I was wondering whether that is similar to your Q4 2016 response or if 80 is something you will try to stick around. Could you give some colour on your load factor guidance, please.

Giorgio Callegari: Okay. Now I understand your question better. As far as 2017 is concerned, as I think we, both Shamil and myself, have said throughout the presentation, 2016, at least its initial part, in terms of both the load factor and yields, was affected by a very high base, the fact that the capacity previously operated by Transaero was not available on the market. Now, that capacity is back to the market, first of all, because again Rossiya is operating 14 wide bodies which it was not operating up until mid-June 2016. This has to be reflected either in significantly lower yields so that we would be aggressively chasing the market share or in accepting the balance between protecting the yields and not pursuing too aggressively the lower yield traffic. That is why, we believe, our load factor is acceptable.

Osman Memisoglu: Okay. And on the regulatory side, particularly on the new routes you gained from Transaero?

Shamil Kurmashov: On the regulatory side, all the destinations of ex-Transaero, which were attributed to Rossiya Airlines, have been prolonged for the full year.

Osman Memisoglu: They are good for this year at least. That is what we can assume, right?

Shamil Kurmashov: Yes, you can assume that for 2017, they will be retained in Rossiya. You know, all the destinations of Transaero were distributed between Aeroflot itself and Rossiya Airlines. Currently, they are 36 destinations; all of them would be retained within the Group. This decision is considered to be taken with a 95–97% probability.

Osman Memisoglu: Okay. From your answer, is there some risk for 2018 onwards?

Shamil Kurmashov: No. 18 previous destinations were not operable because they were the destinations we did not use. That is why approximately 36 out of 56 are business-attractive destinations. We insist on retaining them, only 36 out of 56. That is the thing.

Osman Memisoglu: Okay. Thank you.

Operator: Thank you. We have another follow-up question from Mitch Mitchell from BCS – Investment Bank. Please go ahead.

Mitch Mitchell: Hi. Thank you for taking my follow-up. I just wonder if you could give us a little bit of comment on your outlook for OPEX for 2017. I would assume you were going to need to increase staff a little bit this year. Maybe, we will see increases in salary as long as the Group is doing well. Generally speaking, [could you give] some view on what is going on the OPEX side? Thank you.

Shamil Kurmashov: I would like to refer to the OPEX slide. I am just opening it now. Slide 26. We have a detailed breakdown of OPEX, and a justification for all the items with and without the currency exchange difference. If we speak about headcount, there will be a 4.7% increase in salaries due to our trade union agreement with employees, which states that if a legal entity has some financial possibility, salary should be increased each year. This year the official rate of salary increase is 4.7%, not more than that. It is even lower than the official inflation rate stated in the official sources. We do not expect any significant increase in employees, not justified by the volume of our transactions. Only line personnel will be involved in the Company's operations, not administrative or sales ones.

Mitch Mitchell: Okay, thank you.

Shamil Kurmashov: Thank you.

Operator: Thank you. That concludes today's Q&A session. Now, I would like to hand the conference back over to your hosts for additional closing remarks.

Andrey Napolnov: We would like to thank all participants for joining the call today. If you have any follow-up questions, we are always happy to answer them after the call. Thank you.

Shamil Kurmashov: Thank you for your time and congratulations to those who are our shareholders.

Giorgio Callegari: Thank you.